BRITISH CHAMBER OF COMMERCE IN CHINA
中国英国商会

BRITISH BUSINESS IN CHINA: POSITION PAPER

2021

ABOUT THE BRITISH CHAMBERS OF COMMERCE IN CHINA

The British chambers of commerce in China are a network of membership organisations with a focus on providing advocacy, business support and networking opportunities for British businesses in China. We operate as an independent, not-for-profit organisation with a strong and diverse membership, representing British companies across the country from our offices in Beijing, Shanghai, Guangdong and Southwest China. With 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.

BRITISH CHAMBER OF COMMERCE IN CHINA 中国英国商会

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BRITISH CHAMBER OF COMMERCE GUANGDONG 广东英国商会

ABOUT THE POSITION PAPER 2021

The British Business in China: Position Paper 2021 represents the views of members of the four British chambers of commerce across China on the regulatory challenges for companies operating in the business environment. It offers recommendations to both the Chinese and British governments on how to level the playing field for British companies in a range of industries and regions. It also identifies areas of mutual opportunity where businesses can complement the sustainable development of the economy.

The cross-sector challenges addressed in this report were drawn from the regulatory challenges identified in the *British Business in China: Sentiment Survey 2020-2021*. The 14 entries are ranked in order of severity, with cybersecurity and IT restrictions presenting the greatest challenge for British businesses, followed by accessing and moving company finance and competition with state-owned enterprises. Analysis within the paper is drawn from the data provided in the Sentiment Survey and industry roundtables and interviews. Roundtables and interviews were held with British companies and industry associations from Beijing, Shanghai, Guangdong, Chengdu and other regions between January 2021 and March 2021, providing input from companies across revenue profiles and years of experience in market.

Cooperation against climate change is no less vital this year than in previous years. This year, however, with COP 26 in Glasgow and COP 15 in Kunming, the British and Chinese governments have a unique opportunity to coordinate on high-level and effective national action. At a business-level, we have highlighted important work being done by member companies to become more sustainable and promote ESG. Such sections are marked with this symbol.

Exchange rate used: GBP 1 = RMB 9.02 = USD 1.38

The recommendations in this Position Paper are indicative of priority areas as expressed by members during the data collection period and are not an exhaustive assessment of the issues faced by foreign businesses in China. The British Chamber of Commerce in China does not assume legal liability or responsibility for the accuracy and completeness of the information provided in this paper.

CHAIRS' FOREWORD

The British chambers of commerce in China are delighted to present the *British Business in China: Position Paper 2021*, representing the voices of member companies across China on the challenges and opportunities in China.

UK-China relations have seen extraordinary shifts in the past year. Some quarters of Parliament have expressed a desire to reduce bilateral engagement. However, dialogue is crucial if we are to address our differences and harness areas of common interest.

Differences may exist. Yet the prospects for UK-China trade are positive. UK-China trade reached GBP 79 billion in 2020. While this was a slight decrease on last year, it fell only 8% – far less than the drop in overall UK trade of 17% between 2019 and 2020. China continues to encourage regional decision-makers to source foreign investment from the UK.

These echo trends that the chambers have witnessed since China launched reform and opening-up. From the establishment of the British Chamber of Commerce in China in 1981 to the creation of the chapter in Shanghai in 1985 supporting British business across the entire Pearl River Delta to the chapter in Guangdong in 1996 and Southwest in 1997 to support British business across the south and west of the country. Since the early days of the 1980s the British chambers have provided a platform for the growing community of British businesses engaged in China.

Over the past four decades, we have built a network that drives real change, whether it be through our advocacy work or through our other programmes. We appreciate the engagement that we have had with China's Ministry of Commerce, the UK's Department for International Trade and other key regulatory bodies, and encourage both governments to continue working with the chamber and the business community to improve core issues. Although some of the co-signatories of this letter will soon be stepping down as individuals, we look forward to remaining engaged and supporting the chambers as they continue to create new opportunities for members.

However, the core challenges facing British businesses in China remain largely unchanged from last year. There has been some market opening and positive movement on regulatory challenges, but cybersecurity and IT restrictions, accessing and moving company finances and competition with state-owned enterprises continue to inhibit the growth of British companies operating in China. Addressing these, as well as sector-specific challenges, would improve the dynamism and innovation of the business environment through greater investment.

Trade and investment do not only contribute to economic growth, employment and innovation. They also create a platform for people to meet and improve their understanding of each other. In these times, such exchanges are more important than ever.

ST. JOHN MOORE
British Chamber of Commerce in China

ROSIE HAWES
British Chamber of Commerce Shanghai

As such, it is vital that UK-China travel resumes as quickly as possible in line with pandemic response measures. China's latest census shows a sharp decline in the number of foreigners residing in Beijing and Shanghai. While the pandemic may have had a near-term impact, it is important that China remains a vibrant international hub.

We therefore welcome an announcement from the Chinese embassy in the UK on the 10th May that it now recognises a broader range of COVID-19 vaccines as valid for travel when travellers apply for a visa. Many of our members have been separated from their workplaces and communities for over a year, and are eager to return. However, one widely-used vaccine in the UK is not included, precluding many from accessing this path. Furthermore, even with the required tests and documentation, application processes remain inconsistent, opaque and confusing.

The UK has not included China on a 'green list' of countries from which travellers can enter the country without quarantine. Yet beyond a few isolated local cases, there has been no notable COVID-19 cases in the Chinese mainland since January 2021. In the UK, while COVID-19 is still relatively widespread, infection rates have lowered dramatically and over two-thirds of the UK population have received at least one dose of a COVID-19 vaccine. Developing a mechanism that recognises the safe environments in each country and establishes safe, trusted, reliable and predictable travel corridors is important.

Climate action is another area in which effective cooperation can lead to meaningful outcomes. Net-zero carbon emission commitments by 2050 and 2060 by the UK and China, respectively, have propelled green policies in both countries. The holding of COP 26 in Glasgow and COP 15 in Kunming this year presents a singular opportunity for the two countries to build on these commitments together and coordinate on impactful climate policies.

Members are taking concrete actions to reduce their carbon footprints in China and to promote ESG standards. Their achievements thus far are highlighted not only throughout this paper, but also in the chambers' China Social Impact Awards and the work of our sustainability forum. We are proud of our members' efforts and will continue to foster partnerships and share knowledge as they work towards achieving their net-zero goals.

The challenges in the UK-China relationship can only be resolved through engagement. We continue to call for cooperation around preventing climate change, improving the business environment and other areas of common interest. However, this isn't solely the purview of government. Businesses and ordinary people play a critical role in supporting the bilateral relationship. Facilitating trade and investment can only amplify their capabilities.

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British Chamber of Commerce Guangdong

MATT RYAN
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EXECUTIVE SUMMARY

UK-China relations are at a pivotal point. Amongst UK politicians, support for objective, constructive dialogue with China is waning and public opinion in the UK has hardened against China. COVID-19 and a prolonged period of restricted travel has blocked crucial cultural exchanges that underpin mutual trust and understanding between countries, driving a wedge between China and the UK. This is detrimental both to finding solutions for problems that require global participation, such as climate change, and to finding pathways that develop greater understanding and goodwill. While the resumption of travel and openness to foreign trade cannot resolve all of the challenges in the bilateral relationship, they create opportunities to build common ground and enhance intercultural understanding. Both are vital to counterbalance narratives of disengagement.

COVID-19 is continuing to define daily lives, economic prospects and political narratives around the world. Some countries are still struggling to contain COVID-19, while others have removed lockdown measures, reopened businesses and are experiencing a return of economic growth. Amongst these, China stands alone in its ability sustainably to contain and control the spread of COVID-19 at scale prior to the development of an effective vaccination.

China's GDP expanded by 2.3% in 2020, making it the only G20 economy that experienced growth last year. For many, business activity has returned to 2019 levels. Market confidence has grown. This confidence has supported the opening of 25 million new businesses during the last year – up 4% from 2019.[1] While fewer new foreign-invested enterprises entered the market year-on-year, the Chinese government reported that utilised foreign direct investment in 2020 grew 6.2%, likely driven by improved prospects for economic growth with the successful containment of the pandemic across China.

The government has enacted several market opening measures over the course of the past year, addressing a number of recommendations in the 2020 edition of this paper. British financial services companies saw the greatest level of opening,[2] as they were permitted to gain sole ownership of fund management, pension insurance, securities firms and other financial services operations in China, and inbound investment through the Qualified Foreign Investor pathway was fully liberalised. More broadly, China committed to publishing critical cybersecurity legislation, further reducing the number of industries on the *Negative List for Foreign Investment* and strengthening protection of intellectual property through the *Patent Law* and *Copyright Law*.

The majority of British businesses have stated that they have yet to feel any significant improvement in the business environment over the past year.[3] Core challenges faced by British companies operating in the market remain. Companies recognise that this may in part have

1 'Statistical Communiqué on National Economic and Social Development in 2020', National Bureau of Statistics, February 2021 and 'Statistical Communiqué on National Economic and Social Development in 2019', National Bureau of Statistics, February 2020.

2 'British Business in China: Sentiment Survey 2020–2021', British Chamber of Commerce, December 2020.

3 'British Business in China: Sentiment Survey 2020–2021', British Chamber of Commerce, December 2020.

been driven by the challenge of managing the COVID-19 outbreak, but would urge the government to prioritise improvement of the business environment now that the outbreak has been successfully contained.

As such, we call on the Chinese government to:

1 ENACT CLEAR, CONSISTENT, SAFE AND PRACTICAL TRAVEL PROCESSES BETWEEN THE UK AND CHINA

Businesses welcome an announcement from the Chinese embassy in the UK in early May that foreign nationals who have been inoculated with a range of either Chinese- or foreign-made vaccines can now apply for a visa to China. This is a critical first step to resuming normal business and travel. However, one widely-used vaccine in the UK is not included, precluding many from accessing this path. Furthermore, members report that application processes remain inconsistent, impractical, opaque and confusing. While new employees are receiving the PU letters needed to apply for the Chinese work permit, their families are not able to apply for residence permits, leading many confirmed hires to withdraw their decision to join the company. There is significant uncertainty among foreign nationals that remain in China around how easily they can re-enter China if they travel overseas, and many are making the decision to instead permanently relocate. This creates considerable hiring pressures, but more importantly deprives China of the flow of global talent needed to become a truly global commercial hub. Greater certainty would ensure that this talent remains in the country for longer.

The UK has recently categorised China as 'amber' on a list assessing the risk that travellers from certain countries pose in transmitting COVID-19. This has placed China, which reports less than 20 new cases per day – almost all of which are imported and quarantined – amongst countries that are seeing thousands of new cases per day. Countries that report a similar number of COVID-19 cases as China as of May, such as Iceland, New Zealand and Singapore, are placed on a 'green list'. We suggest that both countries take appropriate steps to facilitate practical, safe UK-China travel.

2 ENCOURAGE THE DEVELOPMENT OF AN ATTRACTIVE ENVIRONMENT FOR GLOBAL TALENT

There are also concerns that China may be missing opportunities to develop its position as a global hub for innovation and investment by creating additional hurdles that diminish China's attractiveness to global talent.

This has in part been exacerbated by COVID-19. Coupled with challenges entering and exiting the country, those who are in the country find that they are sometimes placed under seemingly arbitrary limits or rules, despite being fully compliant with public health requirements. These range from different treatment to Chinese nationals when travelling domestically to being unable to meet with certain government representatives. Reports of such instances are concerning, and we urge that any requirements related to COVID-19 consider whether an individual has entered or left China within 21 days or is exhibiting symptoms of COVID-19, rather than whether they are a Chinese or foreign national.

However, developments unrelated to COVID-19 could also result in foreign investment and foreign workers considering other countries in the Asia-Pacific region. The pending removal of various benefits through the current Individual Income Tax regime, particularly in terms of education allowances, could make opportunities for mid-level and senior-level manager in China less appealing, as they would need to consider the impact that international postings would have on their families as well as themselves. In turn, companies may find it easier to find the best people for a role in countries with more diverse job pools and consider opportunities in other markets.

Addressing these challenges and continuing to encourage foreign talent to work in China is vital if China is to create the diverse business environment it needs to generate new ideas and new growth opportunities.

3 ENABLE THE UNIFORM IMPLEMENTATION OF BENEFICIAL MARKET REFORM POLICIES

Market reforms announced by the central government are welcomed, but companies find that benefits remain limited by inconsistent implementation by different departments or provincial governments. This prevents central policies from achieving their intended effects, and can inhibit businesses' ability to provide uniform products or services to customers in different regions or create artificial constraints on the competitiveness of business if they must comply with requirements not placed on competitors in different areas.

Furthermore, businesses are seeing interesting initiatives coming out of the Greater Bay Area and Hainan Free-Trade Port, and encourage the government to implement the more effective or attractive pilot programmes nationwide.

4 ENSURE THAT THE FINAL ITERATION OF CYBERSECURITY LEGISLATION PROVIDES SUFFICIENT CLARITY AND SUPPORTS INTERNATIONAL R&D

Significant uncertainties remain in the shape of the cybersecurity and IT landscape in China, making it challenging for British companies both to factor cybersecurity and data security compliance into their local business models and to integrate their China operations with their global operations. This has significant implications for China to develop its position as a global commercial hub. Companies are already subject to some level of security assessment requirements and controls on cross-border data transfers, which slow their operations. Furthermore, legislation determining the final details of these controls remain in draft form. The uncertainty and burdensome administration involved limits their ability to coordinate R&D or data analysis with their global headquarters or sister offices, and could increasingly hamper China's ambitions to become a leader in multinational innovation.

5 EXPAND PILOT PROGRAMMES TO LIBERALISE CROSS-BORDER CAPITAL FLOWS

Companies are ultimately constrained from making large payments in a timely manner, as large transactions must first be approved by the State Administration of Foreign Exchange. This not only restricts a company's China offices from making time-sensitive transactions at short notice, but also necessitates that they expend significant resources on the administrative processes required to make payments. Remittances are also often in effect subject to double taxation, through the levying of a withholding tax in addition to corporate income tax. The establishment of a pilot programme to facilitate the cross-border transfer of funds, in which one British multinational is currently participating, is welcome. We encourage regulators to broaden implementation of this programme to cover all firms in order to improve the attractiveness of the business environment.

6 ESTABLISH A LEVEL PLAYING FIELD BETWEEN PRIVATE AND STATE-OWNED ENTERPRISES

Although China has pledged to provide national treatment to foreign companies through a string of recent legislation and regulations, including the *Foreign Investment Law* and the *Regulations on the Optimisation of the Businesses Environment*, in reality there are still many rules designed to favour state-owned enterprises (SOEs), protecting them from competition from private companies. Aims for SOE reform laid out in the 14th Five-Year Plan and other key policy documents are ambiguous, simultaneously calling for the improvement of market conditions for privately-held firms and for a drive to make SOEs 'stronger, better and bigger'. Concrete reforms that remove policies which distort the market must be enacted in order to build a competitive, innovative business environment.

Furthermore, the British government must remain engaged on China and engaged with China. While China's business activity and policy priorities largely reflect the pre-pandemic situation, the same cannot be said for UK-China relations.

Government policy is conflicted. This is not new, but the contradictions set in the 'Integrated Review' released by the UK in March 2021 are striking. Whether it is tenable to manage a constructive relationship on global issues, trade and investment with the country that 'presents the biggest state-based threat to the UK's economic security' remains to be seen. However, it is encouraging that bilateral trade reached nearly GBP 79 billion (RMB 713 billion) in 2020.[4] While this represents a decrease of 8% from 2019, it is much shallower than the drop of 17% in the UK's total annual trade.[5] China remains the UK's third largest trading partner behind the US and the EU, and in 2020 the UK's trade with the nation was larger than its trade with Japan, India, Australia and Singapore combined. China also seems to be interested in increasing investment sourced from the UK, listing it as a country with which regional governments should seek investment opportunities in a circular released by the Ministry of Commerce in March 2021.[6]

Nevertheless, a rise in political tensions between China and the UK has led to greater fracturing of engagement mechanisms and resistance to maintaining dialogue in order to resolve differences. This has real consequences. Trade tensions have discredited the open, global trade links that have driven economic growth and intercultural understanding. The politicisation of overseas development aid in the UK has jeopardised future funding for valuable programmes in China that encouraged inclusive growth, strengthened public health infrastructure, supported cultural exchange and developed standards that

4 'Trade and Investment Factsheets: China', Department for International Trade, May 2021.

5 'Trade and Investment Core Statistics Book', Department for International Trade, April 2021.

6 'Circular on Stabilising Foreign Investment in Accordance with Creating a New Development Pattern', Ministry of Commerce, March 2021.

aligned with international norms. Looking forward, there are concerns that the dual circulation strategy, developed itself in response to US-China trade tensions and the impact of COVID-19 on global trade, could entrench the role of many foreign market entities as marginal players in the economy, which is driven in no small part by the structural categorisation of companies as either 'domestic' or 'foreign-invested'.

Concerted efforts must be made to ensure that political differences do not result in discrimination based on ethnicity or nationality. A surge in hate crimes against people of East and Southeast Asian ethnicity have been seen in the UK, enabled by rhetoric around COVID-19. In China, there is a perception that the risk of COVID-19 comes from overseas, and therefore that there must be a risk from foreign passport holders or those that look foreign. This unfounded perception has led to non-inclusive policies or measures in China and differing treatment of foreign passport holders from Chinese nationals. Both of these issues must be tackled head-on.

While there is no one solution, the normalisation of travel and support for continued intercultural exchange are important elements of improving bilateral relations. Such measures would not only allow international business activities to fully resume, but also create opportunities for ordinary people to develop more nuanced understandings of other perspectives and cultures. This is vital if narratives endorsing decoupling and de-globalisation are to be countered, but it cannot be achieved if borders remain closed, if foreign nationals feel discriminated against or unwelcome, or if mechanisms of engagement are allowed to rust.

Cooperation around preventing climate change must also remain unaffected by volatility in the wider relationship. Global warming cannot be prevented without coordinated input from the world's largest economies. With China and the UK striving to achieve carbon neutrality by 2060 and 2050 respectively, there are ample opportunities to find common ground. Joint initiatives on green standards are already providing dividends. As the UK hosts COP 26 in Glasgow and China holds talks on protecting biodiversity with COP 15 in Kunming, strong bilateral action could generate significant momentum.

British businesses in China are actively reducing the carbon footprint of their supply chains, developing ESG services and creating environmentally-friendly products. Their successes have been in the British chambers' China Social Impact Awards and other similar platforms. However, constraints on their ability to participate in R&D in China and freely compete in China limit the ability of foreign companies to promote these products to their full potential in China. This is also to China's detriment, as it reduces the influence of innovation in the business environment and restricts consumer choice. Greater market reform would allow companies to develop truly global solutions for a global problem.

Challenges in the UK-China relationship cannot be resolved unless both parties engage in dialogue and negotiate in good faith. Bilateral trade and investment alone cannot bridge the divide between our societies, but they have a critical role to play. As such, it is vital that restrictions on foreign companies in China are addressed, and that future economic development creates a level playing field irrespective of a company's country of origin. To do otherwise would create more problems than it would solve.

ECONOMIC AND POLICY OVERVIEW

CHINA'S ECONOMIC OUTLOOK FOR 2021

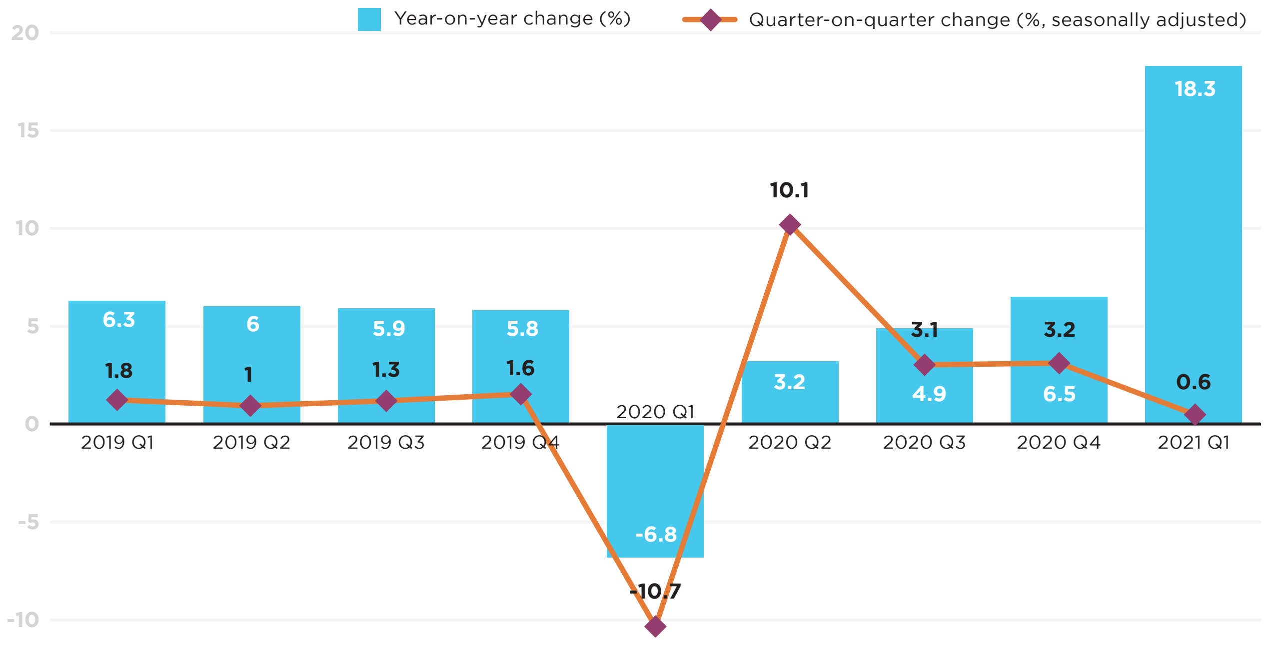
Following the success of China's COVID-19 control measures, resumption of business activity has led to economic growth. China's real GDP expanded 2.3% in 2020, making it the only G-20 economy to grow that year, and it is expected to by forecasters grow by between 6-9% in 2021.[1] The unemployment rate sank from 6.2% at the height of the pandemic to pre-pandemic levels of 5.2% in December 2020, highlighting a rapid return to economic normality.[2]

Foreign participation in the Chinese economy has also remained robust, driven it seems by firms with an existing presence rather than new market entrants. The number of new foreign-invested enterprises (FIEs) opening in China contracted in 2020 but foreign direct investment (FDI) into China grew 6.2%, according to Chinese government data.[3] In particular, investors favoured the retail, business services and information technology industries, while manufacturing, household services and real estate saw significant declines in FDI. Despite disruptions to global supply chains, international freight and the number of FIEs registered to trade with China both grew last year.

