BRITISH CHAMBERS OF COMMERCE IN CHINA

POSITION PAPER 2019

ABOUT THE BRITISH CHAMBERS OF COMMERCE IN CHINA

The British chambers of commerce in China (BritCham) are a collective membership organisation focused on providing advocacy, business support and networking opportunities for British business in China. We operate as an independent, not-for-profit organisation with a strong and diverse membership. With over two decades' worth of business experience in China, we bring the British business community together and help them thrive in one of the world's fastest growing markets.

Our chapters across Beijing, Shanghai, Guangdong and Southwest China build a sense of community for member companies through social and informative events held across the country. Through our British Business Awards, we recognise individuals and companies who represent excellence in innovation, enterprise and endeavour in the British and Chinese business communities. A variety of events service the needs of British business, providing insights on government policy and business trends and fostering a vibrant community with shared interests.

Our advocacy work centres annually around two key initiatives: the *Member Sentiment Survey* and the *Position Paper*. The former takes the pulse of British businesses in China on a series of issues, including their reflections on the past year's business environment, their most pressing market access issues and their views on current events that affect their business. Our *Position Paper* lays out the key recommendations of BritCham's collective membership for the UK and China governments to improve market access for British companies in China.

BRITISH CHAMBER OF COMMERCE IN CHINA 中国英国商会

The British Chamber of Commerce Shanghai ESTABLISHED 1915

British Chamber of Commerce Southwest China 中国西南英国商会

BRITISH CHAMBER OF COMMERCE GUANGDONG 广东英国商会

THE BRITISH CHAMBERS OF COMMERCE IN CHINA
中国英国商会

The British Business Centre
China Life Tower
16 Chaoyangmenwai Avenue
Beijing 100020
北京朝阳区 朝阳门外大街16号
中国人寿大厦 英国商务中心

+86 10 8525 1111
britishchamber.cn

British Chambers of Commerce in China, *Position Paper* 2019,
designed by Katana London Beijing

RECOMMENDATIONS IN THE *POSITION PAPER*

The recommendations in this *Position Paper* are based on the input of a range of British businesses operating in China, gathered between September 2018 and March 2019. The points raised are indicative of priority areas as expressed by members and are not an exhaustive assessment of the issues faced by foreign businesses in China. The British chambers of commerce in China would like to thank all of the Paper's contributors for their time and insights. Particular thanks go to those individuals who acted as industry advisors, providing expert guidance throughout the research and drafting process. Our thanks also go to Anika Patel, Christopher Sargent and Will Miller for their significant contributions to the coordination, research and drafting process.

The British chambers of commerce in China do not assume legal liability or responsibility for the accuracy and completeness of the information provided in this Paper.

FOREWORD

NICHOLAS HOLT

Chairman
British Chamber of Commerce in China

BARRY PIPER

Chairman
British Chamber of Commerce Shanghai

The British chambers of commerce in China are delighted to present the inaugural *Position Paper* for UK business in China. This report is the culmination of feedback from a number of roundtables, interviews and surveys focusing on the business environment and market access issues for UK member businesses operating in China.

With China being the second largest trading partner for the UK outside of the EU, this paper is especially timely. We focus on how British businesses can grow and realise their full potential in China by analysing ten key sectors, and providing insights into the issues, our recommendations and opportunities going forward.

As we look back on 40 years of Reform and Opening up, we acknowledge the continued steps made by China over the last twelve months that further liberalise a number of sectors for foreign business. Changes in foreign ownership restrictions, improving intellectual property rights regulations and enforcement, and the new *Foreign Investment Law* all hold promise for UK businesses operating in China going forward.

However, concerns remain. Implementation of some of these reforms is uncertain, and our members continue to encounter frictions in the business environment. Many foreign companies face headwinds that Chinese companies do not face in the UK. The British chamber advocates the principle of fair, transparent and well-regulated markets. We believe that sustained growth in the Chinese economy will depend on China's ability to foster an environment where the best and brightest come to invest, live and work, where companies compete and succeed on equal terms, and where resources flow to support the best talent and ideas to flourish, regardless of origin.

While each sector is different, a number of cross-cutting issues have been identified that affect the smooth flow of business and markets. Work to address these issues, we believe, will bring benefit not only to our members, but the wider Chinese business environment and economy. We strongly encourage the UK and Chinese governments to continue to engage on these issues going forward.

In addition to recommendations around challenges, this report also highlights areas of opportunity in the sectors, whether it is growing cross-border financial activity, educational partnerships, fintech collaboration, working together on standards or further cooperation along the Belt and Road Initiative. We believe there remains significant potential for much greater growth in goods and services between the UK and China.

This report is also a special milestone, as it represents the culmination of two years of reform of the British chambers of commerce in China. Four British chambers of commerce representing Beijing (China), Shanghai, Guangdong, and the Southwest are now working together for members representing a single combined voice of British business in China.

The unity between the four chambers is an essential step to providing a true independent voice for British business across China. Increasing collaboration through our advocacy work, events and networking platforms can only bring further value to our members, while driving efficiencies to the chamber network.

This inaugural report on UK businesses operating in China is an important first step in our new journey ahead.

While much uncertainty remains in the UK around our future trading relations, the UK business community in China is organising itself to provide the best possible support to ensure UK businesses thrive across all the Chinese mainland.

With this report, we are taking crucial steps in achieving our vision of being the leading independent voice for British business in China and we look forward to taking discussions forward over the coming months and years.

JEREMY SARGENT

Chairman
British Chamber of Commerce Guangdong

MATT RYAN

Chairman
British Chamber of Commerce Southwest China

CONTENTS

EXECUTIVE SUMMARY

This inaugural Position Paper has been launched by the British chambers of commerce in China in order to provide advocacy and representation for British businesses operating across mainland China. Presenting a position on both industry-specific and cross-sector market access issues, the Paper also provides a perspective on areas of mutually beneficial cooperation for UK business and China going forward.

In the face of rising protectionism and the prevailing challenges to the global trading environment, the chambers remain committed to our founding principles, based on an underlying belief in free market ideals. Our position supports reciprocity of markets, achieved through a constructive process of opening up, as opposed to a 'tit-for-tat' approach to bilateral trade. As such, we call for equal access and treatment for all companies, regardless of origin, in both the UK and China markets. It is within this context that we welcome the positive steps that China has taken to improve the business environment for foreign companies operating in-market and address a number of long-standing issues for business. However there remains a need for China to continue its progress in reforming and opening up its markets to foreign investment.

In addition to the specific recommendations provided by industry working groups to alleviate the most pressing market access concerns, the chambers provide six overarching recommendations, which, if addressed, would contribute to the continued success of the Chinese economy and of British businesses operating in the mainland.

1. Although the chambers welcome the principle behind the *Foreign Investment Law*, more concrete details relating to implementation and enforcement mechanisms are needed

China's draft *Foreign Investment Law* (FIL), due to come into force in January 2020, has been presented by the central government as a means to grant equal treatment to foreign and domestic companies, while also strengthening the intellectual property (IP) rights of foreign investors. The FIL has the potential to substantially improve the business environment and place foreign firms on a more even footing with their Chinese competitors, although questions remain around the implementation of the law, which is notably vague on details around enforcement and issues such as a national security review.

2. Continue to reduce the number of sectors on the 'Negative List'

More opportunities in sectors such as automotive, transport and financial services have been opened up to foreign businesses over recent months, after increased nationwide opening-up of the 'Negative Lists'. Many sectors remain completely or partially restricted to foreign investment, however, and expected reforms to further open up agriculture, healthcare and new energy would be well received by foreign investors, and would aid the government's efforts to develop a more consumer-oriented economy.

3. Ensure that the final iteration of the *Cybersecurity Law* gives firms reasonable scope to share crucial information overseas, as long as it does not impact national security

Cybersecurity issues are the top concern of British businesses in China, according to the *British Business in China: Member Sentiment Survey 2018/2019* (*Member Sentiment Survey*), with the most critical issue relating to cross-border data controls. Businesses that score highly on a risk assessment and/or are designated as a Critical Information Infrastructure operator face data localisation restrictions on personal and 'important' data. For many British companies and multinationals, compromising this connectivity could stunt operations, with research and innovation the most acutely affected. Blocking international data exchange in this way will be isolating for the Chinese economy, hindering innovation and making it more difficult for China to expand and develop internationally.

4. Sustain efforts to improve the IP landscape in China and strengthen enforcement to alleviate concerns foreign investors have towards the security of their IP

British businesses recognise the continued efforts of the Chinese authorities to improve IP rights for foreign firms, with concrete progress seen in more stringent penalties for sellers of counterfeit goods, measures to strengthen the protection of trade secrets and positive amendments to the *Technology Import Export Regulation* (TIER). However, more effort is needed to address remaining issues that relate to the protection of companies' patents and trade marks, as well as the inconsistent enforcement of IP rights across the country. One of the most pressing IP concerns for many British companies remains bad-faith trade mark registrations, that is, applicants in China registering the trade marks of foreign and domestic brands with the aim of misleading consumers, misappropriating the reputation of the original brands, and in many situations, extracting a payment from legitimate brands for licencing those rights, or to secure their assignment. Addressing these concerns would aid China's own efforts to develop an innovation-driven economy that is more attractive to foreign investors.

5. Grant foreign businesses access to a wider range of licences and continue to make the application process for licences more streamlined and transparent

Licencing and certification ranks in the *Member Sentiment Survey* as the third most limiting of the cross-sector business environment and market access issues facing British businesses. The ease with which businesses can receive permission to fully operate in China is highly variable, with a significant number of companies still facing restrictions on the products or services they can provide to Chinese clients, cutting off parts of the economy or artificially impacting on their ability to compete with domestic firms. Licences may technically be open to foreign companies but require track records, capital or other 'guarantees' to be held in China, which are difficult to acquire without the licence the company is looking to obtain. In many cases, British businesses feel unfairly discriminated against, with areas of the market a wariness of fully investing in the China market.

6. Ensure transparency and consistency of regulatory enforcement across China

The lack of consistent enforcement of regulation across different cities and provinces has proved a significant challenge to businesses spread across geographies. There are concerns amongst the business community that beneficial policies ratified by the central government may face uneven implementation in certain localities, increasing compliance costs and the uncertainty of investing in the China market. For example, the acceleration of the implementation of *China VI* emissions standards ahead of schedule by some provinces can create immense complications for automotive firms planning on selling vehicles in these regions, as it inhibits their ability to deliver products to market. Efforts to make the regulatory environment in China more uniform would be greatly appreciated by British businesses looking to increase their investment in the market.

SUPPORTING GROWTH, PARTNERING IN INNOVATION AND PROMOTING ECONOMIC SUSTAINABILITY

As the Chinese economy slows and moves towards a 'new normal' of lower but more stable growth, the continuing transition to a more consumer-driven economy presents both challenges and opportunities. The UK is well-placed to support the Chinese government in further improving its citizens' quality of life by offering experience, knowledge and quality products to support the demands of the Chinese economy as it undergoes this transition.

- The policy drive to rebalance economic weight from heavy industry to services and from investment- to consumption-driven growth, can be spurred on respectively by a strong UK services sector with a history of international experience and high quality consumer goods in areas such as retail and food and beverage.
- Healthy China 2030 is a chance for the UK to contribute its sophisticated healthcare and R&D services and previous government policy experience as China strives to achieve similar goals to those of the UK's social and healthcare systems.
- Building on initiatives such as the London-Shanghai Stock Connect, British financial institutions can help China develop more sophisticated capital markets in order to meet the changing demands of business and consumers.
- Both the UK and China lead innovation in areas such as artificial intelligence (AI), data analytics and the Internet of Things. These technologies can benefit both economies through increased interconnectivity of the online ecosystem as well as providing answers to some of China's pressing problems, such as remote services in healthcare and education to reach some of China's most deprived regions.
- Experienced financial, built environment and legal services can be particularly valuable in outbound projects, such as those along the Belt and Road Initiative (BRI), given long-standing experience working in regions that have received significant Chinese investment. A precedent of wide recognition of British standards in international operations and transactions can also be an area of cooperation for the UK and China.

AS CHALLENGES ARE MET, BILATERAL TRADE CAN GROW

Bilateral trade links between the UK and China continue to grow, reaching GBP 65.8 billion (RMB 606.1 billion) in 2018[1]. In order to ensure that bilateral trade and cooperation can continue to grow on this trajectory, the British chambers of commerce in China believe continued reform is needed if China is to create a fully level playing field. This requires the removal of restrictions that hold back UK companies from providing a complete range of goods and services to the benefit of Chinese consumers. The constructive recommendations of the British chambers of commerce contained in this paper would go a long way to benefiting the sustained growth of both UK companies and the Chinese economy as a whole.

1 'UK Economic Accounts: balance of payments current accounts', Office for National Statistics, March 2019.

AT A GLANCE: INDUSTRY REPORTS

ACCOUNTANCY

INDUSTRY TRENDS

British accountancy firms maintain a favourable reputation in China in spite of increased local competition, and welcome the continued alignment between Chinese and international accounting standards.

SUB-SECTORS

Accountancy firms | Qualification bodies

KEY CHALLENGES

- Lack of mutual recognition of British and Chinese qualifications
- Limitations on non-CICIPA ownership
- Inconsistent interpretation of regulations

KEY RECOMMENDATIONS

- Explore the opportunity of signing Mutual Recognition Agreements between CICPA and British accountancy bodies
- Allow British non-CICPA ownership of CICPA firms up to 50% in line with the UK model of corporate ownership
- Provide more clarity and consistency to accounting standards, given the associated costs of vague regulations for both British and Chinese firms

AUTOMOTIVE

INDUSTRY TRENDS

Despite a tough year for China's automotive sector, which saw vehicle output decline for the first time in nearly 20 years, British automotive companies continue to see huge opportunities for growth in the sector, especially in the sales of luxury vehicles and new energy vehicles (NEVs).

SUB-SECTORS

Original equipment manufacturers (OEMs) | Automotive components suppliers (ACSs) | Logistics companies | Automotive consultancy firms

KEY CHALLENGES

- Changes to emissions standards with limited consultation
- Burdensome customs requirements and taxation levies
- Preferential treatment for domestic NEV manufacturers

KEY RECOMMENDATIONS

- Provide more consultation with low-volume OEMs during the drafting phase of implementing new regulations
- Permit the mutual recognition of certifications by accredited test centres in the UK and China which would remove the requirement of retesting at port of entry
- Grant equal treatment to foreign and domestic NEV manufacturers in receiving incentive policies

BUILT ENVIRONMENT SERVICES

INDUSTRY TRENDS

As the government continues to prioritise infrastructure development both in China and third country markets, in addition to the development of a stable housing market and a smarter built environment, opportunities of a maturing market and alternative asset classes will play to the UK's strengths going forward.

SUB-SECTORS

Engineers | Architects | Spatial planners | Property developers | Real estate consultancies/agencies | Construction consultants, project managers

KEY CHALLENGES

- Challenges in obtaining licences
- Mutual recognition of qualifications
- Hiring local and foreign talent

KEY RECOMMENDATIONS

- Provide transparent and equitable approval processes for licences across all sub-sectors
- Ensure mutual recognition of qualifications
- Relax rules for recruitment of foreign experts

EDUCATION

INDUSTRY TRENDS

Education remains a key strength of the UK's commercial presence in China, enjoying a prestigious reputation for high academic standards and educational heritage, which have led to rising numbers of Chinese students enrolled in British educational institutes.

SUB-SECTORS

Early-years | Higher education | TVET | EdTech | K-12 | English language training

KEY CHALLENGES

- Clarity in policy changes
- Limitations on HR and staffing
- Restrictions on investment

KEY RECOMMENDATIONS

- Implement a more structured approach to the delivery of policy information, providing clear outcomes and a clear timeline
- Bring teacher visa laws in line with practical requirements
- Provide greater clarity about what qualifies as a 'for-profit' and 'non-profit' institutions, including clarity about acceptable fee levels

FINANCIAL SERVICES

INDUSTRY TRENDS

Following steps to further open the sector to foreign financial companies, British firms look forward to greater reform of the sector, increased participation in creating sophisticated products for the domestic market and further development of cross-border investment opportunities.

SUB-SECTORS

Asset management companies | Banks | Financial infrastructure | Insurance and reinsurance brokers | Private equity firms

KEY CHALLENGES

- Restrictions regarding obtaining certain licences
- Meeting high capital requirements
- Unclear guidelines on the implementation of new licencing regulations

KEY RECOMMENDATIONS

- Allow foreign institutional investors to apply for a broader scope of licences across all of the sub-sectors
- Allow foreign companies to use globally held assets to satisfy capital requirements
- Provide comprehensive and clear guidelines on how to follow new regulations, and timelines for their full implementation

FOOD AND BEVERAGE

INDUSTRY TRENDS

British food and beverage companies consider China to be a key growth market. Despite low market penetration, flourishing e-commerce platforms and other opportunities grant local consumers increased access to British products.

SUB-SECTORS

Additives | Alcoholic beverages | Catering | Non-alcoholic beverages | Ready-to-eat foods | Seafood

KEY CHALLENGES

- Inefficiency caused by the time taken to process licences and certificates
- Unfamiliar products held to unreasonably high standards
- Difficulties finding up-to-date customs guidelines

KEY RECOMMENDATIONS

- Reduce the time taken to process production permits and Sanitary Certificates
- Consult a wider range of producers in order to fully rationalise GB standards
- Streamline customs processing as much as possible and make guidelines more easily accessible

HEALTHCARE

INDUSTRY TRENDS

Improving the quality, access and affordability of healthcare is a key priority for the government, and China has sought to open its market to foreign businesses in healthcare, medical services, pharmaceuticals and insurance.

SUB-SECTORS

Healthcare services | Medical devices | Pharmaceuticals

KEY CHALLENGES

- Restrictions in licencing
- Pricing pressures and reimbursement requirements
- Fragmentation and restrictions across supply chains

KEY RECOMMENDATIONS

- Continue to centralise and accelerate the approval and registration process while removing clinical services from the 'Negative List'
- Adopt a procurement focus that balances quality, value and sustainability and establish a system of updates for the medical devices reimbursement book
- Continue to consolidate the distribution system and create a fast-track customs service

LEGAL

INDUSTRY TRENDS

Although the Chinese market holds room for strong growth and demand for the skills UK law firms have to offer, this cannot be realised until market barriers are removed and foreign firms with appropriately qualified staff are allowed to practise PRC law.

KEY CHALLENGES

- Inability of PRC-qualified lawyers to practise Chinese law in a foreign firm
- Restrictions on ownership and corporate structure
- Restriction of appearance before government agencies

KEY RECOMMENDATIONS

- Allow PRC-qualified lawyers in foreign firms to practise PRC law in non-sensitive areas of law
- Facilitate greater access to the granting of joint law venture (JLV) licences
- Allow firms to represent their clients in meetings with government agencies

MARKETING AND COMMUNICATIONS

INDUSTRY TRENDS

The sector has attracted significant foreign investment, and is seeing healthy growth in areas such as internet, digital and analytics. The key worry in the industry is one weighing on spending more generally - the recent Chinese economic slowdown.

SUB-SECTORS

Marketing and advertising | Market research | Public affairs | PR and communications

KEY CHALLENGES

- Complexity of financial regulations and the taxation landscape
- Cybersecurity and IT restrictions
- Concerns over business ethics and compliance

KEY RECOMMENDATIONS

- Relax foreign exchange controls and streamline transaction-reporting mechanisms
- Ensure that the final iteration of the *Cybersecurity Law* gives reasonable exception to market research firms to share information internationally
- Apply consistent and transparent standards across the compliance and assessment process

RETAIL

INDUSTRY TRENDS

The continued growth of Chinese household incomes and sustained demand for high quality foreign products offer British brands plenty of opportunities in the world's largest retail market.

SUB-SECTORS

High street retailers | Luxury good | Cosmetics | Shopping outlets | Product developers

KEY CHALLENGES

- Concerns over intellectual property rights
- High import duties and taxation
- Mandatory animal testing for cosmetics

KEY RECOMMENDATIONS

- Enhance government transparency around IP decision-making
- Reduce the burdensome tax levies on retailers
- Remove the mandatory animal testing requirement for cosmetics, and instead permit other proven methods of guaranteeing the safety of products

ECONOMIC AND POLICY OVERVIEW

Faced with an economic slowdown, the Chinese government has responded with fiscal stimulus measures to support private businesses and has revised laws to encourage more foreign investment. Nevertheless, the continued transition to a consumer-driven economy presents substantial opportunities for foreign businesses across a range of sectors.

The Chinese economy has entered unfamiliar territory. Following decades of rapid growth, a protracted slowdown now looks certain. GDP grew by 6.6% in 2018, and at 6.4% in Q4, the lowest reading since the global financial crisis. Although China's annual growth of 6.6% was its weakest in nearly three decades, owing to the sheer size of the economy, nominal GDP increased by RMB 8 trillion (GBP 904 billion), far above the RMB 5.1 trillion (GBP 576 billion) added in 2007 when growth reached 14.2%. The International Monetary Fund (IMF) has projected real GDP growth of 6.3% for China in 2019[2] (raised from 6.2% previously), in line with the government's annual target growth rate of 6% to 6.5%, announced at this year's National People's Congress (NPC). This is the minimum rate of annual expansion for 2019 that will allow the government to realise its ambition of doubling GDP by 2020 from its 2010 level in order to develop a "moderately prosperous society". GDP growth of 6.4% for Q1 of 2019 points to a slight recovery, though this appears to be largely reflective of a recent increase in total social financing and the effect of VAT cuts rather than of a sustained pickup in growth.

CONSUMPTION SHORTFALL

Slower rates of growth represent what high-level officials refer to as the 'new normal', as China rebalances its economy to make growth more sustainable in the long term. As China transitions to a more consumer-driven economy, The Economist Intelligence Unit forecasts private consumption to rise by an annual average of 6% between 2019 and 2023, which will represent the largest overall contribution to economic growth[3]. China's per capita disposable income stands at RMB 28,228 (GBP 3,191), and grew at an average annual rate of 9% between 2011 and 2017, expanding at a much faster rate than most advanced economies[4]. Despite this surge in household income, private consumption accounts for only 38% of GDP, compared with a global average of around 60%. This shortfall between household income and consumption is largely attributed to China's high savings rate. The country's GDP per capita in purchasing power parity terms of USD 19,559 (GBP 14,843) is similar to Brazil's, yet consumption per capita remains more comparable to levels in Nigeria. If Chinese households consumed at the same rate as their Brazilian counterparts, consumption levels would more than double[5]. With enormous room for potential growth in consumption, it is expected that the authorities will continue encouraging Chinese consumers to increase spending this year to support growth.

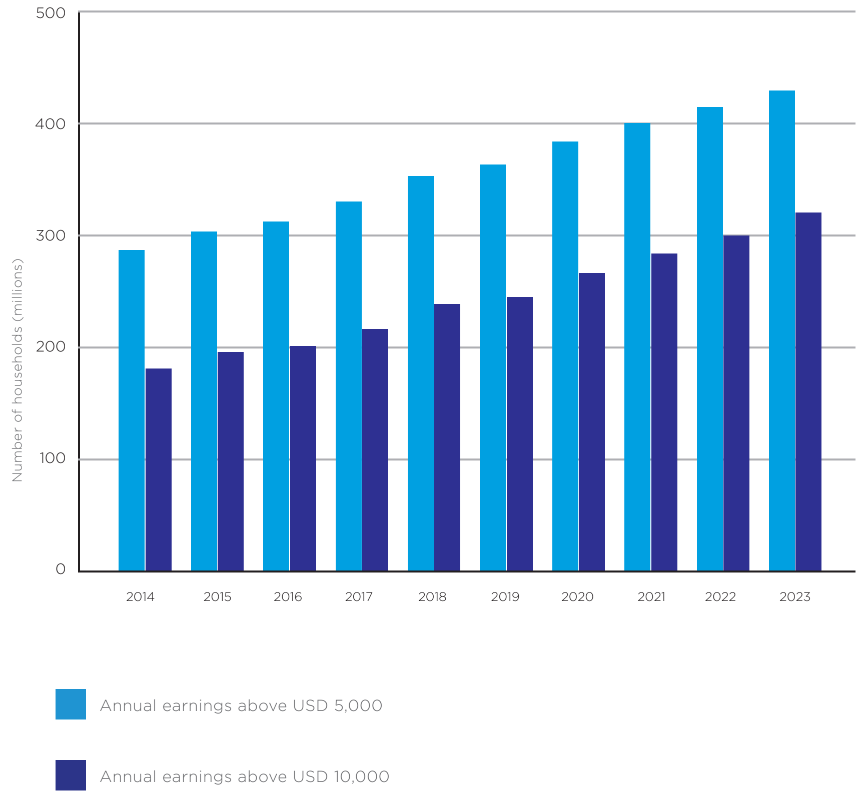
High house prices across China, particularly in Tier 1 and Tier 2 cities, is a crucial factor influencing both household savings and consumer spending. Owing to housing privatisation in the late 1980s, home ownership in China surged from 20% in 1988 to 90% in 2007, and has remained stable ever since. Soaring prices have meant that Chinese citizens now dedicate 74% of their savings towards housing, more than double the average US citizen at 35%[6]. Property represents one of the biggest risks to the health of the Chinese economy in the coming years. Lower income households have to borrow heavily to afford housing, and household borrowing has consequently swollen to 49% of GDP. China's household debt-to-disposable income ratio has risen 9% every year since 2015, driven by mortgages and other consumer debts, which now represent the single biggest component of new credit in the country's banking system[7]. Despite recent policy measures to cool the housing market, rising household debt could likely take its toll on consumption, counteracting the government's efforts to rebalance the economy.

TACKLING RISK VS. MAINTAINING GROWTH

Rising levels of debt throughout China's economy has been a persistent concern for policymakers and investors alike. The government's previous reliance on investment through rapid credit expansion to boost growth has resulted in ballooning levels of debt in the economy. At the end of 2018, China's overall debt stood at 243.7% of GDP, with corporate debt reaching 154%, household borrowings at 53% and government debt at 37%[8]. With limited credit avenues for private businesses, shadow banking in China has proliferated, driven by off-budget local government investment and measures taken by commercial banks to sidestep regulatory constraints on lending. Government measures to reign in excessive levels of debt and speculative lending have hurt economic growth, but many economists and investors believe that this is a necessary pain which the economy must endure if it is to

Number of Chinese households with earnings above USD 5,000 and USD 10,000

Source: The Economist Intelligence Unit



2 'IMF Raises China's 2019 Growth Forecast', Caixin, April 2019.

3 'China Country Report', The Economist Intelligence Unit, April 2019.

4 'China's resident disposable income rises 6.5% in 2018', China Daily, January 2019.

5 'China's High Savings: Driver's, Prospects and Policy', International Monetary Fund, December 2018.

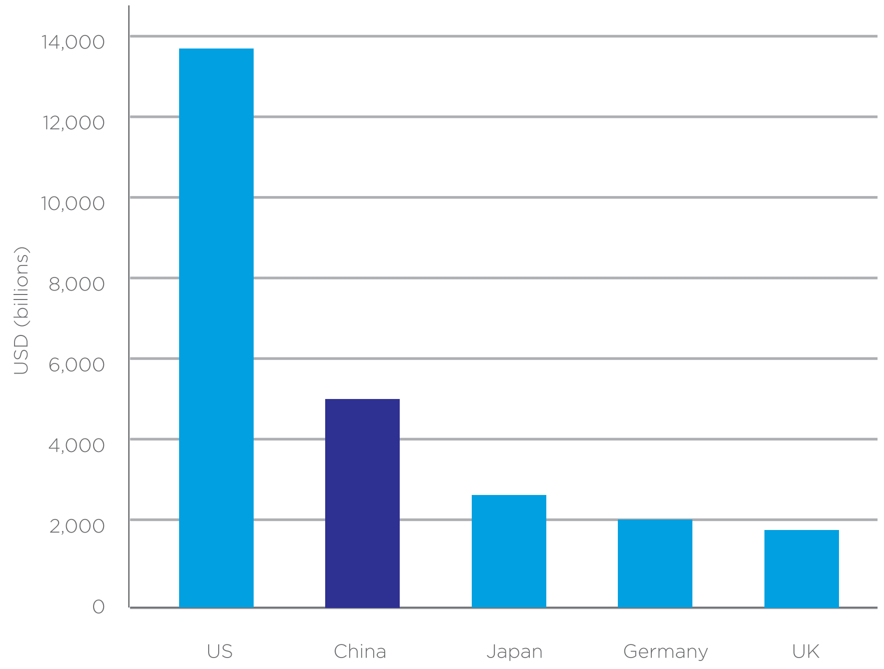
6 'China property: how the world's biggest housing market emerged', South China Morning Post, November 2018.

7 'China's household finances look stretched versus most emerging markets – Fitch', Reuters, March 2018.

8 ' '张晓晶：杠杆率风险主要在于国企与地方政府，要”稳中求进”去杠杆' , Chinese Academy of Social Sciences, February 2019.

Nominal private consumption by country, 2018

Source: The Economist Intelligence Unit



hurt economic growth, but many economists and investors believe that this is a necessary pain which the economy must endure if it is to successfully stabilise growth and reduce risk. However, despite efforts to deleverage its financial system, aggregate credit growth has yet to slow down significantly.