However, the rebound in the economy remains uneven. The recovery of consumption and services has lagged behind investment and industry. Small and medium-sized enterprises (SMEs) were disproportionally affected by the pandemic as they had shallower buffers than their larger counterparts. The weaker recovery of smaller, mainly private, enterprises is concerning, as it could further entrench the dominance of larger firms, including less productive state-owned enterprises (SOEs). Significant regional disparities also remain, with growth in western and eastern China outpacing north-east and central China, and urban disposable income currently standing 2.5 times higher than rural disposable income.[4]

China's quarterly GDP growth

Source: National Bureau of Statistics



1 'China's Economy Could Grow 8-9% This Year from Low Base in 2020 - C. Bank Adviser', Reuters, February 2021.

2 'Statistical Communiqué on National Economic and Social Development in 2020', National Bureau of Statistics, February 2021.

3 'Statistical Communiqué on National Economic and Social Development in 2020', National Bureau of Statistics, February 2021.

4 'Statistical Communiqué on National Economic and Social Development in 2020', National Bureau of Statistics, February 2021.

THE SEARCH FOR GREEN, RESILIENT AND MORE EQUAL GROWTH

Addressing these wealth gaps has been on the policy agenda for some time. The government has encouraged greater development of its poorer provinces through preferential investment and tax policies and its poverty alleviation campaign, and Premier Li Keqiang has consistently emphasised the need for greater financial support for SMEs. These goals are reiterated in the 14th Five-Year Plan and are highly likely to remain core elements of China's growth strategy.[5] More broadly, the Plan outlines a vision of high quality, evenly distributed, resilient and sustainable growth, but provides few concrete details as to how this will be achieved.

One core aim is to foster innovation, while safeguards against external shocks and supply-side risks are more deeply integrated into policymaking. This strategy, known as 'dual circulation', remains relatively conceptual and is generally seen as an effort to drive growth through domestic demand. Yet so far, there have been few concrete details for policy measures to expand provision of welfare, increase disposable income or otherwise encourage spending. As it is, current levels of household consumption – equivalent to around 40% of GDP – are remain low relative to developed market standards.[6] It may be that, at least in the near term, the government is cautious about developing a consumption-led economy, and would like to retain a strong role for investment as well.

The need to rein in fiscal spending and de-risk and deleverage the economy also remains a core focus of the Plan. At the same time, policy signals regarding SOEs are contradictory. Commitments were made in both the 14th Five-Year Plan[7] and the Three-Year SOE Reform Action Plan[8] to improve their productivity and reduce their insulation from private competition as part of a general policy push to strengthen supply-side reform. However, the 14th Five-Year Plan also states an aim to make SOEs 'stronger, better and bigger'. SOEs are expected to maintain their current economic status, receiving significant benefits in exchange for supporting policy objectives, and may even play a wider role in absorbing private firms. This is ultimately to detriment of private firms and competitive forces in the market, as one third of British companies believing they are treated unfavourably compared to SOEs.[9]

SOME IMPROVEMENT TO THE BUSINESS ENVIRONMENT, BUT MANY AREAS SEE NO CHANGE

Going into 2020, there was cautious optimism that commitments to market reform, exemplified in the *Foreign Investment Law* and *Regulations on the Optimisation of the Business Environmen*t, could improve China's business environment. However, one year on, the majority of British companies report no significant market openings and no change to the major regulatory challenges they face in the market.[10]

That is not to say that there have been no market openings. Foreign financial services companies can now apply for full ownership of a range of types of financial institutions, in line with the '11 Measures' published in July 2019.[11] Nevertheless, burdensome application requirements reduces their certainty of successfully receiving these licences or competing on a level playing field with domestic enterprises. Beyond financial services, foreign investors can now take full ownership of commercial vehicles manufacturing businesses, water supply and, in free trade zones, vocational schools.[12] Cosmetics that have not been tested on animals – an important aspect of many British cosmetics companies' values – are now permitted to enter the market.[13]

Elements of China's 14th Five-Year Plan and the dual circulation strategy may benefit foreign firms through a general policy push to improve the business environment, upgrade consumption and develop 'high quality growth'. If foreign and domestic market entities are treated equally, the enhancement of protection of intellectual property, increase in funding available to R&D projects and other

5 'Outline of the Objectives of the 14th Five-Year Plan and Long-term Vision for 2035 for Economic and Social Development', National Development and Reform Commission, March 2021.

6 'Higher Infrastructure Investment Needed to Boost Economic Growth', China Daily, April 2021.

7 'Outline of the Objectives of the 14th Five-Year Plan and Long-term Vision for 2035 for Economic and Social Development', National Development and Reform Commission, March 2021.

8 While statements on the Three-Year SOE Reform Action Plan have been made, the full text is not available.

9 'British Business in China: Sentiment Survey 2020–2021', British Chamber of Commerce in China, December 2020.

10 'British Business in China: Sentiment Survey 2020–2021', British Chamber of Commerce, December 2020.

11 'Relevant Measures for Further Opening of the Financial Sector', Financial Stability and Development Committee, July 2019.

12 'Negative List for Foreign Investment', Ministry of Commerce, June 2020.

13 'Administrative Regulations for the Registration and Filing Information for Cosmetic Products', National Medical Products Administration, February 2021.

commitments to improve the business environment are welcomed by British businesses. Further policy support and market opening for cross-border trade in services would be of particular interest to the UK, due to the strength of its services industry.

UK-CHINA ECONOMIC RELATIONS REMAIN RELATIVELY ROBUST

Global Britain in a Competitive Age: The Integrated Review of Security, Defence, Development and Foreign Policy, a policy document that outlines the UK government's outlook on international relations, characterises China as the UK's "biggest state-based threat to economic security".[14] However, it emphasises this does not preclude the development of positive cooperation in areas of mutual benefit, such as trade and climate action.

Over the past year, the UK's total trade in goods and services with the Chinese mainland reached almost GBP 79 billion (RMB 713 billion) in 2020, with an additional GBP 21.9 billion (RMB 197.6 billion) generated in Hong Kong.[15] This represents a drop of 8.5% on 2019 levels, but is notably shallower than the drop in the UK's total global trade, which was down 17%.[16] China rose above the Netherlands to become the UK's third largest trade partner in 2020, driven partly by UK demand for products related to COVID-19, such as medical masks and electronics.[17]

China was previously thought to be the UK's fifth largest trading partner in 2019 but, revised UK government data now indicates that it narrowly beat France to place fourth.[18] It remains behind the US, which accounts for 22% of the UK's total global trade in goods and services. As our second-largest trading partner, Germany's share of the UK's total global trade stands four percentage points higher than China's, at 13% as compared to 9%. Japan is the UK's next largest trade partner in the Asia-Pacific, but is only our eleventh-largest trade partner overall, with the relationship generating GBP 24.6 billion (RMB 222 billion) in trade in 2020 – a third of our trade with the Chinese mainland.

The UK's Global Trade 2020

Source: Office for National Statistics

Country	2019 rank as trading partner and total trade		2020 rank as trading partner and total trade	
US	1st	GBP 230 billion	1st	GBP 196 billion
Germany	2nd	GBP 133 billion	2nd	GBP 113 billion
China*	4th	GBP 86.1 billion	3rd	GBP 78.8 billion
The Netherlands	3rd	GBP 92 billion	4th	GBP 76 billion
France	5th	GBP 85.4 billion	5th	GBP 65.9 billion
Japan	11th	GBP 29.2 billion	11th	GBP 24.7 billion
India	13th	GBP 23.3 billion	15th	GBP 18.3 billion
Singapore	21st	GBP 17 billion	19th	GBP 14.1 billion
Australia	19th	GBP 18.8 billion	20th	GBP 13.9 billion
South Korea	24th	GBP 11.9 billion	24th	GBP 11.2 billion

* Data represents the Chinese mainland.

14 'Global Britain in a Competitive Age: the Integrated Review of Security, Defence, Development and Foreign Policy', Cabinet Office, March 2021.

15 'Trade and Investment Factsheets: China', Department for International Trade, May 2021. 2019 UK-China trade has been revised upwards from previous estimates of GBP 81.4 billion (RMB 734 billion) to a new figure of GBP 86.1 billion (RMB 777 billion). Please note that revisions to historical data on UK-China trade will affect figures used in previous editions of this paper.

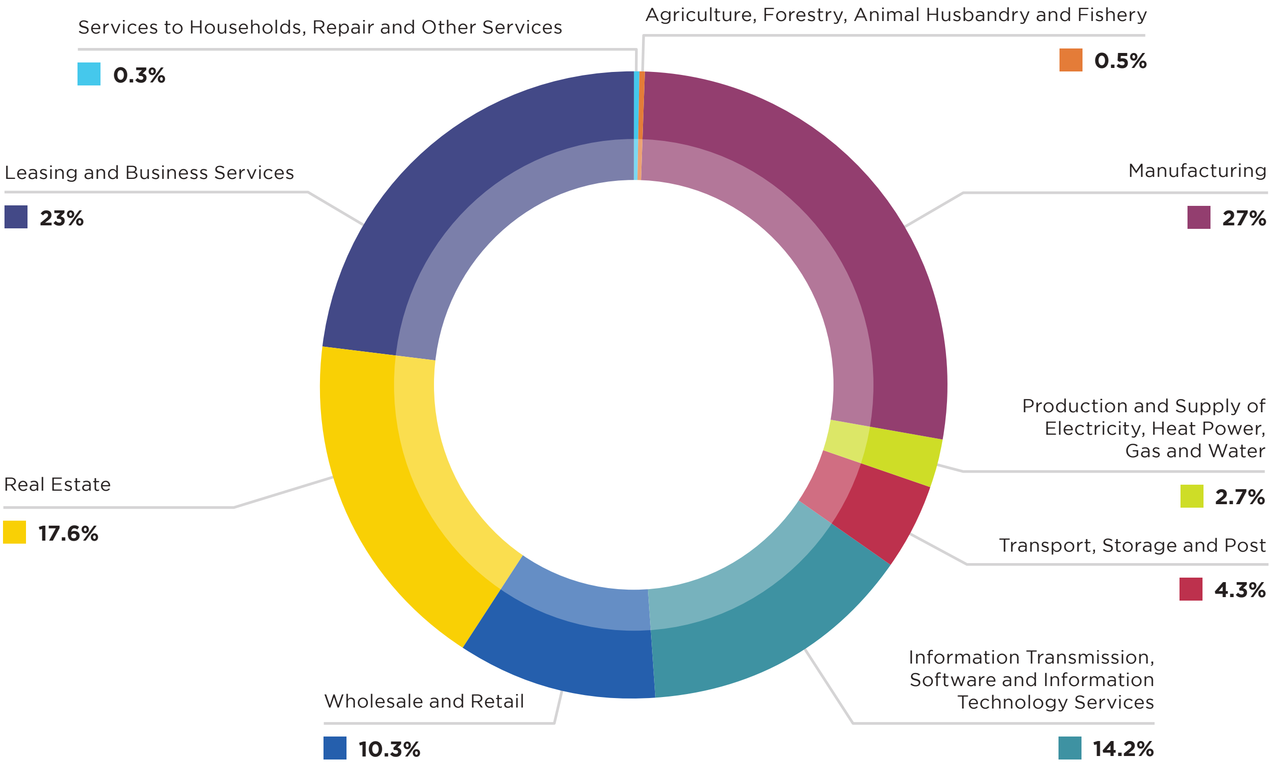
16 'Trade and Investment Core Statistics Book', Department for International Trade, April 2021.

17 'Trade and Investment Factsheets: China', Department for International Trade, May 2021.

18 'UK Total Trade: All Countries, Non-Seasonally Adjusted', Office for National Statistics, May 2021.

Proportion of foreign direct investment (excluding banking, securities and insurance) in different industries in 2020

Source: National Bureau of Statistics



The mainstays of UK goods imports from China in 2020 were telecoms and sound equipment and office machinery, with consumer electronics demand strengthening through the pandemic. Major UK goods exports to China include crude oil, road vehicles, and medicinal and pharmaceutical products, with the share shipped to China standing at just under 10% of the UK's total exports for those categories.[19]

In services, exports to China grew almost 250% between 2010 and 2019.[20] The most significant of these exports are in 'other business services' (comprising of accounting, legal, advisory, built environment and other such services), which account for over a quarter of all of the UK's services exports to China. Other significant categories of services exports include intellectual property, transportation, travel and financial services.[21] While the UK currently runs an overall trade deficit with China, growth in the UK's goods trade deficit pre-pandemic was narrowing, while its surplus in services was widening. These trends may continue in the post-COVID environment, especially if China continues to open its services markets.

In addition, UK services exports to China are significantly higher than previously thought. The UK government has recently published an experimental dataset that expands the traditional metrics used to estimate UK services exports – remote service provision and the movement of people – to include services provided by the overseas offices of British companies and other such British-owned foreign affiliates. This last category is worth almost the sum of the traditional metrics, doubling previous estimates of UK exports of services to the Chinese mainland in 2019 to over GBP 10 billion (RMB 90.2 billion) in total.[22] Nevertheless, there is significant room for growth in trade generated by British-owned foreign affiliates – the UK's trade with China in services is lower than other markets in the region and for what would be expected of an economy of China's size.

Recent trends of British FDI into China also show a bullish trend. Total British FDI stock in China stood at GBP 10.7 billion (RMB 96.6 billion) at the end of 2020.[23] Recovering from a dip in 2019, British investment into China grew by 30.7% last year, according to an announcement by the

19 'Trade and Investment Factsheets: China', Department for International Trade, May 2021.

20 'Trade and Investment Core Statistics Book', Department for International Trade, April 2021.

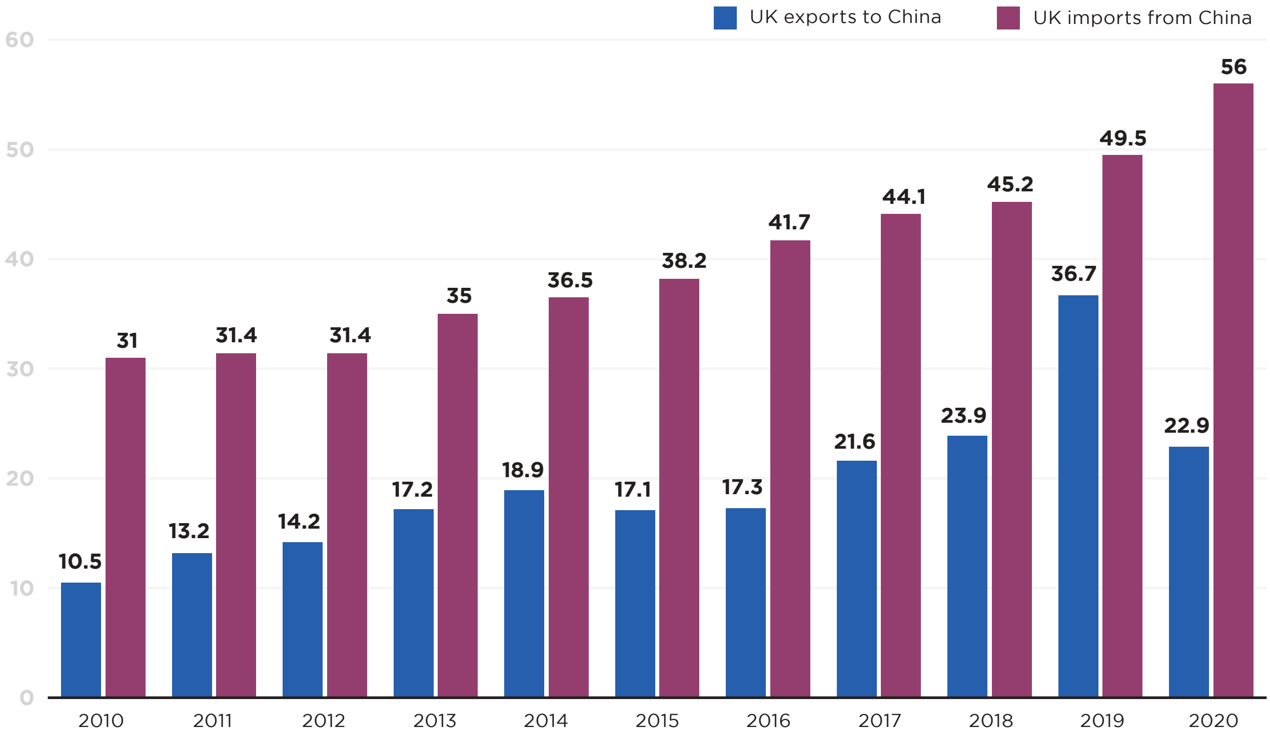
21 'Trade and Investment Factsheets: China', Department for International Trade, May 2021.

22 'Trade in Services by Modes of Supply, UK: 2019', Office for National Statistics, November 2020.

23 'Trade and Investment Factsheets: China', Department for International Trade, May 2021.

UK trade in goods and services with the Chinese mainland(GBP billions)

Source: Office for National Statistics



Ministry of Commerce.[24] This suggests that in 2020 GBP 808 million (RMB 7.3 billion) of British investment entered China.[25] UK FDI flows into China reached an average of roughly GBP 983 million (RMB 8.9 billion) a year over the past five years, and British businesses will be maintaining or growing their current investment in China in 2021, according to the latest edition of the *British Business in China: Sentiment Survey*.[26] Moreover, challenges in the political relationship have not discouraged the Chinese government's interest in attracting further investment from the UK, as seen in a recent circular.[27]

Greater market openings, particularly in the services sector, would allow China to grow jobs, source foreign investment and improve the competitiveness and innovativeness of its business environment. This would in turn generate demand from a larger middle class to purchase British-made goods and services, create opportunities for British investors and ultimately drive the profitability of British companies and job creation in both China and the UK.

Nevertheless, there are concerns that at any time individual companies may be disadvantaged due to geopolitical tensions. In China, British companies in the technology industry, food and beverage industry and others have reported delays to receiving licences. In addition, the role of foreign businesses in China is not defined in the dual circulation strategy, causing uncertainty about potential risks around policy decisions made on the basis of economic or national security. Similar concerns may be held by Chinese companies in the UK. Foreign investment ultimately generates jobs, provides greater consumer choice and supports economic growth. Decisions to limit an individual company's access to a market that are not based on objective, evidence-based reasoning harm all parties involved.

Business-to-business and people-to-people exchange is invaluable to facilitating better understanding in the UK-China relationship and informed economic cooperation. Joint exploration of new programmes around green finance and investment can lead to greater uptake by British and Chinese industry giants, many of whom are already showing increasing appetite for improving their Environmental, Social, Governance (ESG) standards. Cooperation on the development of international standards could uncover pathways to mutual recognition of product standards, opening new markets and fostering innovation. Greater alignment of standards around testing

24 'Foreign Investment Into China Grew 6.2% in 2020, Reaches Record High', Ministry of Commerce, January 2021.

25 'China: Foreign Capital: Utilised: (FDI) Foreign Direct Investment & Others: Europe: United Kingdom', CEIC, May 2021. Calculated from the figure USD 857.05 million (GBP 617.9 million) of UK outbound FDI flow into China in 2019.

26 'British Business in China: Sentiment Survey 2020–2021', British Chamber of Commerce, December 2020.

27 'Circular on Stabilising Foreign Investment in Accordance with Creating a New Development Pattern', Ministry of Commerce, March 2021.

for cosmetics and vehicle safety have already opened markets, improved investor confidence and reduced administrative costs.

Academic exchanges can also lead to better outcomes for trade, strengthening policies through sharing knowledge and by improving intercultural understanding in academia and government. One such session on the draft *Personal Information Protection Law* in March 2021 brought together experts from Renmin University, Durham University and other leading research institutions.[28] Such exchanges improve the quality of analysis both of specific topics and of thought processes driving policymaking, informing debate in think tanks, government departments and other influential bodies.

There will always be disagreement in a bilateral relationship, but disengagement is not the solution. Economic exchange is invaluable, building the goodwill needed to manage more challenging areas. Throughout 2020, the UK and China have continued to build joint mechanisms that promote knowledge-sharing and develop green, fair and open trade. Continuing such projects and maintaining a balance between robust discussion around our differences and engaging on our common interests is the critical.

28 'UK-China Seminar on the Personal Information Protection Law Successfully Held at Renmin University's Law School', Renmin University of China Law School, March 2021.