POLICY RESPONSES

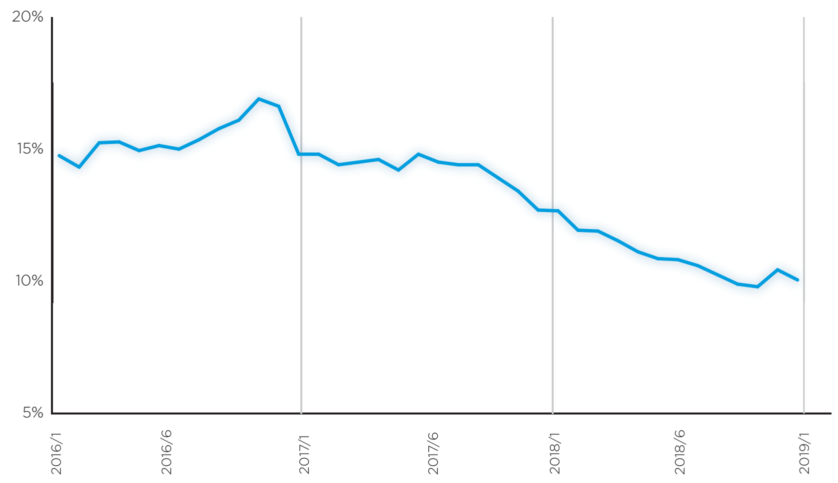
More recently, the authorities have turned to a more expansionary fiscal policy to stimulate economic activity. During this year's *lianghui*, China's annual sessions of the National People's Congress and the Chinese People's Political Consultative Conference, one of the most impactful announcements came in the form of tax cuts worth an approximate RMB 2 trillion (GBP 226 billion, equivalent to 2.2% of nominal GDP in 2018) to encourage companies to raise their investment. Among these were a cut to VAT rates for the manufacturing sector (from 16% to 13%), effective 1st April, and for transportation and construction (from 10% to 9%), while VAT for services was left unchanged. Savings from VAT cuts are likely to be passed on to consumers, with numerous automotive companies having already slashed sales prices for their vehicles. A reduction in enterprise contributions to employee social security funds from a maximum of 20% to 16%, implemented 1st May, was also declared, as well as an increase in bond issuance by local governments to RMB 2.15 trillion (GBP 243 billion) from RMB 930 billion (GBP 105 billion) last year, in order to support higher fiscal spending and infrastructure investment.

9 'China to Maintain Prudent Monetary Policy, PBOC's Chen Says', Bloomberg, April 2019.

The government's necessary clampdown on the country's shadow banking sector, as well as its recent focus on consolidating and strengthening state-owned enterprises (SOEs) has stifled the country's private sector. China's private enterprises are the engines of growth, accounting for 50% of tax revenues, 60% of GDP, 70% of innovation, 80% of jobs and 90% of companies, in what officials call the '56789 formula'. In addition to the widespread reductions to tax rates, more business-friendly policies to support private enterprises were announced at the *lianghui*, such as pledges to increase bank loans to small companies by 30%. Whereas fiscal policy will be "proactive" in this regard, monetary policy will be more "prudent", with further cuts to bank reserve requirements to support more lending to SMEs, as well as an affirmation that the authorities will rely on gradual monetary easing rather than resorting to a "flood-like stimulus" to boost short-term growth[9].

Monthly growth of aggregate credit

Source: Bloomberg



REFORMS TO THE BUSINESS ENVIRONMENT

Over the past year, the authorities have signalled their intent to relax restrictions around market access to encourage more foreign investment and address concerns raised by the foreign business community in China, taking modest steps to further open up its domestic markets. Of these, the 'Negative List' for foreign investment (sectors that are partially or completely closed off to foreign companies) will be revised in June 2019, opening up sectors in modern services such as telecommunications, healthcare and education, in addition to automotive, infrastructure and energy. Specific details around the implementation of this remain unclear, and there is a great deal of overlap between the two 'Negative Lists'. China's long-awaited draft *Foreign Investment Law* (FIL) that aims to address a number of long-standing issues for foreign businesses was quickly passed through the NPC, allowing for limited in-depth consultation. Businesses are largely in agreement that measures such as criminal penalties to prevent the leakage of foreign company trade secrets and the strengthening of intellectual property rights (IPR) protection are positive steps towards developing a more level playing field for foreign firms. However, questions remain around the implementation of the law, which is notably vague on details around enforcement and issues such as a national security review.

While the authorities plan to continue to open markets up to foreign investment, the government's industrial ambitions will entail policies that inevitably aim to directly bolster the standing of domestic firms. The phrase 'Made in China 2025', a directive aiming to cultivate domestic innovation, was completely omitted from the *lianghui*, though having been rebranded under calls to increase the country's 'self-reliance', the state will continue to provide support to local firms in high value-added sectors such as electric vehicles, robotics and semiconductors. With ambitions to push its companies further up the value chain, doubts will remain among foreign businesses as to the enforceability of the FIL, particularly around IP leakage. The government also remains committed to strengthening and supporting the country's SOEs, despite pledges of 'competitive neutrality' between state-owned and private enterprises. With the aim of transforming the largest among them into globally competitive national champions, the presence of SOEs in the Chinese economy is likely to deepen.

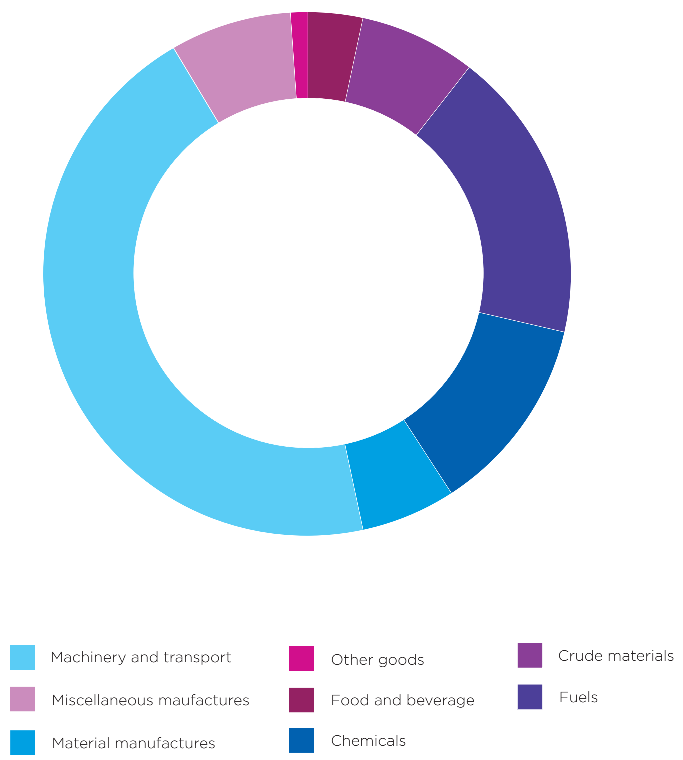
The 'Negative List' for foreign investment will be revised in June 2019, opening up sectors in modern services such as telecommunications, healthcare and education, in addition to automotive, infrastructure and energy.

UK-CHINA BILATERAL TRADE

Sustained levels of growth in the Chinese economy have coincided with growing trading links between the UK and China. In 2018, UK-China bilateral trade grew by 4.6% to reach GBP 23.1 billion (RMB 204.4 billion). That same year, UK goods exports to China grew by 3.1% to reach GBP 18.5 billion (RMB 163.7 billion), accounting for 80.1% of exports, while UK services exports grew by 11.3% to reach GBP 4.60 billion (RMB 40.7 billion), or 19.89% of exports[10] . China is currently the UK's fifth largest trading partner, and the second largest non-EU partner after the US. Despite the present slowdown of the Chinese economy, British exports remain robust. UK goods are in high demand among China's aspirational middle class, and 57% of Chinese consumers are willing to pay more for UK-made goods owing to a perception that they are of a higher quality. Similarly, 61% of consumers have stated that a product showing the Union Jack would increase their likelihood of purchasing a product, highlighting the strong appeal of 'Made in Britain'[11]. In services, deeper connections are being established to increase bilateral investment, especially in sectors where the UK is a global leader. As both countries seek to develop a longer-term partnership, the prospects of more mutually beneficial trade deals look hopeful.

Composition of UK goods exports to China, 2017

Source: ONS

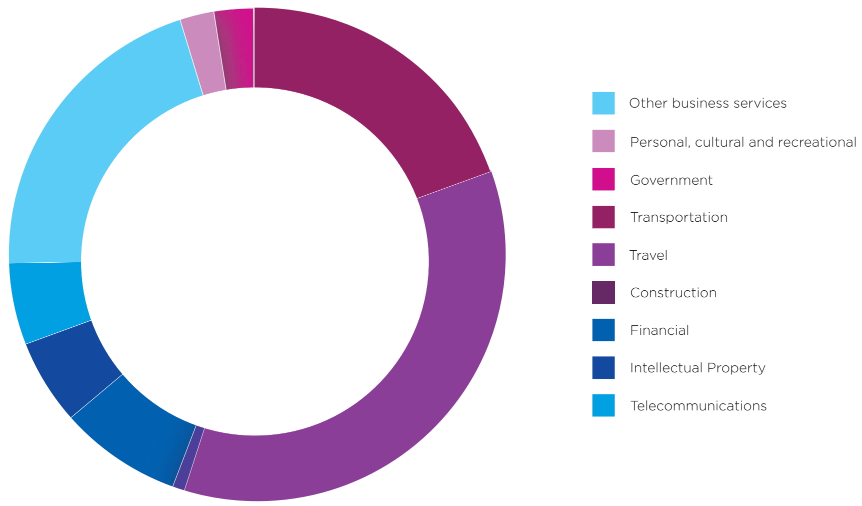


10 'UK Economic Accounts: balance of payments current accounts', Office for National Statistics, March 2019.

11 'Brand Britain: Export opportunities for UK business', Barclays Corporate Banking, February 2018.

Composition of UK services exports to China, 2017

Source: ONS



CROSS-SECTOR ISSUES

CYBERSECURITY AND IT RESTRICTIONS

As business grows increasingly reliant on online systems, cybersecurity breaches pose a major threat to firms around the world. However, cybersecurity issues are the primary concern of British businesses in China, according to the British Business in China: *Member Sentiment Survey* 2018/2019 (*Member Sentiment Survey*), with specific issues including leakage of sensitive information and intellectual property. Personal data and privacy are also of growing importance worldwide, and Chinese netizens are increasingly aware of the risks they expose themselves to in cyberspace. PRC authorities have worked to tackle this challenge by drafting a series of far-reaching laws regulating the previously relatively unregulated area of data and cyberspace. The *Cybersecurity Law* (CSL) was drafted in 2017 and focuses on data protection, national security, social stability and 'cyberspace sovereignty'. The regulations are still incomplete and stipulations vary from one draft to another, making it difficult to assess their impact. As they stand, however, they pose an array of issues to both British businesses and the wider business community, amongst them data localisation and cross-border transfer; assessment processes; internet access; and a lack of regulatory transparency.

Perhaps the most critical of these is the data localisation regulation. The draft of the Cross-border Data Transfer Guidelines (Guidelines) currently state that businesses wishing to share personal or sensitive information must first undergo tests to ascertain the risk level of the information. The Guidelines stipulate that scoring highly on this and/or being designated as a Critical Information Infrastructure (CII) operator results in data localisation restrictions on personal and 'important' data. For many foreign companies and multinationals, this could be highly damaging to their business operations. Multinational companies rely on their global IT systems to share information, increasing collaboration and efficiency as well as synchronising business functions such as finance and human resources. Compromising this connectivity would stunt operations across sectors, with the most acutely affected areas in market and technological research and innovation. Forcing firms to relocate their servers to China also means that they are encouraged to choose between local providers, who have a head start in the market and in compliance, and foreign ones. Firms report that this raises both competition and security questions. Blocking international data exchange in this way will be isolating for the Chinese economy, hindering innovation and making it more difficult for China to expand and develop internationally.

Blocking international data exchange in this way will be isolating for the Chinese economy

The classified protections assessment process that qualifies firms for these restrictions is a point of unease for British firms. Companies can be asked to disclose security information to the authorities that is normally only available to the software developer, such as source code or encryption keys, and so hold concerns over the safety of sensitive data such as intellectual property or customer information[12]. Spot-checks can be ordered by both the government and trade associations, running a risk that local firms may be able to request checks on their competitors. The tiered system of risk classification known as the Multi-Level Protection Scheme constitutes a mandatory audit and compliance procedure unprecedented in international regulation, and does not yet contain enough detail to allow full compliance. Businesses hope that the second version of legislation covering the process will contain more practical information. The Ministry of Industry and Information Technology has recently promised a crackdown on 'non-licensed' VPN usage, restricting use to state-sanctioned VPNs or expensive special circuits from local telecom providers[13]. The 'Great Firewall of China' is already prohibitive to business operations and research, and to restrict this further would make businesses less well-informed in areas such as market trends and disconnect them further from the global market. Furthermore, it is against WTO rules to block commercial access to foreign or private companies while favouring domestic state-owned companies doing the same business[14].

Businesses have found it difficult to prepare for the CSL due to the lack of clarity and transparency that has run through the process – from consultation with business, to legislation, through to the implementation plan. This causes widespread confusion among both local and foreign firms, and compounds compliance costs. These costs cripple SMEs in particular, which have proportionally thinner margins. Regulatory terms are often vague, leaving interpretation to the enforcing authority and implementation open to inconsistencies, as well as making it difficult for companies to execute due diligence and compliance. Important information is unclear, such as the definition of CII, or what constitutes a 'national risk to security[15]'. The Law states that '"important data" could come under review but doesn't define this clearly[16], aggravating the assessment problem detailed above. Whilst businesses recognise that this is partly due to the scale of the Law and the country it regulates, issues are exacerbated by a lack of coordination between the patchwork collection of government agencies jointly responsible for the Law and the inconsistency of implementation across the country. For business to thrive it needs predictability and consistency.

12 Source code review also takes place globally.
13 'Beijing defends crackdown on VPNs, saying there are alternatives for businesses', SCMP, July 2017.
14 'China's VPN crackdown is about money as much as censorship', Financial Times, January 2018.
15 *Cybersecurity Law* of the People's Republic of China, Chapter I General Provisions, Article 5.
16 *Cybersecurity Law* of the People's Republic of China, Chapter III Network Operations Security, Article 37.

CONCERNS OVER INTELLECTUAL PROPERTY RIGHTS PROTECTION

British businesses experience numerous challenges to protecting their intellectual property (IP) rights in China. The Member Sentiment Survey revealed that the majority of businesses believe that the IP landscape in China has either improved (41.2%) or stayed the same (56.5%) relative to last year, yet in practice businesses have expressed that on the ground, substantial challenges remain. These largely concern the protection of trade marks and patents, and issues surrounding the transfer of technology.

BAD-FAITH TRADE MARKS CONTINUE TO BE A PREVALENT ISSUE

The most pressing IP concern for British businesses remains bad-faith trade mark registrations, that is, applicants in China registering the trade marks of foreign and domestic brands with the aim of misleading consumers, misappropriating the reputation of the original brands, and in many situations, extracting a payment from legitimate brands for licencing those rights, or to secure their assignment. Throughout the past decade, China has sought to encourage more trade mark applications, especially among small businesses, cutting the cost of filing a trade mark to just RMB 300 (GBP 33.91) and reducing the average time it takes until an application is examined by China's Trademark Office (CTMO). Subsequently, China has witnessed a sharp uptake in the number of trade mark applications, reaching 7.3 million in 2018 (by comparison, just over 600,000 applications were filed in the US)[17]. This is starting to crowd out available marks for business purposes, thus making it more difficult for British businesses to file competitive and useful marks.

The sheer volume of trade marks being registered every year has put a significant strain on the CTMO. This has resulted in a mass recruitment of new and somewhat inexperienced examiners to deal with the rise in demand and the tight timelines to complete the examination of cases, raising concerns as to the quality of trade marks granted registration. The relative lack of experience of many trade mark examiners in the CTMO means that it is often unable to reliably recognise if a trade mark filed is in bad faith, and the CTMO is often reluctant to review administrative refusals. The draft *Certain Provisions for Regulating Applications for Trademark Registration* issued by the China National Intellectual Property Administration in February 2019 looks to address what it describes as "malicious and improper" trade mark applications based on a number of objective factors such as an unusual number of trade marks filed by a small entity. However, despite the potential positive impact of these provisions, there are concerns that the room for lower level legislatures to create and implement effective ways to strike down bad faith applications would be limited without legal grounds provided by higher level laws.

CONCERNS REMAIN ABOUT THE PROTECTION OF PATENTS

China's most recent iteration of the *Foreign Investment Law* (FIL), due to be implemented 1st January 2020, aims to alleviate some of the IP challenges foreign businesses face when investing in China. It stipulates that administrative authorities are prohibited from forcing the transfer of technology through administrative means, which has been a particularly sensitive matter for foreign-invested enterprises (FIE). However, when British firms enter a strategic or restricted sector they are legally required to form a joint venture (JV) with a Chinese partner. In many cases, they are unable to licence their technology and often cannot provide enough upfront capital to their JV partner, and so transferring their technology may be the only route to market. Businesses therefore believe that this current practice is unlikely to change following the implementation of the FIL, which, beyond high-level principles, offers little in the way of specific details for implementation.

Furthermore, the latest version of the FIL contains just 39 articles, in contrast to the 170 articles contained in the previous draft issued for public comment in 2015 by the Ministry of Commerce. One addition of particular interest, however, was a measure to strengthen protection of trade secrets, prohibiting Chinese officials from sharing commercial information from foreign businesses. While British businesses appreciate the desire of the authorities to move quickly on passing the FIL, they speculate whether there could have been more opportunities for foreign consultation and are concerned about the lack of clarity around its implementation.

In addition, the State Council has made positive amendments to several contentious articles of the *Technology Import Export Regulations* (TIER) as of 2nd March 2019. Previous TIER regulations specified that where the receiving party to a technology import contract infringes another person's lawful rights and interests by using the technology supplied by the supplying party, the supplying party shall bear the liability (Article 24). This article has since been removed from TIER, indicating that the supplying party is not longer obligated to bear the liability. Similarly, the provision requiring that ownership over newly created IP that builds on existing patents belongs to the party that created the IP (Article 27) has also been removed by the State Council, suggesting that parties can now freely agree on ownership over newly created IP. These amendments, however, have not been included in the Contract Law or other anti-trust regulations, leading to inconsistent technology import legislation in some cases.

Current practice is unlikely to change following the implementation of the FIL, which, beyond high-level principles, offers little in the way of specific details for implementation.

17 'China Still Has Too Many Trade Marks', China Law Blog, February 2018.

LICENCING AND CERTIFICATION RESTRICTIONS

Navigating business licencing in China can be difficult for foreign firms, as evidenced by licencing and certification ranking as the third most limiting of the cross-sector business environment and market access issues facing British businesses put to them in the Member Sentiment Survey. The ability to obtain licences or certification is contingent on businesses meeting criteria determined by their industry regulator. As a result, the ease with which businesses can receive permission to fully operate in China is highly variable.

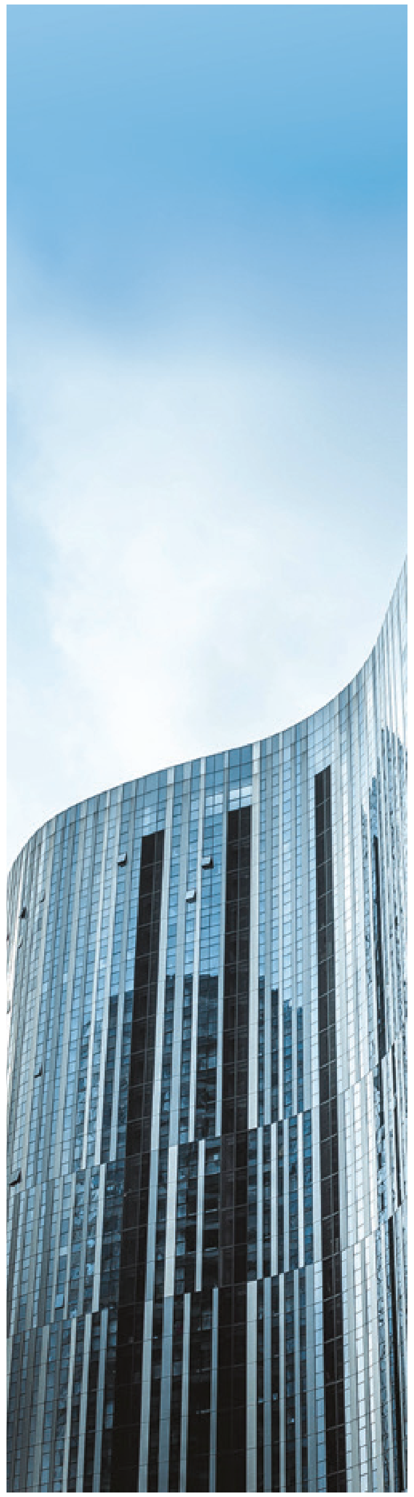
The critical pieces of legislation that guide the availability of licences for FIEs are the *Special Administrative Measures on Access to Foreign Investment 2018* and the *Negative List for Market Access 2018* ('Negative List'). These are jointly published by the National Development and Reform Commission (NDRC) and the Ministry of Commerce, with an updated 'Negative List' of industries in which foreign investment is prohibited or to be restricted released in December last year and a draft 'Encouraged List' of industries that welcome foreign investment closing its call for comments in March 2019. In 2018, 177 sectors were removed from the original 2016 draft,[18] including finance, infrastructure; transportation; agriculture; and energy; while 402 sub-sectors have been added to the draft Encouraged List. This has led to a rise in the maximum equity cap for certain companies in the financial sector from 49% to 51% in 2018 as a result, with another projected rise to 100% ownership in 2021. Measures taken to increase the openness of the business environment and the range of options available to Chinese businesses and consumers are welcomed by British businesses in China.

MANY SECTORS OF THE ECONOMY ARE STILL OFF-LIMITS FOR UK BUSINESS

However, there are a significant number of companies that still face restrictions on the products or services they can provide to Chinese clients, artificially impacting on their ability to compete with domestic firms. Financial and professional services, a particular strength of the UK, are disproportionately affected: a series of licences, including underwriting licences, mutual fund licences and business advisory licences are relatively difficult for foreign firms to attain, compared to in other markets; British accountancy firms cannot conduct audits in China; and civil engineers cannot obtain the 'Super-A' licences that would allow them to design a wider range of projects, to name a few. Licences may technically be open to foreign companies but require track records, capital or other 'guarantees' to be held in China, which are difficult to acquire without the licence the company is looking to obtain. In many cases, British businesses are thus wary of fully investing in the China market, which in turn limits job creation and consumer choice for the Chinese public. Chinese businesses and professionals face far fewer, if any, barriers to entry in terms of business licences or certification of products entering the UK market, constituting a lack of reciprocity between China and the UK.

British businesses are thus wary of fully investing in the China market, which in turn limits job creation and consumer choice for the Chinese public.

Furthermore, there has long been a common belief among foreign businesses in China that the process by which they can obtain licences and certificates are unnecessarily bureaucratic and require too much time. This often inhibits their ability to respond to the shifting needs of the market – particularly in terms of releasing imported fast-moving goods from customs – making their business models less agile and inhibiting the efficiency of the market for the consumer. Recent administrative policies from the government, such as the 'One Window, One Form' registration system and the ability to register your business online in Beijing, Shanghai and Shenzhen, have been well-received by British businesses, who report that the systems are easy to use and reliable. Nevertheless, more streamlining of licencing and certification across all sectors would be welcomed by the business community.



18 'China's New Negative List Targets Unified Market Access', Dezan Shira & Associates, January 2019.

COMPLIANCE AND BUSINESS ETHICS ISSUES

The main concern amongst British businesses in this area is the recent inconsistencies in enforcement of regulation. As a result of the vagueness and lack of transparency of PRC legislation, firms often resort to relying on enforcement precedent to understand how to comply. There have been cases in the past when foreign firms compliant under normal regulation and interpretation were at risk of being shut down. This means that they must work under the knowledge that authorities could make an unpredictable decision to interpret legislation in a more damaging way. A recent increase in spot checks and audits at short notice are one example of enforcement changes reported by businesses, who are nervous that this could herald an imminent change in policy. Sector-specific examples include 'window guidance' given informally by regulators to discourage financial firms from entirely legal actions, an increase in scrutiny on pharmaceuticals after vaccine scandals and heightened stringency on the job titles foreign legal professionals can be awarded. Whilst some of the above changes do not have directly damaging effects, the lack of consistency and predictability in policy is unsettling for businesses, which need stability and consistency in regulation and enforcement to operate and plan for the future.

ISSUES AROUND ATTRACTING FOREIGN HUMAN RESOURCES

China's growing international influence and improving career prospects are encouraging more foreign workers to move to the country, according to a report by the Centre for China and Globalisation[19]. Nevertheless, attracting and retaining foreign talent to work and live in China is a perennial issue for foreign firms. Part of this is due to China's public image problem: despite its reputation as a dynamic country to work in and government measures to encourage high-skill immigration, the relatively poor quality of air and public goods, among other factors, can reduce the appeal of moving to China to work, particularly for prospective employees with families. Concerns over recent regulatory changes, such as the lack of clarity of the new *Individual Income Tax Law* and the level of bureaucracy required to receive permission to remain in the country, also discourage foreign talent currently employed in China from remaining in the country. Should these concerns become more pronounced, employers fear it may trigger a 'brain drain' of foreign talent, disrupting their daily operations in China.

ISSUES AROUND LOCAL HUMAN RESOURCES

A large number of foreign companies hire extensively from the local job pool. However, their status as FIEs can lead to restrictions in terms of the functions that employees can fulfil, limiting the opportunities that local employees have at those FIEs and thus the attractiveness of the company. One particularly demonstrative example is the legal sector, in which local lawyers have their legal right to practise PRC law suspended upon joining a foreign firm. In other companies, particularly those that are restricted to only opening JVs or representative offices, restrictions on the range of operational functions foreign business entities can perform could limit the control they have over the hiring process or the channels through which they could hire new local staff, meaning that they may not be able to fill openings with their ideal candidate. Professional services firms are also more likely to report that local candidates do not always have the full skill-set required by the position, identifying a key area in which UK training associations can work with Chinese accreditation bodies to diversify the local professional's abilities.

INCONSISTENT STANDARDS AND CONFORMITY ASSESSMENT

Managing conflicting and overlapping standards and regulations is highly burdensome for British businesses operating in China, raising substantial concerns around compliance. Standards are often determined by different ministries and regulatory bodies that operate independently of one another, with little coordination. Businesses experience a number of overlapping conformity requirements around mandatory standards, compulsory certification and administrative licencing. This is often accompanied by an absence of any prescriptive guidelines to aid compliance, leading to increased uncertainty for firms in sectors governed by multiple administrators. Having to manage overlapping and inconsistent regulations places significant burdens on British businesses in China and raises concerns around conformity assessment. It also imposes additional compliance costs on businesses as they must take care to clarify competing regulations with all of the relevant authorities to ensure compliance. Inconsistency further arises between standards determined by the central and local governments. For example, several local jurisdictions are accelerating the implementation of emissions standards ahead of schedule, which creates immense complications for automotive firms planning on selling vehicles in these regions.

CONCERNS ABOUT FINANCE AND THE TAXATION LANDSCAPE

China's tax regulatory landscape is complex, can be limiting to business, and sometimes unequal for foreign firms. Among the many issues facing foreign firms, the following have been raised by British businesses. Firstly, capital controls are problematic for firms. Any company with branches outside of China is required to conduct inbound and outbound foreign currency transactions through specific channels, and must declare the nature of the transaction to their bank, meaning that businesses firstly must spend resources on preparing and processing the transfer; and secondly may encounter difficulties if they are in urgent need of transferring funds. Another related issue is the complexity of transfer pricing controls, or regulations regarding the sale of products or services between two related companies. Businesses recognise that transfer pricing needs a certain degree of oversight to prevent unfair price manipulation, but certain areas, such as hard-to-value intangibles and value chain analysis, are vague and can cause unnecessary complications and compliance costs.

There are also concerns around the new *Individual Income Tax Law* that came into effect in 2019. Although the law takes some of the burden off the vulnerable and boosts consumption, the Notice on the Preferential Policy Convergence System removes tax-exempted allowances in areas such as education, language training and home visits. Expatriates must pay for these, whereas locals are free not to thanks to access to state systems. Businesses also report that they face greater scrutiny relative to domestic firms. Finally , British business appreciates China's efforts to align tax systems with international standards. However, the new deferral system for withholding tax (WHT) brings uncertainty to business and burdens both taxpayers and authorities unnecessarily as a result of unclear elements or elements that have not properly taken foreign business into account.

RESTRICTIVE LEGAL ENVIRONMENT

British business welcomes the progress that China's legal environment has made since its accession to the WTO in 2001. However, many areas for improvement remain. The legal environment that foreign firms are greeted with is at once stringent, and opaque and unclear. This combination makes it difficult for foreign businesses to comply in China. Across all sectors, clarity is impinged by the fragmentation and lack of consistency from regulation through to enforcement, and the gap that often develops between the two. Regulation that applies in one region may be differently applied in another, hampering growth across the country as well as supply chains. Although British businesses welcome the liberal atmosphere of the Free Trade Zones, wealth would spread more equally across China if markets were opened uniformly across the country. Fragmentation also occurs across government departments as several departments responsible for one piece of legislation may disagree on the drafting process or the law's interpretation. Legislative language is often vague. One example is that lists of regulation will often be qualified with the phrase "as provided by other/relevant laws and regulations", leaving the enforcer to interpret at their discretion. Whilst this has improved in recent laws, many other issues remain. Similarly, regulatory transparency is still a major issue for any business operating in China. In joining the WTO, China agreed to establish an official journal to publish all laws, regulations and other measures affecting trade. A basic document has now been provided, but business is looking forward to it being advanced further. Both the consultation and implementation processes are neither standardised or transparent. For example, many government bodies do not follow the requirement for 30 days' consultation period in the Interim Measures on Solicitation of Public Comments on Draft Laws and Regulations. Finally, the system suffers from a lack of predictability, with authorities applying legislation retroactively, for example.