AT A GLANCE: INDUSTRY REPORTS

ACCOUNTING

SUB-SECTORS:

Accounting firms | Qualification organisations

KEY CHALLENGES:

- Lack of mutual recognition of British and Chinese qualifications
- Limitations on non-CICPA ownership
- Blacklisting of accountants through the Social Credit System

KEY RECOMMENDATIONS:

- Explore signing Mutual Recognition Agreements between CICPA and British accounting bodies
- Explore easing the ability of British non-CICPA professionals to become partners of accounting firms in China
- Remove requirements for individual accountants to provide their personal identification to accounts to eliminate the risk of being blacklisted, and entrust the relevant accounting bodies to govern the conduct of accountants

KEY MUTUAL OPPORTUNITIES:

- Business and advisory services
- Training and provision of talent
- Technology in accounting services

AUTOMOTIVE

SUB-SECTORS:

Original equipment manufacturers | Automotive components suppliers

KEY CHALLENGES:

- Lack of clarity and consistency around NEV development policies
- Burdensome customs requirements
- Restrictions on ICVs

KEY RECOMMENDATIONS:

- Make national sales targets in the NEV Development Plan optional for OEMs, and implement a mechanism to review sales growth annually and adjust incentive policies according to market demand
- Permit the mutual recognition of certifications by accredited test centres in the UK and China to remove the requirement of retesting at port of entry
- Remove the equity cap on investment into ICVs and permit foreign businesses to offer VATS as a WFOE

KEY MUTUAL OPPORTUNITIES:

- Robust demand for premium and luxury vehicles

BUILT ENVIRONMENT SERVICES

SUB-SECTORS:

Architecture | Project management | Construction | Real estate | Engineering | Spatial planning

KEY CHALLENGES:

- Barriers to obtaining appropriate design licences
- A need to improve and respect protection of intellectual property rights
- Lack of recognition of international qualifications and experience

KEY RECOMMENDATIONS:

- Provide more transparent and equitable approval processes for licences
- Ensure that British design firms retain full control of their IP until they win the relevant contract
- Work towards the mutual recognition of engineering, architecture, and urban planning qualifications

KEY MUTUAL OPPORTUNITIES:

- Sustainable construction
- Training and transnational education
- Specialisations in modular construction

EDUCATION

SUB-SECTORS:

Early Years | K-12 | Higher Education | Non-profit organisations | English Language Training | EdTech | Certification and accreditation bodies

KEY CHALLENGES:

- Inconsistency and lack of clarity in the regulatory environment
- Staffing pressures ahead of the new academic year
- Constraints on foreign participation in non-sensitive areas of education

KEY RECOMMENDATIONS:

- Ensure that regulations are applied uniformly nationwide
- Create a mechanism to facilitate the return of foreign teachers and lecturers to China in a safe manner before the new academic year
- Allow wider scope for cooperation and exchange in non-sensitive areas of education between Chinese and UK institutions

KEY MUTUAL OPPORTUNITIES:

- Growing interest in flexible education styles
- Early years education
- Vocational training and employability

ENERGY

SUB-SECTORS:

Oil and Gas | Nuclear | Renewables | Minerals | Power

KEY CHALLENGES:

- Uncertainty over role of hydrogen in the energy mix and priorities for innovation
- Unclear roadmap and insufficient impetus to transition from coal to gas
- Procurement barriers to market entry

KEY RECOMMENDATIONS:

- Provide more clarity around the future role of hydrogen in China's long-term energy strategy
- As one of the critical tasks for achieving China's goal of net-zero carbon emissions, accelerate the transition from coal to gas by limiting expansion of new coal capacity and continuing to reduce the role of coal in the energy mix, while also clarifying FIEs' role in supporting this transition
- Review procurement practices and de facto barriers to market entry in order to protect fair market practices and encourage innovation

KEY MUTUAL OPPORTUNITIES:

- Sustained demand for battery minerals and EV infrastructure
- Upskilling
- Offshore wind

FINANCIAL SERVICES

SUB-SECTORS:

Asset management | Banking | Commodities | Insurance | Private equity

KEY CHALLENGES:

- Inability to use globally-held assets to fulfil licence requirements
- Limitations of QDII quotas in terms of maximum allocated capital, allocation process and accessibility
- Difficulties with cross-border transactions

KEY RECOMMENDATIONS:

- Allow FIIs to use assets held by their parent companies or other globally-held assets to fulfil capital requirements for licence applications
- Refrain from arbitrarily restricting applications for an increase of a company's QDII quota
- Expand recent pilot schemes to help all multinational companies more efficiently manage global capital

KEY MUTUAL OPPORTUNITIES:

- ESG Investing
- Investment Opportunities in Hainan
- Greater Bay Area

FOOD, BEVERAGE, RETAIL AND CONSUMER GOODS

SUB-SECTORS:

Alcoholic beverages | Catering | Cosmetics | Frozen foods | Hygiene and personal care

KEY CHALLENGES:

- Challenges with customs clearance procedures
- A need to update food safety standards ahead of the GB 2760 revision
- Deviation from international product standards

KEY RECOMMENDATIONS:

- Streamline customs procedures to reduce the amount of time goods are held in port
- Streamline and standardise the food safety approvals process for new additives, as well as new ingredients and packaging and other food-related items
- Exclude recommended standards from market surveillance and supervision, leaving assessments on the performance and function of products to the market

KEY MUTUAL OPPORTUNITIES:

- Policy focus on boosting the consumer market
- Brand Britain

HEALTHCARE

SUB-SECTORS:

Cosmetics | Healthcare services | Medical devices | Pharmaceuticals

KEY CHALLENGES:

- Restrictions on human genetic research and obtaining relevant data
- Pricing pressures and decision-making processes around VBP, the NRDL and the NEDL
- Difficulties obtaining licences for foreign healthcare professionals

KEY RECOMMENDATIONS:

- Loosen restrictions on activities involving human genetic resources and relevant data-sharing
- Balance the need to drive down prices with that to drive innovation when implementing the VBP system
- Explore signing Mutual Recognition Agreements to allow registered nurses and doctors to operate in both countries, or provide an English-language version of requisite examination

KEY MUTUAL OPPORTUNITIES:

- Innovation as a priority
- Healthcare technology
- Demographic trends and healthy aging

LEGAL SERVICES

KEY CHALLENGES:

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

KEY RECOMMENDATIONS:

- Pilot allowing licences in certain areas that are non-sensitive and most relevant to foreign firms, such as commercial and corporate work, particularly in M&A, funds formation, financial regulatory and anti-trust areas
- Allow lawyers from foreign firms to represent their clients in meetings with government agencies, when clients require it
- Increase flexibility of the joint operations models, in particular reducing barriers to entry, such as minimum numbers of lawyers, length of operating history of the local partner and location of the joint operations. Improve the ability of foreign partners to control and share the profits they earn

KEY MUTUAL OPPORTUNITIES:

- Further alignment of standards
- ESG
- Chinese outbound investment


Hda DANSKA
Hdb NORSKA
Tema

CLIMATE ACTION

"COVID-19 reminds us that humankind should launch a green revolution and move faster to create a green way of development and life, preserve the environment and make Mother Earth a better place for all".[1] This was the opening for President Xi Jinping's announcement that China would peak its carbon emissions by 2030 and achieve net-zero carbon emissions by 2060. By now, the case for urgent climate action has been made clear. It is paramount that UK-China cooperation around climate change continues on both a business and government level, insulated from any volatility in the broader relationship.

While there are challenges in the current political landscape, cooperation on environmental protection is more important than ever, and presents a unique set of opportunities for businesses in China. Success in the fight against climate change cannot occur without the largest economies and the largest companies agreeing targets, aligning on green standards and sharing best practice. This year, several promising developments have either been made or are on the horizon. The US has rejoined the Paris Agreement. US Climate Envoy John Kerry met with Chinese Climate Envoy Xie Zhenhua in Shanghai and, while the talks are in early stages, this was the first joint US-China statement to be released in quite some time.[2] Xie and Kerry's amicable working relationship and pivotal roles in the crafting of the Paris Agreement could be leveraged to achieve similarly historic agreements between two of the world's largest emitters. President Xi also recently affirmed China willingness to cooperate on climate change goals with the European Union (EU) in a dialogue with Chancellor Angela Merkel of Germany and President Emmanuel Macron of France.[3] China is already working with the EU on the convergence of environmental credential classifications, streamlining green investment mechanisms and promoting the uptake of Environmental, Social, Governance (ESG) investment across global markets.

The hosting of the COP 26 climate talks in Glasgow and COP 15 conference on biodiversity in Kunming provide timely opportunities for the UK and China to take leading roles in setting the agenda for change. The two COP sessions nevertheless build on years of UK-China cooperation on climate action across governments, academia and businesses. In 2009, a UK-China workshop on low-carbon innovation was held in Hangzhou. A working report produced jointly by the UK, China, the US and India in 2015 led a complete re-evaluation of the way we assess the risks of climate change. Launched in 2018, a UK-China Green Finance Centre has explored information disclosure, green bonds, ESG data and other key elements of the green policy environment. At a business level, some of the largest British and Chinese companies have participated in the United Nations' 'Race to Zero' – an initiative in which nearly 1,400 companies have set net-zero emissions targets. British businesses in China have significant involvement in clean power generation, green transport, green industry standards, green manufacturing, and ESG investing and reporting. If political will is sufficient and

1 'Full text: Xi Jinping's speech at the General Debate of the 75th session of the United Nations General Assembly', CGTN, September 2020.

2 'US-China Joint Statement Addressing the Climate Crisis', US Department of State, April 2021.

3 'Xi Focus: Xi attends video summit with French, German leaders', Xinhua, April 2021.

private enterprises are provided clear opportunities to contribute, cooperation can bring dividends in terms of coordinated, rigorous and effective global climate action.

China is already making headway in growing the proportion of non-fossil fuels in its energy mix and improving energy efficiency, and may even peak earlier than its initial target.[4] The 14th Five-Year Plan commits to growing the proportion of non-fossil fuels in China's energy mix from current levels of 16% to 20%, and to reduce carbon emissions per unit of GDP by 18% before 2025 as China builds a clean, low-carbon, safe and energy-efficient energy system.[5] Nuclear power will play a significant role in this strategy, as China plans to increase generation capacity by 20 gigawatts (GW) to 70 GW by 2025. There will be continued development of solar and wind power, with offshore wind farms built along China's coastline and solar power capacity in eight 'clean energy bases' established in Yunnan, Sichuan, Gansu, Inner Mongolia, and elsewhere across the country. Policymakers will actively support research and development (R&D) in hydrogen capabilities in order to better understand the most effective applications of this new possibility in clean power generation. While the Plan may not explicitly link its 30-60 goals to poverty alleviation, both green growth and inclusive growth are on the agenda, with many of the poorest provinces significantly expanding their clean energy capacity. It is vital that the pursuit of green growth minimises existing inequalities and avoids new ones.

Beyond the 14th Five-Year Plan, there are several ministerial-level plans in place to reduce China's carbon emissions. The *New Energy Vehicle Industry Development Plan (2021-2035)* aims to improve the quality of electric vehicles (EVs), incentivise consumption of EVs in order to increase sales volume to 20% of total new sales by 2035 and expand supporting infrastructure for EVs, such as charging infrastructure, in order to slowly phase out petrol and diesel engines.[6] The National Energy Administration has developed a 'weighted responsibility' mechanism for provincial renewable energy consumption.[7] The mechanism sets annual targets for provincial renewable energy usage, with each province's consumption of renewable energy expected to reach 40% of total energy consumption by 2030. It should be noted that eight provinces have already exceeded the 40% benchmark, including Sichuan (79%), Yunnan (75%) and Chongqing (48.5%). The Ministry of Ecology and Environment (MEE) has recently finalised long-awaited rules for China's carbon emissions trading system (ETS), effective from February 2021. It allows companies with emissions levels higher than 26,000 tonnes of CO_2 per year to offset as much as 5% of their total emissions. These credits come from such sources as renewable energy carbon sinks and methane recovery projects. For now, the ETS only applies to the power sector, but is expected to be rolled out to cover petrochemicals, chemical engineering, construction, iron and steel, nonferrous metals, paper-making and civil aviation.

The government is also exploring the role of financial services and economics in climate action. It has pledged to develop a framework by 2035 that properly accounts for the usage or destruction of the environment and natural resources.[8] The People's Bank of China (PBOC) has coordinated with the MEE to strengthen the financial system and financial support underpinning the ETS. The central bank recently confirmed that it is currently formulating price discovery rules and will provide fewer "freely allocated" emissions quotas in future, which would go some way to reduce potential abuse of the system.[9] The PBOC aims to ensure that the carbon trading market is calibrated to ensure that all risks are fully priced-in and that the price of carbon is set in order to act as "an incentive or a constraint" as needed. Beyond emissions trading, it has also announced plans to establish a mandatory, coordinated information disclosure system in order to strengthen financial markets' assessments of companies' green footprints. Encouragingly, 'clean coal' has been expunged from the development of green bonds. A raft of further policy incentives, such as the availability of low-interest funds for the use of carbon emissions reduction, can also be expected in the coming years.

However, there are still significant challenges to be navigated on the path to 2060. The optimal alignment of green development policies, economic growth and energy security, in China as in the rest of the world, will be a critical question for policymakers going forward. The 14th Five-Year Plan indicates that coal, 'green' or otherwise, will continue to play an outsized role in power supply and

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4 'Analysis: Going Carbon Neutral by 2060 'Will Make China Richer', Carbon Brief, September 2020.

5 'Outline of the Objectives of the 14th Five-Year Plan and Long-term Vision for 2035 for Economic and Social Development', National Development and Reform Commission, March 2021.

6 'New Energy Vehicle Industry Development Plan (2021-2035)', Ministry of Industry and Information Technology, October 2020.

7 'Draft Notice on the Weighting of Responsibility for Renewable Energy Power Consumption in 2021 and Expected Targets for 2022-2023', Huaxia Energy Net, February 2021.

8 'Opinions on Establishing a Sound Mechanism for Realising the Value of Ecological Products', State Council, April 2021.

9 'Governor Yi Gang attended the PBC-IMF High-Level Seminar on Green Finance and Climate Policy and delivered Opening Remarks', People's Bank of China, April 2021.

form an important part of China's energy security going forward.[10] Post-lockdown economic stimulus measures in the second half of the year fuelled a rebound in emissions output, estimated at up 1.5% from 2019 – although it should be noted that growth in CO2 emissions did decelerate in both 2019 and 2020.[11] Industrial production of metals and non-metal minerals account for 25% of all carbon emissions in China, while industry as a whole accounts for 40%.[12] While current renewable technologies aren't always able to generate the extreme heat needed to create many of these materials, hydrogen is a likely replacement for fossil fuels in heavy industry. Nevertheless, the technology remains relatively experimental, and hydrogen gas would need to be supplied in much higher quantities than it is today in order to meet global demand.[13] Ultimately, provincial governments will be considering the importance of these industries to their economies as well as their detrimental environmental effects. Ensuring that the business environment is optimised to facilitate meaningful R&D in hydrogen power and nuclear power is critical to ensuring this balance is maintained.

British businesses in China are in many cases already either directly providing solutions to these challenges or promoting environmentally-friendly products and services to the market. Energy companies are working with Chinese partners to explore opportunities in the highly-experimental hydrogen power sector and in distributed generation solar. In the automotive ecosystem, manufacturers are developing both EVs for the China market and elements of EV infrastructure. Manufacturers of medical devices and drugs are following net-zero carbon emissions timelines set by their UK headquarters to also 'green' their supply chains, improve environmentally-friendly disposal or recycling of waste and improve water preservation. Food, beverage and consumer goods producers are ensuring their products are fully recyclable, minimising their use of virgin plastics and continuously improving the energy and resource efficiency of their production processes.

Considerable advances are also being made in knowledge-sharing and alignment of standards. The PBOC is already cooperating with both the Bank of England and the European Union to align fundamental green investment principles. Financial services enterprises are supporting government initiatives by developing ESG products both in line with similar services already 'proven' by their parent companies in other markets and in line with standards co-developed by the UK, EU and China. Accounting and legal services firms are leveraging their global networks to enhance best practice in ESG due diligence and standards setting. Built environment services firms are incorporating green construction standards into the projects they consult on in China. Education institutions are introducing environmental awareness into lessons and encouraging resource efficiency among students through recycling policies, the building of water fountains and green construction of new sites.

However, companies in all of these sectors face barriers to market entry or market expansion that are not imposed on their domestic competitors. Companies' green credentials are becoming a rising priority for Chinese consumers and investors alike. Creating a level playing field for business and allowing all companies to compete based on the merits of their products or services would allow the most innovative, efficient companies to direct more resources to fulfilling these standards and developing environmentally-conscious offerings. This would optimise the quality of green innovation, ensuring that China becomes a hub for global advances in environmental protection and that foreign enterprises can generate new products or services to help satisfy demand.

10 'Outline of the Objectives of the 14th Five-Year Plan and Long-term Vision for 2035 for Economic and Social Development', National Development and Reform Commission, March 2021.

11 'Analysis: China's CO2 emissions surged 4% in second half of 2020', Carbon Brief, March 2021. Using data from the National Bureau of Statistics' 'Statistical Communiqué on 2020 National Economic and Social Development'.

12 'Zhou Xiaochuan on the Key Questions Facing China's Carbon Ambitions (Part I)', Caixin Global, April 2021.

13 'Europe Leads the Way in the 'Greening' of Steel Output', Financial Times, November 2020.

THE DUAL CIRCULATION STRATEGY

The dual circulation strategy (DCS) is one of the most important concepts developed by the Chinese government in recent years, unfolding in the midst of an economic landscape challenged by COVID-19 lockdowns and the US-China trade war. The strategy aims to fortify China's domestic economic resilience and reduce its reliance on the external economy. Although policies linked to the DCS have been published more and more frequently in recent months, they are mostly relatively broad, and the potential implications of the strategy continue to generate heated debate among analysts.

In a way, the decision to adopt the DCS is not entirely a surprise, as the idea behind it is hardly new. China has long attempted to boost its domestic consumption, upgrade its industries and reorient its economy away from export-led growth. In early 2006, expanding domestic demand was a focus of China's 11th Five-Year Plan. However, China's household consumption remains quite low compared to other high-income nations, accounting for 38% of its GDP, whereas other OECD economies find report figures around 50-60%.[1]

Nevertheless, the formalisation of the strategy is still highly significant, as it demonstrates a sense of urgency from the Chinese leadership to protect Chinese economy against external shocks triggered by geopolitical tensions and 'black swan' events. In particular, increasing tensions with the US likely catalysed the DCS's emergence. Attempts under the Trump administration to decouple from China in areas such as semiconductors highlighted two fundamental economic vulnerabilities – its low value-added industries and high reliance on foreign technology. At the same time, China has become increasingly concerned about the exposure to external shocks created by its deep integration in the global supply chain. Therefore, the DCS above all indicates a shift in China's views on its relationship with the global economy and its plans to manage the changing dynamic of this relationship going forward. By focusing on developing domestic innovation and consumption, it hopes to reduce external vulnerabilities and uncertainties.

However, this naturally raises questions around whether the DCS signals a reversal of China's opening-up policy and what the impact will be on foreign investment and foreign-invested businesses in the country. There is also confusion about whether foreign companies are considered part of the 'internal' ring or the 'external' ring of the DCS. Although their offices in China fall under Chinese jurisdiction, contribute to China's economic growth and are subject to the same market forces as domestic businesses, uncertainty around whether foreign companies will be treated equally to their Chinese counterparts remains.

In an effort to address these concerns, the Chinese government has continuously emphasised that the DCS does not mean it is abandoning its policy of 'opening up'. In the country's 14th Five-Year Plan, it provides more insight into its envisioning of the ways in which internal and external circulation can complement each other. The government hopes to attract global resources through improving the efficiency and stability of the domestic economy, further spurring high-quality growth.[2]

Many elements of the DSC, as outlined in the Plan, suggest positive outcomes for foreign and domestic businesses alike. In terms of 'internal circulation', a key policy

1 'OECD Data: Household Spending', OECD Data, 2020.

2 'Outline of the Objectives of the 14th Five-Year Plan and Long-term Vision for 2035 for Economic and Social Development', National Development and Reform Commission, March 2021.

suggestion put forward in the Plan concerns deepening China's supply-side structural reform, which continues previous policy drives to reduce industrial overcapacity in order to improve the quality of China's manufacturing base, as well as to tackle financial risks. Elements of the DCS, such as improving the quality of education, healthcare and elderly care, are believed to be an extension to China's supply-side reform, although it shifts the focus to ensuring that supply meets middle and high-end domestic demand. This, combined with China's efforts to increase household incomes and bridge urban-rural income gaps,[3] should create more opportunities for foreign businesses to cater to the needs of consumers in the country, especially its 400 million-strong middle class.

Meanwhile, the Plan aims to reduce barriers to the free flow of goods and services across the country and build more efficient logistical networks, so as to create a 'unified national market'. Such endeavours, if successful, should also improve the efficiency of the domestic economy and drive down administrative and logistical costs for businesses. To support 'external circulation' and continue to attract foreign trade, the government will reduce tariffs and costs for importers, diversify sources of products and increase imports of high-quality consumer goods, advanced technology, important equipment and energy resources.[4] It also pledges to protect and facilitate foreign investment, especially in advanced manufacturing, high-tech industries and modern services, as well as in China's central and western regions. Greater market openings can be expected in telecommunications, online services, education, culture and healthcare for foreign investment.[5]

These policy measures link with wider efforts to improve the business environment for foreign firms in China. Both the *Foreign Investment Law* and the *Regulations on the Optimisation of the Business Environment* came into force just prior to the official announcement of the DCS, and commit to creating a transparent and level playing field for domestic and foreign companies. They are just two of the market reforms that have been implemented in recent years. If fully implemented, they could lead to significant improvements for foreign companies. In a recent video conference with American business leaders, Premier Li Keqiang also reiterated the government's promise to create 'a market-based and law-governed business environment that meets international standards' and to treat foreign and domestic companies equally.[6]

However, while China is still opening its doors to foreign trade and investment under DCS, foreign businesses continue to face significant market barriers, and the government's pledge to treat all market entities alike has not always been met with full implementation. Although most British businesses in China are maintaining or increasing current investment levels, this is largely driven by the potential of the market.[7] Half of British businesses still face regulatory challenges in China, with most of these companies report that there has been no significant change to these challenges between 2019 and 2020.

With the introduction of DCS, there are also concerns that these difficulties could be exacerbated. Domestic companies today still enjoy considerably more support than their foreign counterparts, distorting the market. State-owned enterprises in particular are entitled to preferential treatment, ranging from easier access to financing to favourable prospects in government procurement. Many foreign businesses face various restrictions that disproportionately affect their operations relative to those of domestic companies. Sometimes, these range from outright barriers to market entry, such as the ban on foreign entities investing in human stem cells and gene diagnosis and treatment.[8] Foreign legal firms and certain types of built environment services firms are restricted from conducting their core business functions in China, and instead are largely limited to acting as consultants. Other times, however, these constraints are more subtle. For example, the government has made it increasingly difficult for foreign businesses to transfer data to overseas offices, especially if sensitive data is involved. Such transfers must first be approved by regulators, slowing the operations of foreign-invested firms relative to their domestic competitors.

This dual status for foreign companies particularly underscores the 'at arm's length' treatment of many foreign businesses in the market. While opening up measures are appreciated, there is also a sense that by the time policies are fully implemented, few opportunities remain for foreign companies to gain market share. At the same time, genuine positive movements from opening up policies

3 'What Does It Mean to Pay Attention to Demand-Side Management?', Economic Times, December 2020.

4 'Outline of the Objectives of the 14th Five-Year Plan and Long-term Vision for 2035 for Economic and Social Development', National Development and Reform Commission, March 2021.

5 'Outline of the Objectives of the 14th Five-Year Plan and Long-term Vision for 2035 for Economic and Social Development', National Development and Reform Commission, March 2021.

6 'Li Keqiang Attends the Dialogue with U.S. Business Leaders', Ministry of Foreign Affairs, April 2021.

7 'British Business in China: Sentiment Survey', British Chamber of Commerce in China, December 2020.

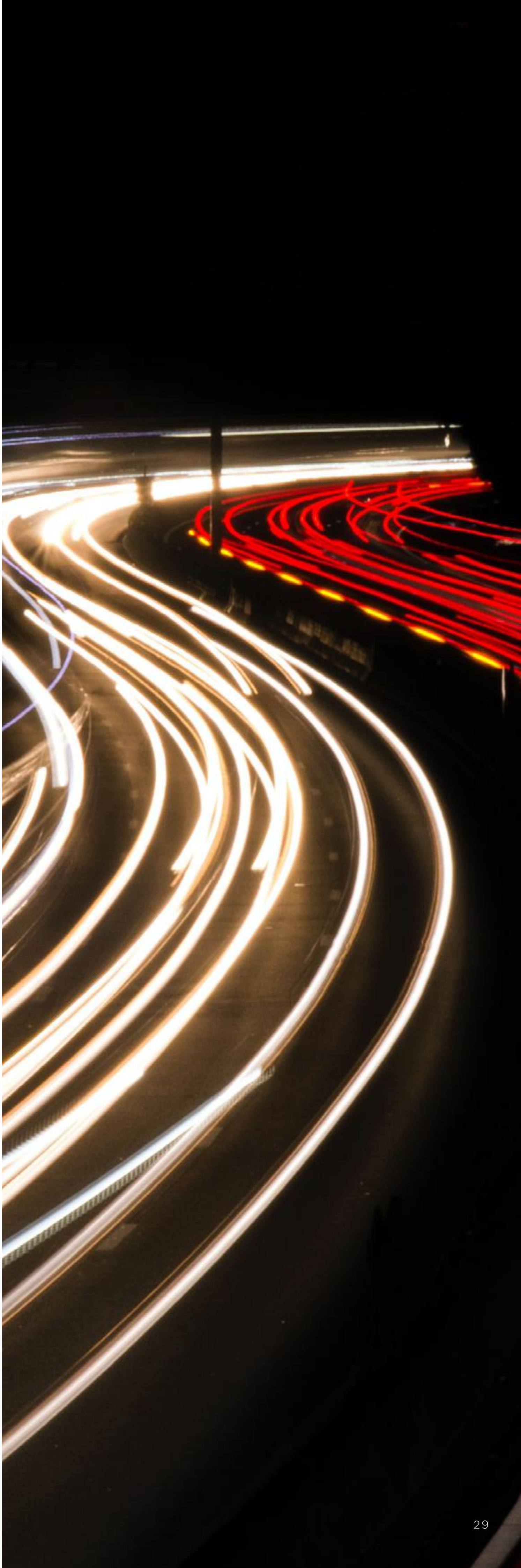
8 'Negative List for Foreign Investment', Ministry of Commerce, June 2020.

may be undermined by other, more serious policies that distort the market in favour of domestic firms. After all, it is important to note that external circulation has an explicit focus on utilising foreign investment to serve China's needs as it climbs up the global value chain. This underscores the risk that, either in the sustained drive to develop internal circulation or in a situation where external circulation is suddenly deprioritised due to external shocks, foreign businesses may continue to receive uneven treatment in favour of developing strong national champions. This is particularly likely in strategically important sectors, such as biotechnology, electric vehicles, new energy resources and technology infrastructure.[9] Governments may also be prompted to increasingly favour domestic companies in public procurement. This type of action must be avoided, as it creates an un-level playing field, distorts the market and suppresses the ability for the market to become more efficient, innovative and competitive.

If China wants to truly increase the efficiency of its economy and improve its firms international competitiveness, developing a fair business environment and equal treatment of all market entities is crucial. The Chinese government has long regarded innovation key to elevating the status of its economy, but often stopped short of allowing genuine competition to take place in the market. Restrictions on foreign businesses also prevent them from operating to their full potential or delivering innovative products and services to the market quickly. A report from the McKinsey Global Institute suggests that in order to move up the technology value chain, China needs to strengthen both an effective system that encourages competition and innovation as well as stronger channels to acquire capital, know-how and talent. Only by effectively attracting, facilitating and protecting foreign investment can China leverage the full benefits of the DCS.[10]

9 'Home Advantage: How China's Protected Market Threatens Europe's Economic Power', Rhodium Group, April 2021.

10 'China and the World: Inside the Dynamics of a Changing Relationship', McKinsey Global Institute, July 2019.



CROSS-SECTOR CHALLENGES

NAVIGATING CYBERSECURITY AND IT RESTRICTIONS

It should come as no surprise that digitalisation is one of the defining trends in China for domestic and foreign companies alike. As online retail platforms grow ever larger and the government incentivises domestic innovation in everything from digital currency programmes to the Internet of Things, businesses will need to keep pace with the latest developments in order to retain their edge in the market. The 14th Five-Year Plan outlines key goals that will energise China's digital landscape as a whole, viewing increasing innovation in information science and digital technologies as a core element of China's economic growth.

It is concerning then, that the critical challenges facing British companies navigating cybersecurity and IT restrictions in China remain largely unchanged. They have been highlighted as the most difficult aspect of doing business in China in all editions of the *British Business in China: Sentiment Survey,* and one in four companies report that restrictions worsened in 2020. While there has been some market opening for foreign firms in the telecommunications industry, significant uncertainties and concrete challenges around data security, obtaining licences and cybersecurity remain. Although digital innovation is at the forefront of the 14th Five-Year Plan, there is also a heavy emphasis on strengthening cybersecurity and data security which, if developed into an inflexible framework, could exacerbate existing challenges for foreign companies.

The *Cybersecurity Law* published in 2017 is the primary piece of legislation governing a crucial element of the business environment in China. It is supplemented by a series of subordinate regulations, some of which remain in draft form. In the work report published by the National Development and Reform Commission in March 2021, it seems as though two of the most critical of these draft laws – the draft *Data Security Law* and the draft *Personal Information Protection Law* – may be finalised in the next five years.[1] Alongside the *Cybersecurity Law*, these three laws will form the core of China's cyberspace policy.

Concerns around the vague wording of the draft *Data Security Law*[2] are sustained in 2021. 'Important data', which will be subject to strict controls in terms of collection, processing and storage, is not defined in the law. This creates significant uncertainty for foreign businesses, as they cannot accurately map out the processes and systems they need to put in place to be compliant with China's new cyberspace landscape. Furthermore, the draft law assigns responsibility to industry-specific and regional government bodies to oversee data activity within their particular remits. This is necessary to ensure that regulations are practical and effective, but currently there is no clarity on which bodies will be ultimately responsible for enforcing the regulations or timelines for enforcement. For example, a clear delineation of whether the Ministry of Public Security or the Cyberspace Administration of China will decide when a company's data operations are considered to have implications for national security and oversee inspections would make the data environment more straightforward.

1 'Outline of the Objectives of the 14th Five Year Plan and Long-term Vision for 2035 for Economic and Social Development', National Development and Reform Commission, March 2021.

2 'Data Security Law', National People's Congress, July 2020 (via AppInChina).

The *Personal Information Protection Law* remains in draft,[3] and British businesses encourage the government to release a final version as soon as it has adequately addressed the concerns raised by businesses and other stakeholders. In particular, there are several aspects of the law where more concrete detail would help improve the business environment. For example, if an organisation processing personal information needs to share this information with an organisation outside of China, the recipient organisation needs to meet one of three conditions. However, in respect to the security assessment and accreditation conditions, there is currently no clarity around the nature of these processes, including whether they are one-time conditions or whether they must be completed for every cross-border transfer. Similarly, businesses are unsure how financial penalties for data breaches or other instances of non-compliance are calculated for organisations or their responsible personnel.

As in last year's chapter, businesses are still struggling to understand the full implications of the designation of 'Critical Information Infrastructure Operator' (CIIO) in the *Cybersecurity Law*. Qualifying as a CIIO subjects a company to a number of additional obligations including the requirement to undertake security assessments internally[4] or, in some cases, have their security reviewed by the Chinese authorities, before transferring personal information or 'important information' overseas.

The stringency of security assessments on organisations operating in China are also decided by a company's designation in the *Multi-Level Protection Scheme* (MLPS) – another categorisation method under the *Cybersecurity Law* which requires organisations to adhere to different standards of network and data security compliance, but fails to clearly delineate which type of organisation must adhere to which set of standards. Many businesses are currently spending significant resources on self-assessments to understand if they might be designated as CIIO, which assessment level they will be placed under within the MLPS and what steps they need to take to ensure compliance going forward.

This also gives rise to uncertainty about the government's broad rights to access firms' IT systems in the case of an assessment, security breach or under investigative powers more generally – in particular, access to private information such as encryption codes and source keys. It is currently unclear whether there is a boundary that the authorities cannot cross, and whether offshore as well as onshore data is covered under these access rights. The government has yet to provide any information on what the assessment criteria are for either CIIO designation or the MLPS, what compliance teams would look like or what potential penalties for non-compliance might be.

This may change, as the 14th Five-Year Plan mentions further development of CII as one of the goals for 2025, but few details are given regarding timelines or expected outcomes. Similarly, the Plan places a strong emphasis on data security, stating that data security assessments will be strengthened and emphasising that the flow of data across borders will be "safe and orderly", implying that criteria will become stricter in the next five years. No concrete policies or requirements, however, are provided under the Plan and it is not clear whether these developments will be limited to the changes forecasted in the current draft of the *Data Security Law* and *Personal Information Protection Law* alone.[5]

Reports have emerged that domestic Chinese companies who are designated as CIIOs have been encouraged to procure products and services from domestic companies rather than foreign companies. This is concerning as it not only creates an artificial market barrier for foreign firms, but may deny Chinese CIIOs the ability to choose from a full range of products and services.

Similarly, the opacity of the approval process for certain licences inhibits the dynamism of foreign companies in the sector. British businesses are pleased to see the number of approvals for foreign-invested telecommunications companies rising year-on-year.[6] However, foreign investors looking to enter these VATS businesses are subject to equity caps, limiting their participation to 50%. They would also appreciate more clarity on the process by which they can receive Type 2 Value-Added Telecoms Services (VATS) licences, particularly:

- Online data processing and transaction processing services (B21)
- Domestic multi-party communication services (B22)
- Storage and forwarding services (B23)
- Information services (B25)

Recommendations on page 44.

3 'Personal Information Protection Law', National People's Congress, October 2020 (via AppInChina).

4 'Measures on Network Security Review', Cyberspace Administration of China, April 2020.

5 'Outline of the Objectives of the 14th Five-Year Plan and Long-term Vision for 2035 for Economic and Social Development', National Development and Reform Commission, March 2021.

6 'The state of development of foreign investment in the telecommunications industry', China Academy for Information and Communications Technology, July 2020.

ACCESSING OR MOVING COMPANY FINANCES

As China develops its new dual circulation system, policymakers in the State Administration of Foreign Exchange (SAFE) seem to be signalling a greater liberalisation of the capital account in China. The past year has seen some opening, particularly in regards to inbound capital flows. However, core challenges remain unchanged, including caps on capital outflows, bureaucratic and unpredictable administrative procedures and challenges contacting regulators to resolve problems. In 2020, 62% of British businesses in China reported no change to their ability to access or move company finances.[1]

China's closed capital account results in significantly burdensome compliance requirements for foreign companies. These include necessitating that companies submit a 'tax filing certificate' and receive approval for remittances after exhausting an allowance of USD 50,000 (RMB 325,000 or GBP 36,000) worth of renminbi; forbidding the conversion of capital out of renminbi for the purchase of overseas real estate, life insurance and other financial instruments; and restricting the amount of capital that domestic institutional investors can invest offshore, among others. In a similar effort to crack down on money laundering, from July 2017 banks were instructed to report all foreign exchange sales exceeding RMB 50,000 (GBP 5,700) and any cross-border bank account transfers exceeding RMB 200,000 (GBP 22,700).[2]

There are signals that regulators are becoming less concerned about capital outflows – a primary trigger for the economic destabilisation of 2015. External debt in 2020 was seen to be stable, despite the uncertain global economic environment.[3] As such, the past year has seen new openings in equity investments provided by SAFE and the People's Bank of China (PBOC), indicating regulators' interest in further liberalising the capital account. In November 2020, SAFE committed to expanding two outbound investment programmes for domestic institutional investors,[4] and in early 2021 a director at SAFE announced that the body was studying the feasibility of allowing individuals to use their foreign currency exchange allowance to make direct overseas investments, such as in offshore securities, insurance and properties.[5] A pilot project was established to allow a number of multinational companies to transfer funds overseas more easily, with one foreign-invested enterprise (FIE) included among the ten initial participants.[6] If the pilot is expanded to cover more FIEs, it would tangibly improve the business environment for foreign firms.

1 'British Business in China: Sentiment Survey 2020-2021', British Chamber of Commerce in China, December 2020.

2 'Administrative Measures on the Reporting of Large-Sum or Suspicious Transactions by Financial Institutions', People's Bank of China, July 2017.

3 'SAFE Deputy Administrator and Press Spokesperson Wang Chunying Answers Media Questions on External Debt Data at the end of 2020', State Administration of Foreign Exchange, March 2021.

4 'China to Expand Scope and Scale of Outbound Investment Schemes', CGTN, November 2020.

5 'China May Ease Controls on Citizens' Offshore Investments', Caixin Global, February 2020.

6 'Further Facilitating the Coordinated Use of Cross-border Funds by Multinational Companies', State Administration of Foreign Exchange, March 2021.

Nevertheless, difficulties accessing or moving company finances artificially inhibit the competitiveness of foreign firms in China. The most widespread concern is the high administrative costs of cross-border money transfers, caused by complex processes and rigid requirements for supporting documents. When companies wish to make remittances to their parent company or pay foreign contractors, they must provide proof of the validity of the transaction, including proof of their legal status and contracts pertaining to the transaction. The time needed to collate and submit the documents is unduly burdensome and can be a considerable drain on resources for small enterprises. Some companies even feel the need to engage consultancies to assist them with this process, preferring to absorb these material costs instead of dealing with the inconvenience of processing transactions. Smaller financial institutions report that the slow approval process for transferring funds to a sister office can create risk if that office is in need of a short-term liquidity injection. These are factors that British businesses do not have to account for in many other jurisdictions, making their China operations comparatively less efficient and less able to coordinate with global offices.

Two layers of taxation on companies making cross-border payments or remittances also add to these efficiencies. The withholding tax, applicable to payments sent to non-resident enterprises with no presence in China as a tax on their China-derived income, effectively stands at 10%. However, some services companies have noted that their remittances are often subject to both Corporate Income Tax and the withholding tax, resulting in an effective double tax and creating confusion with their parent or partner company.

Businesses also report that legitimate transactions can be unexpectedly rejected, constraining cash flow and potentially threatening the survival of smaller enterprises. This may be due to administrative errors made by clients or partners outside of China, who are unfamiliar with the stringent requirements for provision of information when processing payments. A common difficulty is ensuring that the recipient's name is entered exactly as it appears on their Chinese bank account which, although not a legal requirement, is a common policy of individual banks. This may be because banks in their own country have a character limit on company name fields and generally allow for slight variations, as long as the name entered leaves no room for doubt that payment has reached the intended recipient. However, if the recipient's bank account name contains the abbreviation 'Ltd.', for example, transactions in which it is styled as 'ltd' will be rejected by the bank. British businesses appreciate that similarities of company names when using the *pinyin* spelling system can lead to confusion if a spelling error occurs, but also emphasise that the speed at which they can conduct business is often significantly reduced. Issuing national guidelines on acceptable variations in the recipient's name in transactions could be one solution that increases flexibility while also preserving failsafe mechanisms against incorrect payments.

More generally, developing stronger communication channels between SAFE and market entities would allow companies to quickly understand the reasons for a transaction's failure and the method in which it can be corrected. Companies report that it can be difficult to reach SAFE on their hotline, limiting their ability to resolve specific or uncommon problems. Furthermore, considerable regional variation in the interpretation of regulations confuses businesses and inhibits their ability to operate efficiently, which can result in much greater difficulties for those that operate more than one office across China. Both the central office and the Shanghai branch of SAFE have issued a 'Q&A' document that companies find particularly helpful.[7] The adaption of this document by other regional SAFE branches would be of use to businesses across the country, and would also reduce the administrative burden on SAFE in the long-term.

As China continues to issue more policies in conjunction with its vision for economic development in the next five years, greater facilitation of inbound and outbound capital flows must be high on the agenda. Under its outline for the Dual Circulation System, the 14th Five-Year Plan highlights an aim to create balanced development of inbound and outbound investment.[8] As Chinese firms continue to 'go out' and develop their business in other markets, greater freedom for foreign companies to share capital with their China offices is vital to maintaining this balance.

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7 'Policy Q&A', State Administration of Foreign Exchange, April 2020 and 'Special Services', State Administration of Foreign Exchange, March 2019.

8 'Outline of the Objectives of the 14th Five Year Plan and Long-term Vision for 2035 for Economic and Social Development', National Development and Reform Commission, March 2021.

COMPETITION WITH STATE-OWNED ENTERPRISES

The direction of state-owned enterprise (SOE) reform, as laid out in the 14th Five-Year Plan and other key policy documents, is ambiguous. The Plan simultaneously calls for the improvement of market conditions for privately-held firms and for a drive to make SOEs 'stronger, better and bigger'.[1] However, these aims are fundamentally contradictory. China's SOEs continue to dominate a number of industries, as they enjoy a range of preferential policies that grant them distinct competitive advantages over private firms. Reallocating resources that allow market forces to guide productivity, innovation and competition is essential in order to drive high-quality growth.

China states in its *Government Work Report* for 2021 that all market entities contribute to China's modernisation and should be treated equally.[2] However, this statement is subsequently followed by another pledge that China will deepen its three-year SOE reform and make SOEs 'stronger, better and bigger'. The continued focus on growing SOEs' strength sends contradictory messages about the government's aims and reduces confidence in the prospects for genuine competition in the market.

Foreign companies are rarely able to compete directly with SOEs on a level playing field, owing both to market access restrictions and to the dominance of SOEs in several sectors such as telecommunications, finance, energy and aviation. In some cases, this has in effect created two parallel ecosystems within the overall Chinese economy: one where SOE monopolies have crowded out private investment, and a separate, smaller slice where foreign and domestic firms engage and compete with each other.

China's public procurement processes illustrate the systemic challenges facing British businesses in industries that have a strong SOE presence. Although Article 16 of the *Foreign Investment Law* (FIL) states that FIEs can compete with other domestic firms on an equal footing in bidding for government procurement,[3] contracts are often awarded to the company based solely on the lowest-priced bid, rather than such factors as quality or life cycle. Due to the broad array of financial privileges and benefits they receive, SOEs are naturally afforded a strong price advantage when bidding. More often, however, their advantage lies in greater access to financing from state-owned banks, significant influence in policymaking processes and application approvals, and other such mechanisms.

While China has continued to open up markets by steadily removing sectors from the 'Negative Lists' for private investment and foreign investment, rules continue to

1 'Outline of the Objectives of the 14th Five-Year Plan and Long-term Vision for 2035 for Economic and Social Development', National Development and Reform Commission, March 2021.

2 'Full Text: Government Work Report', State Council, Marchl 2021.

3 'Foreign Investment Law', State Council, March 2019.

favour SOEs. In the case of the financial services sector, the particular requirements for businesses to receive certain licences are such that only large domestic firms — and in particular, large SOEs — can gain approvals, while foreign businesses cannot qualify. Foreign banks must satisfy extremely high locally-held capital requirement thresholds for many licences despite their expertise, size of globally-held assets and proven track record in other markets, while 'Big Four' state-owned banks with large assets are easily able to apply. In the built environment services sector, foreign design firms must partner with local design institutes (LDIs) on bids. A number of these LDIs are state-owned, but generally are able to receive greater policy support, such as more certainty when applying for Grade A design licences or other key approvals.

Businesses urge greater consideration of both visible and invisible barriers that inhibit foreign businesses from fully accessing the market and competing with China's SOEs. Although the government has stated in the *SOE Reform Three-Year Action Plan*, 14th Five-Year Plan and other policy documents that it intends to introduce more competition to the economy, further open up China's key sectors, and improve SOEs' corporate governance and ability to innovate, the previous rounds of reforms that had similar focuses have not resulted in significant progress. There are also concerns that, even if greater market openings take place as promised, foreign businesses will only gain limited share, given the time that SOEs, in particular, have had to establish dominance in these sectors. Establishing a level playing field is vital to enhancing economic efficiency. The government must ensure reform measures are rigorously enforced to bring about meaningful changes in practice.