DIFFICULTY COMPETING WITH STATE-SPONSORED COMPETITION

State-owned enterprises (SOE) in China receive various form of preferential treatment over private businesses and FIEs, owing to their unique position in the Chinese economy. In sectors which are dominated by SOEs, British businesses have to compete with state-backed firms that can benefit from government subsidies, access to prime real estate, better prospects of winning public procurement contracts and a larger share of state bank loans. Although the return on SOEs assets is less than half that of their private sector counterparts[20], the government has continued to merge SOEs and consolidate state assets, creating enormous enterprises that have crowded out private competition. An endorsement of the principle of 'competitive neutrality' by the State Council is certainly a step in the right direction, which would in theory mean that SOEs and private enterprises compete on a level playing field. British businesses, however, would like to see this rhetoric translated into effective measures that guarantee more equal treatment in areas such as public procurement, licencing and business operations.

ISSUES AROUND ACQUIRING VISAS FOR FOREIGN WORKERS

China's current visa requirements for foreign professionals mean that it is difficult for international companies to hire both young graduates and older professionals. China requires that, to be eligible for a work permit under Class B, foreigners must have either a minimum of two years of relevant work experience plus a bachelor's degree, or a master's degree. Such restrictions on visas for foreign talent impede both domestic and international companies from accessing a wider job pool of recent graduates, to say nothing of highly-skilled workers without formal higher education, in order to build dynamic and creative teams. At the other end of the spectrum, the restrictions forbidding foreign professionals over the age of 60 to continue working in China lead to the exit of experienced human capital, harming the interests of both firms, who lose a valuable employee, and the Chinese consumer, who misses out on the potential ideas these individuals could bring to the market after they leave for elsewhere. The British business community would welcome exploration by both governments of ways in which they can facilitate the ability of British and Chinese professionals to work in each other's country.

CONSTRAINTS RESULTING FROM PUBLIC PROCUREMENT POLICY AND PRACTICES

While the public procurement market in China has improved significantly over the past decade, the bidding process remains highly complex, opaque and unequal. Two separate laws govern public tendering: the *Government Procurement Law* (GPL) and the *Tender and Bidding Law* (BL). The GPL, administered by the Ministry of Finance (MOF), applies to goods and services purchased by central and local governments, but does not cover projects undertaken by SOEs because their procurements are not financed by fiscal funds. Initiated by NDRC, the scope of the BL by contrast is considerably wider, covering large-scale projects such as infrastructure or public utilities that concern social and public interests, projects that are partially or fully funded by state-owned funds, and projects financed by international organisations or foreign governments. The BL however lacks an effective appeals procedure, meaning that if companies have concerns about the evaluation process, they have few avenues to raise these with the relevant authorities. British businesses also have difficulty obtaining timely and accurate information about upcoming projects, the evaluation process and bid announcements, and this lack of transparency raises further issues around price pressures and compliance. The government is currently in the process of applying to join the World Trade Organisation's (WTO) Government Procurement Agreement. Its most recent application was submitted in December 2014, and in 2018 China reaffirmed its intention to put forward a revised offer with comprehensive improvements pertaining to its state-sponsored entities, though no announcement was made as to when it would do so. The second iteration of the *Foreign Investment Law* guarantees FIEs fair participation in government procurement bidding. Going forward, more concrete action in offering better access to the country's procurement marketplace and promoting a level playing field to compete for procurement contracts would undoubtedly aid China's efforts to join the agreement.

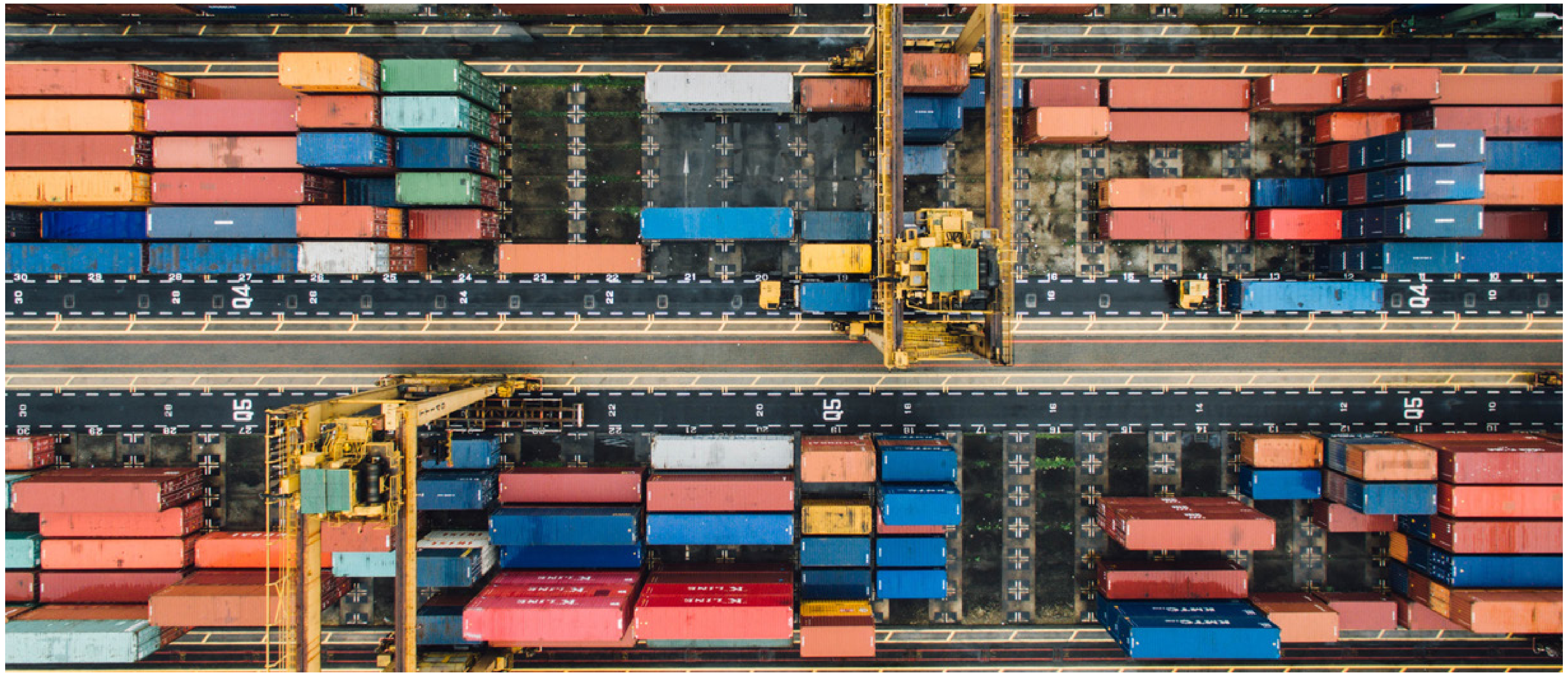
RESTRICTIVE INVESTMENT POLICY

Overall, China remains an attractive destination for foreign direct investment (FDI), ranking as the second largest recipient of FDI after the US[21]. The country's economy was also ranked the second most attractive to multinational companies for 2017-2019, with an FDI inward flow of USD 136.2 billion in 2017[22]. Nevertheless, the regulation of FDI avenues into China have caused a tempering of confidence in the market, with China falling from second to fifth place in A.T. Kearney's Foreign Direct Investment Confidence Index[23]. Key to this are the series of regulations that specifically limit foreign investment, restricting the ability of foreign firms to directly apply their business model to the China market. Although December's *Negative List for Market Access 2018*, is welcome in that it is applicable to both domestic and foreign firms, the *Special Administrative Measures on Access to Foreign Investment 2018* sets out a series of sectors that are still either 'off-limits' to foreign firms or heavily regulated. One sector-specific example is that British healthcare companies looking to contribute to the sector through investment are limited to a 70% equity cap on foreign investment, when they would prefer full ownership and control of their business. Similarly, while most companies welcome the improvements to the business environment presented in the most recent iteration of the draft *Foreign Investment Law*, the existence of a law aimed exclusively at foreign investors at all implies that foreign companies will always be the subject of discriminatory regulation, adding to their hesitancy to fully commit to the China market. Chinese investment into the UK is welcomed and has delivered substantial benefits to both sides; reciprocated openness to foreign investment would create a wealth of opportunities for both foreign companies and domestic markets.

19 'Attracting skilled international migrants to China', Centre for China and Globalization, September 2017.
20 'The story of the Chinese economy as told through the world's biggest building', The Economist, February 2019.
21 'World Investment Report 2018', UNCTAD, June 2018.
22 'China: Foreign Investment', Santander Trade Portal, April 2019.
23 'A.T. Kearney Foreign Direct Investment Confidence Index 2018', A.T. Kearney, January 2018.

UNCLEAR CUSTOMS REQUIREMENTS

For British businesses importing into China, a considerable amount of bureaucracy and a lack of transparency limits the speed and ease by which their products are cleared through customs. Companies importing goods into China must comply with the *guobiao* (GB) standards, the country's national standards issued by the Standardisation Administration of China. GB standards frequently change, and importers receive little consultation from the authorities prior to any changes in which products are and are not permitted into the country. A lack of specific guidelines creates issues for British importers into China, especially when importing ingredients commonly used in food and beverage products in the UK and the EU which may be unfamiliar in China. It is also not uncommon for products to remain in customs for several months, reducing their shelf life for food and beverages once they are finally cleared and delaying the delivery of orders of other consumer goods. Many companies must rely on a country agent based at a port, whose relationship with local Chinese customs officials has a significant bearing on the length of time it takes for products to clear customs. More transparency and consistency of the clearing process would therefore be appreciated by British firms. Furthermore, there is a great deal of geographic inconsistency between ports, which notably influences the ease in which goods are accepted into the country.



RECOMMENDATIONS FOR CROSS-SECTOR ISSUES

Cybersecurity and IT restrictions

- Ensure that the final iteration of the *Cybersecurity Law* gives firms reasonable scope to share information overseas that is crucial to business operations, as long as it does not have a tangible impact on national security.
- Align cyber laws closer with international standards to improve commercial clarity and create a space for information-sharing and collaboration on standards. Examples include GDPR, ISO and CBPR (contributed to by PRC).
- Create a consultation space for business to participate in the legislative process in cyber, and clarify the law's language.

Concerns over intellectual property rights protection

- Ease the process by which companies can apply to have bad-faith trade marks cancelled, reversing the burden of proof by placing the onus on the applicant to defend oppositions and invalidations.
- Train IP examiners to better recognise bad-faith trade marks by providing them with clear guidance and examples of past case decisions.
- Allow foreign businesses to use a licence of their technology as an equity contribution into a JV, removing the necessity of transferring technology to their Chinese partner, while adding more clarity to the implementation of regulations in this regard.

Licencing and certification restrictions

- Grant foreign businesses access to a wider range of licences, and continue to make the application process for licences more streamlined and transparent.

Compliance and business ethics issues

- Apply consistent and transparent standards across the compliance and assessment process.

Issues around attracting foreign human resources

- Explore bilateral measures to encourage talent, particularly young talent, to take advantage of the opportunity to work in China.

Issues around local human resources

- Remove restrictions on the functions fully-qualified local staff can perform in foreign firms.
- Allow representative offices to be able to use a wider range of recruitment channels to find new talent.

Inconsistent standards and conformity assessment

- Ensure better coordination between government ministries in the drafting of standards to prevent regulatory inconsistencies.

Concerns about finance and the taxation landscape

- Combine the withholding tax deferral system with a minimum holding period for those shares that have been obtained through re-investment.
- Take steps to reduce the complexity of and bureaucracy involved in mechanisms of transferring money in and out of China.

Restrictive legal environment

- Apply consistent and transparent standards across the regulatory process and implementation.

Difficulty competing with state-sponsored competition

- Remove privileges to SOEs and ensure more equal competition between private and foreign enterprises and SOEs.

Issues around acquiring visas for foreign workers

- Adjust the age and experience requirements for work permits to allow a broader range of foreign talent to contribute to the development of China's economy.

Constraints resulting from public procurement policy and practices

- Ensure that foreign enterprises enjoy equal treatment in China's public procurement market, as guaranteed in the *Foreign Investment Law*.

Restrictive investment policy

- Continue to reduce the number of sectors in which foreign investment is restricted in the 'Negative List', and grant equal treatment to domestic and foreign companies in terms of the sectors in which they can invest.

Unclear customs requirements

- Issue a consistent set of guidelines on products and ingredients that can be imported into China, while reducing the degree of discretion customs officials have in determining the speed and ease by which products can enter the country.

INDUSTRY REPORTS

ACCOUNTANCY

AT A GLANCE

SUB-SECTORS

Accountancy firms

Qualification bodies

KEY CHALLENGES

- Lack of mutual recognition of British and Chinese qualifications
- Limitations on non-CICPA ownership
- Inconsistent interpretation of regulations

KEY RECOMMENDATIONS

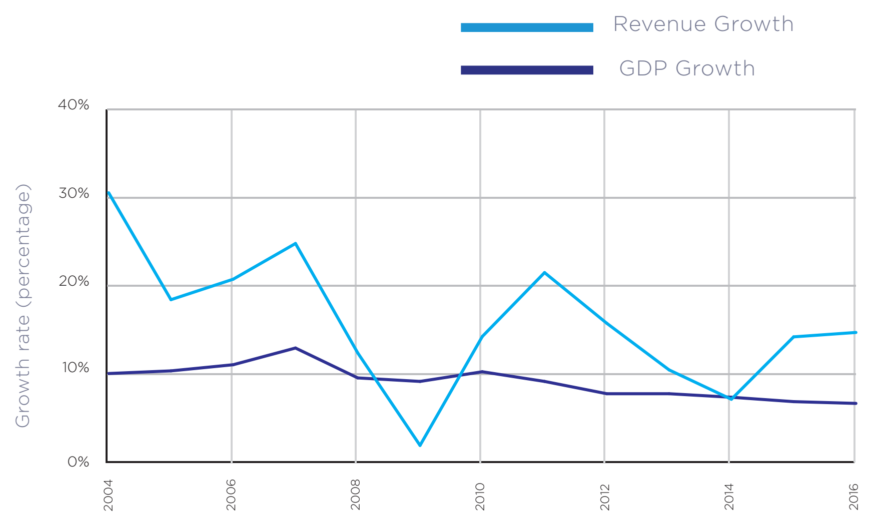
- Explore the opportunity of signing Mutual Recognition Agreements between CICPA and British accountancy bodies
- Allow British non-CICPA ownership of CICPA firms up to 50% in line with the UK model of corporate ownership
- Provide more clarity and consistency to accounting standards, given the associated costs of vague regulations for both British and Chinese firms

STATE OF THE SECTOR

Since the opening up and reform of the Chinese economy, the accountancy sector has been a consistent generator of revenue for both the Chinese economy and foreign firms. The sector has enjoyed robust growth rates over the past 20 years, often well exceeding average GDP growth. According to Ministry of Finance (MOF) data, China's accounting sector recorded an estimated annual revenue of RMB 100 billion (GBP 11.4 billion) in 2018, accumulated by 109,352 certified public accountants operating in 7,862 firms[24].

The principal regulator of auditors is the Chinese Institute for Certified Public Accountants (CICPA), which operates under the MOF in formulating professional standards for the industry and monitoring their implementation. CICPA consults widely with both Chinese and foreign accounting firms and associations, granting British businesses the opportunity to influence the regulatory environment in which they operate and advising the MOF on relevant laws at all stages of the drafting and review process. CICPA also functions as China's principal certification body for accountancy qualifications and membership organisation for accountants. Certified auditors must hold a CICPA qualification in order to provide auditing services in market.

The presence of British accountancy organisations in China consists of



Comparison of the Growth Rate between the Revenue of the Accountancy Profession and Chinese GDP from 2004 to 2016

Source: CICPA

24 'China's accounting sector records 14.8 bln USD revenue last year', Xinhua, February 2019.

SMEs, qualification bodies, and Big Four firms with their historical roots in the UK. British accountancy firms are prohibited from operating as a wholly foreign-owned enterprise (WFOE), and many smaller firms have instead strengthened their profile in China by joining international accountancy networks, granting them greater brand recognition while cutting down on operating costs and vulnerabilities to shifts in the market. Big Four firms, by contrast, were granted the right to audit in 1992 and began providing accounting services in China through joint ventures (JV), while also managing representative offices in other cities and WFOEs through which they provided business consulting services. More recently, the Big Four were required to restructure into Special General Partnerships (SGP) once their initial JV licences expired.

MARKET ACCESS ISSUES

An MRA would forgo the need for British accountants to sit a Chinese qualification exam and vice versa, broadening the range of opportunities available to accountants from both countries.

1

LACK OF MUTUAL RECOGNITION OF BRITISH & CHINESE QUALIFICATIONS

A key concern shared by accountancy firms and bodies is the lack of mutual recognition of UK and Chinese accountancy qualifications. British accounting organisations are unable to sign audit reports, a right reserved only for firms governed by Chinese qualification bodies, and the MOF has demonstrated an unwillingness to allow CICPA to sign exemptions. It should be noted, however, that Chinese accountancy qualifications such as CICPA are not recognised in the UK. Although precedent has been set for British accountancy qualification bodies to establish reciprocal membership with CICPA, allowing students to transfer credits from one qualification to the other, all previous agreements have since expired with no plans as of yet to renew. If another long-term Mutual Recognition Agreement (MRA) were to be signed between British accountancy bodies and CICPA, then both UK and Chinese accountancy firms would benefit from the exemptions, as they could become members of the equivalent body and operate more efficiently in the other country. Furthermore, while foreign accountants may take the CICPA qualification exam, language barriers dissuade many of them from attempting it, as it is only offered in Chinese. An MRA would forgo the need for British accountants to sit a Chinese qualification exam and vice versa, broadening the range of opportunities available to accountants from both countries. Alternatively, a reciprocal agreement to translate the CICPA exam into English and vice versa would further ease the ability of British accountants to become CICPAs.

CICPA law stipulates that financial statements and audit reports must be completed in Chinese and can only be signed off by a CICPA. Although prior to China's accession to the World Trade Organisation (WTO) only PRC citizens could complete audit reports, China has since removed nationality-based restrictions. In this way, British CPAs in China are prohibited from providing assurance services to clients unless they are qualified CICPAs. However, many British firms express the view that such assurance services are generally of a higher risk and offer lower profit margins, meaning that the provision of advisory services such as tax advisory, corporate finance or risk consulting is becoming a much more attractive service for British accounting firms to offer.

25 'Regulations governing the use of the description Chartered Accountants and ICAEW general affiliates', ICAEW, June 2017.

2

LIMITATIONS ON NON-CICPA OWNERSHIP

As in most countries, CPA firms in China are governed by their qualifications. British accountancy firms holding a British accountancy qualification, however, are prohibited from operating as a WFOE. To provide assurance services, firms can instead become members of international accountancy associations, which has significant advantages in terms of quality, risk mitigation and client service. As assurance services are regulated by a separate government bureau to accounting and business advisory services, British firms must register separate companies in order to provide these services., British firms must register separate companies in order to provide these services. This then generates further complications and added costs for firms in seeking to maintain consistent branding across multiple legal entities.

Furthermore, regulations dictate that only CICPAs can be partners in any Chinese firm, prohibiting British accountants from holding this position in Chinese CPA firms unless they possess a CICPA qualification. In the UK, however, there are no regulations prohibiting non-CPAs from becoming partners in accountancy firms, with the exception of firms that provide auditing services, in which 50% of partners can be non-CPAs[25]. Therefore, Chinese non-CPAs can serve as partners in CPA firms in the UK, constituting a lack of reciprocity. In 2012, the MOF announced new guidelines for the restructuring of the Big Four in China. The rules stipulated that Big Four firms must undergo the transition to form SGPs before their JV contracts with their respective local Chinese firms expire. In accordance with these rules, Big Four firms were required to cap the percentage of their non-CICPA partners in China at 40% under their next contract, and at 20% by the end of 2017, in effect capping the number of foreign partners in possession of British accountancy qualifications.

Travelling back and forth to various tax offices in order to clarify regulations is highly time consuming, and one British firm estimates that the time spent doing so roughly accounts for 10-20% of the costs that they charge clients.

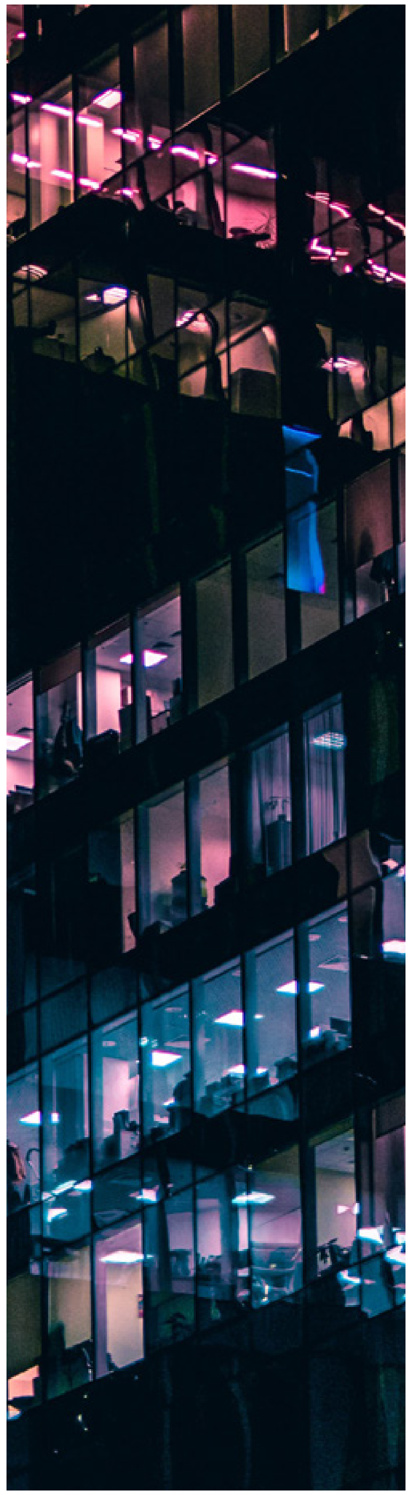
3

INCONSISTENT INTERPRETATION OF REGULATIONS

The frequent need to interpret government policy, owing to the vagueness of regulations, incurs time and monetary costs on British accountancy firms in China. Many standards in China employ deliberately vague language in order to afford the government more discretion in enforcing rules or changing its position. Poorly defined regulations, however, mean that government officials and accountancy professionals in different regions will often have a different interpretation of any particular law. Clarifying vague regulations with the relevant authorities is often unavoidable for British accountancy firms, as non-compliance with a particular law as a result of misinterpretation could incur severe financial penalties. Travelling back and forth to various tax offices in order to clarify regulations is highly time consuming, and one British firm estimates that the time spent doing so roughly accounts for 10-20% of the costs that they charge clients. The added costs from clarifying accountancy standards in China are therefore not only limited to British organisations in the sector, but are passed onto client firms, whether they are Chinese, British or other foreign-invested enterprises (FIE).

For British accountancy firms, unclear regulations and a lack of policy guidance can hamper business operations in China. As is often the case across many sectors in China, rules and standards are issued by the principal regulatory body and the guidelines for compliance follow later. For example, when the Big Four were required by the MOF to transition to SGPs, the guidelines provided to firms were limited in their detail and practicality. Similarly, the rules for the implementation of strict quotas for the firms' non-CICPA partners in China did not specify whether the cap would remain at 20% or if the firms must continue reducing the proportion of its foreign accountants. Although some of the Big Four were able to simply reorganise their management structure so that previous partners retained the title unofficially, those partners were subsequently prohibited from signing PRC accounts. The ambiguity regarding possible further reductions to the ratio of their non-CICPA to CICPA partners has generated significant uncertainty for firms with regards to compliance, as well as for the British partners themselves.

Furthermore, the time lag between the initial announcement of the new regulation and the time in which guidelines for compliance are released causes further uncertainty for Big Four firms. Although phase-in periods for the new rules are designed to assist firms in their adjustment before guidelines are released, uncertainty towards compliance is still a major concern among Big Four firms during this period. Nevertheless, the MOF generally consults with the Big Four before passing changes to accounting regulations to take their views into account and reach a compromise on the implemented rules.



RECOMMENDATIONS

Please refer to the cross-sector chapter for issues that apply across industries.

Qualifications

- Explore the opportunity of signing Mutual Recognition Agreements between CICPA and British accountancy bodies.
- Allow British non-CICPA auditors to provide other assurance services to clients, such as IFRS audits. It is reasonable however that only CICPAs may sign statutory audits agreements for Chinese firms.

Non-CICPA Ownership

- Allow British non-CICPA ownership of CICPA firms up to 50% in line with the UK model of corporate ownership. There is currently an evident lack of reciprocity in refusing to allow British non-CICPAs to become partners in CICPA firms.

Inconsistent Interpretation of Regulations

- Provide more clarity and consistency to accounting standards, given the associated costs of vague regulations for both British and Chinese firms.
- Shorten the transition period between the initial announcement of a new law and the release of the guidelines.

MUTUAL OPPORTUNITIES

BUSINESS ADVISORY SERVICES

Local regulations currently prevent most foreign firms from performing auditing services. Even those companies that do have access can often be under-priced by PRC companies. Advisory services bring higher margins and lower risk, which British accountancy firms generally find more attractive. This also mitigates against increasing competition from two main areas: Chinese firms, and the rise of automated accountancy services. Chinese firms are all able to offer tax services, but not all can offer the more complex business advisory service. Switching services also helps alleviate the threat to jobs from automated accountancy, as business advisory is an area that is difficult to replicate with artificial intelligence (AI).

AI AND TECH IN ACCOUNTANCY SERVICES

Examples include the increasing prevalence of cloud accounting, and firms collaborating with tech companies to deliver more effective services. One major British accountancy body recently signed a Memorandum of Understanding with e-commerce firm Alibaba, for instance. Furthermore, despite concerns in the industry that a number of standard accounting services will soon be replaced by AI, such as tax preparation, payroll and audits, there will still be a large number of accounting tasks that demand human intelligence. Accountants that can analyse accounting data and apply this to a business scenario will always be in demand. These are skills that British accountants can certainly offer in China.

AUTOMOTIVE

AT A GLANCE

SUB-SECTORS

Original equipment manufacturers (OEMs)
Automotive components suppliers (ACSs)
Logistics companies
Automotive consultancy firms

KEY CHALLENGES

- Changes to emissions standards with limited consultation
- Burdensome customs requirements and taxation levies
- Preferential treatment for domestic NEV manufacturers

KEY RECOMMENDATIONS

- Provide more consultation with low-volume OEMs during the drafting phase of implementing new regulations
- Permit the mutual recognition of certifications by accredited test centres in the UK and China which would remove the requirement of retesting at port of entry
- Grant equal treatment to foreign and domestic NEV manufacturers in receiving incentive policies

STATE OF THE SECTOR

The automotive industry is a vital part of the UK economy, in terms of employment, manufacturing production, economic output and exports. In 2017, the motor vehicle industry contributed GBP 15.2 billion (RMB 134.4 billion) gross value added to the economy, equal to 0.8% of total output, while employing some 169,000 people directly in vehicle manufacturing. The sector is heavily reliant on trade, with total exports of commercial and passenger vehicles totalling GBP 34.3 billion (RMB 303.4 billion). Behind the European Union and the United States, China is the third largest destination for UK-manufactured cars (7.5%), with road vehicles representing the single largest export to China, valued at GBP 4.5 billion (RMB 39.8 billion), equivalent to 27% of all UK goods exports to China[26].

Despite a difficult year for automotive companies globally in 2018, as the world's largest automotive market, China remains an attractive destination for continued investment, and is the biggest source of sales and profits for many British carmakers, components suppliers and supply-chain services companies. Nevertheless, passenger vehicle sales in China fell last year for the first time since the early 1990s to 23.8 million, down 4.1% from the previous year. The downturn reflects a phasing out of a government tax cut for vehicles with engines smaller than 1.6 litres, as well as weakened consumer confidence and slowing growth in household incomes that reflect a wider national economic slowdown. However, sales of luxury vehicles remain robust in China's Tier 1 cities where wealthy consumers

26 'The motor industry: statistics and policy', House of Commons Library, May 2018.

have been relatively insulated from the slowdown, and sales of new energy vehicles (NEVs) across China remain high owing largely to government subsidies.

Several government agencies play a part in regulating China's automotive sector. For manufacturers to market and import their products they must first obtain approval by the China Compulsory Certification scheme, administered by the Certification and Accreditation Administration of China, their product fleet complied with both Corporate Average Fuel Consumption regulations and NEV credits administrative rules, administered by the Ministry of Industry and Information Technology (MIIT). Furthermore, the Ministry of Ecology and Environment determines the country's national emissions standards which manufacturers must comply with before selling their vehicles. For companies manufacturing vehicles in China, they must obtain investment approvals and a manufacturing licence from the National Development and Reform Commission (NDRC) and MIIT.