China cannot achieve its aims to improve the competitiveness, innovativeness and productivity of its SOEs if it continues to distort the market through preferential treatment, shielding them from competition. This not only hampers effective private innovation, but also allows a disproportionate amount of resources to flow into inefficient entities. Reducing the impact of these structural distortions on the market would improve the ability of China to foster a business environment that both nurtures dynamic private enterprise and attracts global ideas and innovations.

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EMPLOYING FOREIGN STAFF

While navigating regulations on employing foreign staff is relatively challenging in normal times, the restrictions on travel imposed under COVID-19 has meant that for many countries it has become significantly more difficult to process applications and bring staff into the country.[1] After visas and work permits were cancelled for all foreign nationals outside of the Chinese mainland in March 2020, many workers have been unable to return to their offices in China. Visa approvals for new staff applying for their first work permit are inconsistent.

As of mid-May, recent policy changes seem to allow UK nationals inoculated with inactive or live attenuated vaccines, irrespective of the vaccine's country of origin, to receive the Health Declaration Form necessary for visa applications.[2] This potentially creates a path for businesses in China to bring employees with British passports back to the country, but it seems to preclude those returning who have received adenovirus vectored vaccines, which have been widely distributed around the UK. Furthermore, companies report having challenges ensuring that foreign nationals with reinstated and valid work permits receive the 'green health code' needed to re-enter China. For new hires, the slow issuance of Work Permit Notices needed for work permit applications is creating significant uncertainty, particularly for industries that are time-sensitive, such as education.

Furthermore, whilst changes to the Individual Income Tax regime at a broad level reduce the tax burden and provide more clarity around tax reductions, there is significant concern that the loss of certain deductibles will disincentivise British and other foreign talent from considering postings in China. This has significant implications both for China's ability to fully facilitate innovative forces in its market by attracting a diverse range of talent and ideas, and for the attractiveness of the business environment relative to those of other countries.

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ALIGNMENT WITH INTERNATIONAL STANDARDS

China is playing an increasingly prominent role in its involvement in international standards-setting, particularly following a policy drive started in 2015. It has grown both its membership of and its active participation in international standards-setting organisations. The Standardisation Administration of China (SAC) has a Memorandum of Understanding with the British Standards Institute on the recognition of voluntary standards in business and industry,[3] and has adopted 3,500 international standards set by the International Standards Organisation and the International Electrotechnical Commission over the past year.[4]

Alignment on international standards is a strong area for cooperation and there has been positive movement in some areas, in tandem with mutual recognition of testing processes and certificates. In March 2021, China allowed general cosmetics that have not been tested on animals to enter the market, as long as a certificate of compliance with Good Manufacturing Practices has been issued by the country of origin and safety assessment results are provided.[5]

However, challenges around complying with many standards applicable to products sold in China create barriers

1 'British Business in China: Sentiment Survey 2020-2021', British Chamber of Commerce in China, December 2020.

2 'Supplementary Notice on HDC Application from Passengers Who Have Been Vaccinated, Have an Infection Record or Are Close Contacts of COVID-19', Chinese Embassy in the UK, May 2021.

3 'BSI Extends Agreement with Standardisation Administration of China', British Standards Institution, June 2019.

4 'National Public Service Platform for Standards Information', State Administration for Market Regulation, May 2021.

5 'Administrative Regulations for the Registration and Filing Information for Cosmetic Products', National Medical Products Administration, February 2021.

to market entry for foreign manufacturers. Standards for equipment or machinery associated with nuclear energy production in China are diverging from international standards. Approvals for the use of these products are increasingly based on a track record of meeting technical requirements established by China's Generation III nuclear power plants but, as these do not currently align with standards in the UK, greater exploration of alignment or equivalence would be of benefit. Similarly, 'voluntary' standards in the consumer goods industry are in reality mandatory, as they are included in market surveillance processes for mandatory standards. As such, companies are liable to penalties if their products are not compliant.

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ENFORCEMENT OF LAWS AND REGULATIONS

Policy directions to further open market access and improve the business environment, such as legislation that strengthened protection of intellectual property, are highly beneficial and highly appreciated by British businesses in China. However, challenges ensuring that these laws are fully enforced, different interpretations of certain laws in different provinces and the localisation of certain policies to particular areas all affect companies' competitiveness and ability to provide uniform services across China. This was particularly challenging to navigate during periods of lockdown in China in early 2020, where health and safety measures could vary significantly even in the same district.

Nevertheless, the above situation reflects long-standing difficulties faced by companies. It is found that licence applications may not be processed as quickly as might otherwise be expected due to country of origin of the business making the application. Different ports can have different customs processes, creating confusion for importers and potentially leading to inefficiencies or penalties if they don't anticipate a particular requirement due to their experience at other ports. Inconsistencies between various cities in terms of standards for new energy vehicles (NEVs) and the ability to sell vehicles with 'green licence plates' can create additional hurdles for manufacturers. In Shanghai, for example, even once NEVs have gained China Quality Certification Center approval, manufacturers must undergo additional tests and link their real-time data on battery performance to the server of the local Shanghai government, as well as the national server, in order to access green number plates.

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TAXATION LANDSCAPE FOR FOREIGN FIRMS

There have been a number of developments in China's tax system in the past year. As China continues to develop the Hainan free trade port, certain imported products to Hainan have been exempted from import tax and corporate income tax rate has been capped at 15%. [6] Three planned free trade zones (FTZ) and an upcoming expansion of the Zhejiang FTZ will all feature preferential tax arrangements with the goal to incentivise innovation. [7] As the government also aims to strengthen Beijing's service industry, a work plan released last year announces that the ceiling exemptions in corporate income tax on income gained through technology transfer will rise from RMB 5 million to RMB 20 million (GBP 555,000 to GBP 2.2 million) in certain areas in Zhongguancun Innovation Center.[8]

However, changes to the Individual Income Tax system starting in 2022 are a cause of significant concern. Foreign workers may no longer be able to enjoy six tax-exempt allowances, including expenses for their children's education. This could significantly reduce China's attractiveness as a destination for foreign talent, precluding its ability to attract a diverse range of innovative ideas to the market. Furthermore, businesses may be incentivised to explore options in other countries in Asia with more beneficial policies for foreign employees.

Furthermore, companies in encouraged industries are not necessarily receiving benefits outlined in enacted regulations. In the healthcare sector, for example, foreign-invested hospitals are currently taxed at 25%. According to the *Opinions on Promoting the Sustainable, Healthy and Orderly Development of Private Hospitals*, for-profit private hospitals should be able to enjoy the same tax rate as small-sized enterprises, which currently sits at 20%.[9] However, this policy has yet to be implemented. Regulators should ensure that they are aligned and uniformly implement central policies.

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CUSTOMS REQUIREMENTS

Complex and opaque customs requirements can cause considerable delays and confusion for British importers to China. This is particularly true for manufacturers of food and beverage (F&B) and consumer goods importing completed products from the UK, but it also impacts a broad range of manufacturers and logistics firms. Bureaucratic and unclear processes mean that items may take weeks, if not months, to clear customs, impacting supply chains and timelines and, in some cases of food imports, causing the products to spoil. Other inconsistencies between ports in terms of processes and requirements can disrupt production and sales for certain industries. For example, the automotive sector finds that procedures to import vehicles are much quicker in certain ports than in others. Concerns around the risk of COVID-19 transmission through cold chains has also led to impractical testing requirements, with results from overseas testing centres expiring before the products enter China.

Frequently updated requirements and *guobiao* standards can make it is difficult for companies to comply with the most recent guidelines. Furthermore, labelling regulations

6 'Masterplan for Developing Hainan Free Trade Port', State Council, June 2020.

7 'Notice of the State Council on Masterplans for Developing Beijing, Hunan and Anhui Free Trade Zones and Expanding Zhejiang Free Trade Zone', State Council, June 2020.

8 'Deepening the New Round of Service Industry Opening-up and Comprehensive Demonstration Zone Work Plan', State Council, August 2020.

9 'Opinions on Promoting the Sustainable, Healthy and Orderly Development of Private Hospitals', National Health Commission, June 2019.

for F&B products that are currently in draft form are not wholly aligned, leading to some uncertainty as to what requirements must be followed.[10] Current penalties for non-compliance are significant, but while companies fully understand the need to penalise significant and misleading labelling errors, inconsequential errors can lead to entire batches either being rejected at port or subject to fines, despite the fact that they pose no risk to the consumer. Greater clarity and stronger lines of communication with customs officials would be immensely beneficial.

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OBTAINING BUSINESS LICENCES AND CERTIFICATES

Obtaining business licences and certificates was the second most-improved challenge for British businesses overall last year. This may reflect greater support in approval processes and access to a wider range of licences and certificates for some companies. In the past year, more efficient licence approval processes has been a core element of government drives to improve the business environment,[11] with calls to streamline applications, create 'one-stop' services and quicken approval times. Foreign-invested enterprises in certain sectors have also been granted the ability to apply for a greater range of licences through removal of categories from the *Negative List for Foreign Investment* (FINL).[12]

Nevertheless, the majority of companies have seen no change to this area. Foreign partners in businesses are subject to operational restrictions or equity caps in a range of industries, such as value-added telecoms, as per the FINL. Many types of licences can take months to be approved and can be restrictive when it comes to foreign investment, slowing a company's ability to fulfil new market demands before competitors. Certain licences in financial services require large upfront capital commitments, but foreign companies are prevented from using globally-held assets to fulfil these requirements, artificially raising barriers to entry and limiting their ability to apply compared to domestic companies. Similarly, British game developers face long approval processes to receive an 'International Standard Book Number' for their game. [13]

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10 'Draft Limits for Food Contaminants and 13 Other Draft National Food Safety Standards', National Health Commission, December 2019, and 'Draft Administrative Measures of the Supervision of Foodstuff Labelling', State Administration for Market Regulation, July 2020.

11 'Businesses See Faster, Convenient, and Low-Cost Services', State Council, August 2020.

12 'Negative List for Foreign Investment', Ministry of Commerce, June 2020.

13 Although the ISBN designation originally applied to book publication, China also required mobile games to receive ISBNs for a similar purpose of providing a unique identifier for each game.

TRANSPARENCY AND CONSULTATION AHEAD OF REGULATORY CHANGES

Transparency and consultation ahead of regulatory changes is not necessarily a core concern, but nevertheless impacts around 50% of British businesses in China.[14] In particular, a lack of transparency around new or updated legislation, as well as licencing and procurement decisions can make it difficult for companies to plan their business strategy for China.

In the automotive sector, for example, changes to legislation on emissions standards were made without publishing feedback on comments made by industry participants or reasoning behind some of the changes to the draft standards. Furthermore, while an original grace period of four years before implementation was set out by the central government, some local governments have significantly shortened this period. This placed unexpected pressure on manufacturers to find new technological solutions, which can take years to develop and significant capital expenditure.

This also remains a challenge for certain sectors due to COVID-19 restrictions. Private schools note that ongoing health and safety measures can even vary between private schools in the same district. At the same time, health and safety requirements are not always practical, leading to uneven administrative burdens on different schools. Greater transparency around decision-making and the ability to communicate with regulators to ensure that new guidance is both workable and offers appropriate protection would be of benefit for students, parents and schools.

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INTELLECTUAL PROPERTY RIGHTS PROTECTION

China's intellectual property protection (IP) landscape has continued to improve significantly in 2020. As a result, IP fell from one of the top three challenges for British businesses in 2018 to among the least challenging issues in 2020.[15] The previous edition of this Position Paper highlighted British businesses' call to update *China's Patent Law*[16] and *Copyright Law*.[17] China has since passed amendments to these two laws in October and November 2020 respectively, both of which will take effect in June 2021. They are hugely beneficial, expanding the scope for protection and increasing the civil damages available to rights holders to deter future infringements. In particular, the amended *Patent Law* increases the term of protection for design patents from 10 to 15 years, and provides term extensions to compensate for delays in granting patents. It also strengthens the protection of pharmaceutical IP by establishing a patent linkage regime for innovative drugs. The amended *Copyright Law* broadens the scope of protection by including 'audio-visual works', in line with the emergence of online streaming and short videos. Meanwhile, the new *Civil Code* introduces punitive damages for IP violations,[18] while the newly-amended *Criminal Law* increases prison terms for receiving significant profits from knowingly selling pirated goods.[19]

14 'British Business in China: Sentiment Survey 2020-2021', British Chamber of Commerce in China, December 2020.

15 'British Business in China: Sentiment Survey 2020-2021', British Chamber of Commerce in China, December 2020.

16 'Patent Law', National People's Congress, October 2020.

17 'Copyright Law', National People's Congress, November 2020.

18 'Civil Code', State Council, December 2021.

19 'Criminal Law', National People's Congress, December 2020.

Propelled by China's innovation drive, the 14th Five-Year Plan also makes commitments to improve legal protections for IP. This is welcomed by British enterprises, but subsequent laws must be implemented uniformly at all levels to ensure tangible improvement of the business environment. Some industries continue to face notable IP challenges, particularly education, built environment services, and retail and consumer goods. Digitalisation also necessitates innovative and up-to-date regulatory solutions. Regulations restricting sales of counterfeit goods on social media platforms, for example, are relatively lax. British businesses encourage the government to continue updating its regulations on IP protection, including revision of the *Trademark Law* and the finalisation of *Regulations on Protecting Trade Secrets*, and ensure rigorous enforcement of existing legislation.

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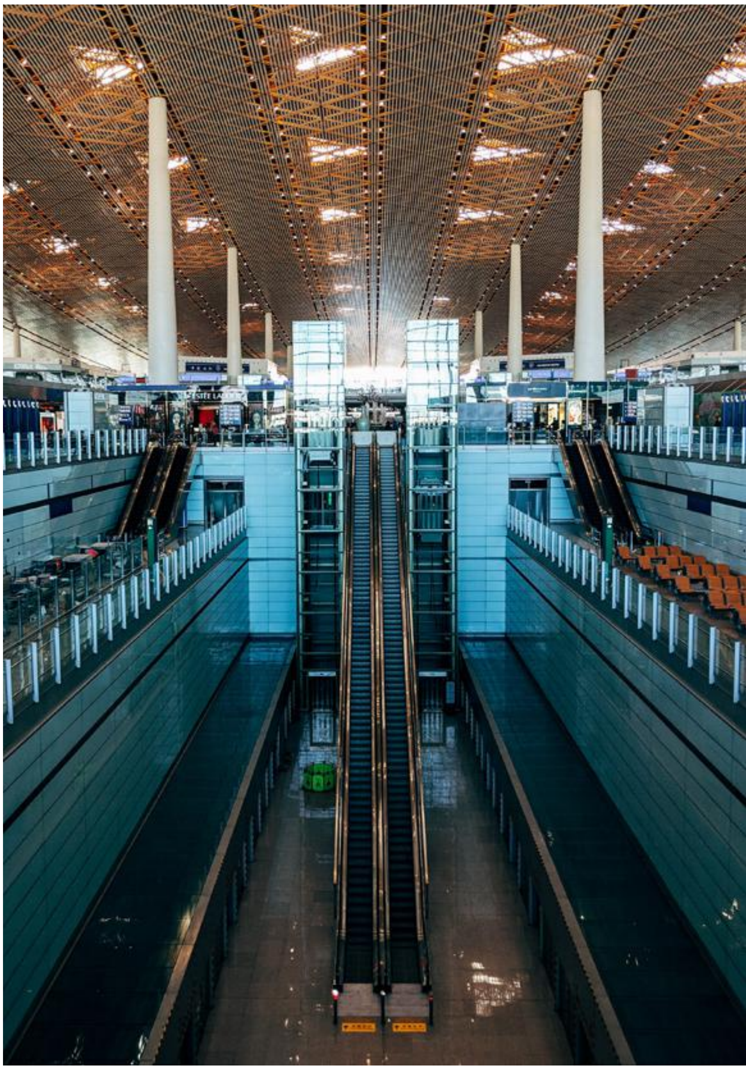
PUBLIC PROCUREMENT POLICY AND PRACTICE

China's procurement regime is governed by the *Government Procurement Law* (GPL) and the *Tendering and Bidding Law*. While the former oversees purchasing activities conducted with fiscal funds by the central and local governments, the latter imposes uniform procedures for certain types of procurement programmes, such as construction and works projects, regardless of the type of entity that conducts the procurement.

As China continues to negotiate its accession to the *World Trade Organisation's Government Procurement Agreement* (GPA), it has accelerated the revision of its legislation regarding public procurement in recent years. In December 2020, the Ministry of Finance (MOF) opened a draft amendment to the GPL for public comment. [20] It continues a previous policy that requires the government to buy 'domestic goods' with only limited exceptions, such as when certain goods, projects or services are not available in China. However, what constitutes 'domestic goods' has long been an area of ambiguity which the State Council has yet to define. The provision prompts concerns that goods and services supplied by foreign-invested enterprises (FIEs) will continue to be discriminated against, in direct contradiction with repeated directives to allow all market entities to participate in public procurement fairly. A circular released in 2019 by MOF explicitly prohibits unfair treatment towards private, foreign and domestic companies in government procurement.[21] The *Foreign Investment Law* also requires national treatment towards FIEs in the procurement process. British businesses hope that the Chinese government will treat foreign companies equally as domestic ones and continue to improve the transparency of bidding processes.



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20 'Draft Public Procurement Law', Ministry of Finance, December 2020.

21 'Circular on Promoting Fair Competition in Government Procurement and Optimising Business Environment', State Council, July 2019.

RECOGNITION OF PROFESSIONAL QUALIFICATIONS

British businesses in China hire from both the local and global talent pool. However, in certain sectors, a lack of recognition of professional qualifications not only makes it difficult for foreign professionals to be employed by foreign businesses in China, but also limits the attractiveness of foreign companies to local employees. The health sector is a case in point where British-qualified nurses have to pass China's nurses exams, which are in Chinese, before they can practise in the country. The lack of clarity on the validity of different degree certifications in China including vocational diplomas and online qualification, such as PGCEi, also discourages schools from hiring foreign teachers. British built environment companies in China are equally affected by a lack of recognition of their credential and expertise, which constrains their ability to hire foreign staff. These restrictions reduce foreign businesses' chances of hiring the best candidates and narrow the scope of services they can provide. It is important that the government increases the recognition of foreign qualifications, which will allow foreign professionals and professional services firms to bring a diverse range of skills and knowledge to the Chinese market.

Recommendations on page 47.

EMPLOYING LOCAL STAFF

Although measures put in place to control the spread of COVID-19 created human resources challenges in China in early 2020, the relatively short lockdown period has allowed the situation to normalise. By late February 2020, only 16% of British businesses in China reported labour shortages,[22] and subsequent short lockdowns throughout 2020 did not cause further concerns.

British companies are largely unaffected by regulations in regards to local staff. For those that are, however, they have not seen any significant changes to the policy environment over the past year. Revisions to the Individual Income Tax regime do not particularly change considerations for employers in terms of staff that are Chinese nationals. The government has also announced adjustments to payment of medical insurance,[23] but this has no reported negative impact on British firms.

Nevertheless, challenges exist in particular around contracted labour. Companies report that contractors sometimes request payment before work has been completed, despite the deliverables being clearly stipulated in the labour contract. Individual arbitrators are able to override contractual agreements without proper recourse for businesses, particularly at lower levels of government. This creates significant uncertainty in the business environment, undermining China's attractiveness as an investment destination. Furthermore, a ruling in favour of contractual workers may require businesses to settle a dispute in cash within a short period of time – in some cases on the day of the ruling. This can be extremely difficult to fulfil both for both small- and medium-sized enterprises, which have smaller balance sheets, and for foreign companies, which may have to navigate foreign exchange controls on inbound remittances.

Recommendations on page 47.

22 'British Business in China: The Impact of COVID-19', British Chamber of Commerce in China, February 2020.

23 'China to Improve Employee Basic Medical Insurance', State Council, April 2021.

RECOMMENDATIONS

REGULATORY CHALLENGE	RECOMMENDATION
Navigating cybersecurity and IT restrictions	▪ Ensure that the final iteration of the implementing rules under 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. ▪ Expedite the publication of the *Data Security Law*, providing greater detail on the definition of 'important data', the regulators responsible for national security considerations, the requirements for individuals managing cybersecurity compliance within an organisation, and other matters of interest to foreign businesses. ▪ Expedite the publication of the *Personal Information Protection Law*, providing greater detail on the regulators responsible for enforcing compliance, and the potential penalties for non-compliance. ▪ Establish a clear and transparent boundary for rights of access to company IT systems for both the authorities and third parties in the case of a security assessment, security breach, or general investigative powers. ▪ Ensure that all entities designated as CIIO are able to uphold the concept of non-discrimination between domestic and foreign companies. ▪ Make the approval process for VATS licences more transparent and open to foreign operators.

REGULATORY CHALLENGE	RECOMMENDATION
Accessing and moving company finances	▪ Provide clearer parameters for the types of products businesses cannot purchase from overseas. ▪ Encourage provincial and municipal branches of SAFE to issue their own Q&As to address common enquiries from businesses. ▪ Reduce the complexity of cross-border remittance processes, particularly regarding the number of supporting documents required for smaller transactions. ▪ Expand effective pilot programmes to cover all multinational firms. ▪ Work with banks to create national guidelines on acceptable variations of a recipient's name when processing bank transactions. ▪ Provide clearer parameters for the types of products businesses cannot purchase from overseas. ▪ Reduce the withholding tax rate.
Competition with SOEs	▪ Implement commitments to open up more key sectors to private investment. ▪ Improve the efficiency of the Chinese economy by ensuring free competition between all market entities. ▪ Ensure that the principle of competitive neutrality is rigorously enforced by identifying and removing both explicit and invisible barriers that grant SOEs a competitive advantage over foreign companies.
Employing foreign staff	▪ Ensure that vaccinated foreign nationals are able to reliably and consistently receive visas to re-enter China. ▪ Ensure that individual income tax regimes include similar incentives to previous regimes.

REGULATORY CHALLENGE	RECOMMENDATION
Alignment with international standards	▪ Continue to address areas in which standards in China are not aligned with standards followed by British companies. ▪ Ensure that different provinces across China adopt consistent standards.
Enforcement of laws and regulations	▪ Encourage consistent implementation of legislation that affects foreign businesses across regional jurisdictions.
Taxation landscape for foreign firms	▪ Consider the negative impact of the cancellation of the tax-exempt allowances on foreign investment and retain certain preferential tax arrangements to attract foreign talent. ▪ Expand the scope of tax incentives to cover more industries. ▪ Increase coordination between different tax authorities in order to reduce administrative costs for businesses.
Customs requirements	▪ Consult with British businesses more frequently when formulating requirements, and provide more notice to businesses when standards change. ▪ Ensure that customs processes and rules are applied consistently across ports in China. ▪ Streamline customs approvals processes. ▪ Create stronger mechanisms to communicate with regulators in the event of difficulties.
Obtaining business licences and certificates	▪ Ensure that applications for business licences made by foreign and domestic companies are treated equally. ▪ Provide detailed feedback if a business's application for a licence is rejected. ▪ Continue to reduce the number of sectors on the 'Negative Lists', with the aim to remove all sectors in the long-term.

REGULATORY CHALLENGE	RECOMMENDATION
Transparency and consultation ahead of regulatory challenges	▪ Ensure that changes to legislation properly account for the time needed to ensure compliance with new measures. ▪ Engage businesses at all stages of formulating or updating policies in order to optimise business environment.
Intellectual property rights protection	▪ Continue to improve legal protection of intellectual property. ▪ Ensure uniform implementation of notably beneficial legislation passed recently, including the Copyright Law and the Patent Law.
Public procurement policy and practices	▪ Ensure that pledges made in the Foreign Investment Law to grant equal treatment to foreign and domestic enterprises in government procurement are fully implemented. ▪ Make sure the revised Government Procurement Law and Tendering and Bidding Law do not discriminate against foreign invested companies.
Recognition of professional qualifications	▪ Work towards signing mutual recognition agreements between British and Chinese qualification bodies across the services industries.
Employing local staff	▪ Provide companies with effective recourse mechanisms when an individual arbitrator overrules the terms of agreements between companies and contractors. ▪ Allow companies a longer grace period to pay settlements.


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INDUSTRY REPORTS

ACCOUNTING

AT A GLANCE:

SUB-SECTORS:

Accounting firms

Qualification organisations

KEY CHALLENGES:

- Lack of mutual recognition of British and Chinese qualifications
- Limitations on non-CICPA ownership
- Blacklisting of accountants through the Social Credit System

KEY RECOMMENDATIONS:

- Explore signing Mutual Recognition Agreements between CICPA and British accounting bodies
- Explore easing the ability of British non-CICPA professionals to become partners of accounting firms in China
- Remove requirements for individual accountants to provide their personal identification to accounts to eliminate the risk of being blacklisted, and entrust the relevant accounting bodies to govern the conduct of accountants

KEY MUTUAL OPPORTUNITIES:

- Business and advisory services
- Training and provision of talent
- Technology in accounting services

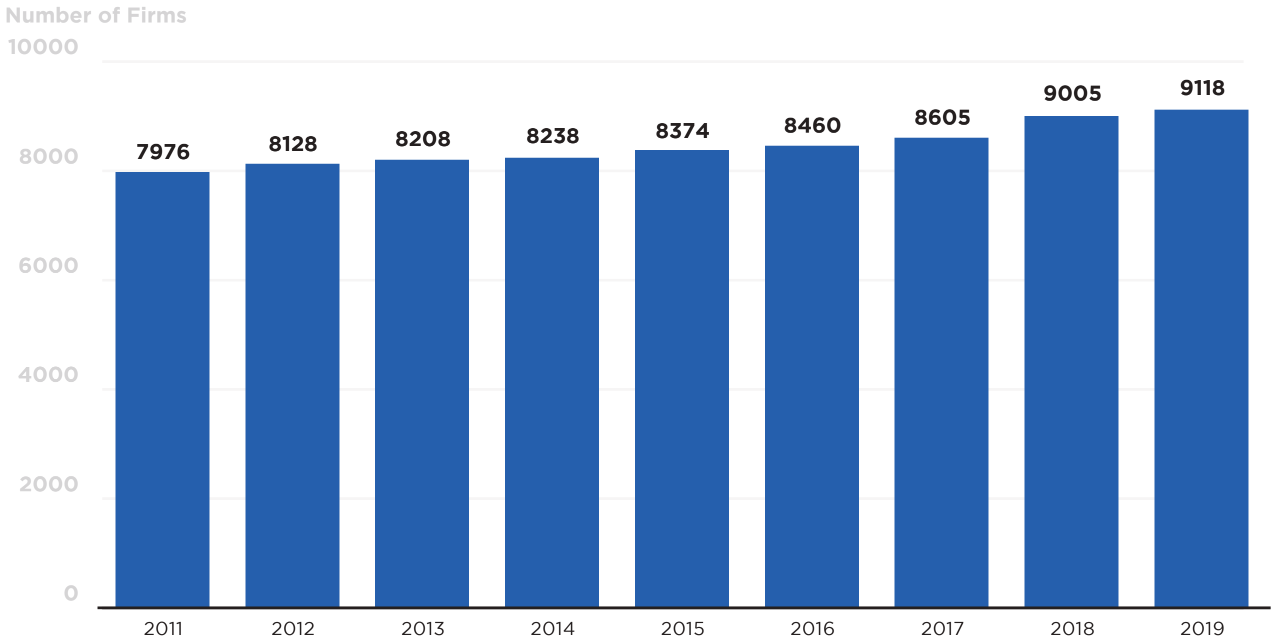
STATE OF THE SECTOR

As interest in strengthening corporate governance and stabilising the financial system grows in China, the role of the accounting sector is critical to further improving the business environment in the country. According to the draft *Development Plan for China's Accounting Sector (2021-2025) (the draft Development Plan)* published by the Chinese Institute for Certified Public Accountants (CICPA), at the end of 2020, there were over 9,800 accounting firms (1,200 of which were branches) and over 110,000 certified public accountants operating in China, providing services to more than four million organisations. In 2019, the sector recorded a total revenue of GBP 12.3 billion (RMB 111 billion).[1]

China's accounting profession has experienced a rapid development since the 1980s, when the country began to open up to the world.[2] In 1992, Big Four firms were granted the right to audit and began providing accounting services in China through joint ventures (JVs). As China lacked experience and talent in developing its accounting sector, the Big Four immediately established a dominant presence in the country. After nearly two decades, the Chinese government published the *Opinions on Accelerating the Development of China's Accounting Sector* in 2009, which recommended localising China's accounting profession and supporting indigenous accounting firms.[3] In 2012, as the Big Four's JV licenses were expiring, a more detailed scheme on localisation was released by Ministry of Finance (MOF) where the Big Four were required to restructure into Special General Partnerships (SGPs) and cap their non-CICPA partners at 20% by the end of 2017.[4] Over the past few decades, indigenous accounting firms in China have grown in strength, but the Big Four still rank among the top five firms in terms of revenue.[5]

Number of accounting firms in China from 2011 to 2019

Source: Chinese Institute of Certified Public Accountants (CICPA)



1 'Draft Development Plan for the Accounting Sector (2021-2025)', Chinese Institute of Certified Public Accounts, March 2021.

2 'The Big Four in China: Hegemony and Counterhegemony in the Development of the Accounting Profession in China', Paul L. Gillis, June 2011.

3 'Opinions on Accelerating the Development of China's Accounting Sector', State Council, October 2009.

4 'Notice of Issuing the Scheme of Localising Chinese-Foreign Cooperative Accounting Firms', Ministry of Finance, May 2012.

5 'Top 100 Accounting Firms with Highest Revenues in 2017', Chinese Institute of Public Certified Accountants, May 2018.

The draft *Development Plan* released in March 2021 outlines the government's vision of how the sector should be developed over the next five years. It sets out goals to enhance the quality and specialisation of China's accounting firms, put equal emphasis on traditional value-added services as well as auditing and assurance, fully digitise the sector and help Chinese accounting firms 'go out' into third markets.[6] It recognises the need to strengthen the international competitiveness of China's accounting sector by cultivating more talents with international working experiences and creating national champions in accounting. Similarly, China also states in both its 14th Five-Year Plan[7] and an earlier plan to develop trade in services[8] that it aims to promote the international development of its service industries, including financial, business advisory, accounting and legal services. However, specific measures for the accounting sector have yet to be released.

The involvement of foreign professionals and businesses in the Chinese market has in the past played an indispensable role in building China's accounting sector, and foreign firms should be encouraged to expand their operations in the Chinese market in order to contribute to further development and innovation in the sector. The UK has a strong reputation for excellence in accounting, and is home to a number of widely recognised qualification bodies and global accounting firms, with 17 of the top 20 global accounting firms headquartered in the UK. Engagement with UK accounting qualification bodies and professionals in this area will complement China's drive to strengthen its service industry including its accounting sector and enhance its international competitiveness.

6 'Draft Development Plan for the Accounting Sector (2021-2025)', Chinese Institute of Certified Public Accounts, March 2021.

7 'Outline of the Objectives of the 14th Five Year Plan and Long-term Vision for 2035 for Economic and Social Development', National Development and Reform Commission, March 2021.

8 'General Pilot Programme for Comprehensively Deepening the Innovative Development of Trade in Services', State Council, August 2020.

REGULATORY CHALLENGES

1 LACK OF MUTUAL RECOGNITION OF BRITISH AND CHINESE QUALIFICATIONS

A key concern of accounting firms and bodies is the lack of recognition of accounting qualifications between the UK and China. Although CICPA and the Institute of Chartered Accountants in England and Wales (ICAEW) signed a mutual exam exemption agreement in 2008 and have collaborated on joint training and qualification programmes over the years,[9] there is scope to deepen cooperation and bring about mutual recognition of accounting qualifications between the two countries. This would be beneficial for firms from both countries as it would allow both British and Chinese accountants to become members of the equivalent body and operate more efficiently in the other country, without needing more time to pass additional CPA qualification exams. Moreover, a reciprocal agreement to translate the CICPA exam into English and vice versa could facilitate the ability of accountants to become CPAs in the other jurisdiction.

The cooperation between China and Hong Kong in professional services could serve as a blueprint for the future cooperation between China and the UK in the accounting sector. China and Hong Kong first signed a mutual examination paper exemption agreement in accounting in 2004 as a subsequent agreement under the *Closer Economic Partnership Agreement* (CEPA), and have since expanded the scope of exam exemptions. The two sides further signed the *Agreement on Economic and Technical Cooperation (Ecotech Agreement)* in June 2017, which covers cooperation in accounting, including improving mutual exemption mechanisms for certain papers and deepening the convergence of accounting and auditing standards.[10] In November 2015, under the CEPA, China and Hong Kong also agreed to further open up their services market and signed the *Agreement on Trade in Services*.[11] This introduced new liberalisation measures in various service sectors, including legal and accounting services. These arrangements show the feasibility of aligning provision of professional services across jurisdictions with different regulatory frameworks, and could be made applicable to a firms from a broader range of countries. As China continues to explore ways to improve its trade in services, both sides could benefit from enhancing their cooperation in accounting with possible measures ranging from expanding joint training programmes between qualification bodies, increasing scope for examination exemptions to signing a mutual recognition agreement of accounting qualifications.

2 LIMITATIONS ON NON-CICPA FIRM OWNERSHIP

In the UK, up to 50% of a CPA firm's shareholders can be non-CPAs,[12] which permits Chinese nationals who are not chartered accountants to serve as partners in a British CPA firm and own shares. In China, however, accountants with foreign qualifications are more restricted on their ability to become partners in accounting firms. As China tries to further develop the non-audit services of its accounting sector, it is important to allow accountants that follow different disciplines and have different skillsets to become partners. For example, management accounts are specialised in company metrics, forecasting, company improvement and investment management. Their expertise is important for developing accounting firms' advisory businesses. The Beijing National Accounting Institute, the certification body of Certified National Management Accountant, has exam exemption arrangements with UK professional bodies, but expanding this to full mutual recognition between qualification bodies of the two countries would enhance knowledge-sharing and the development of both countries' industries. Bringing a diverse mix of knowledge and experience to the market through international exchange would generate

9 'Overview of the Accountancy Profession of China', Chinese Institute of Certified Public Accountants, June 2018

10 'Agreement on Economic and Technical Cooperation under the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA)', Trade and Industry Department of the Government of HKSAR, June 2017

11 'Consolidated Version of Agreement on Trade in Services under the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA)', Trade and Industry Department of the Government of HKSAR, November 2019

12 'Regulations Governing the Use Of the Description of Chartered Accountants and ICAEW General Affiliates', ICAEW, June 2017.

Five Goals listed in the Draft Development Plan of China's Accounting Sector (2021-2025)

Cultivate the professionalism of accountants and the accounting industry.

Standardise accounting principles, regulations and oversight of the accounting industry.

Improve China's participation in international accounting practice and the establishment of international standards.

Develop high quality firms that lead the global competitiveness of China's accounting industry.

Promote digitalisation in the accounting industry.

significant resources in China's further development of the international competitiveness of its accounting industry.

3 BLACKLISTING OF ACCOUNTANTS THROUGH THE SOCIAL CREDIT SYSTEM

British accounting firms continue to express concern about the potential for accountants to be blacklisted under China's Social Credit System. The system, through its various fragmented local system and pilot programmes, attempts to create a platform for users to assess the trustworthiness of entities in China by monitoring the behaviour of individuals, companies and government bodies, providing an assessment through ratings systems established by regulators and compliance records. Against this background, the MOF released the draft *Administrative Measures for the Blacklisting of Accounting Personnel in Serious Violation of the Law and in Breach of Trust* in September 2019 which, if ratified in its current form, will have particular implications for the accounting sector. Whereas lawyers can be protected under legal professional privilege, accountants do not enjoy such protections. Accountants would strongly prefer to be registered under the company's name, but the draft measures require them to list their own name and identification. It also states that accountants found to have engaged in criminal acts, such as providing false financial and accounting reports, forging or altering accounting books or embezzling public funds, will be subject to administrative punishment and blacklisted for five years.[13] This is reasonable in principle, but there are concerns around the strength of the training provided to those regulating this policy. Accounting relies heavily upon the technical knowledge of qualified accountants. Some officials may not necessarily have sufficient experience of the profession to determine whether an accountant has carried out misconduct, and in the regulations there is no clarity on what recourse accountants have to defend their name and reputation. The conduct of accountants should therefore remain under the governance of their respective professional body, which are better versed in the complexities and nuances of the profession. Additionally, while company law covers the responsibilities of directors, expanded legislation to cover fiduciary duties of directors and their role in the running of a company versus that of accountant would be welcome.

4 INCONSISTENT INTERPRETATION OF REGULATIONS

Loosely defined regulations that cause inconsistencies of interpretation by government officials and accountants from region to region can incur significant costs on British accounting firms in China. This is an issue in many industries and is particularly prevalent in accounting, where misinterpretation of a particular law could be viewed as non-compliant behaviour and can incur severe financial penalties. Travelling back and forth to various tax offices in order to clarify regulations is highly time consuming, and some firms have estimated that the time spent doing so roughly accounts for 10-20% of the costs that they charge clients. These additional costs similarly impact Chinese accounting firms, as well as other businesses in the wider economy as fees are passed onto client firms. As part of the drive to further improve China's business environment and develop its services sector, British accounting companies hope that well-defined regulations and consistent policy implementation will continue to be a priority for policymakers going forward.

5 CYBERSECURITY AND IT RESTRICTIONS

British accounting firms are further inhibited by restrictions on access to corporate technology platforms in China. Cloud and remote access solutions are becoming increasingly popular among accounting firms globally. The inability of British accounting companies to access restricted technology solutions, such as cloud-based services, to share resources and collaborate across offices hinders international business interactions and isolates companies' China operations. British businesses hope that regulators can consider lifting restrictions on non-sensitive business software, applications and tools used by international businesses, and encourage more use of paperless accounting and reporting.

13 'Draft Administrative Measures for the Blacklisting of Accounting Personnel in Serious Violation of the Law and are in Breach of Trust', Ministry of Finance, September 2019.

RECOMMENDATIONS

	REGULATORY CHALLENGE	RECOMMENDATION
1	**Lack of mutual recognition of British and Chinese qualifications**	▪ Explore expanding the scope of examination exemptions or signing Mutual Recognition Agreements between CICPA and British accounting qualification bodies.
2	**Limitations on non-CICPA firm ownership**	▪ Address the challenges that non-CICPA professionals face when becoming partners of accounting firms in China. ▪ Remove ceilings on minority ownership of CICPA firms for non-CICPA individuals.
3	**Blacklisting of accountants through the Social Credit System**	▪ Remove requirements for individual accountants to link their personal identification with a corporate SCS account, and entrust the relevant accounting bodies to govern the conduct of accountants. ▪ Expand legislation to cover fiduciary duties of directors and their role in the running of a company as opposed to that of the accountant.
4	**Inconsistent Interpretation of Regulations**	▪ Ensure that policies are uniformly implemented to remove discrepancies in the interpretation of accounting standards and regulations.
5	**Cybersecurity and IT Restrictions**	▪ Consider lifting restrictions on non-sensitive business software, applications and tools used by international businesses, and encourage more use of paperless accounting and reporting.

MUTUAL OPPORTUNITIES

BUSINESS ADVISORY SERVICES

Accounting firms across the globe are continuing to provide innovative business advisory solutions as well as traditional auditing and assurance services. Advisory services are widely viewed as offering higher margins and lower risks, which accounting firms naturally find naturally find more attractive. The CICPA has also recognised the importance of developing China's non-audit services and since 2010, formulated a series of guiding documents, including *Opinions on Implementing the Strategy of Developing Non-Audit Services*.[14] Although the whole accounting industry is experiencing some level of digitalisation globally, the role of human talent will remain apparent in business advisory services. Foreign firms and partners can contribute their own knowledge and capabilities to support a better delivery of business advisory services in China's accounting sector, making it more competitive and bring clients better value.

TRAINING AND THE PROVISION OF TALENT

A sharp increase in the number of qualified and experienced accountants is needed to satisfy the growing demand for business advisory services in China. The opportunity to provide business advisory is dependent on the availability of talented accountants with practical business experience, which the draft *Development Plan* states as one of the core priorities for regulators. To help Chinese accounting students and trainee accountants holistically understand the challenges their future clients will face, many qualification bodies are already working with universities to embed their courses into accounting, finance and other curriculums. British accounting qualification bodies' strong experience in training a global cadre of accountants would complement China's shift to a more service-based economy and provide more resources for the development of its accounting sector.

TECHNOLOGY IN ACCOUNTING SERVICES

As in many other countries, the accounting industry in China is becoming increasingly digitalised, using cloud accounting software, artificial intelligence, big data and other new tools to expand or improve firms' services. A survey conducted by Shanghai National Accounting Institute finds that cloud accounting, e-invoicing, big data technology, digital files and robotic process automation (RPA) are seen as having the most significant impact on the future accounting profession in China.[15] However, the level of digitalisation has room for growth and the government has included the goal to further digitalise its accounting industry in its draft *Development Plan*. China could benefit from increased engagement and collaboration with other countries in this area to accelerate the trend of digitalisation in accounting. However, these technologies in their current forms have limitations. For example, although companies around the world are exploring ways to apply artificial intelligence (AI) more widely in accounting, AI technologies are more likely to be useful in standard accounting services such as tax preparation, payroll and audits. The demand for value-added business advisory services that is reliant on human intelligence and judgement will help alleviate the threat to jobs from automated accounting, as business advisory is an area that is difficult to replicate with AI.

14 'Overview of the Accountancy Profession of China', Chinese Institute of Certified Public Accountants, June 2018.

15 'Evolving Trends in China's Accounting Landscape', Financial Management, December 2020.