The past year has seen a substantial number of reforms to the country's automotive sector. China's most recent set of emissions standards, *China VI*, are due to be implemented next year and have been described by many British automotive companies as the most rigorous in the world. *China VI* standards retain European emissions standards (EC No.715/2007, EC No. 692/2008, ECE R83-07) for testing, while also combining these with those issued by the United States Environmental Protection Agency. Numerous tax cuts for automotive companies have been announced in the past year, in line with the government's current fiscal policy. On 22nd May 2018, the Ministry of Finance (MOF) declared that the import duty for vehicles would be reduced from 25% to 15% of their wholesale value, and in Premier Li Keqiang's Government Work Report on 5th March 2019, it was stated that VAT rates in the manufacturing sector would be lowered from 16% to 13% (taking effect 1st April 2019). Tariffs on automotive parts have further been reduced to 6%, from an average of 8% to 25%. For NEVs on the other hand, the MOF recently announced that it is scaling back subsidies to encourage NEV manufacturers to increase innovation instead of relying on state support. Subsidies for battery electric vehicles (BEVs) with a range of 400 kilometres and above will be cut to RMB 25,000 (GBP 2,827) per vehicle from RMB 50,000 (GBP 5,653) previously. Furthermore, the MOF has raised the standards for vehicles eligible for subsidies, ensuring that electric cars must have a range of at least 250 kilometres, up from 150 kilometres previously[27]. Despite the rollback of subsidies, foreign OEMs are still required to continue increasing the proportion of NEVs in their product portfolio.

MARKET ACCESS ISSUES

1

CHANGES TO EMISSIONS STANDARDS WITH LIMITED CONSULTATION

Tackling air pollution is a major government priority, and China has subsequently taken steps to introduce more stringent regulations pertaining to emissions standards. The authorities consulted with high-volume manufacturers prior to drafting the China VI standards, yet little effort was made by the government to solicit the views of foreign SMEs beyond a routine call for comments. Few of the remarks submitted by British automotive firms appear to have influenced the new standards. A lack of consultation and prior warnings have an adverse effect on British automotive firms, especially for low-volume manufacturers, causing significant uncertainty and generating additional costs.

The *China VIa* emissions standards are expected to come into effect 1st July 2020 and 1st July 2023 for *China VIb*. However, a number of local governments, such as those in Shenzhen and Guangzhou, are implementing the new standards ahead of schedule this year. A draft for comments was issued to businesses along with a planned date for implementation, yet this only gave manufacturers a few months to adjust to the new standards. Original equipment manufacturers (OEMs) need more time to complete necessary product verification, road testing and certification. Accelerating the implementation of *China VI* in a number of cities with little time for adjustment makes it very difficult for companies to meet those standards. Automotive firms are already in the process of designing cars to be launched in four or five years time and so need to know the details of the future standards they must adhere to in advance before developing new vehicles and technology. Reacting to abrupt policy changes adds substantial costs onto firms as they must quickly modify their vehicles to comply with new standards.

Accelerating the implementation of China VI in a number of cities with little time for adjustment makes it very difficult for companies to meet those standards.

27 'China toughens subsidy program for new energy vehicle companies', Reuters, March 2019.

2

BURDENSOME CUSTOMS REQUIREMENTS AND TAXATION LEVIES

Taxation levies on imported and domestically manufactured vehicles substantially raises the price of vehicles and components sold in China, forcing Chinese consumers to pay more for premium and luxury British cars. However, in recognition that the automotive market is transitioning to more sustainable levels of growth, the government has recently introduced a number of tax cuts to reduce the costs for automotive manufacturers. While these measures are welcomed by British automotive manufacturers, further cuts to the country's consumption taxes, which currently average between 10% and 15% according to engine displacement, would certainly benefit Chinese consumers.

On 1st January 2017, the Vehicle Emission Control Centre under the Ministry of Environmental Protection removed the categorical separation between low-volume and high-volume imports of vehicles. Under previous regulations, low-volume importers were subject to emission tests and EU conformity standards, but were exempt from an endurance test. Vehicles are now required, however, to undergo endurance tests to examine the depreciation of their catalytic converters, tested over 100,000 kilometres on a rolling drum and not in a static position. Undergoing the test allows companies to gain the necessary certification for import of the same model without further testing. The testing procedure emulated the New European Driving Cycle test for Euro V emissions standards, carried out by the Vehicle Certification Agency in the UK. However, removing this separation between low-volume imports and high-volume imports of vehicles meant that despite having already passed EU emissions tests, companies were still required to test in China. This not only contributes to the deterioration of vehicles before they are sold, but also creates additional costs and delays for low-volume importers.

Preferential treatment given to domestic NEV manufacturers ultimately undermines China's environmental objectives of cutting fuel emissions, while putting British companies at a significant competitive disadvantage.

3

PREFERENTIAL TREATMENT FOR DOMESTIC NEVS MANUFACTURERS

The development of NEVs is a central focus for the Chinese government, representing a strategic emerging industry as part of the country's effort to move up the value chain. Yet the industry has been heavily reliant on state subsidies to stay competitive Subsidies for NEVs, however, are limited to domestic companies, and foreign manufacturers of NEVs are excluded from obtaining full subsidies according to the MIIT's NEV catalogue. Although these subsidies are being phased out, preferential treatment for domestic NEVs prevents British firms from being able to compete on a level playing field. British companies do, however, appreciate the equal treatment given to foreign and domestic companies regarding the exemptions from the purchase tax for NEVs.

Furthermore, although foreign NEV manufacturers are, on paper, eligible to obtain a special green number plate if they meet technical requirements, in reality British firms have experienced difficulty in obtaining these preferential number plates. Whereas regular number plates in many Chinese cities can only be obtained through a lottery at very high prices to limit congestion, special green number plates are more easily available at much cheaper prices (RMB 100, GBP 11.31), and are exempt from both the lottery system and bans on driving during periods of exceptionally high pollution levels. In effect, this means that British NEVs without a green number plate are much more expensive and less attractive to Chinese consumers. Preferential treatment given to domestic NEV manufacturers ultimately undermines China's environmental objectives of cutting fuel emissions, while putting British companies at a significant competitive disadvantage.

4

RESTRICTIONS ON INTELLIGENT CONNECTED VEHICLES

In recent years, China has established itself as a leading market for the development and testing of intelligent connected vehicles (ICVs), but the sector remains heavily restricted for foreign investors. Many of the internet and telematics services ICV companies provide are legally classed as value-added telecommunications services (VATS). Foreign businesses are prohibited from providing VATS as a WFOE under China's telecommunications regulations, and can only do so by forming a joint venture (JV) with an equity cap of 50%.

China's *Cybersecurity Law* (CSL), implemented in June 2017, further places heavy restrictions on cross-border data transfers and the location where data must be stored. The regulations stipulate that foreign businesses must store their data locally in mainland China (Article 17), inhibiting them from pooling information in cloud data centres overseas. As British automotive firms in China engage in extensive R&D of ICVs and autonomous vehicles, the need to work in collaboration with their counterparts in other countries necessitates the exchange of data such as traffic information. Furthermore, isolating servers from their global headquarters' servers slows the transfer of information, and can complicate the company's standard operating procedures. However, British businesses are aware of cases where other foreign automotive companies store their data outside of China, raising concerns about the consistency by which national regulations are interpreted and enforced.

5

CHALLENGES IN DISPOSING OF USED COMPONENTS

British automotive component suppliers express concern about the disposal of used automotive components following testing. There is a current lack of any detailed guidelines and established procedures in place that would allow companies to dispose of their used automotive components with the assurance that they will not be copied and resold by other parties during the disposal process. Given that the licence for handling dangerous goods, such as electric car batteries, is heavily restricted, it is extremely difficult for British companies operating as a WFOE to obtain the licence needed for them to deal with the disposal themselves.

6

BAN ON IMPORTING SECOND-HAND COMPONENTS

Foreign businesses are prohibited from importing second-hand vehicles, engines and other components into China. Businesses recognise that this ban on used components does not significantly restrict their operations in China, however they are aware that removing restrictions on the automotive remanufacturing industry would significantly benefit both British and domestic manufacturers who want to import remanufactured components. The automotive R&D industry in China would also gain increased access to imported used vehicles and parts to develop globally-competitive automotive components. The quality and quantity of used parts sold in China does not meet the production needs of remanufacturing enterprises, and permitting imports of used components from overseas would contribute significantly to China's pool of available parts. Repealing the ban would further bring numerous environmental benefits. Allowing British and Chinese automotive manufacturers to utilise existing components through the development of its remanufacturing industry would aid China in its effort to build a more sustainable, low-carbon and resource-efficient economy.

Permitting imports of used components from overseas would contribute significantly to China's pool of available parts

RECOMMENDATIONS

Please refer to the cross-sector chapter for issues that apply across industries.

Changes to emissions standards with limited consultation

- Provide more consultation with OEMs during the drafting phase of implementing new regulations.
- Extend the transition period between the announcement of new standards by local governments and the date of implementation to allow companies more time to adjust.

Burdensome customs requirements and taxation levies

- Permit the mutual recognition of certifications by accredited test centres in the UK and China which would remove the requirement of retesting at port of entry.
- Continue to align the tax rates on imported foreign vehicles and components with those levied on Chinese companies importing into the UK.

Preferential treatment for domestic NEV manufacturers

- Grant equal treatment to foreign and domestic NEV manufacturers in receiving incentive policies.

Restrictions on intelligent connected vehicles

- Remove the equity cap on investment into ICVs to ensure a level playing field for British firms entering the market, while permitting them to offer VATS as a WFOE.
- Ensure that the final iteration of the *Cybersecurity Law* gives automotive firms reasonable scope to share information overseas that is crucial to the development of ICVs as long as it does not have a tangible impact on national security.

Challenges in disposing of used components

- Issue clear procedures and guidance on the disposal of used automotive components, while making it easier for foreign automotive companies to obtain licenses to handle the disposal themselves.

Ban on importing second-hand components

- Lift restrictions on importing second-hand automotive parts and components.

MUTUAL OPPORTUNITIES

CONNECTIVITY

Despite the restrictions on foreign investment into ICVs, British businesses are still optimistic about the opportunities that this burgeoning market presents. The development of ICVs is a strategic priority for China's central government, and British businesses hope that certain restrictions can be lifted to allow for more collaboration in the development of ICV technology between British and Chinese automotive companies. ICV technology is in high demand in China, with 79% of Chinese consumers believing that increased vehicle connectivity would be beneficial – roughly twice as many consumers than in Japan and Germany[28]. As British automotive firms continue to develop advanced ICV and autonomous driving technologies, and as Chinese consumers continue to demand better and more sophisticated connectivity offerings, an ICV market that is more open to foreign investment would only increase the number of opportunities for British and Chinese automotive firms.

NEVS

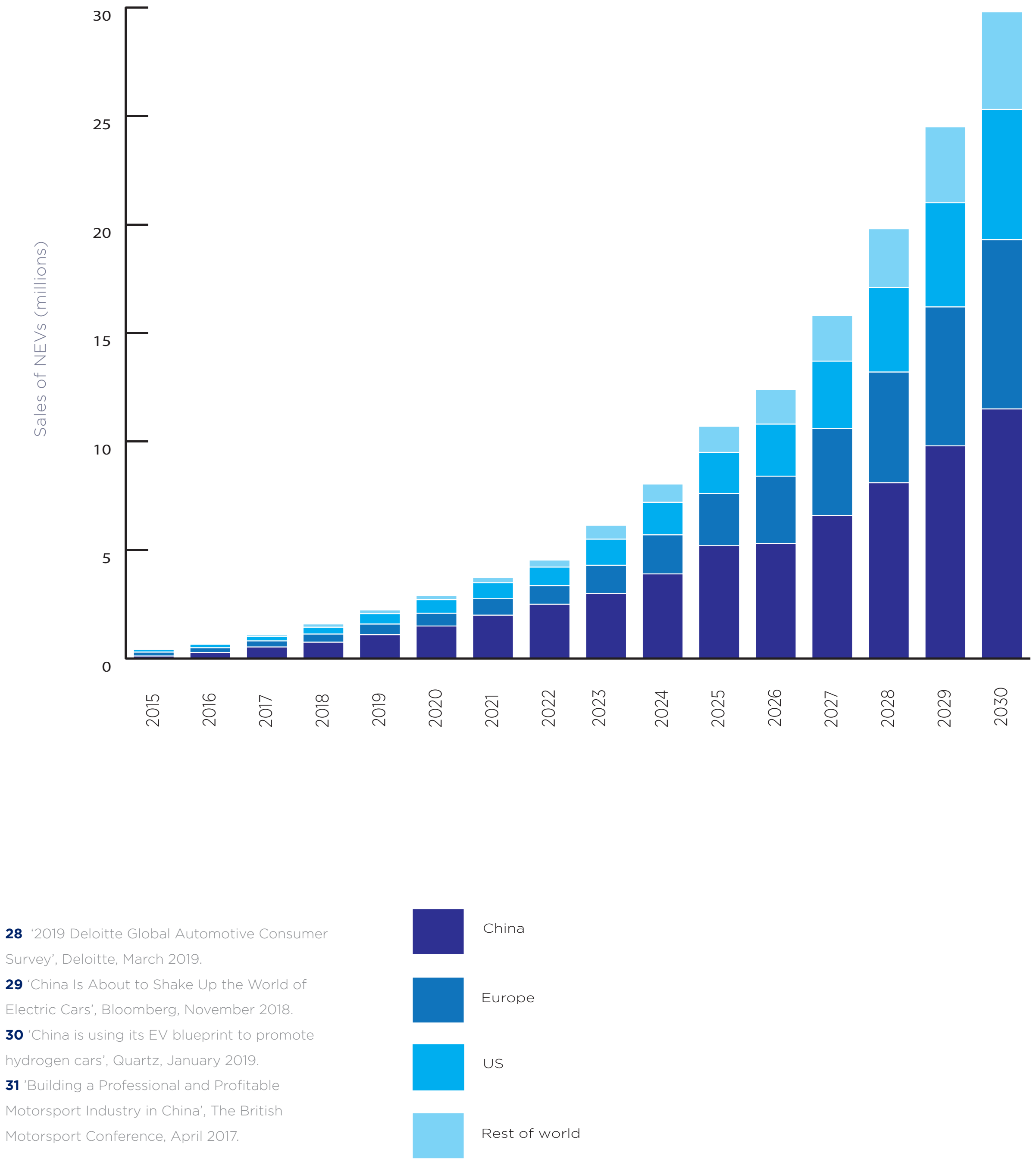
China is a world leader in NEVs, with sales of electric vehicles topping 1 million for the first time in 2018, accounting for little under 50% of global sales[29]. The emphasis on environmentally-friendly vehicles provides opportunities for UK automotive firms developing technology pertaining to electric vehicles (EVs), BEVs and plug-in hybrid vehicles (PHEWs). More recently, the government has directed its focus towards the development of hydrogen-powered fuel cell vehicles (FCVs) which take several minutes to refuel and can run up to 350 to 600 kilometres, as opposed to electric vehicles which take several hours to charge and have ranges of between 200 and 300 kilometres. Plans are in place to build more hydrogen fuel stations in certain Chinese cities such as Foshan (currently only 12 such stations exist in the country), and the government is now considering implementing a plan to promote the use of hydrogen vehicles, similar to the *Ten Cities, Thousand Vehicles* plan for EVs introduced in 2009[30]. Ongoing efforts by British automotive companies and engineers to develop more efficient and cheaper clean energy vehicles would reduce the need for state intervention in promoting NEVs in China, making the industry more sustainable and market-driven in the long term.

MOTORSPORTS

The growing popularity of motorsports in China offers new opportunities to British motorsport manufacturers, engineers and competition bodies. The UK possesses the world's largest motorsport cluster, and is home to seven of the current 10 Formula 1 teams, 4,500 motorsport engineering companies, and 32 race circuits. China currently has six racing tracks, including the Formula 1 circuit in Shanghai, and is expected to have close to 10 by 2020, indicating the huge scale for growth[31]. While the concept of motorsport is still in the early stages of development in China, the number of competitions is growing, as are the number of people engaging in racing. British motorsport academies are widely acclaimed around the world for their rich heritage and expertise, and their entry into China would present more opportunities for trade in technology, training and logistics.

Forecast of global NEV sales

Source: Bloomberg



28 '2019 Deloitte Global Automotive Consumer Survey', Deloitte, March 2019.
29 'China Is About to Shake Up the World of Electric Cars', Bloomberg, November 2018.
30 'China is using its EV blueprint to promote hydrogen cars', Quartz, January 2019.
31 'Building a Professional and Profitable Motorsport Industry in China', The British Motorsport Conference, April 2017.

BUILT ENVIRONMENT SERVICES

AT A GLANCE

SUB-SECTORS

Engineering

Architecture

Spatial planning, property development

Construction consultation, project management

Real estate consulting/ services

KEY CHALLENGES

- Challenges in obtaining licences
- Mutual recognition of qualifications
- Hiring local and foreign talent

KEY RECOMMENDATIONS

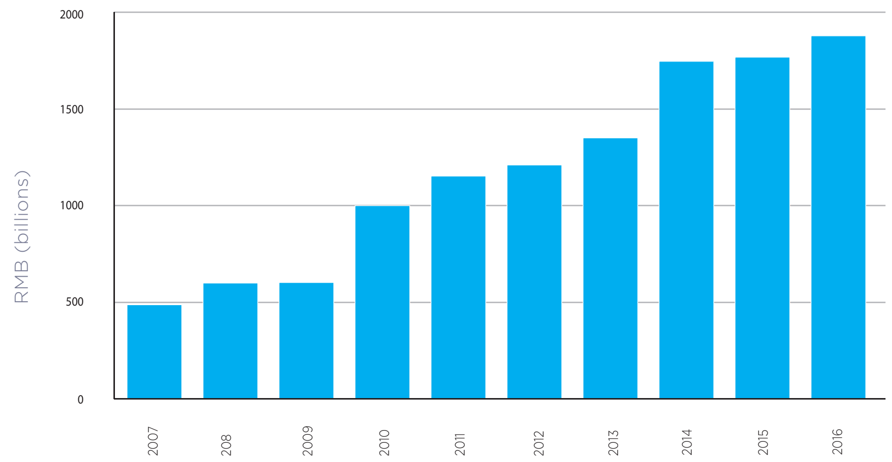
- Provide transparent and equitable approval processes for licences across all sub-sectors
- Ensure mutual recognition of qualifications
- Relax rules for recruitment of foreign experts

STATE OF THE SECTOR

China's rapid economic growth over the past three decades has been supported by enormous investment in infrastructure, as the Chinese government has recognised the importance of reliable transport networks, electricity and telecommunications to the economy. This policy priority is reflected in the investment rate, with Chinese investment in the sector over the last 25 years far exceeding those of other markets, accounting for an annual average of over 8% of total GDP[32].

Over recent years, policymakers have also used substantial infrastructure spending to hedge against flagging economic growth, both domestically and increasingly in third country markets, most notably along the Belt and Road Initiative (BRI). Going forward, China has ambitious plans for infrastructure development, with the goal to bring the entire country's urban infrastructure up to the level of infrastructure in a middle-income country, while using increasingly efficient transport logistics to increase connectivity within the country. Driven by breakneck economic growth, continued urbanisation and rising living standards, the property development and construction sectors contributed over 13% of Chinese GDP in 2017[33] with record expenditure on land plots by developers over recent years.

Real estate developers' expenditure on pilot purchases in China



Source: National Bureau of Statistics of China (Department of Investment and Construction)

32 'Infrastructure Investment in China', Reserve Bank of Australia, June 2014.

33 'China Economic Quarterly Q4 2017', PwC, February 2018.

The last decade has seen significant interventions in the residential market – including home purchase restrictions, mortgage restrictions and increased down-payment requirements – with an aim to cool the rapid growth in housing prices. Other major policy initiatives are encouraging the construction of more affordable housing, the growth in purpose-built rental housing and management of the migrant worker population. Additionally, as the economy rebalances away from the traditional industries, there is more emphasis on developing technology zones, R&D clusters, healthcare infrastructure, logistics and data centres. In terms of land sales, since the early 2000s local land bureaus have been responsible for all allocations of land for (re) development, with all leasehold rights to be sold at public auction. There are no significant foreign buyer restrictions on developers entering the Chinese real estate development market.

In the next 10 years, China's construction market will be worth around RMB 15.9 trillion (GBP 1.8 trillion) and will represent 19.1% of the global construction output, according to the Global Construction 2020 report. The extensive opportunities in China's construction market have attracted many foreign real estate and construction enterprises, with some of the oldest and most well-known professional brands from the UK now present in the China market – although contractors are notable in their absence due to numerous challenges around licencing and unfair competition. According to the National Bureau of Statistics, foreign construction companies in the market do not exceed 1% of the total operating companies.

In 2016 and 2017, the Chinese government released a number of measures related to opening up the construction sector. According to the Government Work Report for 2016, the Chinese government will revise the Catalogue for the Guidance of Foreign Investment Industries, to make the construction industry more open to foreign investment. The report states that foreign firms will be treated the same as domestic firms when it comes to licence applications, standards-setting, and government procurement. Although the *Special Administrative Measures on Access to Foreign Investment 2018* and *Negative List for Market Access* (2018 Version) have more closely aligned domestic and foreign firms, construction is not among the sectors removed from the Negative List. Nevertheless, in the Government Work Report released at the National People's Congress in 2019, the Premier also emphasised green development and livability – while stressing the importance of the development of the city clusters Beijing-Tianjin-Hebei, Greater Bay and Yangtze River Delta, which will provide huge potential going forward for built environment services.

MARKET ACCESS ISSUES

1

CHALLENGES IN OBTAINING LICENCES

The major challenges across a number of the sub-sectors – particularly engineering, architecture and urban (spatial) planning – are related to the difficulty in obtaining industry grade-A design licences. While technically it is possible to obtain one, companies must navigate a number of hurdles. For example, only past project records in China can be used to apply, which don't exist if you have not previously had a licence, leading to a "chicken and egg" scenario. To circumnavigate this issue companies could consider merging with or acquiring a local firm, but it is not possible to continue to use their licence without the required number of registered professionals. Super-A licences, which allow design in all areas, have been introduced but have not yet been granted to foreign companies. In urban planning and related functions, responsibility for the granting of licences has recently passed to the new Ministry of Natural Resources (MNR, established up in April 2018) and reformulated as 'spatial planning'. There are currently no new licences being issued. British businesses would appreciate receiving some idea of when the issuing of licences is likely to resume. In terms of valuation and appraisal licences, a domestic valuation licence can only be obtained by a company that is 100% domestically owned with 50% of its shares owned by domestically registered valuers who are employed by the company and possess an individual licence. To date, only one foreign consultancy has been awarded a Grade A licence for valuation, the highest in a grading system of A to C.

Only past project records in China can be used to apply, which don't exist if you have not previously had a licence, leading to a "chicken and egg" scenario.

2

MUTUAL RECOGNITION OF QUALIFICATIONS

In a number of built environment disciplines, most notably engineering, architecture and urban planning, there is a lack of mutual recognition of qualifications. For example, the Institute of Structural Engineers currently recognises Chinese educational qualifications with a conversion exam. UK qualifications are not recognised in China, constituting a lack of reciprocity.

RECOMMENDATIONS

Please refer to the cross-sector chapter for issues that apply across industries.

Licences

Subsector	
Engineering, architecture, construction, real estate consulting/ services	• Provide transparent and equitable approval processes for licences across all subsectors.

Licences

Subsector	
Architecture, urban design, engineering	• Allow China-registered architects, urban planners and engineers to park their registrations with potential non-licensed British companies to ensure they can practise in their sector of expertise. • As an interim step, establish a system for providing a transitional licence for UK firms that meet certain criteria, to ensure that they can continue to practise in China prior to ultimate granting of full design licences.

Licences

Subsector	
Spatial planning	• Ensure that the needs of British firms providing world-class spatial planning services in China are not ignored under the new MNR system and that they are able to realistically secure the relevant design licences.

Licences

Subsector	
Built environment professional institutions	• Clarify the intended coverage of the recent NGO law and whether it is deemed to apply to professional institutions in the built environment. If so, encourage the identified Professional Supervisory Unit to fulfil their designated function and assist in the registration of these bodies.

Recognition of qualifications

Subsector	
Architecture, engineering, urban planning	• Push for equal and transparent mutual recognition of engineering, architecture and urban planning qualifications between the UK and China.

MUTUAL OPPORTUNITIES

KNOWLEDGE-SHARING

British built environment services have a reputation for quality and the UK is recognised as the origin of thinking on the core professional skills of design, spatial planning, architecture engineering and project management. It has also been integral to the formation of international standards in their current state, and so the mutual recognition of BSI standards would help increase collaboration between the two countries. UK educational establishments not only produce high calibre apprentices and graduates, but could also leverage their capabilities and reputation to have greater engagement with China. For example, there are no degree level courses in China on project or cost management – students graduate as engineers and then have to re-train and gain further local qualifications while working as project managers or quantity surveyors. Making more links in these areas would therefore open more opportunities for development for Chinese graduates and professionals.

Encouragement by the government to develop infrastructure necessary for healthcare, education and other public goods also point to significant areas of opportunity

MATURING MARKETS AND FUTURE CITIES

As the Chinese economy moves away from a reliance on heavy industry, there is an opportunity for UK built environment services to advise and participate in development of brownfield sites and regeneration projects, where the UK is seen as a global leader. Encouragement by the government to develop infrastructure necessary for healthcare, education and other public goods also point to significant areas of opportunity for built environment services. Advising the Chinese on smart infrastructure and city development, or partnering on new city development could provide downstream opportunities to other developers and built environment professionals. Notably, the plan for the Greater Bay Area, along with continued development of free-trade zones, could allow UK built environment professionals to use their expertise to benefit Chinese citizens by contributing to the creation of an interconnected region that will be on the forefront of urban digitalisation and commercial innovation.

BELT AND ROAD INITIATIVE

British engineering consultancies are well-placed to work with Chinese partners in the Belt and Road Initiative (BRI) given their complementary skill-sets, international track record and the widespread adoption of British standards in these markets. British businesses believe that our two countries' expertise is highly compatible, and that the UK particularly has something to offer in advising on feasibility and risk management, strengthening the project as a whole. As such, there are opportunities here for significant win-win cooperation in promoting the BRI.

EDUCATION

AT A GLANCE

SUB-SECTORS

Early-years

Higher education

TVET

EdTech

K-12

English language training

KEY CHALLENGES

- Clarity in policy changes
- Limitations on HR and staffing
- Restrictions on investment

KEY RECOMMENDATIONS

- Implement a more structured approach to the delivery of policy information, providing clear outcomes and a clear timeline
- Bring teacher visa laws in line with practical requirements
- Provide greater clarity about what qualifies as ‘for-profit’ and ‘non-profit’ institutions, including clarity about acceptable fee levels

STATE OF THE SECTOR

The Chinese education sector remains exceptionally buoyant, with average households spending RMB 8,143 (GBP 920.68) annually on preschool and primary education for their children[34]. Widespread belief about the importance of education, and improvements and innovation in all educational sub-sectors, have led to rapid growth. By some estimates, the Chinese education market was worth RMB 2.58 trillion (GBP 291.7 billion) in 2018, and predicted to grow to RMB 3.6 trillion (GBP 407.1 billion) by 2020[35]. This positive perception is echoed by British businesses: 87.1% of education professionals surveyed in the *Member Sentiment Survey* reported that they felt optimistic about the business outlook for China’s education industry over the next two years.

With its international reputation for high academic and pastoral standards, British education has been able to play a major role in China’s international education market. As preschool education continues to develop rapidly in China, British early-years providers are gaining a strong foothold in the market, mirroring the situation in K-13 education. As of 2018, 41% of China’s 821 international schools offered British curricula, well ahead of the US’ AP (26%) and the International Baccalaureate (15%)[36]. In higher education, British universities currently account for 223 of China’s China-Foreign Cooperation in Running Schools (CFCRS) programmes, putting the UK second only to the US in its number of these partnerships in China[37]. Meanwhile 106,530 Chinese students were studying abroad at British universities in 2017/18, a 21% increase from four years ago[38].

With its international reputation for high academic and pastoral standards, British education has been able to play a major role in China’s international education market.

Impressive growth has been accompanied by increased government oversight, and the past year has seen a number of new policies introduced to strengthen regulations over the education industry. These include a 2018 draft amendment to the Implementing Regulations of the *Law of the People’s Republic of China on the Promotion of Private Education*, which may restrict foreign investment in compulsory education, and a policy document that outlines plans to ban private kindergartens across the nation from seeking public listing. Private training centres have seen new

34 ‘Household education spending totals $296 billion’, China Daily, January 2018.
35 ‘A new era of education: China education development report 2018’, Deloitte, August 2018.
36 ‘China International School Report 2018’, NewSchool Insight Media, December 2018.
37 ‘Chinese-Foreign Cooperation in Running Schools, Ministry of Education’, April 2019.
38 ‘Where do HE students come from?’, UK Higher Education Statistics Agency, December 2018.

regulation affect tuition and staffing, while guidelines for offline tutoring are expected in the coming year. Although the Chinese government continues to seek international collaboration in higher education, there has been a greater emphasis on quality and oversight. In July 2018, 234 CFCRS programmes were closed, including 62 with British higher education institutions.

Despite these changes to the market, British education businesses are largely positive about their experiences in the Chinese market. Citing the enthusiasm Chinese parents and institutions have for British education, and increasing access to high-quality UK products and services, firms feel that China's business environment continues to present a myriad of opportunities for British education companies.

MARKET ACCESS ISSUES

1

LACK OF CLARITY IN RECENT POLICY CHANGES

Recent government policy changes have included curricula, investment and profit-models in their scope. Educational institutes cite the communication of these changes as one of the main challenges, noting that there is frequently no advanced notice for changes, and that changes in regulation and new policies were communicated in a way that hindered, rather than encouraged, business. This lack of prior warning has sometimes added pressure onto school administration personnel and resources. It is felt that this could be alleviated with clearer initial information such as clearer timeframes for implementation, and that information sessions held by the relevant bureaus would be welcomed by businesses.

The requirement of two years' work experience makes it impossible to hire newly qualified teachers or enthusiastic fresh graduates

2

RESTRICTIONS ON EARLY-YEARS INVESTMENT

While early-years providers appreciated the need for more governmental oversight of the to-date relatively unregulated pre-school education market, concerns were raised about recent regulations over private investment in pre-school education. In November 2018, the CCP Central Committee and State Council Committee released '*Several Opinions on Deepening the Reform of Preschool Education and Regulating its Development*'. These included bans on private kindergartens seeking public listing and on for-profit kindergartens raising funds from listed companies. Despite substantial consumer interest in international early-years education, investors are now wary of the market and there are concerns that the new regulations will impede further growth in this area.

39 'Scale of UK Higher Education Transnational Education 2015-16', Universities UK, February 2018.

3

LIMITATIONS ON HR AND STAFFING

Increasing restrictions on visas for foreign educators has led to some institutions struggling to provide the qualified staff needed to meet growing demand from consumers. The requirement of two years' work experience makes it impossible to hire newly qualified teachers or enthusiastic fresh graduates, and the lack of recognition for those with early-years National Vocational Qualifications (NVQ) or other non-traditional qualifications, restricts businesses from hiring qualified teachers who, for various reasons, may not have found HEI (Higher Education Institution) suitable for their needs or career plans. Limits restricting the hiring pool for pre-secondary teachers to applicants from seven countries (the US, the UK, Canada, Ireland, Australia, New Zealand and South Africa) do not take the experience, qualifications or English-language expertise of applicants from any other countries into account. Similarly, changes in the recognition of teachers who have received PGCE or IPGCE teaching qualifications through distance-learning programmes with UK universities have been met with concern by British businesses. All of these limitations exclude qualified candidates from the job pool and thus impede the ability of businesses to hire the ideal candidate for the role.

4

LACK OF RECOGNITION FOR ONLINE DEGREES

Online education has become an integral part of the global higher education industry, widening access to high quality degree programmes through distance, flexible and distributed learning. A trend analysis of UK TNE (transnational education) from Universities UK in 2018 found that 20% of TNE students were studying for their degree through online programmes[39]. However, despite these developments, there is still no recognition for online degrees from UK universities in China. These restrictions can limit British universities' access to the Chinese market, and prevent students who have an interest in international education but do not have the means to travel abroad from studying for a British online degree.

RECOMMENDATIONS

Please refer to the cross-sector chapter for issues that apply across industries.

Lack of clarity in recent policy changes

- Implement a more structured approach to the delivery of policy information, providing clear outcomes and a clear timeline that includes a grace period for education organisations to adapt to changes.
- Hold information sessions between the relevant authorities and companies to assuage uncertainty in policy changes.

Restrictions on early-years investment

- Provide greater clarity about what qualifies as a 'for-profit' and 'non-profit' institution, including clarity about acceptable fee levels.

Limitations on HR and staffing

- Bring teacher visa laws in line with practical requirements, through opening up relevant positions to NQTs and those with NVQs and other vocational qualifications.
- Recognise online PGCE and IPGCE diplomas and make provision allowing international school teachers to work in schools according to language qualifications as well as nationality.

Lack of recognition of online degrees

- Recognise accredited online and distance-learning degrees from British HEIs.

MUTUAL OPPORTUNITIES

EARLY-YEARS

British companies express a general feeling of optimism about the early-years education sector, where there has been significant growth in both investor capital, and the number of private kindergartens in operation. The introduction of the 'Two-Child Policy' has provided a small boost to national birth rates and is also expected to drive further market growth. The market access issues outlined above notwithstanding, the policy environment has been generally positive in early-years, and the MOE (Ministry of Education) has introduced a number of policies aiming to raise preschool enrolment by supporting both private and public kindergartens. As clarity on investment develops, and assuming new investment regulations prove not too restrictive, investors are broadly confident about the future development of the early-years market, particularly for the 0-3 age group.

SCIENCE AND TECHNOLOGY DEVELOPMENT

In a bid to bring more universities into global rankings and to position China as a global leader in research and innovation, local governments have begun to work on promoting innovation-led models of curriculum, teaching and learning in higher education. This year, the 'Implementation Plan on Promoting the Acceleration of Education Modernisation 2018-2022' made the development of higher education one of the government's key tasks, calling for the promotion of innovation, research and science and technology. With a strong academic culture and well-developed, deep expertise in areas such as AI, robotics and medicine, members feel that many British universities are well-placed to work with Chinese universities in research partnerships.

ONLINE LEARNING

Online education has opened up new opportunities outside the major cities, offering less-developed areas greater access to better quality teaching resources and teaching staff. This, combined with increased consumer confidence in the quality of online services and technological advances, led to the number of Chinese online education users reaching 201 million in 2018 - 24.3% of the total number of internet users in the country[40]. Despite this growth, however, the market remains unsaturated and there are still significant opportunities for online education providers to find their own niche.

TVET

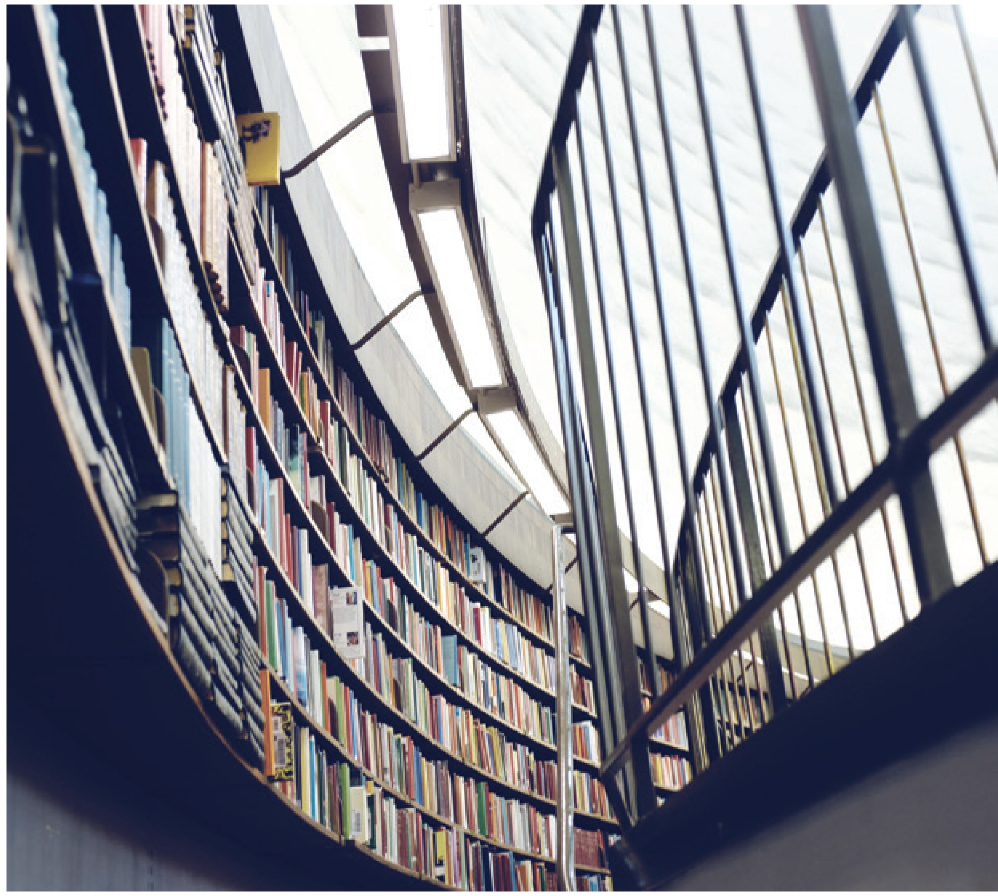
The government has consistently reiterated its desire to develop the country's vocational education, referring to the sector in numerous policies - including its education development plans and the 2019 Government Work Report at the *lianghui*. In February, a new diploma system was introduced to encourage students to gain vocational skills, and major companies were encouraged to run vocational schools and offer high-quality programmes. There is a feeling that British vocational providers, with their innovative teaching methods and balance of practical and theoretical content, could create positive and impactful partnerships with Chinese training institutions.

EMPLOYABILITY

The government has consistently reiterated its desire to develop the country's vocational education, referring to the sector in numerous policies - including its education development plans and the 2019 Government Work Report at the *lianghui*. In February, a new diploma system was introduced to encourage students to gain vocational skills, and major companies were encouraged to run vocational schools and offer high-quality programmes. There is a feeling that British vocational providers, with their innovative teaching methods and balance of practical and theoretical content, could create positive and impactful partnerships with Chinese training institutions.

TEACHER TRAINING

British curricula enjoy considerable popularity throughout China; they are the most widely used of any international curriculum in international schools, while British textbooks, examinations and testing systems are widely used in the English language training market. As curriculum and materials become increasingly widely used and known, focus is shifting to the need for effective and thorough implementation. In many cases, this involves narrowing the gap between Chinese and British educational theory and pedagogy, and developing teacher training and consultations that can work alongside teaching materials, and help to deliver the MOE's stated desire for more active and applied approaches to teaching and learning in China. There are clear and considerable opportunities for UK education businesses to capitalise on this trend.



40 'Popularity of online education grows rapidly in China', china.org.cn, March 2019.

FINANCIAL SERVICES

AT A GLANCE

SUB-SECTORS

Asset management companies

Banks

Financial infrastructure

Insurance and reinsurance brokers

Private equity firms

KEY CHALLENGES

- Restrictions regarding obtaining certain licences
- Meeting high capital requirements
- Unclear guidelines on the implementation of new licencing regulations

KEY RECOMMENDATIONS

- Allow foreign institutional investors to apply for a broader scope of licences across all of the sub-sectors
- Allow foreign companies to use globally held assets to satisfy capital requirements
- Provide comprehensive and clear guidelines on how to follow new regulations, and timelines for their full implementation

STATE OF THE SECTOR

China's financial sector, estimated to be worth over RMB 270 trillion (GBP 30.5 trillion)[41], is a key market of interest for British firms. Its banking sector is the largest in the world in terms of assets held, at RMB 268.2 trillion (GBP 30.3 trillion) by the end of 2018[42]. Aggregate net profits for commercial banks in 2018 stood at RMB 1.8 trillion (GBP 206.9 billion)[43], and are projected to continue to grow at a rate of 6.8% in 2019[44], outpacing official projections for domestic GDP growth. The Big Four banks continue to dominate, earning RMB 949.4 billion in net profits[45]. There are some warning signs; the non-performing loans ratio stood at 1.8% in 2018 (1.5% for the Big Four) and is estimated to rise to 2.1% in 2019[46]. The People's Bank of China's (PBOC) monetary policy points to a gradual, targeted approach to managing risks in the sector. These policies, according to Moody's credit outlook, will be broadly supportive of bank credit quality and stable asset quality, leading to a stable operating environment over the next 12 to 18 months[47].

While foreign banks have been able to establish themselves in the China market relatively easily compared to other emerging markets, market penetration remains low. As of H1 2018, there are 41 foreign banks licensed to operate in China – of which two are British – with 115 branches and 156 representative offices between them[48]. This only translates to a 1.3% share of China's banking assets at the end of 2017, down from a peak of 2.4% in 2007[49]. Commenters attribute foreign banks' lack of scale to a challenging wholesale market, continued repercussions of the global financial crisis on foreign banks, China's control of foreign exchange, other regulatory barriers and foreign banks' poor understanding of local needs. However, foreign banks are encouraged by the increase in maximum equity caps following the removal of banking from the 'Negative List' in 2018, which has created opportunities for foreign banks to increase their share in the China market. A new joint venture (JV) has been created by a large Chinese and Dutch bank in order to establish a digital bank, in which the Dutch bank has a controlling interest[50]. As of March 2019, four foreign banks have also granted permission to establish majority-owned brokerage JVs, allowing them to diversify their offerings to consumers and retain more control over their business. Nevertheless, banks and other financial institutions welcome the possibility of being able to hold complete ownership of an FII, which could be granted by 2021. British businesses are also encouraged to see that one key aspect of supply-side reforms is continued opening of different revenue streams to foreign banks. Increased access to the China Interbank Bond Market (CIBM),

41 'China Pledged to Give Foreign Financial Firms More Access', Bloomberg, April 2019.
42 '2018 Annual Report', Bank of China, March 2019. Total liabilities stand at RMB 246.6 trillion (GBP 27.9 trillion).
43 '2018 Annual Report', Bank of China, March 2019.
44 'China's Banking Sector to See 6.8% Profit Growth', China Banking News, December 2018.
45 '2018 Annual Report', BOC, CCB, ABC and ICBC, March 2019.
46 'Asia-Pacific Banking Outlook 2019', S&P Global, December 2018.
47 'China banking system outlook stable, but high economy-wide leverage slow to reduce', Moody's Investor Services, September 2018.
48 '多家外资银行负责人谈改革开放40年——外资银行日益扮演重要角色', GOV.CN, December 2018.
49 'China: Foreign banks fumble over their expansion strategies', Euromoney, June 2018.
50 'ING and Bank of Beijing create digital bank in China', BankingTech, March 2019. It should be noted that the Dutch bank already holds a minority stake in the Chinese bank.

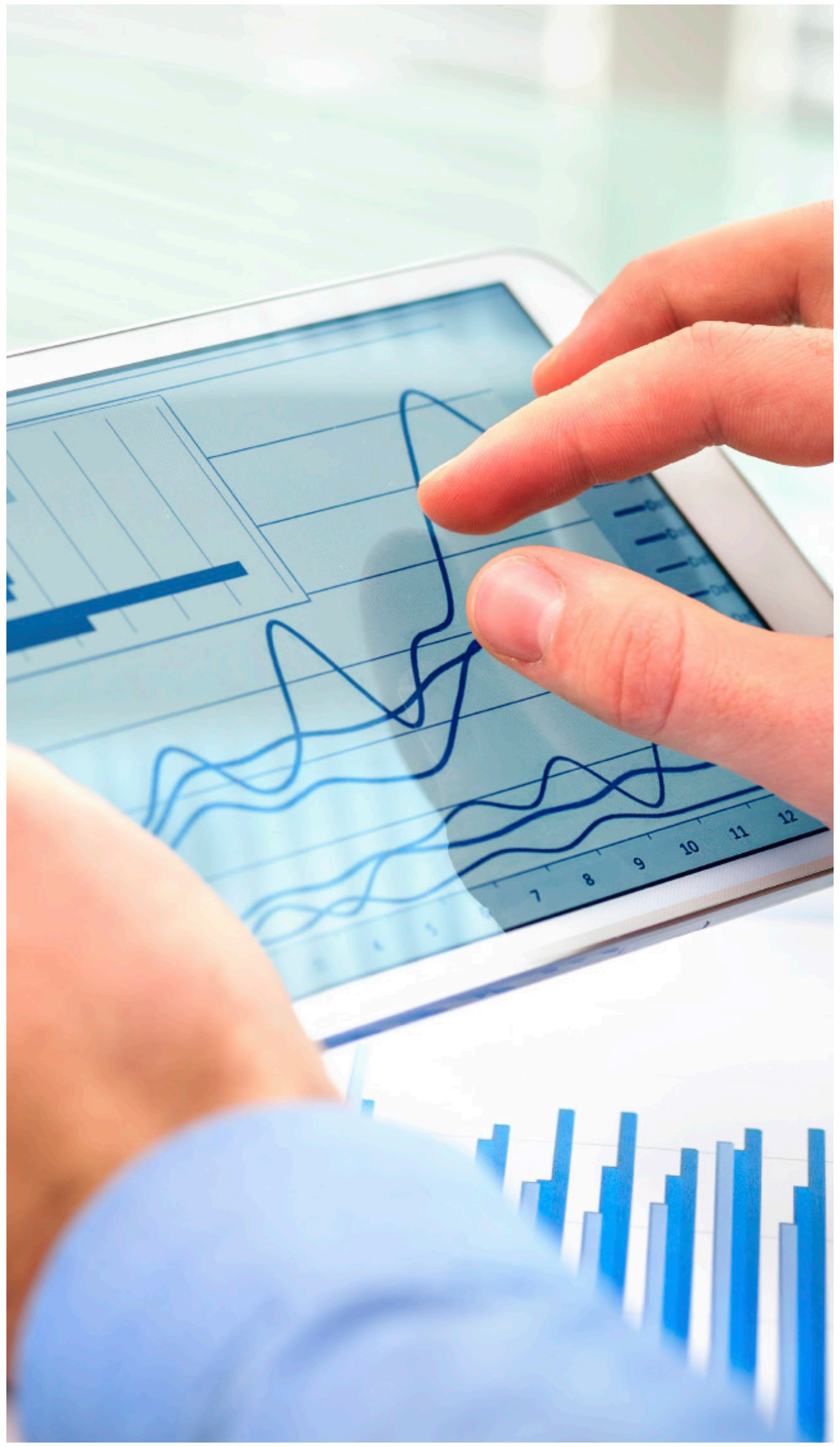
through both CIBM Direct and the Mainland-Hong Kong Bond Connect, gives foreign institutional investors (FII) access to more sources of credit and improves their ability to compete, making China's financial sector more efficient.

The insurance industry in China saw a stable increase in premium income in 2018 and industry watchers only expect this trend to continue, despite the insurance market's poor reputation in China and slowing GDP growth. The world's second largest insurance market as a whole earned RMB 3.8 trillion (GBP 428.1 billion) in 2018 in premiums, up 3.9% year-on-year. Of this, property and casualty insurance – still dominated by auto insurance despite a recent downturn, but with strong performance in agriculture and liabilities in 2018 – comprised RMB 1.2 trillion (GBP 135.7 billion), while premium income for life insurance firms rose 0.9% to RMB 2.6 trillion (GBP 294 billion)[51]. Going into the next decade, it is estimated that almost one-third of the additional premium income global forecast between 2018 and 2030 will be generated in the China market, driven in particular by a growth rate in non-life premiums of over 20%[52]. Nevertheless, the low overall insurance penetration rate in China (4.4% in 2017), relatively low insurance density (RMB 2,631.60 or GBP 296.20 in December 2017)[53] and low penetration by foreign firms (7% of the life market and 2% of the non-life market)[54] indicate that there is still significant room for growth. As of the end of 2017, only 50 foreign insurers operate in market: 28 in life business (of which four are British) and 22 in non-life business (of which one is British).

For the domestic insurance sector, 2011 to 2015 was a period of relative freedom in terms of regulation. Foreign firms joining the market after the removal of foreign investment restrictions in insurance brokerages from the 'Negative List' in 2015. Nevertheless, loose regulations prompted fears of a liquidity crisis, leading to more stringent regulation between 2016 and 2018, starting with the establishment of the China Risk Oriented Solvency System (C-ROSS), a key regulatory mechanism providing risk-based capital and solvency regimes. 2016 also saw more thorough auditing of life insurance companies. Over 2017 and 2018, the China Insurance Regulatory Commission – merged into the China Banking and Insurance Regulatory Commission (CBIRC) in April 2018 to supervise both banks and insurers – continued to reduce systemic risk and discourage wealth-management products in favour of traditional protective insurance. An example of such measures was the *Circular on Regulating the Development and Design of Products by Personal Insurance Companies*, which banned the sale of universal life insurance as a rider to traditional policies, to catastrophic effect on life insurance sales. British businesses welcome the removal of limitations on the business scope of foreign-invested insurance brokers in April 2018, the raising of the life insurance equity cap for foreign firms and the recent approval of one Sino-British JV to participate in the Chinese pensions business as constructive moves towards a more open market and a level playing field for the industry[55].

China's asset management sector continues to grow and diversify in an increasingly liberal environment. 2019 assets under management (AUM) figures are expected to grow to RMB 14 trillion (GBP 1.6 trillion), and KPMG China forecasts that AUM in China in 2025 will total RMB 36.3 trillion (GBP 4.1 trillion)[56], which would make it the second-largest asset management market in the world and a key market of interest for British investors. In the past five years alone, the marketplace has grown by 22% in terms of AUM to RMB 73.6 trillion (GBP 8.3 trillion), driven by a doubling of household financial assets, rebounding discretionary income growth and high savings rates[57], indicating bright prospects for the sector. After strong growth in Q4 2018, fund managers are optimistic about further growth of the RMB 12.9 trillion (GBP 1.4 trillion) in AUM held by 131 domestic and Sino-foreign JV fund management companies at year end. The securities industry also projects strong growth, with estimated profits for 2030 of RMB 22.2 billion (GBP 2.5 billion)[58].

Foreign investors can access China's securities markets through applying to the China Securities Regulatory Commission (CSRC) for the following five schemes: as a Qualified Foreign Institutional Investor (QFII), Renminbi Qualified Foreign Institutional Investor (RQFII), or through the two Stock Connects, the Bond Connect or the CIBM Direct Access Scheme. As of April 2018, 27 offshore British firms are making use of the QFII access channel, including asset management companies (AMC), sovereign wealth funds, foundations and endowments[59], although capital control mechanisms issued by the State Administration of Foreign Exchange (SAFE) restrict many from fully utilising the opportunities the schemes present. Since 2016, a handful of companies have been allowed to establish wholly foreign-owned private fund management entities (PFM WFOE) onshore, registered with the Asset Management Association of China (AMAC). In January 2017, one PFM WFOE had been recognised by AMAC; by the end of 2018, 16 recognised PFM WFOEs operated in China, of which 14 had issued private funds[60]. Progress has also been made in opening up PFMs to foreign investment through QFII and RQFII (although in the form of draft rules

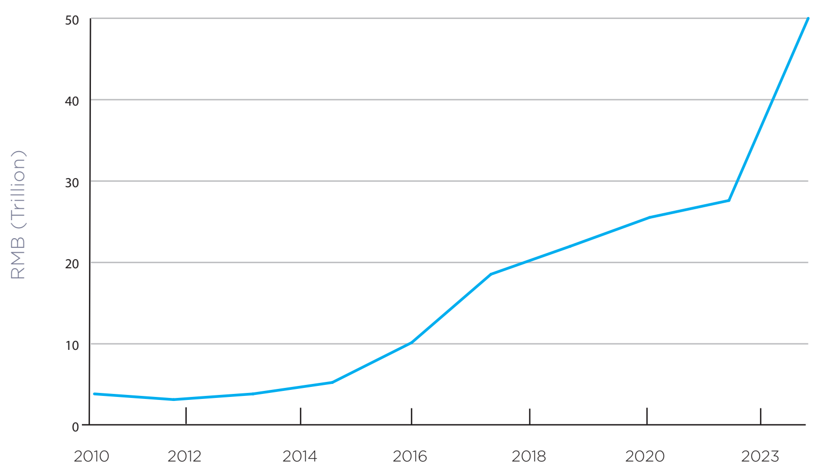


pending publication), as well as giving PFM WFOEs greater flexibility in qualifying for CIBM access. Other policy measures in 2018 to open the market to foreign securities companies include the lifting of the 20% cap on monthly repatriations by QFIIs; the three-year exemption from withholding tax and value-added tax on interest income derived by FIIs on onshore China bonds; and the removal of the lock-up period for QFIIs and RQFIIs.

Although the liberalisation of the sector is welcomed, capital controls, restrictions placed on onshore FIIs and an increasingly difficult business environment means this has not necessarily translated into meaningful business success for the approved PFM WFOEs. Compared to two years ago, global AMCs are therefore slightly more cautious about the opportunities available in practice[61], and would welcome greater access to the full market.

Onshore third-party managed AUM in China

Source: Oliver Wyman



51 'China's insurers collect more premium income in 2018', China Daily, February 2019.
52 '2018 Insurance Industry Outlook', Deloitte, January 2018.
53 'China Insurance Industry Overview', CEIC, December 2017.
54 'China moves closer to allowing foreigners to control insurance ventures', Reuters, November 2018.
55 'Insurance and Reinsurance 2019', Chambers and Partners, February 2019.
56 'Asset Management in China', KPMG, June 2018.
57 'Global Asset Managers Chart a Course For China', Morgan Stanley, March 2019.
58 'China Pledged to Give Foreign Financial Firms More Access', Bloomberg, April 2019.
59 'QFII一览表(2018年4月)', CSRC, June 2018.

MARKET ACCESS ISSUES

1 GENERAL

1.1 LIMITATIONS OF QDII QUOTAS IN TERMS OF MAXIMUM ALLOCATED CAPITAL AND ALLOCATION PROCESS

The QDII programme allows financial institutions that meet certain qualifications to invest in overseas securities and bonds. As the only avenue for domestic individual investors to access offshore capital markets until the launch of the Qualified Domestic Limited Partnership in 2013 and the Qualified Domestic Investment Enterprise and Shanghai-Hong Kong stock connect in 2014, it remains a popular investment mechanism. However, the programme itself is tightly controlled by SAFE in order to manage capital outflows, leading to a period between 2015 and 2018 when no new investment quotas were approved.

Issuance of new quotas resumed in April 2018, but while the QDII quota totalled RMB 692.8 billion (GBP 78.3 billion) as of February 2019, only two Chinese banks received new quotas in H1 2018 and no quotas have been released to either domestic or foreign banks since. British FIIs have expressed that these quotas are far too limited compared to the scope of services they would like to provide; have not kept pace with the growth of the economy or personal and institutional financial assets; and are not sufficient to match the demand for investment in overseas securities markets in China that they have the expertise to manage. In addition, unannounced and prolonged restrictions on the QDII quota as outlined could disrupt an FII's long-term business strategy, discouraging FIIs from fully committing themselves to the China market. It should be noted that, while not discussed in great depth by contributors, QFII and RQFII quota applicants face similar issues.

1.2 VARYING ABILITY TO USE GLOBAL ASSETS IN APPLICATIONS FOR CERTAIN LICENCES

British financial institutions are concerned about the relatively high amount of capital required to

60 'Foreign Institutional Investment in China', ASIFMA, March 2019.
61 'Foreign Institutional Investment in China', ASIFMA, March 2019
62 'Deutsche Bank China obtains bond underwriting license in China's Inter-Bank Bond Market', Deutsche Bank, July 2018.
63 'Foreign Institutional Investment in China', ASIFMA, March 2019.
64 '资产管理机构开展公募证券投资基金管理业务暂行规定', CSRC, October 2013.

33.6 billion (GBP 3.8 billion), in addition to operating in-market and globally for a certain period of time and meeting other conditions the Chinese insurance regulator deems necessary. PFM WFOEs are required to hold RMB 2 billion (GBP 225.6 million) in AUM to qualify for access to the CIBM. FIIs understand that it is important to have effective safety mechanisms in place to prevent financial crises. However, unlike their domestic counterparts, foreign FIIs cannot use the assets held by their parent companies to support their application and thus aren't always able to meet these recommendations, despite being a reputable global institution. AMCs have received an exemption from AMAC allowing them to include global AUMs gained from Chinese onshore bonds to support their application, which further highlights the feasibility for all FIIs to be able to use global AUMs to support other licence applications. Banks have also had some success in reducing capital controls. In terms of applying for a custodian licence, it has been mentioned to some FIIs that the China Securities Depository and Clearing Corporation may be willing to accept a 'Letter of Commitment' in lieu of a capital requirement of RMB 40 billion (GBP 4.5 billion) for certain banks with both a strong reputation and strong global balance sheets. However, no updates on this have been forthcoming. British FIIs would appreciate clarification on the viability of and timetable for both these changes and changes to requirements more broadly.

2

BANKING

2.1

LIMITED ACCESS TO LEAD UNDERWRITING LICENCES FOR THE BOND MARKET

The further liberalisation of the CIBM after 2016 presents myriad opportunities for all FIIs, not only QFIIs and RQFIIs. As the main market for government and policy bank bonds, providing about 38% in terms of value of all outstanding bonds in China, it offers a reliable and lucrative source of finance. As of the end of June 2018, CIBM reached a combined size of over RMB 78.7 trillion (GBP 8.9 trillion) with a net new issuance volume of RMB 4.1 trillion (GBP 460 billion), of which 10% went to foreign investors. It is expected that RMB bond investment flows will be as high as RMB 5.3 trillion (GBP 600 billion) over the next five years[62]. FIIs have a growing presence in the system, with 598 registered with the PBOC to access the Bond Connect alone in January 2019[63]. A number of foreign banks, including British banks, have been granted access to sub- and joint-lead underwriting licences for the panda bond market. However, the available capital in panda bonds is now considered too limited and too expensive to be a viable growth opportunity if banks are restricted to joint-lead underwriting. Banks are particularly interested in accessing the ability to underwrite deals made by domestic issuers, such as Medium Term Notes and Commercial Papers. Allowing more foreign banks to become independent lead underwriters would grant them more control over the application process, and the opportunity to serve a wider range of clients.