AUTOMOTIVE

AT A GLANCE

SUB-SECTORS

Original equipment manufacturers

Automotive components suppliers

KEY CHALLENGES

- Lack of clarity and consistency around NEV development policies
- Burdensome customs requirements
- Restrictions on ICVs

KEY RECOMMENDATIONS

- Make national sales targets in the NEV Development Plan optional for OEMs, and implement a mechanism to review sales growth annually and adjust incentive policies according to market demand
- Permit the mutual recognition of certifications by accredited test centres in the UK and China to remove the requirement of retesting at port of entry
- Remove the equity cap on investment into ICVs and permit foreign businesses to offer VATS as a WFOE

KEY MUTUAL OPPORTUNITIES:

- Robust demand for premium and luxury vehicles

STATE OF SECTOR

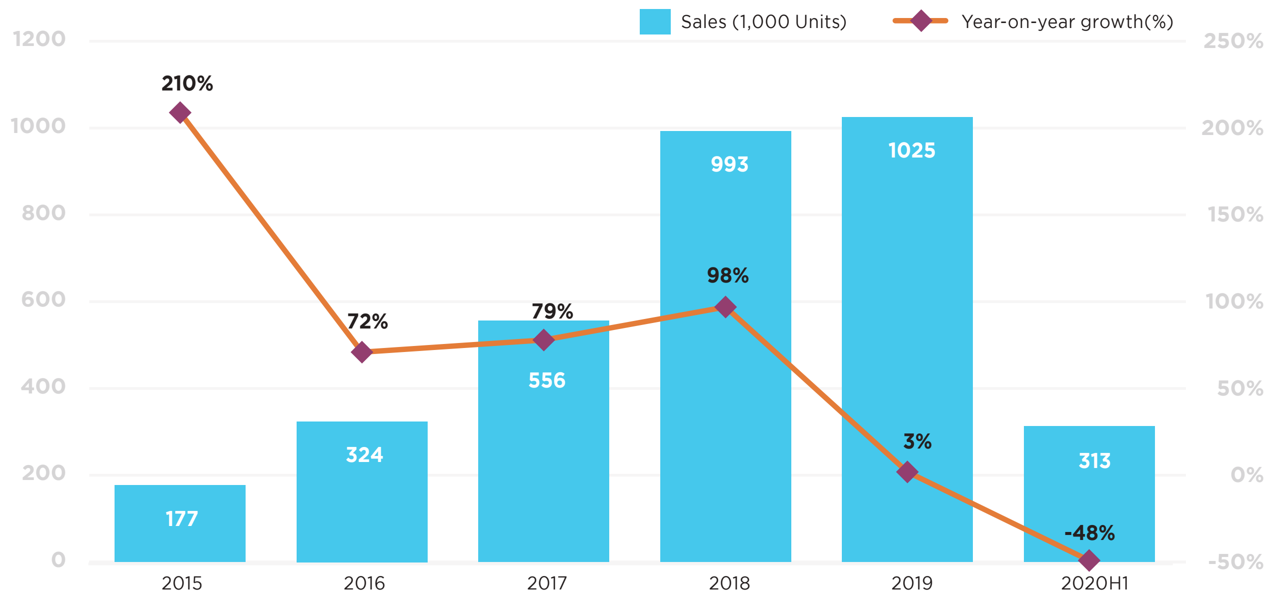
The car industry is a leading force behind the British economy, contributing GBP 15 billion (RMB 135 billion) value added and providing 864,000 jobs across the industry to the UK economy. With eight out of every ten cars manufactured in the UK exported worldwide, the industry is also a vital contributor to the UK's global exports.[1] Road vehicles are the UK's third largest goods export to China, worth GBP 3 billion (RMB 27 billion) and representing 13% of total goods exports to China, down from 19% the previous year.[2]

While the UK's motor industry has been devastated by COVID-19 and is expected to be significantly impacted by the UK's departure from the European Union, China's domestic car market showed signs of a strong recovery in the second half of 2020, both regarding internal combustion (ICE) vehicles and new energy vehicles (NEVs). Sales picked up again in July 2020 following an extended slump in car sales from June 2018, leading to only a 2% drop for the year as a whole.[3] The industry may grow by as much as 4% in 2021.[4] China remains the world's largest automotive market and, as other major economies continue to be heavily impacted by the pandemic, foreign original equipment manufacturers (OEMs) will likely increase their reliance on the China market as a source of global growth. British OEMs report that China contributes between 10% and 25% of their total global sales, and this is likely to rise in the coming year as much of the rest of the world remains in lockdown.

China's automotive industry has shown continued progress over the past year in further opening up to foreign manufacturers and moving towards a new model of sustainable mobility. As part of a broad revision to the *Negative List for Foreign Investment* in July 2020, the authorities removed equity caps for OEMs manufacturing commercial vehicles in China and limits on the number of domestic partners with which foreign manufacturers can enter into joint ventures (JVs).[5]

Sales and growth rates of China's New Energy Vehicles

Source: China Passenger Car Association (CPCA), Hengda Research Institute



1 'SMMT Motor Industry Facts 2020', Society of Motor Manufacturers and Traders, June 2020.

2 'Statistics on UK Trade with China', House of Commons Library, July 2020.

3 'Winners and Losers in the 2020 Global Car Market', Autocar, February 2021.

4 'Chinese Auto Recovery On Track as Vehicle Sales Rise for Ninth Month', Reuters, January 2021.

5 'Equity Cap in Commercial Vehicle JVs to be Removed', State Council, June 2020.

Several notable regulatory developments to stimulate domestic autonomous driving capabilities have also been released. In June 2020, the Ministry of Natural Resources and the Ministry of State Secrets announced an easing of restrictions on high-precision mapping used in autonomous driving technology. The amendments expand the commercial use of certain geographic information including road gradients, curvature and texture, which were previously classified as state secrets and were prohibited to be collected for commercial use.[6]

The Ministry of Transport has further issued guidance on promoting the application of autonomous driving technologies, which aims to achieve key breakthroughs in areas such as integrated sensing systems, smart roadside inspection systems and smart infrastructure.[7] In last year's Position Paper, British automotive companies called for a single national permit for autonomous driving testing. The Ministry of Industry and Information Technology (MIIT) has since revised the previous 2018 regulations and streamlined the process for autonomous driving tests, permitting companies with a licence to test in one pilot city to transfer it to test in other cities, removing the burdensome requirement that OEMs must apply for a separate licence for each city.[8]

The government has similarly continued to drive the development of the NEV sector as part of a broader push towards greater sustainability. Since MIIT released the initial draft *New Energy Vehicle Industry Development Plan (2021-2035)* in December 2019, a final draft has since been issued which revised sales targets for NEVs to 20% of all new automotive sales by 2025 (down from 25% in the first draft), and 80% of new automotive purchases by the public sector, including buses and taxis, starting in 2021 (down from 100%). The final version of the plan additionally removed an initial goal that intelligent connected vehicles (ICVs) would make up 30% of new car sales by 2025.[9] Such revisions are welcome by the British automotive community, as they should allow the market to develop at a more natural rate rather at the expense of stringent supply-side policies.

Despite the impact of COVID-19 and the subsequent extension of subsidies for NEVs to stabilise the sector, the Chinese authorities have maintained their position of seeking to gradually reduce the reliance of OEMs on government support and allowing the market to "play a decisive role in resource allocation".[10] Following the announcement that NEV subsidies and purchase tax exemptions would be extended until 2022, the Ministry of Finance has since clarified that subsidies would be cut by 10% in 2020, 20% in 2021 and 30% in 2022. This has since been reaffirmed, although subsidies for new energy buses and taxis will be reduced by 10%.[11]

The future development of the automotive industry has significant implications both for the government's aims to retain a degree of industrial self-sufficiency, upgrade domestic consumption and to achieve carbon neutrality by 2060. As such, several policies are outlined for the sector in the 14th Five-Year Plan.[12] The production of cars, and NEVs in particular, will continue to receive government support as part of a push to upgrade core competitiveness in manufacturing and reduce China's carbon emissions. The government expects breakthroughs in high-security EV cells, high-efficiency drive motors and high-performance power systems for NEVs, as well as accelerated R&D of key components such as basic technology platforms, software and hardware systems, wire-controlled chassis, intelligent terminals for ICVs and further development of the Internet of Vehicles. Consumer-focused application of Beidou satellite navigation systems will also be encouraged. The Plan also plans to switch consumption of cars from a 'management of purchase' to a 'management of usage' model. While there is no agreement within the industry what these terms mean, one interpretation is that the policy landscape will shift from focusing on situations where one user has full ownership of one vehicle to considering situations where multiple users might rent one vehicle.[13] However, no details on the concrete policies behind this shift are provided in the Plan itself.

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6 'Provisions on the Scope of State Secrets in the Administration of Surveying and Mapping Geographic Information', State Council, June 2020.

7 'Guidance on Promoting the Development and Application of Autonomous Driving Technology on Roads', Ministry of Transport, December 2020.

8 'Administrative Rules on Intelligent Connected Vehicle Road Testing', Ministry of Industry and Information Technology, January 2021.

9 'New Energy Vehicle Industry Development Plan (2021-2035)', Ministry of Industry and Information Technology, October 2020.

10 'Premier Urges Building National NEV Market', State Council, October 2020.

11 'Notice on Further Improving the Fiscal Subsidy Policy for the Promotion and Application of New Energy Vehicles', Ministry of Finance, December 2020.

12 'Outline of the Objectives of the 14th Five Year Plan and Long-term Vision for 2035 for Economic and Social Development', National Development and Reform Commission, March 2021.

13 'As It Shifts from Management Of Purchase to Management Of Usage, the Car Consumption Market Model is at a Turning Point', Jiemian News, October 2020.

China's subsidies for NEVs in 2021

Types of NEVs	Electric Range (R=Kilometre): $300 \leq R < 400$	$R \geq 400$	$R \geq 50$ (NEDC) / $R \geq 43$ (WLTC)
Battery Electric Vehicles	RMB 13,000 (GBP 1,443)	RMB 18,000 (GBP 1,998)	
Plugin Hybrid Electric Vehicles	N/A		RMB 6,800 (GBP 754)

REGULATORY CHALLENGES

1 LACK OF CLARITY AND CONSISTENCY AROUND NEV DEVELOPMENT POLICIES

In line with China's broader efforts to reduce climate emissions and become a leading global player in electric vehicles and technology, the government has continued its policy-driven approach to developing its domestic NEV sector. British businesses appreciate the need to ensure a transition away from traditional ICE vehicles, but express frustration at many of the uncertainties and inconsistencies in China's policy strategy.

British businesses welcome the amendments to China's final draft *New Energy Vehicle Industry Development Plan (2021-2035)*, which revised downwards the target share of sales of NEVs to 20%. The initial sales target of 25% raised concerns that businesses would be compelled to produce and sell more NEVs at discounted prices, despite the fact that the consumer market is still currently in its infancy stage as well as lingering anxieties over battery range, safety and the national availability of charging infrastructure. However, sales targets currently only run until 2025, with little certainty as to what, if any, targets Beijing will put in place in subsequent years. With manufacturers developing NEVs to be launched years down the line, clarity and clear communication on the future of China's NEV policies will be essential to sustaining continued investment.

Uncertainty similarly remains around the future of subsidies and sales tax exemptions. While businesses equally welcome the extension of subsidies until 2022, there is no indication as to what incentive policies will follow. With national sales targets in place and an NEV Mandate Policy which assigns compulsory NEV credit targets to all manufacturers, businesses continue to harbour concerns that there is still not yet sufficient market demand from consumers to sustain significant NEV sales without government support. Low-volume manufacturers that have not yet launched an NEV model are able to comply with China's NEV Mandate Policy by purchasing surplus credits from other foreign manufacturers. However, many struggle to navigate this system, which does not provide information on overall credit transactions between manufacturers within the market.

Inconsistent NEV requirements between various cities also add unnecessary obstacles to OEMs selling their vehicles across China. This is particularly the case concerning preferential green number plates that are more easily accessible for consumers and generally exempt from driving bans. While vehicles manufactured domestically by foreign OEMs are now able to access green number plates in major cities such as Shenzhen, imported plug-in hybrid vehicles (PHEVs) are not eligible to access such plates, and OEMs face additional requirements in other cities. Unlike across the Chinese mainland, PHEVs are not permitted to access green number plates and are prohibited from driving on the roads in Beijing during rush hour unlike purely electric vehicles. In Shanghai, even once NEVs have gained CQC certification, OEMs must undergo additional tests and link their real-time data on battery performance to the local Shanghai government server as well as the national server in order to access green number plates.

2 BURDENSOME CUSTOMS REQUIREMENTS

The lack of mutual recognition of test reports and other customs challenges, many of which have been exacerbated with COVID-19, present British importers with additional barriers from selling their vehicles in China. The Certification and Accreditation Administration of China, through the China Compulsory Certification scheme, and Ministry of Ecology and Environment require importers to conduct certification tests in China's regional testing facilities, despite largely replicating the New European Driving Cycle test that manufacturers will already have undertaken. Importers must therefore first conduct the necessary safety tests in Europe before repeating them again in China, incurring additional costs and delays. A mutual recognition agreement (MRA) between the UK and China would not only reduce costs and uncertainties for British importers from repeated testing, but would also significantly benefit Chinese exporters as the country increasingly looks to sell their models abroad.

The global outbreak of COVID-19 and the subsequent closure of China's border has brought about additional challenges for importers. For many low-volume manufacturers, new models are designed and developed entirely in the UK before being exported. In normal times, engineers and technicians would be able to travel to China to assist in testing procedures and ensure that any technical issues can be resolved. However, with stringent travel restrictions in place and engineers on the ground in China unfamiliar with the technical specifics of new vehicle models, importers have had to delay the launch of new models in China and ship vehicles with significant uncertainty as to whether or not they will gain clearance.

3 RESTRICTIONS ON ICVS

China's ICV market continues to see positive technological progress and supportive policies from the central government, but foreign companies are largely shut out from participating in its development. The ability to conduct surveying and mapping necessary for the development of autonomous vehicles is particularly restrictive. Despite recent amendments to the *Provisions on the Scope of State Secrets in the Administration of Surveying and Mapping Geographic Information*, which expanded the availability of certain geographic information for commercial use, British businesses are sceptical that these amendments will apply to foreign entities. British manufacturers currently integrating ICV technology in their models are instead are partnering with indigenous Chinese companies to conduct high-precision mapping.

Many of the internet and telematics services provided by ICV companies are legally classified as value-added telecommunications services (VATS). Foreign automotive manufacturers are prohibited from providing VATS as WFOEs under China's telecommunications regulations, and can only do so by forming JVs with an equity cap of 50%.[14] Furthermore, the ability of businesses to conduct R&D into autonomous vehicles and exchange necessary data on traffic information and algorithms with other operational bases abroad is severely restricted by China's *Cybersecurity Law*.[15] The requirement that foreign businesses must store their data locally in the Chinese mainland prevents companies from pooling information in cloud data centres overseas.

14 There are preferential policies in certain free trade zones allowing foreign investors to hold majority ownership of joint ventures for some VATS business, but these are not suitable for British automotive manufacturers in China.

15 'Cybersecurity Law', Cyberspace Administration of China, November 2016.

RECOMMENDATIONS

REGULATORY CHALLENGE	RECOMMENDATION
1 Lack of clarity and consistency around NEV development policies	■ Make national sales targets in the NEV Development Plan optional for OEMs, and implement a mechanism to review sales growth annually and adjust incentive policies according to market demand. ■ Issue a clear timeline for NEV financial subsidies and tax exemptions that extends beyond 2022. ■ Remove inconsistent NEV requirements across regions and ensure consistent implementation of incentive policies. ■ Increase the transparency of the NEV Mandate Policy by publicly disclosing information on credit transactions within the market.
2 Burdensome customs requirements	■ Permit the mutual recognition of certifications by accredited test centres in the UK and China to remove the requirement of retesting at port of entry. ■ Allow the safe and controlled return of foreign nationals into China so that overseas engineers and technicians can assist in vehicle testing. ■ Consider granting certain exemptions on testing to low-volume manufacturers importing few vehicles into China such as noise, emissions and crash tests.
3 Restrictions on ICVs	■ Remove the equity cap on investment into ICVs and permit foreign businesses to offer VATS as a WFOE. ■ Continue to lift restrictions on access to non-sensitive high-precisions maps, and ensure that FIEs have equal access to relevant licences.

MUTUAL OPPORTUNITIES

ROBUST DEMAND FOR PREMIUM AND LUXURY VEHICLES

As China's passenger car sales rebounded in the second half of 2020 following a drawn-out slump, sales of premium and luxury vehicles have been doing particularly well. Virtually every manufacturer saw sales grind to a halt in the first quarter of 2020 due the COVID-19 pandemic, but since then sales have steadily risen. China's economic recovery has been heavily concentrated among wealthy consumers and in the more developed coastal cities, fuelling a strong rebound in car sales in the premium and luxury segment of the market. Although global luxury car sales fell 6% in 2020 to just under 10 million units, Chinese luxury car sales actually grew by 13% in 2020.[16] With international travel restrictions in place and wealthy overseas students returning to China, consumers have turned to the domestic market to spend their money, leading to a rise in luxury consumption. Many British OEMs that focus on offering a unique driving experience through luxury high-performance vehicles have been well-placed to cater to this growing demand, and as such, many are expecting sales growth in the double digits in 2021.

16 'Winners and Losers in the 2020 Global Car Market', Autocar, February 2021.

BUILT ENVIRONMENT SERVICES

AT A GLANCE

SUB-SECTORS:

Architecture

Project management

Construction

Real estate

Engineering

Spatial planning

KEY CHALLENGES:

- Barriers to obtaining appropriate design licences A need to improve and respect protection of intellectual property rights
- Lack of recognition of international qualifications and experience

KEY RECOMMENDATIONS:

- Provide more transparent and equitable approval processes for licences
- Ensure that British design firms retain full control of their IP until they win the relevant contract
- Work towards the mutual recognition of engineering, architecture, and urban planning qualifications

KEY MUTUAL OPPORTUNITIES:

- Sustainable construction
- Training and transnational education
- Specialisations in modular construction

STATE OF THE SECTOR

China's real estate sector was greatly impacted by the outbreak of COVID-19 in early 2020, with lockdowns and travel restrictions making it challenging for work to resume on construction sites throughout the country. Rapid control of the viral spread eventually permitted the resumption of work, while tax deductions, monetary stimulus and government support enabled a swift recovery of economic activity and output. Nonetheless, global economic headwinds and continued market uncertainties dented business sentiment and corporate occupier demand, with office and retail vacancy rates rising and rents falling in many cities. The market was looking more optimistic at the start of 2021, though market conditions still generally remain tenant favourable.

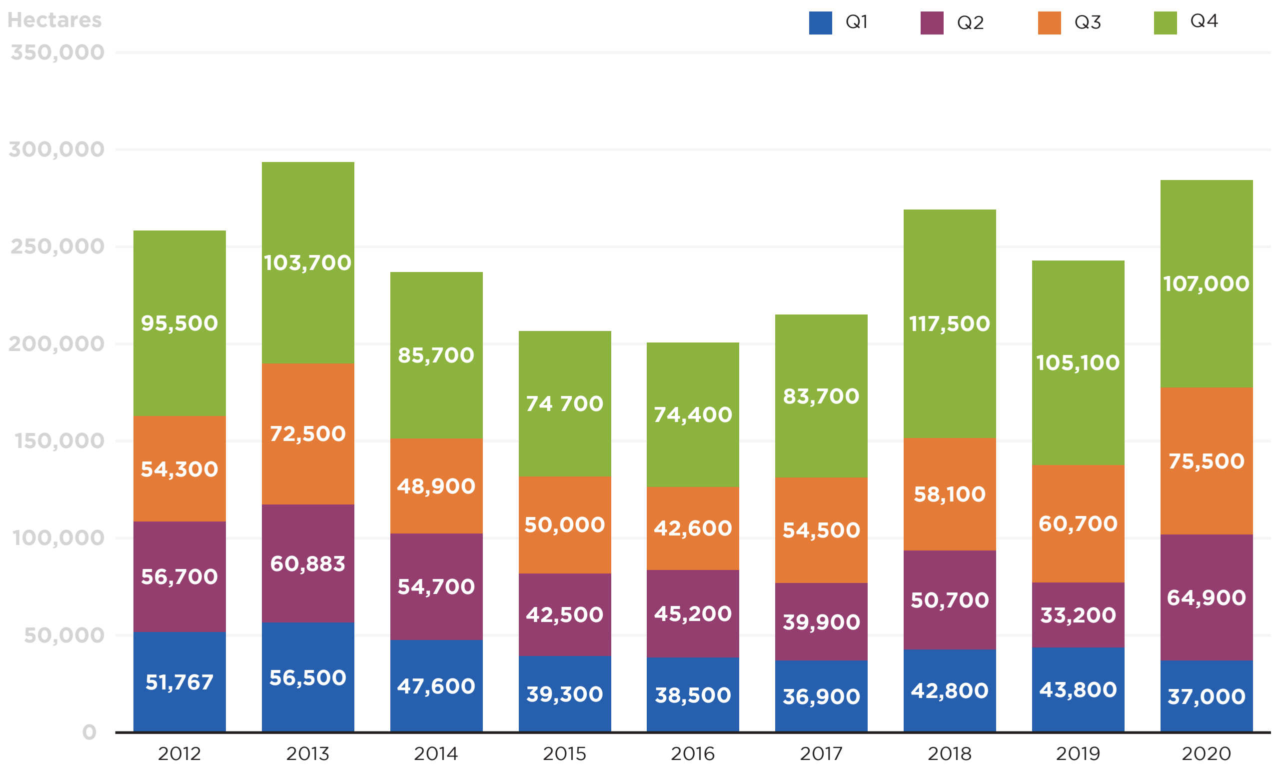
After a weak first half of 2020, the residential sector made up for lost ground in the second half of the year with annual volumes increasing year on year and prices surging, with central and local authorities eventually having to step in to cool the market. On the other hand, demand for some other real estate sectors has outstripped pre-COVID levels, namely logistics and data centres. Major drivers behind this demand include the Real Estate Investment Trust (REIT) legislation, targeted fiscal stimulus and a broad focus on upgrading and modernising infrastructure, of which they are considered part.

The land market has also been a particular focus of attention last year, with a surge in land sales recorded as local authorities looked to attract new investment and job creation while also generating revenue to make up for lost taxes and pay for local stimulus plans. Year-on-year growth of 105 surveyed cities' land sales increased by 17% in 2020 to 284,400 hectares, the highest level of growth since 2013. Development has focused on urban rejuvenation and large city clusters.

British companies in the built environment sector have the potential to play an important role in China's ongoing shift towards high-quality development. Several of the world's most renowned and innovative engineering, architecture, construction and design companies originate from the UK, many of which established operations in China more than 25 years ago. In 2018, registered UK construction

Land Supply: 105 City (China)

Source: CEIC



services exports to China alone totalled GBP 44 million (RMB 389 million).[1] However, this is a fraction of the true worth of British investment into the sector in China. While statistics are incomplete, a single British firm can easily generate a similar amount in annual revenue through its operations in the country.