2.2

RESTRICTED ACCESS TO CUSTODIAN LICENCES

Increased internationalisation of China's bond and stock connects, through such measures as the evaluation of Chinese securities in the MSCI index and the Shanghai-Hong Kong and London-Shanghai stock connects, is a key catalyst for many international investors to increase their stake in China's financial markets. British banks are therefore interested in providing their international clientele with custodian services, reassuring them that they can safeguard their assets in a familiar institution. It is encouraging to see that one British bank has been able to obtain both the domestic and the cross-border fund custodian licence, allowing it to directly access domestic funds and maximise the full potential of the market. However, the regulatory processes involved in obtaining both licences need to be streamlined and made more transparent in order to offer the opportunity to more foreign banks. The decision-making process should, at all stages of the licence application, adhere to clear, stringent guidelines as published by the regulator, which has the mutual benefit of encouraging greater compliance and increasing foreign banks' confidence in their China investment.

> *Denying PFM WFOEs access to offshore assets emphasises the unlevel playing field between foreign and domestic owned PFMs*

3

INSURANCE

3.1

PENALISATION OF OFFSHORE REINSURANCE COMPANIES UNDER C-ROSS

While efforts to manage China's insurance sector more prudently and reduce instances of malpractice through C-ROSS are laudable, some measures lead to structural penalisation of offshore reinsurance companies. Higher capital charges on risk transfer outside China means that C-ROSS disproportionately discriminates against foreign reinsurers. Under C-ROSS, domestic cedants incur a capital charge of 58.8% on unsecured reinsurance balances due from overseas reinsurers, reducing to 8.7% if secured – assuming they meet the additional solvency requirement. Capital controls also require that another charge is imposed when the risk is brought back into China. Ceding companies may choose to utilise collateral to reduce the credit risk, but this requires offshore reinsurers to possess another set of assets that domestic reinsurers aren't obligated to produce in order to manage the risk of reinsurance, reducing their overall ability to compete and thus the efficiency of China's insurance market.

3.2

PROHIBITIONS ON SHARING PERSONAL DATA OF ORIGINAL POLICYHOLDERS

In the reinsurance sector, internal due diligence and compliance measures often require employees to check the background of the original policyholder, in order to ensure that they are allowed to purchase the policy under UK and international law. However, domestic direct insurers are bound by Chinese law to protect the privacy of the policyholder, and so cannot give the cedant company the full set of policyholder's personal information for due diligence checks. Difficulties with the transliteration of pinyin names to Chinese characters adds a further layer of complexity to verifying the identity and legal status of the policyholder. One example of this is the ability to check the policyholder's details against both the UK and the Chinese government's list of sanctioned individuals. Due to the lack of background information and the multitude of possible characters denoted by any given syllable in a pinyin name, it can be difficult for reinsurance companies to verify the policyholder's presence on the Chinese list. Furthermore, greater alignment between these two lists would improve reinsurance companies' ability to streamline internal compliance checks for their China operations.

3.3

INSUFFICIENT REPRESENTATION IN CBIRC

Moves to streamline the regulation of the insurance industry are welcomed by British businesses. However, there are concerns that the full spectrum of insurance companies operating in the China market are not fully represented among the key influencers in CBIRC. Diversifying the range of industries and corporate structures that have a significant voice in CBIRC would allow the industry to optimise the industry in a way that incorporates the needs of all types of firms.

4

ASSET MANAGEMENT AND PRIVATE EQUITY

4.1

INABILITY TO TRADE SOUTHBOUND ON THE SHANGHAI-HONG KONG STOCK CONNECT

PFM WFOEs are not allowed to invest southbound in assets on the Shanghai-Hong Kong Stock Connect, in order to guard against capital flights. While British businesses understand the importance regulators attach to managing the capital flowing in and out of China, local PFMs are not restricted in the same way, granting them access to more investment opportunities and the ability to promote their brand to the offshore market. Denying PFM WFOEs access to offshore assets emphasises the unlevel playing field between foreign and domestic owned PFMs, and limits the ability of Chinese investors to make full use of the experience foreign PFMs have in navigating overseas markets.

4.2

PROCESS BY WHICH PFM WFOES CAN BECOME MUTUAL FUNDS UNCLEAR

China's large and aging population portends a need for increased private support of public funds, allowing PFMs the chance to access larger revenue streams by becoming a public mutual fund and providing another source of capital for public schemes, such as pensions. In response to welcomed moves to increase the foreign ownership cap to 51% in 2018 and allow 100% ownership by 2021, many PFM WFOEs are considering turning to mutual funds. Although applications are open to foreign PFMs, none have had their applications accepted, raising concerns that the market may not be as open as looser ownership restrictions might indicate. In addition, although CSRC has provided a set of requirements for prospective mutual funds in the 2013 law *Interim Provisions on the Management of Publicly Offered Securities Investment Funds by Asset Management Institutions*, some FIIs are unclear as to whether or not the provisions also apply to WFOEs. One stipulation in particular, the declaration that the applicant "must meet other conditions prescribed by CSRC"[64], is considered particularly vague, and British firms would appreciate more clarity over what these conditions may be in order to allay fears that the provision could be misused to favour private interests.

4.3

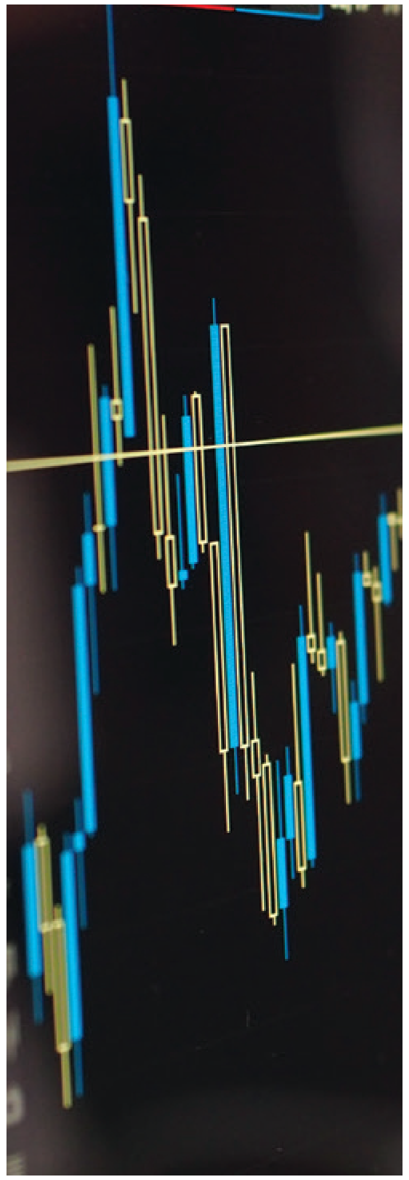
RESTRICTIONS ON THE ESTABLISHMENT OF FOREIGN PRIVATE EQUITY FIRMS

The segregation of private equity firms in China complicates the ability of WFOEs to invest in the market fully. British private equity firms feel that the differences between the regulatory treatment of RMB-denominated funds and USD-denominated funds forces them to choose the latter, limiting their operations to sectors not on the negative list and conversely limiting the choice available to Chinese investors in the market. While the private equity space should be monitored for malpractice, foreign firms and domestic should be treated the same by regulators. Higher tax rates on outbound capital also means that the cost of operations for private equity firms are artificially higher than domestic firms, granting domestic firms an unfair advantage in terms of net gains and competitiveness, and limiting the ability of market forces to improve the efficiency of other sectors through investment.

4.4

DIFFICULTIES MEETING BUSINESS ADVISORY LICENCE REQUIREMENTS

British investment companies have a breadth experience across a variety of markets that they could use to benefit their clients. To do this, AMCs need to obtain a business advisory licence. However, to obtain this licence, eligible members of staff must have a consecutive three-year active record in management. In some AMCs, there may be staff who have three years non-consecutive management experience or are have a similar level of knowledge but have gained the bulk of their experience in more varied or more junior roles. The business advisory sector is an area of particular strength for the UK, and firms are highly interested in offering their expertise to Chinese clients.



RECOMMENDATIONS

Please refer to the cross-sector chapter for issues that apply across industries.

Limitations of QDII quotas in terms of maximum allocated capital & allocation process

Subsector

Banking, Asset Management and Private Equity

- Develop the quota allocation framework so that it can be adapted to the business models and needs of the FII applying.
- Refrain from arbitrarily restricting applications for an increase of a company's QDII quota.

Varying ability to use global assets in applications for certain licences

Subsector

Banking, Insurance, Asset Management and Private Equity

- Allow foreign applicants to use their parent company's assets to support their application.

Limited access to lead underwriting licence for the bond market

Subsector

Banking

- Grant more foreign banks the lead underwriting licence for corporate and government bonds in the CIBM.

Restricted access to custodian licences

Subsector

Banking

- Clarify and lighten requirements for obtaining third-party custodian licences, and increase the number of custodian licences granted to foreign banks.

Penalisation of offshore reinsurance companies under C-ROSS

Subsector

Insurance

- Reduce the capital charge on both secured and unsecured reinsurance balances.
- Pilot measures that allow sufficiently compliant offshore firms to transfer risk for domestic clients without extra charge.

Prohibitions on sharing personal data of original policyholders

Subsector

Insurance

- Ensure that the final iteration of the *Cybersecurity Law* grants reinsurers reasonable scope to request personal information crucial to conducting background checks, as long as it does not have a tangible impact on national security.

Insufficient representation in CBIRC

Subsector

Insurance

- Promote the inclusion of a broader range of insurance firms in CBIRC.

Inability to trade southbound on the Shanghai-Hong Kong Stock Connect

Subsector

Asset Management

- Allow PFM WFOEs access to offshore securities through southbound trade via the Hong-Kong Shanghai Stock Connect.

Process by which PFM WFOEs can become mutual funds unclear

Subsector

Asset Management

- Clarify the more vague requirements in the Interim Provisions (2013) and provide feedback on how PFM WFOEs can apply to successfully become a mutual fund.

Restrictions on the establishment of foreign private equity firms

Subsector

Private Equity

- Reduce capital controls on USD funds and align regulation of USD funds with domestic RMB funds.

Difficulties meeting business advisory licence requirements

Subsector

Asset Management and Private Equity

- Allow for more flexibility regarding the official job position of the AMC employee, as long as they have the requisite experience to advise firms.

MUTUAL OPPORTUNITIES

INTERNATIONALISATION OF THE RENMINBI

Although it is still limited in terms of its use in offshore trade and investment and as a currency reserve, FIIs believe that the Renminbi's growing reputation as an operating currency of choice presents them with a range of opportunities to support an ever-more diversified and global financial system. The RMB has significant heft in the international monetary system, through the Asian Infrastructure and Investment Bank, inclusion in the International Monetary Fund's special drawing rights and increasing international usage. It is anticipated that further internationalisation and interconnectivity will continue, driven by the needs of global trade, portfolio diversification and outbound investment from China. The foreign exchange market is seen as the fastest-growing element of RMB internationalisation[65] despite foreign exchange controls, and so London's strength as a key foreign exchange spot market could be advantageous in securing opportunities in the UK to develop RMB exchange, which then creates more opportunities for British FIIs in-market in China. Similarly, Chinese government support for the further integration of the RMB into the global financial system facilitates such initiatives as the London-Shanghai Stock Connect, which in turn provides investors with the opportunity to further diversify their portfolios.

FIIs believe that the Renminbi's growing reputation as an operating currency of choice presents them with a range of opportunities to support an ever-more diversified and global financial system

THE BELT AND ROAD INITIATIVE

The development projects across Asia, Europe and Africa spurred by the Belt and Road Initiative (BRI) present potentially rewarding opportunities for British financial firms. The focus of the BRI is primarily on national infrastructure, transport and commodities, but countries with strong service-focused sectors, such as the UK, can still lend their experience to the market. Banks have access to the capital flowing in and out of emerging markets partnering with China on BRI projects, and would be able to contribute to syndicate loans, providing foreign exchange services and loans. The value of British insurance companies for the BRI lies in the provision of specialist insurance products in which they have significant experience and capacity. Asset managers, typically focused on smaller portfolios, would be able to supply capital to innovative and promising securities as new commercial entities, and also begin to tap into the benefits brought by BRI infrastructure and create new investment opportunities.

FREE TRADE ZONES

Free trade zones (FTZ) are a valuable area of mutual benefit to both the Chinese government and foreign firms. They provide a testing ground for the government to trial new regulations, and a jurisdiction that has been relatively liberalised and optimised for businesses. Basing an FII in an FTZ also opens up the possibility for it to benefit from advantageous pilot schemes, such as reduced limits on cross-border transactions, access to a greater number of licences, unrestricted foreign currency exchange and fewer requirements for setting up financial WFOEs. In January 2019, for example, SAFE announced a pilot program for cross-border foreign exchange settlements in Greater Bay Area, Shanghai and Zhejiang. It also means that FIIs are more likely to be located geographically closer to Financial infrastructure and other companies in the industry, increasing their access to the latest developments in their field. Nevertheless, it should be noted that liberalisation of FTZs should not be a substitute for improving market access across China as a whole.

FINTECH

The UK and China are both world leaders in fintech development, and there are natural areas of cooperation to be found. The UK attracted over RMB 107.5 billion (GBP 12.1 billion) of investment in H1 2018, a figure that accounted for over half the total fintech investment into Europe and was higher than the level of US investment[66]. This complements China's clear advantages as a world leader in fintech innovation, with Ant Financial, among others, continuing to shape China's increasingly digitalised society. It has been reported that 68% of Chinese financial institutions expected to increase their partnerships with fintech firms between 2020 and 2022[67], showing clear interest in funding the next generation of technological innovation in the sector. Subsectors of fintech that are particularly promising in China include mobile payments, online lending, consumer finance, online money-market funds, online insurance, personal financial management and online brokerage.

65 'Going global', KPMG, January 2017.
66 'UK global leader for fintech investment in H1 2018', KPMG, June 2018.
67 'Global FinTech Survey China Summary 2017', PwC, January 2018.

FOOD AND BEVERAGE

AT A GLANCE

SUB-SECTORS

- Additives
- Alcoholic beverages
- Catering
- Non-alcoholic beverages
- Ready-to-eat foods
- Seafood

KEY CHALLENGES

- Inefficiency caused by the time taken to process licences and certificates
- Unfamiliar products held to unreasonably high standard
- Difficulties finding up-to-date customs guidelines

KEY RECOMMENDATIONS

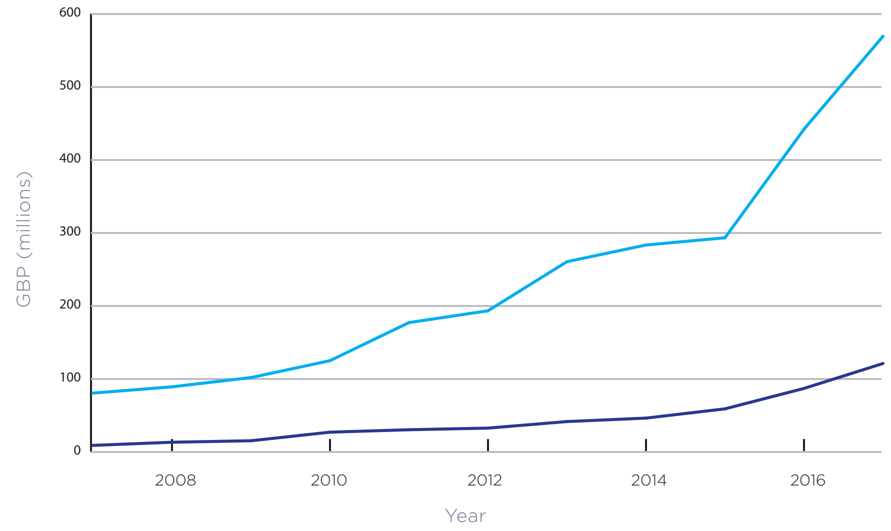
- Reduce the time taken to process production permits and Sanitary Certificates
- Consult a wider range of producers in order to fully rationalise GB standards
- Streamline customs processing as much as possible and make guidelines more easily accessible

STATE OF THE SECTOR

As China has the lowest amount of agriculturally productive land per capita in the world, opportunities to import agricultural products, processed food and beverages (F&B) into China are immense. F&B exports from the UK to China in H1 2018 alone totalled GBP 296.5 million (RMB 2.6 billion), representing a year-on-year increase of 8.6% from H1 2017 despite the economic slowdown in China. China was the eighth largest market for UK F&B products in H1 2018, and the second largest non-EEA market[68]. Overall F&B exports to China in 2017 totalled GBP 564.4 million (RMB 5 billion), of which the largest categories included salmon, whisky, milk powder and beer[69].

UK F&B exports to China

Source: Food and Drink Federation



Nevertheless, there is still scope to improve market penetration by British firms. In alcoholic beverages, for example, 95% of beer sales are generated by domestic producers. The market still favours local brews: baijiu dominates at 70% of all alcohol sales, while its most significant Western competitor, whisky, holds 2% of the total drinks market and other traditional British alcoholic drinks, such as cider, are even less popular. Therefore, there is significant scope for increased market education on British alcohol. Despite low market penetration in several subsectors, F&B businesses are confident that growth in the import market will continue, particularly sustained by middle class urban consumers. As the majority of British F&B companies

68 'Exports Snapshot H1 2018', Food and Drink Federation, August 2018.

69 'British food exports to China increase by 28 percent', China Daily, February 2018.

70 'National Standards of the People's Republic of China - GB 14963-2011', Embassy of the Republic of Argentina, October 2001. The UK limit is 10,000 cfu/g.

71 'Current Market Situation and Medium Term Outlook', Food and Agriculture Organization of the United Nations, May 2018.

Despite low market penetration in several subsectors, F&B businesses are confident that growth in the import market will continue, particularly sustained by middle class urban consumers.

are importers rather than in-market producers, bilateral trade deals are the key opportunity to improve market access for both countries, promising future returns for British firms, greater product variety for the consumer and increased stability in the China market for foreign investors. A case-in-point is the August 2017 deal to export GBP 200 million (RMB 1.8 billion) of pork products to China, which presents tangible benefits to both F&B companies and Chinese consumers.

The government restructuring in 2018 had major policy implications for the F&B industry. The China Food and Drug Administration was replaced by the State Administration for Market Regulation (SAMR), which is now the principal regulator for the industry and is responsible for drafting and implementing food safety regulations. SAMR's supervision of imports is supported by the General Administration of Customs. Although agriculture does not fall under the scope of this paper, the Ministry of Agriculture and Rural Affairs - which replaced the Ministry of Agriculture - influences regulatory policies for the F&B sector through their ability to influence domestic production trends through favourable agricultural policies.

MARKET ACCESS ISSUES

1

INEFFICIENCY CAUSED BY THE TIME TAKEN TO PROCESS LICENCES AND CERTIFICATES

For F&B producers and importers to China, licencing difficulties comprise the bulk of market access concerns. A common complaint is the unreasonable amount of time and paperwork needed to apply for key licenses, which are required by companies to fully develop the offerings they can provide to the China market. Members are generally complimentary of the ease with which bespoke products can be accommodated by the *guobiao* (GB) system. Nevertheless, production permits for individual ingredients can take four to eight weeks to be fully processed. Streamlining the production process would allow British companies to be develop more agile business strategies and be more responsive to the China market. Caterers are a notable exception, stating that they themselves encountered few complications and received licences relatively quickly.

F&B importers into China are particularly concerned with difficulties obtaining Sanitary Certificates. Products imported into China are issued these certificates at the port of entry by China Inspection and Quarantine, but these often take up to four weeks to process. The products cannot be sold in-market and payment to the producer won't be processed by financial institutions until the certificate is awarded, impeding companies from fulfilling time-sensitive client orders, fully responding to shifts in the market and efficiently resolving outstanding payments. In addition, certain businesses are concerned about the possibility that importers may be required to obtain a Sanitary Certificate from an approved organisation in the country of origin, increasing costs. Several of the accompanying guidelines for this regulation, initially proposed in 2015, are vague - the criteria by which an organisation may be approved, for example - and businesses feel that the uncertainty this could cause if implemented in its current state would discourage them from increasing investment into China. While some companies report that they have received assurances that certain products can qualify for an exemption as a 'low risk' item, there has been little subsequent communication on this and it is difficult to know which products would be eligible, further reducing incentive to increase investment.

2

UNREASONABLE FOOD SAFETY STANDARDS FOR UNFAMILIAR PRODUCTS

In many cases, GB standards align quite closely with EU standards, minimising the need for suppliers to adjust sources of supply for the two markets. The seafood industry is particularly complimentary of bilateral efforts to optimise trade in their industry in recent years, reporting few market barriers and promising opportunities. However, China's regulatory landscape has shifted so that local authorities and customs officials now bear increased liability for food safety scandals. This in turn makes them cautious about loosening GB standards on products alien to Chinese cuisine, even if they have been proven safe for consumption in the UK. Below are a few example issues raised in working groups:

2.1

HONEY

GB standards for honey production stipulate the legal definition, chemical indexes and microbial limits allowed for imported honey. In China the microbial limit stands much lower than the UK at 1,000 colony-forming units/gram[70], which requires imports to undergo more intense heat processing, necessitating expensive testing and damaging the quality and nutritional value of the product. In addition, certain GB standards have been introduced with limited consultation and notification. One such example is the sudden prohibition of honey products imported into China that contains traces of American Foulbrood (*paenibacillus larvae*), even though the bacteria is commonly found in honey and poses no risk to humans, limiting the stock available to companies for import into the market.

2.2

HERBAL TEAS

The herbal tea market is rapidly developing in China[71], and several British tea brands are well-positioned to meet growing demand. However, herbal teas are historically more closely associated with medicinal products than casual beverages, so Chinese regulators are likely to handle these products with greater caution. Specifically, the importation of certain ingredients are subject to safety review of National Health Commission, such as hibiscus, some species of chamomile, rooibos and lavender, and as the products are generally unfamiliar to traditional Chinese medicine, regulators may not fully understand the their properties. However, it should be noted that such ingredients are usually not present in large enough quantities to physiologically affect the consumer, and as such current regulations unduly limit tea importers' ability to offer a full range of products to the market.

2.3

EGG POWDER

China imposes strict regulation on the import of products containing egg or egg powder, due to fears over contamination with avian flu. UK exporters to China are currently prohibited from importing such products into China. However, egg powder is pasteurised in the production process, eliminating the risk of transmission to humans.

2.4

RAISINS

British raisins are judged by Chinese regulators in accordance to the standards set for a similar American product, the sultana. However, there are several key differences between them, including size and production method. As a result, raisins have higher microbial levels than the GB standards allow, necessitating that British companies adjust their recipes and production processes in order to further dry raisins specifically for the China market. This increases production costs by 5% according to one business, and reduces the efficiency of production lines.

3

DIFFICULTIES FINDING UP-TO-DATE CUSTOMS GUIDELINES

British companies report that the most recent guidelines for the required documents and other processes involved in importing products to China are not readily available, which can lead to them facing penalties at the border if they make an error operating under false information. Another common observation is that products are often held in customs for a significant length of time (between one and three months) which can affect the responsiveness of companies to shifts in demands in the market, potentially harming their clients' confidence in their ability to deliver goods.

4

INCONVENIENCE CAUSED BY OPPORTUNISTIC PROFESSIONAL CONSUMERS

Many British companies in China have reported falling foul of the 'professional consumer' phenomenon. Professional consumers bulk-buy items, actively seek out trivial errors on product labels and then apply for a refund and sue the producer for ten times the value of the sale under a punitive compensation system. Companies may also face further fines and the need to conduct a total recall of their products, damaging their revenue and reputation. While consumer oversight is necessary for quality assurance, the generosity of the compensation system encourages opportunists to burden the judicial system with cases of small typos, detracting from serious cases of misleading claims or omissions of information and adding to administrative costs for the Chinese judiciary.

5

TARIFFS ON ALCOHOLIC BEVERAGES

British businesses welcomes the significant move the State Council's Customs Tariff Commission took in December 2017 to reduce whisky tariffs from 10% to 5%. However, they would encourage that these tariffs are reduced to 0%, in line with beer, to provide more consumer choice in an increasingly demand-fuelled market. Tariffs on imported cider currently stand at 40%, despite the limited nature of China's domestic cider industry. A reduction in these tariffs would again help diversify the choice present in the current alcohol market.

RECOMMENDATIONS

Please refer to the cross-sector chapter for issues that apply across industries.

Inefficiency caused by the time taken to process licences and certificates

- Reduce the time taken to process production permits and Sanitary Certificates.
- Refrain from requiring importers to provide Sanitary Certificates in a product's country of origin.

Unreasonable food safety standards for unfamiliar products

- Consult F&B producers more often and more closely align GB standards and EU F&B standards in example cases.

Unreasonable food safety standards for unfamiliar products (honey)

- Increase the maximum microorganism limit for honey.

Unreasonable food safety standards for unfamiliar products (herbal tea)

- Revise the standards for herbal teas and allow them be imported into China as a 'food and beverage' product.

Unreasonable food safety standards for unfamiliar products (egg and egg products)

- Allow egg powder and products that include egg powder to be imported into China.

Unreasonable food safety standards for unfamiliar products (raisins)

- Increase the maximum microbe threshold for dried grapes.

Difficulties finding up-to-date customs guidelines

- Streamline customs processing as much as possible in order to reduce the length of time products are held, and make import guidelines more easily accessible.

Inconvenience caused by opportunistic professional consumers

- Hold case-by-case decisions of whether labelling mistakes are severe or misleading enough to warrant action and reduce the compensation awarded to professional consumers in cases that are deemed to be trivial.

Tariffs on alcoholic beverages

- Remove tariffs on cider and whisky in order to level the playing field and diversify consumer choice.

MUTUAL OPPORTUNITIES

A more affluent and environmentally-aware class of consumer, particularly among young professionals and families, is emerging in China

E-COMMERCE PLATFORMS:

The growth of e-commerce in China has been phenomenal, and the likes of Jingdong, Taobao and Tmall account for a major share of the sales of food and drinks. China is a largely cashless and increasingly digitalised society, and so accessing these platforms is key for building brand awareness in China. In addition, working through e-commerce can ease the licencing, overhead costs and bureaucracy involved in getting products into China, posing a useful alternative strategy for companies who struggle with navigating food safety standards for products unfamiliar to regulators. Nevertheless, the high tax on e-commerce sales and exacting specifications on shelf life, labelling and price show that there are still ways in which platforms can be further optimised for British business in China.

ENVIRONMENTALLY-AWARE CONSUMERS:

A more affluent and environmentally-aware class of consumer, particularly among young professionals and families, is emerging in China, and a large number of both domestic and foreign F&B companies are expanding their range of environmentally-friendly offerings to meet this demand. E-commerce and food delivery generate a lot of waste in terms of packaging, and a growing trend in the UK for F&B producers to use biodegradable packaging could translate to the China market. Veganism is also increasingly popular, and if British companies can adjust their offerings to meet this new niche market they will further differentiate themselves from their competitors.

HEALTHY CHINA 2030:

The development of a 'healthy China' is central to the government's agenda for health and development, and British F&B companies can use their expertise to contribute to a healthier offering in supermarkets and restaurants. China's need to manage an aging population and focus on environmentally-friendly public and private initiatives means this policy is likely to retain its relevance, presenting a long-term opportunity for British companies. One specific policy aim is the promotion of health literacy, healthy lifestyles and a healthy production and living environment[72], and so there could be scope for the Chinese government and British companies to partner on these issues. Potential areas in which the Chinese and UK governments could cooperate include comparing strategies for the promotion of sugar-free food and drink; organic produce; and health foods and supplements in-market as part of a healthier lifestyle – all areas in which UK public policy has been relatively successful.

72 'Outline of the Plan for "Healthy China 2030"', LexisNexis, October 2016.

HEALTHCARE

AT A GLANCE

SUB-SECTORS

Healthcare services

Medical devices

Pharmaceuticals

KEY CHALLENGES

- Restrictions in licencing
- Pricing pressures and reimbursement requirements
- Fragmentation and restrictions across supply chains

KEY RECOMMENDATIONS

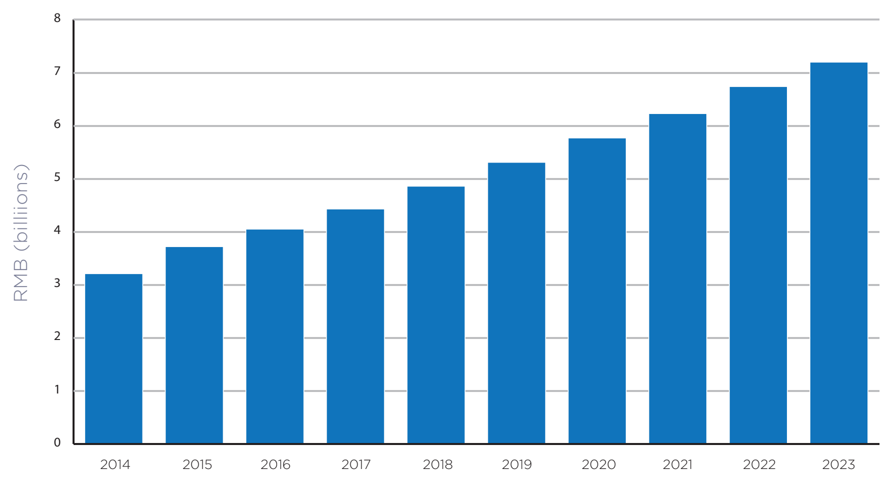
- Continue to centralise and accelerate the approval and registration process while removing clinical services from the 'Negative List'
- Adopt a procurement focus that balances quality, value and sustainability and establish a system of updates for the medical devices reimbursement book
- Continue to consolidate the distribution system and create a fast-track customs service

STATE OF THE SECTOR

There is enormous opportunity for continued growth in healthcare in China that will benefit Chinese and global citizens. But this is contingent on reforms continuing and foreign firms being treated equally to domestic firms.

Government spending on healthcare in China

Source: The Economist Intelligence Unit



Over the last two years China's regulatory authorities have transformed China's healthcare industry with notable opening-up and regulatory reforms, becoming the fastest-growing[73] healthcare market of all large emerging economies and an attractive destination for investment. It is estimated that in 2018, the healthcare market reached RMB 7 trillion (GBP 791.4 billion), a year-on-year increase of 11.4% on 2017[74]. This has been driven by a desire to address systemic health challenges. China's leaders have made significant progress that has been well-received, but further healthcare reform is needed. This includes, for example, strengthening its primary care system and enhancing systems to ensure drug and vaccine safety and security.

There are also distinct healthcare challenges. In his opening address at the National People's Congress in March 2019, Premier Li Keqiang noted that "tens of millions of Chinese families are affected by cancer" and voiced commitment to taking "action in cancer prevention and treatment" as well as chronic illnesses. Changing lifestyles and a rapidly aging population are adding strain to an already strained system. The state of the China healthcare sector is closely tied to government policy. In early 2018, responsibility for the policy direction shifted as a result of governmental restructuring. The key emergent government stakeholders impacting healthcare include the National Health Commission (NHC), charged with handling the country's social and medical insurance schemes,

73 'Healthcare Reforms Underscore Market Growth', Dezan Shira & Associates, February 2018.

74 'Report of Industry Strategic Planning and Enterprise Strategic Planning on China Major Health Industry', Forward Industry Research Institute, March 2019.

formulating and regulating healthcare commissioning and advancing payment reform; the National Medical Products Association (NMPA), responsible for drug and medical device regulation; and the National Healthcare Security Administration which manages policies, funds and standards on Basic Medical Insurance.

The emphasis that the Chinese government places on innovation, specialisation and evidence-based evaluation plays to the UK's strengths, and there are strong mutual benefits in working together to address today's healthcare needs and tackle tomorrow's challenges. UK healthcare exports to China come from a strong base, with medical and pharmaceutical products currently constituting the UK's third largest goods export to China . There is enormous opportunity for continued growth in healthcare in China that will benefit Chinese and global citizens. But this is contingent on reforms continuing and foreign firms being treated equally to domestic firms.

AGAINST THIS POLICY BACKDROP, THE AUTHORITIES HAVE RECENTLY INTRODUCED A SERIES OF REGULATORY REFORMS:

November-December 2015

The China Food and Drug Administration (CFDA, the NMPA's predecessor) released the *Circular Concerning Several Policies on Drug Registration Review and Approval*, resulting in the piloting of the Marketing Authorisation Holder system to give more agency to pharmaceuticals firms, and the expansion of the fast-track pathway to include selected drugs.

January 2017

The National Health and Family Planning Commission (NHFPC, the NHC's predecessor) released the Two-Invoice System policy for drugs, restricting the supply chain to two invoices. Some local authorities have since begun implementation of the policy on medical devices.

June 2017

The CFDA joined the International Council for Harmonization of Technical Requirements for Pharmaceuticals for Human Use (ICH), linking China with the system of international standards.

October 2017

The State Council announced the *Opinion on Strengthening the Reform of the Drug and Medical Device Review* and *Approval Process to Encourage Drug and Medical Device Innovation* (Innovation Opinions), seen as the blueprint for future reforms.

May 2017

The General Office of the State Council issued the *Opinions on Encouraging Development of Diverse Private Healthcare Services* (The Opinions), granting eligible private clinical institutions and foreign investors equal treatment to local public ones.

November 2018

The Joint Procurement Office (JPO) published its Paper on Centralised Drug Procurement in '4+7' Cities, standardising the procurement system to 11 major cities in an effort to bring down pricing and ensure consistency.

MARKET ACCESS ISSUES

1 RESTRICTIONS IN LICENCING, CERTIFICATION AND STANDARDS

In the last two years there has been notable healthcare regulatory reform, including an alignment with international standards. However, this progress is unevenly distributed both between subsectors and regions, limiting growth across China, and many approval processes are still unnecessarily complex. There remains room to remove obstacles to service provision in all three subsectors.

1.1 PHARMACEUTICALS

Pharmaceuticals companies have experienced progress in the speed of registration and approval processes for their products. On average, approvals for Investigational New Drugs (IND) submitted after December 2016 took 8.6 months, slashing ten months off the previous average[76]. Reforms detailed above in State of the Sector have encouraged innovation and increasingly aligned Chinese and global standards. One example of resulting success is the approval of a UK pharmaceutical firm's drug roxadustat in China before it was authorised in any other country – a first in China[77]. Many British firms are keen to emulate this mutual win as regulatory burdens ease. However, regulatory reform is mostly limited to drugs that meet policy priorities, and in general drug approval times remain much longer than in the UK and other countries. British business applauds the work being taken by the authorities to ensure industry-wide drug and vaccine safety, but the current execution of these policies is disruptive, risks client confidentiality and undermines companies seeking stability and consistency in regulation and enforcement.

1.2 MEDICAL DEVICES

Device companies are seeing stagnant licencing regulation. Whilst measures resulting from the 'Innovation Opinion' such as the draft *Conditional Approval for Urgently Needed Drugs Technical Guidance* are recognised and appreciated, there are a number of areas preventing British device firms from contributing fully. Product registration and approval times are still prohibitively long – firms report that Class II and Class III devices will take around three years, while Class I can take four years. This negatively impacts patients' access to new medical solutions and demonstrates a lack of reciprocity, as the UK's approval times range from a number of weeks to six months at most. Standards for the subsector also diverge substantially from international standards. One example of this is in data requirements for approval processes – the NMPA require pre-batch data, whereas the ICH do not. Once again, this causes unnecessary delay and elevates costs.

1.3 HEALTHCARE SERVICES

Licencing regulation in healthcare services is improving, but it is a slow process. *Clinical services remain on the Special Administrative Measures on Access to Foreign Investment 2018* ('Negative List'). Specifically, investment in technology and application of human stem cells, gene diagnosis and treatment are restricted for foreign investment, and the operation of medical institutions in China is restricted to the form of Sino-foreign equity or cooperative joint venture (JV) with a 70% shareholding limitation for foreign parties. Reforms in favour of private hospitals do not give foreign business the opportunity to contribute to their full potential, as they are barred from setting up a wholly foreign-owned clinical operation in some regions, while in others it is difficult. Many try to work around this by operating under a JV, providing services for a Chinese-owned establishment, or providing services through leasing the hospital. However, these strategies suffer from their own problems, namely, regulatory obstacles to forming JVs, Chinese partners' understandable hesitancy to trust partners legally obliged to be half-invested, and the high initial outlay of leasing. Many businesses are hesitant to set up clinical operations as a result of the opacity of regulations and associated costs, explaining the relative paucity in foreign clinical operations and hospitals. It is estimated that the number of Sino-foreign medical JV institutions is less than 300[78], compared to 9.9 million Chinese institutions[79].

2 PRICING PRESSURES AND REIMBURSEMENT REQUIREMENTS

As a result of budgets falling behind rising spending initiatives, government policy is aimed at squeezing pricing for reimbursing products. One example of strategies to reduce prices is the JPO's '4+7' initiative.

In pharmaceuticals regulation, the government is working to increase access by increasing the number of innovative drugs and vaccines while reducing prices, making the tender process more transparent and evidence-based; and adding more innovative drugs to the reimbursement list. However, there are concerns that some of the initiatives designed to drive prices down are doing so through the exclusion of certain products, as well as prioritising cheap pricing above all other factors. This prioritisation also translates into incentives to move away from originator drugs towards generics, with a major risk of damaging quality and innovation and promoting monopolies. A more economical strategy for the long term would espouse a quality

75 'Inside Healthcare UK,' GOV.UK, November 2014.

76 'China regulatory reform: An Update on review Timelines and Drug Lag', Regulatory Focus, May 2018.

77 'China first to approve AstraZeneca, FibroGen anaemia drug', Reuters, December 2018

78 '外资医疗在中国的发展形势!', sohu.com, November 2017.

79 '2017年我国卫生健康事业发展统计公报, nhc.gov.cn', June 2018.

80 '关于印发城镇职工基本医疗保险诊疗项目管理、医疗服务设施范围和支付标准意见的通知关于印发城镇职工基本医疗保险诊疗项目管理、医疗服务设施范围和支付标准意见的通知', cnx.gov.cn, December 2016 service over short-term deals, as it enriches intellectual innovation and expertise in the Chinese market.

Medical devices companies report that the sector's reimbursement book policy, which combines a collection of medical insurance funds from society with individual accounts, hasn't changed since 1999[80], and so the original rules, regulations and prices cannot adequately meet the development requirements of new medical technologies in the current environment. Finally, state-owned enterprises (SOE) often undercut local and foreign competitors by bidding at a loss, at the expense of competition and sustainability in the market, as well as future foreign investment. Healthcare services firms do not find pricing and reimbursement to be a major issue.

3

FRAGMENTATION AND RESTRICTIONS ACROSS SUPPLY CHAINS

The logistics system in China is modernising through initiatives such as the 'two-invoice;' 'and incoming 'track and trace' systems. Infrastructure development has brought remote areas into reach of services and an increase in hospitals has improved provision to patients. However, these reforms bring their own problems and logistics organisation and regulation remain fragmented, opaque and inconsistent.

For medical devices and pharmaceuticals firms, passing products through customs is impaired by considerable bureaucracy, and it is common that the product remains in customs for a month, compromising pace that is critical to business' agility and ability to meet shifts in market demand. When particularly complex or unique devices need to be returned to the UK or elsewhere in the world for repair and then resent to China, this cost is compounded. Substances deemed as 'dangerous' cannot be sent across provincial borders, encumbering supply and restricting growth across China. This can endanger lives if critical items are not available within the province, such as the appropriate blood type for transplant, or life-saving drugs.

Business welcomes that the government has responded to a fragmented supply chain with the creation of the 'two-invoice system.' However, it is unrealistic and oversimplifies the whole supply chain to two links, impacting a necessarily complex and sophisticated chain. In selected areas of the medical device industry, products must be built in China or have a good explanation for importing, demonstrating a lack of reciprocity.

4

CYBERSECURITY, DATA SECURITY AND IT ISSUES

Data security is imperative to the continued development of the healthcare sector, including research and development, in China and around the world.
As we move into an Internet Plus healthcare environment with increasing amounts of personal healthcare data in the cloud, it is critical that patient data is protected. It is equally vital that intellectual property, which includes product blueprints, research data, and patents, is protected and intellectual property rights are fully enforced. A lack of confidence in data integrity will undermine China's role as a host for continued investment in R&D and the potential of the Internet Plus healthcare environment.
The 2017 *Cybersecurity Law* (CSL) introduced a new legal framework to address data security concerns. Yet the CSL includes policies that negatively impact the ability of foreign investors to operate effectively in China. These need to be addressed to bring the full potential of British healthcare to China.

The CSL's data storage and transfer restrictions impede important business and research functions, such as transferring patient or R&D data, which negatively impacts the effectiveness of research and development. Recently, pre-existing areas of legislation have seen a shift in enforcement, such as the Human Genetic Resources Office of the Ministry of Science and Technology tightening supervision over transfer of genetic human data. This has driven some firms to relocate their physical presence outside of mainland Chinese jurisdiction.
Broader concerns applicable to all sectors can be found in the Cybersecurity and IT section of the horizontal market access issues chapter.

RECOMMENDATIONS

Please refer to the cross-sector chapter for issues that apply across industries.

Restrictions in licencing, certification and standards

- Continue to centralise the approval and registration process to ensure consistency and combat fragmentation.

- Accelerate and streamline the registration and approval process for services and medical devices and continue to do so for pharmaceuticals.

- Continue to harmonize with international organisations and recognise approval for pharmaceuticals and medical devices conducted in other countries.

- Allow the establishment of wholly foreign-owned clinical operations and hospitals and remove clinical services from the 'Negative List', allowing foreign firms to contribute to the Chinese healthcare industry to their full potential.

Pricing pressures and reimbursement requirements

- Adopt a procurement focus that balances quality, value, transparency and sustainability.

- Bring the medical devices reimbursement book up to date and establish a system of regular updates.

Fragmentation and restrictions across supply chains

- Continue to consolidate the distribution system in China.

- Create a fast-track customs service or reduce the number of forms needed in state bureaucracy in order to prevent long waits.

Cybersecurity, data security and IT issues

- Ensure that the final iteration of the *Cybersecurity Law* gives healthcare firms reasonable scope to share information crucial to medical care and R&D abroad, as long as it does not have a tangible impact on national security.

- Allow sensitive data to be kept in the private domain, creating a conducive environment for R&D development while protecting patient data.

MUTUAL OPPORTUNITIES

CHANGING MODEL OF THE HEALTHCARE SERVICES SYSTEM

As China continues to reform its healthcare system and operates various pilot projects across the country to test their efficacy, it is apparent that the government fully intends to lessen the burden on the public hospitals. It aims to do this by moving towards more of a community health-based system which will, by its nature, be less centralised. Community care will screen larger numbers of patients and allow the bigger public hospitals to focus on more complex specialist care. In doing so China appears to be moving toward a system similar to that in the UK. China benefits from its cooperation with the UK National Health Service, the National Institute for Health and Care Excellence; and hospital trusts, and the UK government can be more assertive and vocal in advocating the experience and merits of the medical system in the UK, whether these be in specialist clinical care, or systems of governance, training and so on.

China needs a workforce in the areas into which authorities plan to expand. The healthcare talent pool is strong in some areas, but lacking in others. Businesses have found this to be the case in a number of areas, but mainly general knowledge for GP (general practitioner) practice, hospital managers, specialist engineers of devices, and in nursing and elderly care. The British healthcare industry has strong experience and knowledge in many of these areas, thanks to a well-established tradition in both healthcare practice and education. Partnering in these areas both in business and education would help China on its path to develop an excellent workforce across the board.

HEALTHCARE TECHNOLOGY

China faces a number of healthcare problems, such as saturated Tier 1 hospitals, areas deprived of adequate healthcare and a lack of qualified doctors. Good doctors are reluctant to relocate to rural areas and so rural patients often travel to major cities, where hospitals have stronger reputations in terms of patient care. Building infrastructure and training doctors in these regions would take years, but telemedicine and teleconsultation can allow one doctor to contact patients in remote locations in a time-efficient manner, while AI and big data can decongest services. This will be especially effective if regulations are relaxed to allow for the initial consultation to take place through health teleservices, which is currently not the case. The UK healthcare tech industry can provide China with experience and expertise, but also agility and innovation – it is worth RMB 158 billion (GBP 17.8 billion), but is 80% made up of SMEs[81]. A recent string of signings between UK and Chinese tech firms[82] attest to the potential of the relationship. The UK government is making plans for Britain to become "the global centre of health tech,"[83] and so the two governments have shared interests in cooperation.

DEMOGRAPHICS

By 2050 China's elderly population is expected to hit 26% of its overall population[84] and this rapidly aging population poses significant social challenges. Demand is increasing for services in areas such as elderly care, dementia care, oncology, diabetes services, cardiovascular and respiratory care. As a result of China's cultural norms there is also a demand for elderly home care, rather than nursing homes. Other aspects of elderly care need attention in the healthcare system. For example, the World Health Organisation recommends that China strengthen its policy focus on dementia[85] and predicts that those living with dementia will reach 75.6 million by 2030[86]. The UK has already learned to deal with some of the problems that China will soon be facing, as in 2010 17% of the UK's population was aged over 65 compared to 8% in China[87]. The UK has correspondingly developed strong specialist knowledge and resources in these areas, as well as in home care, which can be used to meet Chinese demand.

HEALTHY CHINA 2030

China 2030 is a flagship government initiative that aims at holistically improving the Chinese population's health and the success of the industry. The main goals are[88]:

- Continuous improvement of the health of the people – in life expectancy and physical fitness.
- Effective control of major risk factors – through education and lifestyles, a good living environment, food and drug safety, and the elimination of several serious diseases.
- Significant increase in health service capacity – through health security, tech innovation and quality.
- Significant expansion in the scale of the health industry – through industry, large enterprise and the economy.
- Improvement in institutional system for health promotion – through improvement and modernisation of law and governance.

Bolstered by concrete regulatory reform, this initiative shows a commitment from the government to both quality and growth in the healthcare industry. The UK is well known for its high quality healthcare services and rich experience.

81 'Welcome to the Association of British Health Tech Industries', ABHI.org, April 2019.
82 'Strong UK-China collaborations in healthcare', GOV.UK, February 2018.
83 'The Future of Healthcare: Our Vision for Digital Data and Technology in Health and Care', GOV.UK. October 2018.
84 'China Country Assessment Report on Ageing and Health', World Health Organisation, 2015.
85 'The Economic Burden of Dementia in China, 1990-2030: Implications for Health Policy', World Health Organisation, October 2016.
86 Ibid
87 'Population Ages 65 and above', The United Nations Population Division's World Population Prospects, 2017.
88 'Healthy China 2030 (from Vision to Action)', World Health Organisation, November 2016.

LEGAL SERVICES

AT A GLANCE

KEY CHALLENGES

- Inability of PRC-qualified lawyers to practise Chinese law in a foreign firm
- Restrictions on ownership and corporate structure
- Restriction of appearance before government agencies

KEY RECOMMENDATIONS

- Allow PRC-qualified lawyers in foreign firms to practise PRC law in non-sensitive areas of law
- Facilitate greater access to the granting of joint law venture (JLV) licences
- Allow firms to represent their clients in meetings with government agencies

STATE OF THE SECTOR

Demand for legal services in China has grown rapidly in tandem with China's exponential growth. This has in turn driven an impressively high pace of growth in the private legal sector having evolved out of the state apparatus less than 40 years ago, with China's top 30 firms doubling their revenue between 2013 and 2016[89]. However, the sector still has plenty of room for growth given that the rate of saturation of one lawyer per 4,600 citizens[90 91], which is far lower than the rates of one lawyer to between 300 and 500 citizens on average in high- and medium-wealth Western countries. In addition to domestic demand for legal services, another driver of future growth is servicing internationally, and particularly in advising Chinese parties on outbound investments. The Chinese government has supported this internationalisation, specifying four major areas in which the Chinese legal sector can engage: in the Belt and Road Initiative (BRI), overseas Chinese firms and citizens, Chinese diplomacy and tackling international crime. However, although Chinese law is gaining some traction as a law of choice, it is still not among the preferred laws for use in international business.

English law remains one of the most trusted and widely used systems of law for international trade. The UK's legal services sector is highly developed and competitive, and many of the world's most respected and established law firms originate from the UK. As such, they can play a key role in supporting the internationalisation of China's legal sector. Having UK and foreign firms that have strong experience and understanding of both international and Chinese markets is in China's interests. UK firms can also work with Chinese firms to expand into areas of China that do not yet have a fully-developed legal services market.

However, China's comparatively restricted access to the legal sector currently limits the ability of UK and other foreign law firms to contribute fully in China. UK and other foreign law firms in China as a whole have lost market share to Chinese firms, which enjoy regulatory advantages and have turned into dominant market players. On average, foreign firms only make 5% of their global revenue in China[92]. Given the strength of domestic law firms it is the belief of British law firms that existing restrictions on the operation of foreign law firms are no longer warranted from the perspective of protecting the development of domestic players. For Sino-international relationships to achieve their full potential in all areas, UK and foreign firms need to be able to operate and cooperate more fully with Chinese firms in the China market, just as Chinese firms are free to do so in the UK and many other jurisdictions around the world, in accordance with WTO terms.

89 'Top 30 Chinese firms double revenue in four years', The Lawyer, September 2018.
90 '中国执业律师近30万人', People's Daily, March 2016.
91 'Population, total, China', The World Bank, 2019.
92 'The Outpost Office: How International Law Firms Approach the China Market', Berkeley Law, 2016.

MARKET ACCESS ISSUES

1

INABILITY OF PRC-QUALIFIED LAWYERS TO PRACTISE CHINESE LAW IN A FOREIGN FIRM

PRC-qualified lawyers' legal right to practise Chinese law is suspended while they are employed by foreign law firms. This means that UK and foreign firms cannot practise Chinese law without entering into arrangements with local firms in which the Chinese firm services clients' domestic needs. Representatives of foreign law firms are also not permitted to appear before Chinese courts and tribunals. Furthermore, foreign passport-holders are barred from obtaining PRC legal practising certificates. Amongst the disadvantages of these arrangements are the fact that they are time-consuming and expensive to set up, pushing up fees to clients at the cost of firms' competitiveness. The inability to practise PRC law also compromises firms' attractiveness to talent, as lawyers would not be able to receive direct experience and training in PRC law. On the other hand, a PRC-qualified lawyer at a local firm can be dual-qualified in China and in another jurisdiction, and in the UK any English-qualified lawyer can practice English law. There are no restrictions on PRC law firms opening up offices and employing appropriately qualified lawyers to advise on English law in the UK. Recently, in contrast to the position for foreign firms, the regulations on PRC firms in China has been further relaxed in a pilot scheme in certain key cities which allows PRC firms to employ foreign lawyers to practise foreign law within a PRC firm.

2

RESTRICTIONS ON OWNERSHIP AND CORPORATE STRUCTURE

In view of the above restrictions, some firms have sought to form alliances with local firms and the PRC authorities have made available some routes to doing so. However, such alliances with local firms have not proved to be as popular as expected. Key reasons for this are the inability to operate as a single firm, and the significant barriers to entry which make a decision to set up joint operations a very significant investment and one which carries a substantial cash and time cost, which is a burden on many firms' competitiveness.

The main arrangements that have been used by firms in the past are detailed below, along with their regulatory constraints.

There is a scheme in the Shanghai Free Trade Zone (FTZ) which allows a foreign and local firm to set up "joint operations", in which they can co-market and share referrals. However, it is subject to certain requirements which significantly reduce its attractiveness to foreign firms:

At least 20 lawyers must be employed in the joint operations, making any such venture a very significant investment for both the PRC and foreign party;

The joint operations must be located in the Pudong area of Shanghai, creating additional overheads for firms with existing tenancies elsewhere in Shanghai or based in other cities;

There is a minimum 3-year operating history for the PRC partner, which reduces the pool of potential partners and increases due diligence risk for the foreign partner;

The limitations for the foreign partner on taking part in the management of, or sharing the profit of, joint operations which would be the preferred model for many foreign firms.

Under the *Hong Kong Closer Economic Partnership Agreement* (CEPA) there is a scheme which, while subject to somewhat similar limitations, is not as restrictive as to the location of the joint operations in China. However, it is restricted to representative offices of Hong Kong firms or offices, and the position appears to be that this will not currently be offered to the Hong Kong firms or offices of international firms whose headquarters are outside Hong Kong.

Other domestic and foreign firms have combined through a Swiss Verein structure. In a Swiss Verein, the locally-established legal entity keeps its finances independent but shares other core functions with the foreign firm, such as strategy, branding and IT systems. Crucially, blocking the sharing of finances forces the local entity to fund all operations independently, and also removes the shared interest in making client referrals between entities. Most firms operating this model stated that if regulation made it possible they would choose to become fully integrated instead.

A PRC-qualified lawyer at a local firm can be dual-qualified in China and in another jurisdiction, and in the UK any English-qualified lawyer can practice English law

3

RESTRICTIONS ON APPEARANCE BEFORE GOVERNMENT AGENCIES

Foreign firms are generally prohibited or restricted from appearing or participating in meetings between their clients and mainland Chinese government authorities, but, depending on the authority, there may be a lack of transparency and consistency as to whether they are permitted or not, resulting in firms generally opting not to do so out of a desire to comply with applicable regulations. Some examples of agencies that clients may benefit from their lawyers holding meetings with include the State Administration for Market Regulation; the Ministry of Commerce; the National Development and Reform Commission; and China's Intellectual Property Office. Such meetings may be helpful for clients in relation to issues such as product licencing; regulatory compliance; approvals and registrations; and intellectual property protection and enforcement amongst others. This policy puts both law firms and clients in a position in which they may not be free to select the lawyer or firm of their choice. This could have particular impact in cross-border transactions, in which the services of foreign lawyers would likely be required but to bring in additional counsel who were not familiar with the wider complexities of the case would result in inefficiencies and additional cost for clients.

4

UNEQUAL TAX TREATMENT

In terms of tax arrangements, Chinese regulations treat foreign law firm representative offices like corporate entities, despite being representative offices of partnerships in reality. Consequently, foreign firms in effect bear two layers of tax – a tax on the profit of the representative office and also Individual Income Tax on employees. Foreign firms do not have available to them the model that is available to PRC firms, which is to establish as a partnership. The key tax benefit of establishing as a partnership is that the partnership itself is not taxed and the partners themselves pay tax on partnership income, which has a significantly lower marginal rate than Individual Income Tax. This effectively means that even if all other things were equal, partners of PRC firms would be able to sustain the same level of net income as their equivalents in a foreign firms but at the same time charging a significantly lower price to clients, significantly impacting the competitiveness of foreign firms.

5

OFFICE LICENCE AND HR RESTRICTIONS

In order to set up a representative office, a foreign law firm must demonstrate a "need" to do so, and wait three years before opening an additional one. This limits firms' opportunities for growth, and contrasts with the UK, where Chinese firms may set up offices with relative ease. In terms of HR, the process of changing the representatives (especially chief representatives) of a firm or transferring foreign lawyers between overseas offices and PRC offices or hiring foreign lawyers either from within PRC or from abroad is bureaucratic and very time-consuming (for example to hire a new foreign lawyer and complete all relevant paperwork can easily take a year). This means resourcing decisions have to be made long in advance of need and significantly restricts the ability of foreign firms to react quickly to market opportunities. Limits on the duration of work visas for foreign lawyers exacerbate the problem.

RECOMMENDATIONS

Please refer to the cross-sector chapter for issues that apply across industries.

Inability of PRC-qualified lawyers to practise Chinese law in a foreign firm

- Pilot allowing PRC-qualified lawyers in foreign firms to practise PRC law in non-sensitive areas of law on a consistent basis with pilot schemes available to PRC law firms employing foreign lawyers, bringing a higher degree of reciprocity to UK-China legal trade.

Restrictions on ownership and corporate structure

- Increase flexibility of the joint operations models, in particular reducing barriers to entry, such as minimum numbers of lawyers, length of operating history of local partner, location of the joint operations and increasing ability of foreign partner to control and share profit.

Restriction of appearance before government agencies

- Allow lawyers from foreign firms to represent their clients in meetings with government agencies when clients require it.

Unequal tax treatment

- Amend tax regulations to bring taxation of foreign representative offices and partners in line with that of their domestic law firm counterparts.

Office licence and HR restrictions

- Reciprocate the ease of setting up a representative office and employing representatives that Chinese firms enjoy in the UK.

MUTUAL OPPORTUNITIES

UK firms can make a huge contribution to the development of the legal market in China, as outlined below, but to be able to do so they need to be able to operate on a basis that allows their own business to thrive.

Thanks to the long operating history and experience of British firms, and the dynamism and high potential of the Chinese market, there are considerable mutually beneficial opportunities in the China-UK relationship in the legal sector. This would be facilitated by a greater access to participation in the legal market according to the issues outlined above.

COOPERATION ON INTERNATIONAL TRADE AND INVESTMENT

As China develops its global footprint through trade, investment and development, foreign partners expect to transact using internationally recognised choices of law and dispute resolution. UK law firms have a history of providing cross-border services and English law is one of the top choices for international transactions. In particular, many UK firms have been operating in China for a considerable time and, having gained significant experience of working with Chinese companies. They are also well-placed to understand the issues they face in doing business overseas. They can therefore advise throughout the full life of investment or project development, including structuring, negotiation, drafting, completion, financing and dispute resolution. This is particularly true of outbound investment, including development projects such as the BRI initiative. Such projects will frequently be driven by state-owned enterprises but increasingly the sponsors and PRC bank financiers of these projects will be looking to access international investors to co-sponsor, finance or refinance such investments. UK firms are particularly well placed to give the guidance on setting up those projects in a way that will meet international standards and make them attractive investments for international investors.

KNOWLEDGE-SHARING

Many UK firms have a long history and a proven record of a high degree of professionalism, including investment in internal training and education. Their commitment to training to high international standards, coupled with experience in international business, can help Chinese business, and indirectly Chinese law firms, to innovate and expand internationally through the migration of UK law-firm-trained lawyers to domestic firms. The UK firms that have been established in China the longest have played an important role in training PRC-background lawyers who have gone on to rise to positions of importance in domestic PRC companies and PRC law firms alike.

MARKETING AND COMMUNICATIONS

AT A GLANCE

SUB-SECTORS

Marketing and advertising
Market research
Public affairs
PR and communications

KEY CHALLENGES

- Complexity of financial regulations and the taxation landscape
- Cybersecurity and IT restrictions
- Concerns over business ethics and compliance

KEY RECOMMENDATIONS

- Relax foreign exchange controls and streamline transaction-reporting mechanisms
- Ensure that the final iteration of the *Cybersecurity Law* gives reasonable exception to market research firms to share information internationally
- Apply consistent and transparent standards across the compliance and assessment process

STATE OF THE SECTOR

In recent years the Chinese marketing and communications sector has attracted significant foreign investment. In terms of UK-China trade, UK government statistics valued measurable UK advertising and marketing exports to mainland China and Hong Kong at GBP 28 million (RMB 247.7 million) in 2016, growing by eight million in two years[93]. It should be noted that this figure is likely to be even higher, with the revenue of smaller British firms or firms with self-contained China operations not necessarily represented.

One of leading drivers of growth is the demand for marketing and communications firms to create greater engagement with their target audience about their products, services and corporate values in an increasingly innovative way. There is increasing demand for integrated services, and industry is responding to this with cross-sector collaborations and mergers. Internet, digital and analytics continue to have a disruptive influence, but are now established staple elements of the sector[94] .

Most marketing and communications foreign-invested enterprises (FIE) in China are wholly foreign-owned enterprises (WFOE), showing the sector to be a relatively frictionless and attractive market to enter, in contrast to many others. According to the *Member Sentiment Survey*, 76.5% of firms believe that the business environment had remained the same in 2018 as the previous year. Respondents' outlook for the next two years is evenly split between optimism (47.1%) and neutrality (47.1%), with a negligible percentage reporting a negative outlook. Among a list of business environment concerns for marketing and communications firms, the greatest is China's slowing economic growth, followed by increased competition from local firms. Although respondents agree that competition is necessary for a healthy economy, current norms could encourage a market culture that prioritises low pricing strategies at the expense of quality, while also contributing towards market saturation. Concerns such as these demonstrate that the major challenges for this sector do not stem from market access barriers, as there are no regulatory measures specific to marketing and communications firms, but rather from trends such as slowing economic growth and rising competition.

93 'DCMS Sectors Economic Estimates', HM Department for Digital, Culture, Media and Sport, June 2018.
94 'State of the Industry Report 2019', Prospect and PublicAffairsAsia, 2019

MARKET ACCESS ISSUES

Most marketing and communications firms agree that they operate in a relatively successful industry, and that any difficulties they face are more related to the business environment in China than market access. The consensus is that to do business in a market, a firm must adapt to the local environment to a certain extent. However, any measures that allow firms to further align their China operations with their international business models would be welcome. Although firms do not see a great need for change, those areas of difficulty that do exist are as follows.

1

COMPLEXITY OF FINANCIAL REGULATIONS AND THE TAXATION LANDSCAPE

Difficulty navigating China's financial and taxation landscape is the most problematic regulatory issue for marketing and communications firms, out of 14 issues put to them in the *Member Sentiment Survey*. Any company with branches outside of China is required to conduct inbound and outbound foreign currency transactions through prescribed channels, and must declare the nature of every transaction to their bank. Preparing and processing the transfer is usually resource- and time-intensive, impeding operations that are dependent on speed or rapidly changing cash flows.

The withholding tax system can also cause unnecessary difficulties for companies with international operations. Dividends derived by a non-tax resident enterprise from China are subject to a 10% withholding tax, of which extraterritorial clients or business partners may not be aware. The process of having the China-based business pay a tax on the extraterritorial client's behalf can be frustrating, and impacts the attraction of the China market for long-term investors for both FIEs and local firms.

2

CYBERSECURITY AND IT RESTRICTIONS

Ability to navigate cybersecurity and IT restrictions is another potentially problematic areas for marketing and communications firms, largely due to difficulties with data access and control. In the *Member Sentiment Survey*, 41.7% of companies surveyed report that online content publishing laws in no way affect their business operations in China, whereas only 16.7% believe that business is significantly inhibited by the laws.

Nevertheless, there are some issues that could be addressed to improve the overall business environment for British firms. China's *Cybersecurity Law*, introduced in June 2017, is of significant concern, particularly to firms that provide market research. Cross-border data transfer guidelines are proposed in the draft legislation to restrict data-sharing internationally, and data localisation laws compel firms to relocate servers to use exclusively in China. This will force business to isolate the China market from operations abroad, from upstream data collection and analysis through to downstream solutions. Transferring data and data analysis is an integral part of the market research offering and makes for a bigger data and analysis pool with richer results. Cutting this link could mean conducting the same research twice and would lead to a loss of value for clients and a loss of market understanding for business.

3

CONCERNS OVER BUSINESS ETHICS AND COMPLIANCE

It is generally accepted that, to operate in China, a business should adapt to the local business environment to a point. Nevertheless, a common observation is that improving the transparency of the regulatory process would assist foreign firms' ability to ensure full compliance. Several firms stated that they had concerns about the consistency of the standards applied to different categories of marketing and communications businesses, and imbalances in the implementation of regulation. This includes differences in implementation between regional jurisdictions, and the differing treatment of domestic and foreign firms. Clarification of the code of conduct for marketing and communications firms would be beneficial on two main fronts – it would allow multinational companies to better reconcile their China business standards with their international standards; and strengthen their confidence in the idea that they would be equal to local firms in the eyes of the law.

RECOMMENDATIONS

Please refer to the cross-sector chapter for issues that apply across industries.

Complexity of financial regulations and the taxation landscape

- Relax foreign exchange controls and streamline transaction-reporting mechanisms.
- Reduce the withholding tax levied on non-tax resident enterprises.

Cybersecurity and IT restrictions

- Ensure that the final iteration of the CSL gives reasonable exception to market research firms to share information internally.

Concerns over business ethics and compliance

- Promote more opportunities for both foreign and domestic tech companies to develop the range of products and data sources in China's digital ecosystem.
- Clarify and communicate industry standards and regulations acrossall aspects of their business operations, and the apply these standards consistently.

MUTUAL OPPORTUNITIES

THE BELT AND ROAD INITIATIVE

As Chinese SOEs and private firms continue to go overseas and win contracts through the Belt and Road Initiative (BRI), their reputations have partially suffered from a lack of financial transparency and questions over the provision of contracts. British marketing and communications firms can therefore capitalise on their global reputation and experience in helping to improve the global image of Chinese firms as they navigate unfamiliar markets.

EDUCATION AND TRAINING

Given the UK's expertise regarding its qualification bodies and professional societies in the marketing and communications sector, there is an opportunity for British associations to cooperate with their Chinese counterparts. British qualifications benefit from global recognition, good governance and transparency that Chinese businesses may find attractive. As of yet, neither the Chartered Institute of Marketing nor the Chartered Institute of Public Relations are awarded in China. For a Chinese marketing and communications firm, being accredited with a British qualification could bolster their global standing

BIG DATA ANALYTICS

The vast size of China's market makes its consumer data invaluable. The challenge is to analyse and make sense of this huge amount of data, to which British skills and experience are well suited. This means that purchasing and analysing big data from popular tech companies presents a major opportunity for firms working in market research.

RETAIL

AT A GLANCE

SUB-SECTORS

High street retailers
Luxury goods
Cosmetics
Shopping outlets
Product developers

KEY CHALLENGES

- Concerns over intellectual property rights
- High import duties and taxation
- Mandatory animal testing for cosmetics

KEY RECOMMENDATIONS

- Enhance government transparency around IP decision-making, both through increasing consultation with British retailers around changes to IP regulations and through improving the transparency of IP decisions by Chinese courts
- Reduce the burdensome tax levies on retailers to lessen the price gap between products sold in the UK and China and to stimulate further domestic consumption
- Remove the mandatory animal testing requirement for cosmetics, and instead permit other proven methods of guaranteeing the safety of products

STATE OF THE SECTOR

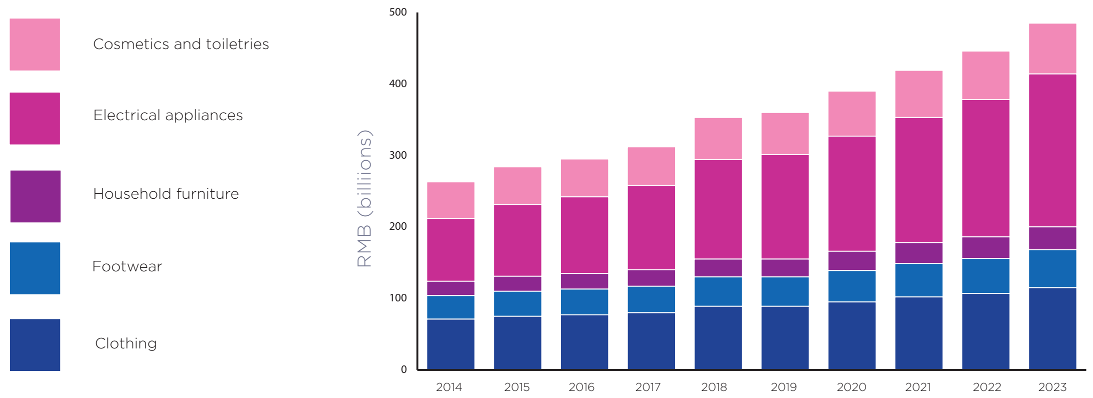
The retail sector is a key contributor to the UK economy and an essential element defining the perception of Brand Britain overseas. The retail sector contributed GBP 92.8 billion gross value added (GVA) to the UK economy, which was 5% of total UK GVA, and the sector's output over the past ten years has largely mirrored the growth of the economy as a whole[95].

Despite an enduring economic slowdown, total retail sales in China grew by 6.9% in 2018, while e-commerce sales increased by 25.4%. Having eclipsed the US as the world's largest retail market in terms of total retail sales, the Chinese market continues to be incredibly attractive for British retailers. In the face of slowing growth, British retailers in China remain optimistic and have continued to witness high rates of year-on-year revenue growth. This is being driven by China's growing middle class, and in particular, the emergence of consumers in Tier 3 and Tier 4 with higher spending power, who are are increasingly looking to purchase higher quality foreign products and brands. At 33% of global consumption, global sales of luxury goods are driven by Chinese consumers. This is expected to reach 46% by 2025, half of which will be purchased in China through a trend described as the 're-localisation of luxury'[96].

Owing to a strong recognition of British heritage among consumers in China, many British retailers have an established physical presence throughout the country, and many others sell their products through cross-border e-commerce platforms. China's retail sector increasingly integrates online and offline spaces, and brands are adopting strategies that are both data-driven and consumer centric. Consumers in China are increasingly savvy and are looking for products that can offer them more of an experience, offering British retailers the opportunity to build on their unique heritage and culture.

Market demand for consumer goods in China

Source: National Bureau of Statistics



MARKET ACCESS ISSUES

1

CONCERNS OVER INTELLECTUAL PROPERTY RIGHTS

The ability to protect intellectual property (IP) rights is a concern shared by British businesses across multiple sectors, not least in retail. The existence in the market of poor quality counterfeit goods damages the reputation of British retailers and the sense of exclusivity for luxury brands can be diluted if counterfeit goods are widely available. Since its accession to the World Trade Organisation (WTO), China has been obligated to adhere to a minimum standard of IP protection, although it is important for British retailers to recognise the important legal differences between the UK and China that influence the country's ability to protect IP. As China is a country governed by civil law, in order to gain protection a retailer must first register their trade mark before entering the market, a process that may take around two to four years. In effect, this means that just because a UK brand sells products in China they do not automatically have IP rights, and must therefore be quick to file the trade mark before a third party registers it first in bad faith.

In recognition that a strong legal IP framework is the foundation of an innovation-driven economy, the Chinese authorities have redoubled in their efforts to improve IP protection, taking a more proactive approach to identifying IP theft and issuing harsher penalties for infringements. An amendment to the *PRC Anti-Unfair Competition Law* became effective 1st January 2018, removing provisions that conflicted with other laws and imposing harsher penalties for offenders[97]. In January 2019, the State Administration of Market Regulation issued a report titled *2019-2021 Counterfeit Crackdown Working Priorities*, which aims to enhance the enforcement capabilities of market regulators, specifically with regards to rural markets, food safety, e-commerce and certification[98]. Lastly, China's latest E-Commerce Law, which took effect 1st January 2019, placed more responsibility on e-commerce platforms such as JD.com and Taobao for the sale of fake goods on their websites – these companies will be fined between RMB 500,000 to RMB 2 million (GBP 56,500 to GBP 226,100) if they fail to establish appropriate restrictions to prohibit retailers from selling counterfeit goods on their platforms. As a consequence of government pressure, as well as concerns about their own reputation, China's e-commerce platforms have been very quick to take down counterfeit goods. China's Public Security Bureau has also been alerting businesses to cases of IP infringement and has demonstrated a willingness to work with British retailers to overcome such issues.

While these legislative changes are indicative of the government's readiness to improve the IP landscape for British firms, more action is still needed. One significant issue that remains is the widespread use of social media channels in China to sell counterfeit goods. Social media platforms such as WeChat present a significant challenge to brand protection. Many private group chats and personal accounts facilitate the sales of fake products, and are particularly hard for companies to identify and track down. With limited legislation pertaining to IP rights on social media platforms, current laws and regulations are unclear about assessing the crime if an individual posts a counterfeit product on social media. Furthermore, outside Tier 1 and Tier 2 cities – where enforcement is relatively stringent – the protection of IP rights can be notably lax and opaque, as the civil, criminal and administrative authorities might have a poorer understanding of IP and less experience in upholding IP rights.

2

HIGH IMPORT DUTIES AND TAXATION

China is a high tax jurisdiction and imposes a wide range of taxes on FIEs. Such high rates of taxation on businesses are incredibly burdensome for British retailers in China, especially for SMEs operating in Tier 1 and Tier 2 cities. During his Government Work Report at the 2019 *lianghui*, Premier Li Keqiang announced tax cuts for businesses of up to RMB 2 trillion (GBP 226.1 million), although it should be noted the reductions in value-added tax benefit mainly firms in manufacturing, construction and transpor[99]. A number of British businesses have expressed that, while many of their local competitors are able to find ways around paying full rates taxes, foreign firms are under much more scrutiny by the taxation authorities. Furthermore, local tax administrations are given targets for fines, which can lead to the unfair targeting of foreign companies despite being fully compliant in order for government workers to meet their quotas.

High import duties on luxury items are another key issue for British retail brands, as the increased cost creates a sizable price gap between what the product sells for in China and its market price in the UK, Europe and other foreign markets. This price gap has led to a grey market in which individuals have an incentive to sell counterfeits and capitalise on the price disparity, provoking concern among consumers about the authenticity of their purchase. The State Council announced in July 2018 that it would cut import tariffs on 1,499 consumer goods from 15.7% to 6.9% on average, including a reduction to 2.9% from 8.4% on cosmetics products[100]. Although the average price gap between luxury goods in China and the rest of the world has fallen from 68% in 2011 to 16% in 2017[101], the difference nonetheless remains sizable. British luxury retailers are concerned about their brand's perception in the eyes of Chinese consumers, who may not consciously recognise the added cost of the import taxes and therefore assume that British brands think they can discriminatorily raise their sales prices.

In recognition that a strong legal IP framework is the foundation of an innovation-driven economy, the Chinese authorities have redoubled in their efforts to improve IP protection

95 'Retail sector in the UK', House of Commons Library, October 2018.
96 'The Future of Luxury: A Look into Tomorrow to Understand Today', Bain & Company, January 2019.
97 'China's New Anti-Unfair Competition Law Has Taken Effect: Providing New Armor in Battle Against Unauthorized Use of Trademarks', Baker McKenzie, January 2018.
98 '假冒伪劣重点领域治理工作方案(2019-2021)', 国家知识产权战略网, January 2019.
99 'China's 2019 Work Report: Growth Target, Tax Cuts Announced', China Briefing, Dezan Shira & Associates, March 2019.
100 'China puts new tariff cuts into place', State Council, July 2018.
101 'Chinese luxury goods sales sour as wealth perceptions rise', Nikkei Asian Review, June 2017

MOST COMMON TAXES FOR BRITISH RETAILERS AND ASSOCIATED COSTS

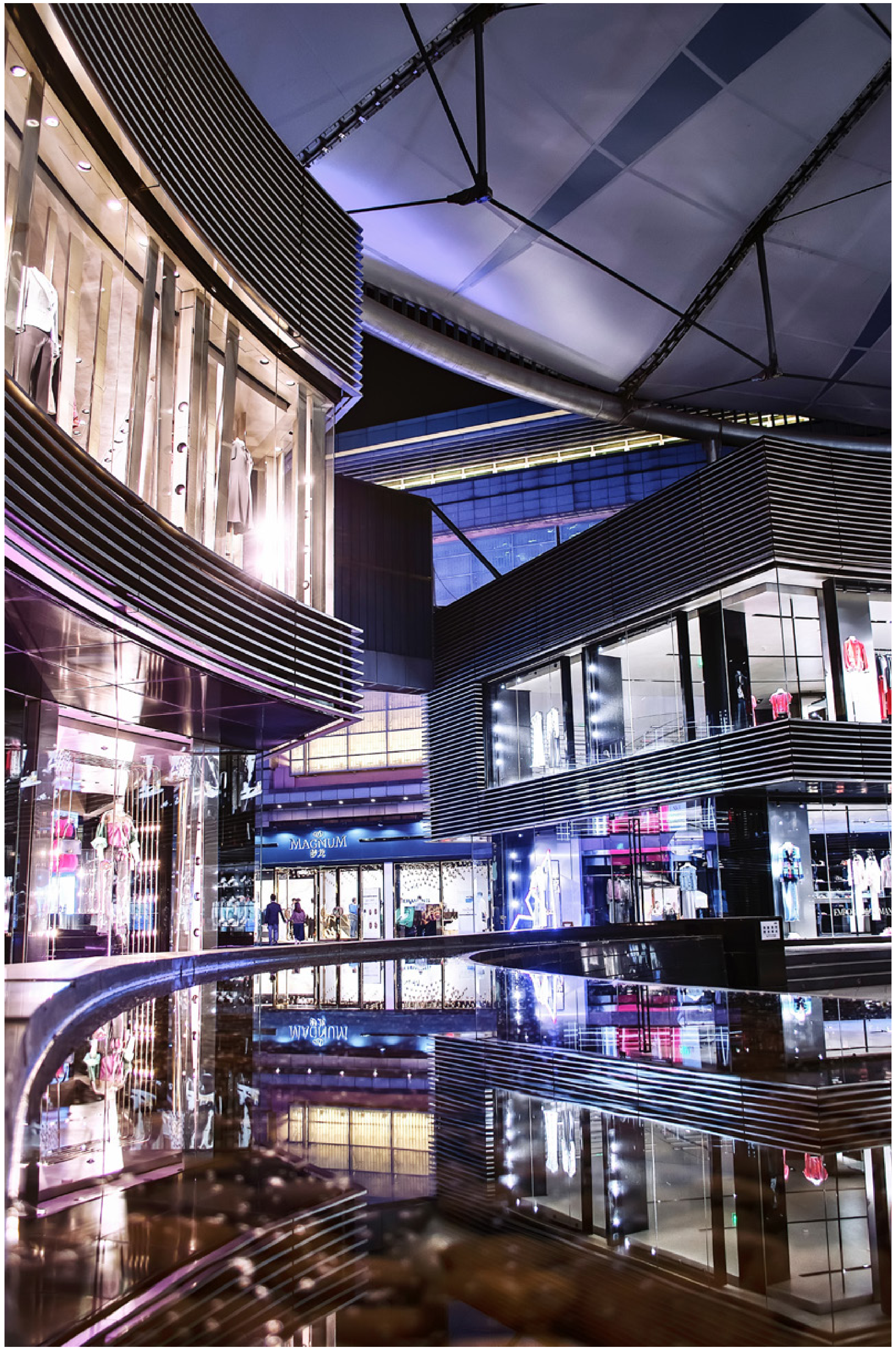
Source: PwC

Income tax	Corporate income tax: standard tax rate of 25% Individual income tax: rate ranges from 3% to 45%.
Turnover tax	Value added tax: standard tax rate of 16% applies to the sales of goods Consumption tax: rate calculated based on sales price and/or sales volume; applies to 14 categories of consumable goods, including tobacco, alcoholic drinks, cosmetics, jewellery, fireworks, gasoline, diesel oil, tires, motorcycles, automobiles, golf equipment, yachts, luxury watches, disposable chopsticks and wooden floorboards.
Property tax	Real estate tax: imposed on the owners or users of property at the rate of either 1.2% of the original value with certain deduction or 12% of the rental value.

3

MANDATORY ANIMAL TESTING FOR COSMETICS

Cosmetics products manufactured overseas and imported into China are required by the Chinese authorities to undergo animal testing prior to obtaining approval to be sold in the Chinese market. This in effect blocks a large number of cosmetics firms with cruelty-free ethical codes from physically selling their products in China. In June 2014, China repealed the animal testing requirement for non-special use cosmetics such as make-up and perfume manufactured in the country. However, for British companies, importing the requisite raw materials would be extremely challenging, while having the product 'made in China' would diminish the brand's premium appeal in the eyes of Chinese consumers. For many cosmetics companies, the only alternative is to sell via cross-border e-commerce platforms such as Tmall Global, which is not subject to China Food and Drug Administration (CFDA) approval. This approach can, however, incur substantially high import levies (in some cases up to 25.5%), which are born by the retailer as opposed to the consumer, in accordance with the platform's policy of maintaining competitive prices for products. The Chinese authorities have signalled their intent to remove the animal testing requirement for foreign cosmetics companies exporting to China, although the complexity of national implementation has led to delays in the process. Repealing this requirement would be equally beneficial for Chinese cosmetics companies looking to export to countries where animal testing is prohibited, as they will need to validate the safety of their products via other methods



RECOMMENDATIONS

Please refer to the cross-sector chapter for issues that apply across industries.

Concerns over intellectual property rights

- Enhance government transparency around IP decision-making, both through increasing consultation with British retailers around changes to IP regulations and through improving the transparency of IP decisions by Chinese courts.
- Provide more clarity on IP regulations pertaining to social media platforms and enhance the enforcement mechanisms and penalties for IP infringement on social media.

Cybersecurity and IT restrictions

- Ensure that the final iteration of the CSL gives reasonable exception to market research firms to share information internally.

High import duties and taxation

- Reduce the burdensome tax levies on retailers to lessen the price gap between products sold in the UK and China and to stimulate further domestic consumption.
- Offer British retailers the same treatment as their Chinese counterparts with regards to tax inspections and audits.

Mandatory animal testing for cosmetics

- Remove the mandatory animal testing requirement for cosmetics, and instead permit other proven methods of guaranteeing the safety of products.

MUTUAL OPPORTUNITIES

BRAND BRITAIN

The UK is recognised for the quality and distinctiveness of its retail brands, which are often associated with luxury and sophistication. Chinese consumers today are much more conscious of simply wearing and using the same brands as everyone else, and are increasingly looking to purchase more unique and premium products. British retailers are strong at creating innovative new content, and British goods are often perceived as being distinct from commonly known brands. With a growing number of Chinese consumers willing to spend more on premium products, British brands that engage and communicate well with Chinese shoppers and tap into their unique history can achieve much greater success in China.

GROWING LEVELS OF CONSUMPTION

Consumption levels in China have risen steadily since the 1970s as the economy has grown, yet the share of household consumption in GDP remains at around 40% – much lower than in most advanced economies[102]. As the country shifts to a growth model that is less dependent on investment, the continuing expansion of China's middle-class presents vast opportunities for British retailers operating in China's enormous consumer market. With a revised individual income tax raising the minimum payment threshold above which an individual is subject to income tax, it is evident that boosting consumption in China is a key priority for the central government. Furthermore, China's continued urbanisation and the emergence of consumers in Tier 3 and Tier 4 cities with greater spending power will generate further demand for premium British brands outside of China's most developed cities. These consumers are incredibly quality-conscious, and with a reputation for offering premium, high-quality products, British retailers are poised to capitalise on China's increasingly savvy consumers.

E-COMMERCE

China is the world's largest e-commerce market, offering opportunities for retailers already in-market as well as allowing British brands to sell their products in China without investing in a physical presence. A survey by Royal Mail found that 55% of Chinese online shoppers had purchased goods from the UK within the past three months, highlighting the 'premium quality' that consumers attach to British brands and the importance of e-commerce for businesses' strategies[103]. The digitalisation of retail in China enables brands to better understand consumer habits, establish a strong consumer-centric business model and offer a more compelling customer experience. Improvements in cross-border e-commerce logistics have further reduced the cost of sales, and more integrated supply chains have made it possible for British retailers in China to meet current consumer demands and expectations for next-day delivery.

102 'Consumption to replace investment as key to China growth', Financial Times, May 2018.
103 'Understanding online shoppers in China in 2017', Royal Mail, 2017.

APPENDIX: ACRONYMS

ACS	Automotive Component Supplier
AMAC	Asset Management Association of China
AMC	Asset Management Company
AUM	Assets Under Management
AI	Artificial Intelligence
BEV	Battery Electric Vehicle
BL	Tender and Bidding Law
BRI	Belt and Road Initiative
CBIRC	China Banking and Insurance Regulatory Commission
CFCRS	China-Foreign Cooperation in Running Schools
CIBM	China Interbank Bond Market
CICPA	Chinese Institute for Certified Public Accountants
CII	Critical Information Infrastructure
CFDA	China Food and Drug Administration
C-ROSS	China Risk Oriented Solvency System
CSRC	China Securities Regulatory Commission
CSL	Cybersecurity Law
CTMO	China's Trade Mark Office
EV	Electric vehicle
F&B	Food and Beverage
FDI	Foreign Direct Investment
FIE	Foreign-invested Enterprise
FII	Foreign Institutional Investor
FIL	Foreign Investment Law
FTZ	Free Trade Zone
GAAP	Generally Accepted Accounting Principles
GB	*Guobiao* Standards (National Standards)
GBP	Great British Pound
GP	General Practitioner
GPL	Government Procurement Law
GVA	Gross Value Added
ICH	International Council for Harmonization of Technical Requirements for Pharmaceuticals for Human Use
ICV	Intelligent Connected Vehicles
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IND	Investigational New Drugs
IP	Intellectual Property
JLV	Joint Law Venture
JPO	Joint Procurement Office
JV	Joint Venture
MIIT	Ministry of Industry and Information Technology
MOE	Ministry of Education
MOF	Ministry of Finance
MNR	Ministry of Natural Resources
MRA	Mutual Recognition Agreement
NDRC	National Development and Reform Commission
NEV	New Energy Vehicles
NHC	National Health Commission
NMPA	National Medical Products Association
NPC	National People's Congress
NVQ	National Vocational Qualifications
OEM	Original Equipment Manufacturer
PBOC	People's Bank of China
PFM	Private Fund Management
WFOE	Wholly Foreign-owned Enterprise
PRC	People's Republic of China
QFII	Qualified Foreign Institutional Investor
R&D	Research and Development
RMB	Renminbi
RQFII	Renminbi Qualified Foreign Institutional Investor
SAFE	State Administration of Foreign Exchange
SAMR	State Administration for Market Regulation
SGP	Special General Partnership
SOE	State-owned Enterprise
TIER	Technology Import Export Regulations
VATS	Value-added Telecommunications Services
VECC	Vehicle Emission Control Centre
WFOE	Wholly Foreign-owned Enterprise
WHT	Withholding Tax
WTO	World Trade Organisation

METHODOLOGY

The British chambers of commerce in China's *Position Paper* 2019 represents the views of its members and the wider British business community on market access issues and China's business and regulatory environment, offering recommendations to both the Chinese and UK government on how to create a more level playing field and hospitable business environment for British firms operating in China.

The cross-sector concerns addressed in this report were drawn from the market access issues highlighted from the British Business in China *Member Sentiment Survey* 2018/2019 conducted by BritCham in November 2018. Of the 14 concerns, the following three ranked highest: cybersecurity and IT restrictions; intellectual property rights protection; and restrictions on business licencing and certification. Our analysis uses a combination of the qualitative data provided by responses to the Sentiment Survey, roundtables and interviews to identify the broad concerns of British businesses. All 14 concerns are listed in this paper in order of perceived negative impact on an organisation's ability to operate in China, from most to least restrictive.

Roundtables and interviews were held with over 100 British companies and industry associations from Beijing, Shanghai, Guangdong, Chengdu and other regions between September 2018 and March 2019, providing input from companies that varied in terms of revenue profile, experience in the China market and location. In roundtables and interviews, participants discussed the major market access issues they experience, the recommendations they propose to remedy them and the key opportunities they see in the China market. The specific industries of focus for this iteration of the *position paper* were: accountancy; automotive; built environment services; education; financial services; food and beverage; healthcare; legal services; marketing and communications; and retail. The information given was then compiled into the relevant chapter of this paper, with all participants remaining anonymous.

CONTACTS

STEVEN LYNCH

MANAGING DIRECTOR

British Chamber of Commerce in China (BCCC)

steven.lynch@britishchamber.cn

PHIL ROEBUCK

EXECUTIVE DIRECTOR

British Chamber of Commerce Shanghai (BCCS)

phil.roebuck@britishchambershanghai.cn

CHRIS CHEN

OFFICE ADMINISTRATOR

British Chamber of Commerce Guangdong (BCCGD)

chris.chen@britchamgd.cn

MAVIS YANG

OPERATIONS MANAGER

British Chamber of Commerce Southwest (BCCSW)

mavis.yang@britchamswchina.org