The previous edition of the *British Business in China: Position Paper* highlighted some encouraging general market liberalisations in 2019 and early 2020 that have positive implications for the built environment services sector. *The Foreign Investment Law*[2] and the draft *Tendering and Bidding Law*[3] both signalled a greater focus on ensuring a level playing field between domestic and foreign firms operating in China. Unfortunately, in 2020 there were few updates to these steps and no new significant initiatives have yet been finalised, possibly due to the need to focus on managing the COVID-19 outbreak. As such, the built environment sector in China remains highly competitive and dominated by domestic firms, largely owing to licence requirements that inhibit the operations of foreign companies.

The National Development and Reform Commission (NDRC) and Ministry of Commerce (MOFCOM) issued revisions to the 'Negative List for Market Access' in December 2020,[4] but the construction industry still remains on the 'restricted list'. Foreign and domestic private companies alike must apply for particular licences from the Ministry of Housing and Urban-Rural Development (MOHURD) in order to engage in construction, housing, civil engineering, marine engineering and other related projects. As outlined in the next section, the nature of the requirements needed to apply for these licences serve as a *de facto* barrier for foreign firms. British firms therefore tend to either operate in partnership with Chinese companies to utilise their licences or work directly with other foreign clients in China.

1 'Statistics on UK Trade with China', House of Commons Library, November 2019.

2 'Foreign Investment Law', State Council, March 2019.

3 'Tendering and Bidding Law', National People's Congress, December 2019.

4 'Negative List for Market Access', National Development and Reform Commission, December 2020.

Ways for foreign design firms to obtain a Grade A licence

REGULATORY CHALLENGES

1 BARRIERS TO OBTAINING APPROPRIATE DESIGN LICENCES

For British built environment services companies in China, barriers to obtaining licences remain in place. In the case of engineering firms and Grade A design licences, the ultimate difficulty lies in the inability of British firms to claim previous projects on which they acted as consultants as part of the track record necessary to successfully apply for a Grade A licence. Despite providing a significant level of knowledge and capabilities to many projects across China, the contributions of foreign firms are not always recognised in the final account of the work provided due to their status as consultants irrespective of the level of their contributions. As a result of this, although Grade A licence applications require relevant engineers with a track record of projects in China, foreign companies cannot use any of their experience in China as part of their application materials for the licence.

Businesses were encouraged by a pilot program that allowed foreign-invested enterprises to circumvent this difficulty by receiving a Grade B design licence once fulfilled relevant requirements with the option of upgrading it to a Grade A licence after six months. This was first piloted in Shanghai, and has since been expanded to a number of other cities. However, the approval process is lengthy and relatively opaque, making it difficult for foreign businesses to understand the amount of resources that would need to be dedicated to it. Some estimates conclude that the process may take anywhere between six month and four to five years. With most upcoming market opportunities and the bulk of firms' expertise lying in Grade A-level projects, waiting for that length of time is a troubling prospect for many British companies.

2 A NEED TO IMPROVE AND RESPECT PROTECTION OF INTELLECTUAL PROPERTY RIGHTS

Despite widespread attempts by the Chinese government to holistically improve its intellectual property (IP) landscape for other industries, there are signals that, in the built environment services sector, IP provided by prospective foreign contractors may no longer retain the same level of protection it has received in previous years. Foreign design firms report that they are obliged to transfer their IP to local design institutes during the pitch process for a bid, irrespective of whether or not they win the final contract. This substantially reduces British businesses' ability to protect their IP in this sector and disincentivises the participation of foreign companies in the bidding process, particularly as there are uncertainties as to whether the resources used in the compilation of the bidding application will be a worthwhile investment from a business perspective. A smaller number of participants in the market would be disadvantageous for all, as it limits the potential for innovative, environmentally-friendly ideas being put forward for future projects in China.

3 LACK OF RECOGNITION INTERNATIONAL QUALIFICATIONS AND EXPERIENCE

Requests for proposals in China often require that team leaders are 'relevant national design Grade A' registered, in order to ensure they have a suitable level of experience and training. In a number of built environment disciplines, most notably engineering, architecture and urban or spatial planning, the credentials of UK-qualified professionals are not currently recognised in China, despite the fact that the UK has already introduced mechanisms to recognise Chinese credentials. For example, the Institute of Structural Engineers recognises Chinese educational qualifications through a conversion exam. However, there is no similar conversion process for UK-qualified professionals in China looking to work on Grade A projects, severely limiting the opportunities available to them in-market, as well as their ability to share their knowledge and capabilities with partners and co-workers.

The fundamental lack of recognition of the capabilities and expertise of companies themselves in China has placed severe limitations on their ability to bid for projects, hire staff and protect their IP. In particular, it is uncertain in cases where foreign firms who are eligible for a conversion from a Grade B to Grade A licence on the basis of their own track record can also fulfil certain staffing requirements due to this lack of recognition. We are encouraged by indications from some local governments that avenues to explore mutual recognition of qualifications for certain built environment services firms are being explored. We would welcome further details on such initiatives and hope that these could cover nationwide operations and will be available to the full spectrum of built environment qualifications.

RECOMMENDATIONS

REGULATORY CHALLENGE	SUB-SECTOR	RECOMMENDATION
1 Barriers to obtaining appropriate design licences	**ARCHITECTURE** **CONSTRUCTION** **ENGINEERING**	▪ Ensure that approval processes for licences are transparent, equitable and have clearly defined requirements.
	ARCHITECTURE **CONSTRUCTION** **ENGINEERING** **SPATIAL PLANNING**	▪ Uphold the spirit of the *Foreign Investment Law* and the DIT-MOHURD Memorandum of Understanding on infrastructure investment by taking global experience into account in licence applications.
	ARCHITECTURE **CONSTRUCTION** **ENGINEERING**	▪ Ensure that foreign companies in Shanghai are able to transition from a Grade B to a Grade A licence within a reasonable timeframe and provide clear, workable application guidelines with regards to staffing requirements.
	SPATIAL PLANNING	▪ Reaffirm the ability for British firms to apply for and secure relevant design licences under the MNR within a reasonable period of time.
2 A need to improve and respect protection of intellectual property rights	**ARCHITECTURE** **ENGINEERING** **URBAN DESIGN**	▪ Ensure that British design firms retain full control of their IP until they win the relevant contract.
3 Lack of mutual recognition of qualifications	**ARCHITECTURE** **ENGINEERING** **URBAN DESIGN**	▪ Allow China-registered architects, urban planners and engineers to park their registrations with foreign firms who meet certain qualifications.
	ALL	▪ Ensure that foreign-trained professionals with experience and training similar to their counterparts trained in China are able to work on the same grade of projects, particularly at the grade A level.

MUTUAL OPPORTUNITIES

SUSTAINABLE CONSTRUCTION

China and the UK have both set ambitious targets for curbing carbon emissions in the coming decades. As the built environment is one of the leading sources of emissions (both embodied and operational), advancing sustainability agendas in this sector is incredibly important to reaching to broader goal of net zero emissions by 2050 (for the UK) and 2060 (for China). There are significant opportunities to collaborate on green materials, urban resilience planning, sustainable design and construction practices as well as ongoing operational processes and monitoring or certification standards. Many foreign firms active in the China market are already pursuing market leading practices and innovative concepts as a point of market differentiation and client engagement, and are eager to help progress broader standards. The sunk costs and the long-life cycle of real estate assets mean that action needs to be taken now to achieve stated future goals. Real estate practitioners (planners, architects, engineers, developers) need to work closely with smart energy infrastructure providers and clean electricity producers to create integrated energy systems. The UK has some experience in this, and British and Chinese institutions can work together to share existing knowledge and discover new opportunities for green construction.

TRAINING AND TRANSNATIONAL EDUCATION

The UK is globally recognised for its role in setting and promoting international standards throughout the built environment industry. Greater collaboration with British built environment professional institutions can significantly support the sustainable development of the sector in China. This can be done through aligning training staff to contribute technical knowledge, enhance risk management and promote health and safety. UK educational establishments could not only produce high-calibre apprentices and graduates, but also engage Chinese institutions to share capabilities and knowledge. For example, British firms report that many of the graduates with engineering degrees that they hire require significant further training in order to have their project management, cost management, quantity surveyors and other such skills formally certified. Providing transnational education programmes in these years could improve the talent pool for the industry as a whole.

SPECIALISATIONS IN MODULAR CONSTRUCTION

The opportunities for modular construction and pre-casting are significant, allowing not only for rapid development of projects at low cost but also for sustainable development (in terms of embodied and operational savings) and many other benefits. This is particularly true for the education and healthcare sectors, both of which are booming in China and in which there will be increasing demand for new facilities. British and Chinese firms collaborate to develop the sector as a whole, sharing experience, knowledge and best practice. The UK has significant experience in large scale modular projects (especially in the built-to-rent and hospitality sectors) and Chinese firms are increasingly involved in modular construction for the education sector or residential projects. UK-China cooperation in modular construction has already begun – for example, in 2017 a Chinese enterprise partnered with a UK housing association to develop modular housing factories in the UK, with a third partner providing renewable energy technologies for the products.[5] There is substantial scope for bilateral partnerships to bring similar types of sustainable builds to China.

5 'Volume Modular Housing to Arrive in 2017', Royal Institute of British Architects, January 2017.

EDUCATION

AT A GLANCE

SUBSECTORS:

Early Years

K-12

Higher Education

Non-profit organisations

English Language Training

EdTech

Certification and accreditation bodies

KEY CHALLENGES:

- Inconsistency and lack of clarity in the regulatory environment
- Staffing pressures ahead of the new academic year
- Constraints on foreign participation in non-sensitive areas of education

KEY RECOMMENDATIONS:

- Ensure that regulations are applied uniformly nationwide
- Create a mechanism to facilitate the return of foreign teachers and lecturers to China in a safe manner before the new academic year
- Allow wider scope for cooperation and exchange in non-sensitive areas of education between Chinese and UK institutions

KEY MUTUAL OPPORTUNITIES:

- Growing interest in flexible education styles
- Early years education
- Vocational training and employability

STATE OF SECTOR

A vibrant, innovative education sector is critical for encouraging intellectual curiosity, strong communication skills and intercultural understanding. Greater cooperation between the UK and China in the education sector is vital to help prepare the next generation of global citizens.

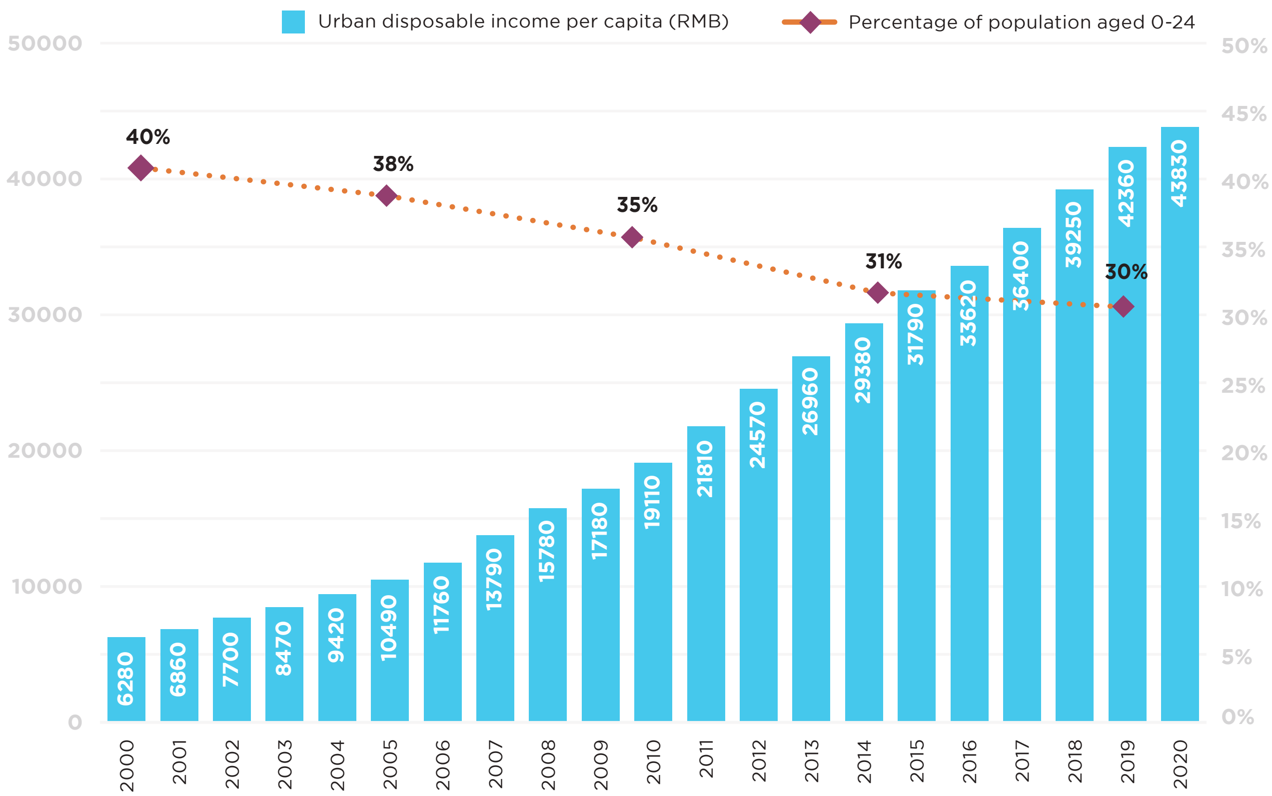
Private entities in this sector continue to face challenges posed by the COVID-19 outbreak. 75% of British education providers reported that doing business became more difficult over the course of 2020.[1] Travel restrictions have created hiring pressures on international schools and higher joint education institutions, while closures of schools, testing centres, shops and other facilities in the first half of the year necessitated rapid adoption of online learning strategies and dampened demand for traditional education materials and certification services.

Nevertheless, few education companies or institutions are pessimistic about the China market. In line with most industries, almost half are optimistic about their prospects in 2021, while a similar number maintain a neutral outlook.[2] One company reported that China was their only growth market for 2020.

This is mostly driven by China's market potential and new capabilities. Emerging capabilities in EdTech, accelerated by demand during the COVID-19 outbreak, is pushing China's online education market to more than triple in value to RMB 696 billion (GBP 77 billion) in 2023, from RMB 203 billion (GBP 22 billion) in 2019. 400,000 students were enrolled in English-medium international schools as of July 2020, generating RMB 45 billion (GBP 5 billion) in tuition fee income.[3] 14 British independent schools

Urban household disposable income and Population aged 0-24 in the Chinese mainland

Source: UN World Population Prospects, Trading Economics



1 'British Business in China: Sentiment Survey 2020-2021', The British Chamber of Commerce in China, December 2020.

2 'China's E-Learning Leaders Add $3.2 Billion As Coronavirus Fears Drive Students Online', Forbes, February 2020.

3 'China Market Intelligence Report 2020', ISC Research, February 2021.

opened in China last year. Although initially 16 schools were expected to open, this is still a notable increase from only four in 2019.[4]

Similarly, the vast majority of the general public in China continue to attach value to English fluency, which could drive the English Language Training market in China up to RMB 532 billion (GBP 59 billion) by 2025.[5] Interest in studying in British universities, either as an international student in the UK or in a transnational education (TNE) programme in China, continues to rise despite perceptions over COVID-19 control measures and geopolitical challenges. Currently, the UK is a leading partner in Sino-foreign TNE initiatives, with 41,000 students are studying for UK higher education qualifications and over 300 joint UK-China degree programmes, joint research institutions or joint universities in the Chinese mainland. One estimate places the value of all higher education exports to China at over GBP 4 billion (RMB 36 billion).[6]

In the next five years, there may be policy support for creating new opportunities in the China market. The 14th Five-Year Plan calls for improving the quality of the education system from Early Years through to Higher Education and vocational training. The Plan actively pledges to support Sino-foreign cooperation in running schools, as well as more generally developing the private school sector, enhancing the quality of teacher training and management, creating higher quality and specialised universities, developing online learning capabilities and improving standards for vocational training, among other policy objectives. British education institutions are well-placed to contribute to these efforts.

The education sector saw some market openings in the past year, such as the ability for certain specialised foreign universities to establish wholly foreign-owned enterprises (WFOEs) in the Hainan Free Trade Port. However, the majority of British entities in the sector have either seen no market liberalisation or liberalisation only in areas of limited market potential.[7] Foreign investment in the majority of education institutes in Hainan, as elsewhere, is capped at 50%.[8] Among several draft laws that have been released by the Ministry of Education in 2020 and the first half of 2021, the draft *Administrative Measures on Employing and Managing Foreign Teachers*[9] and a draft *Regulations on the Protection of Minors in Schools*[10] have both raised some concern, although neither has been ratified. The former raised widespread concern in the business community around potential administrative challenges and the impact on China's attractiveness as a destination for foreign education professionals. However, more details are needed before the full impact on education providers can be understood.

4 'British Independent Schools in China: Annual Report 2021', Venture Education, January 2021.

5 'English Language Training (ELT) Market in China 2021-2025', Research and Markets, January 2021.

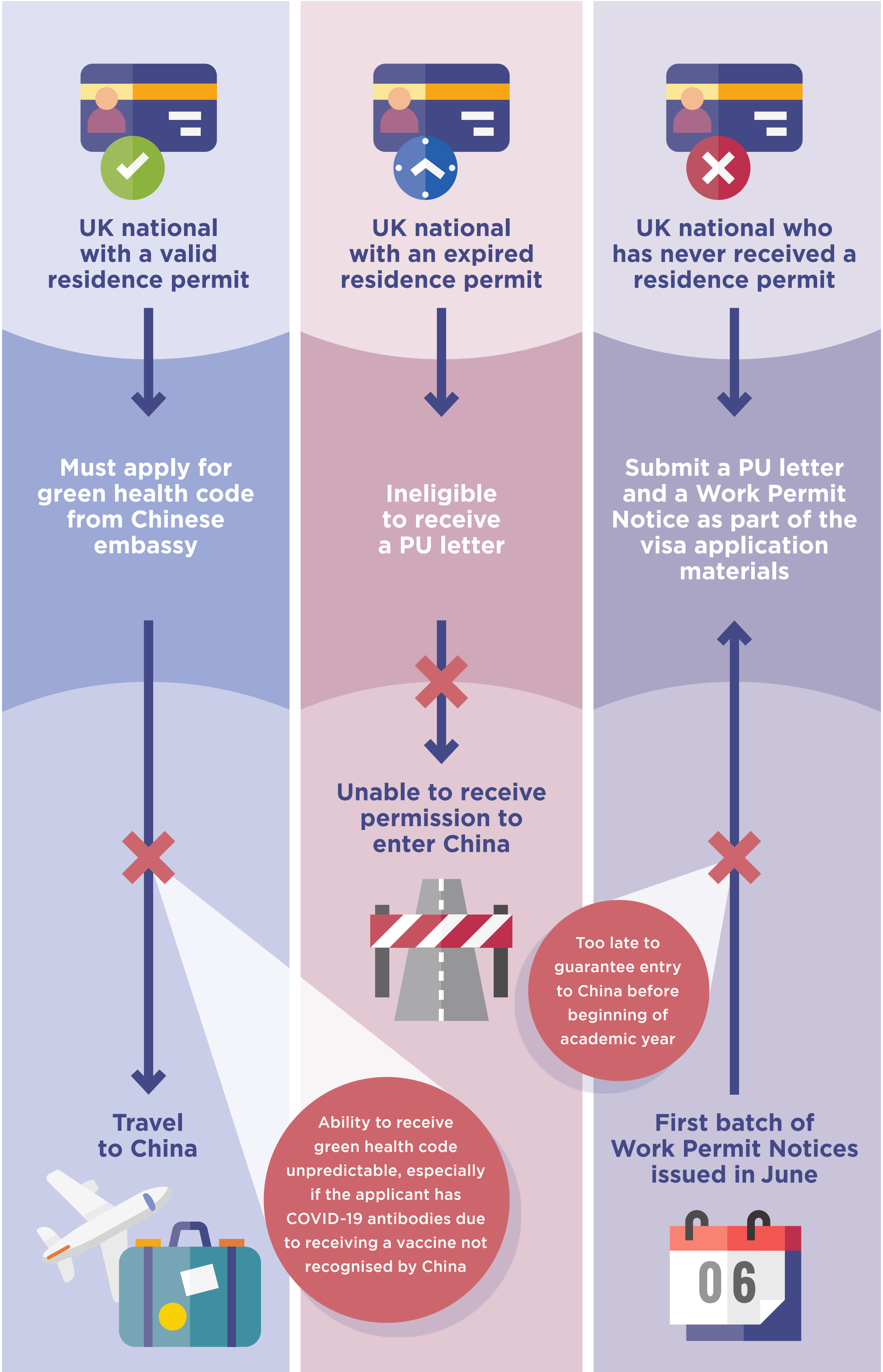
6 'Did UK Higher Education Institutions Export More to China in 2019 Than Any Other Sector?', Higher Education Policy Institute, December 2020.

7 'British Business in China: Sentiment Survey 2020-2021', The British Chamber of Commerce in China, December 2020.

8 'Special Administrative Measures on Access to Foreign Investment in the Hainan Free Trade Port', National Development and Reform Commission, December 2020.

9 'Draft Measures for Employing and Managing Foreign Teachers', Ministry of Education, July 2020.

10 'Draft Regulations on the Protection of Minors in Schools', Ministry of Education, April 2021.


UK national with a valid residence permit
Must apply for green health code from Chinese embassy
Travel to China
Ability to receive green health code unpredictable, especially if the applicant has COVID-19 antibodies due to receiving a vaccine not recognised by China
UK national with an expired residence permit
Ineligible to receive a PU letter
Unable to receive permission to enter China
UK national who has never received a residence permit
Submit a PU letter and a Work Permit Notice as part of the visa application materials
First batch of Work Permit Notices issued in June
Too late to guarantee entry to China before beginning of academic year
06

REGULATORY CHALLENGES

1 INCONSISTENCY AND LACK OF CLARITY IN THE REGULATORY ENVIRONMENT

One of the biggest operational challenges faced by British education companies and institutions lies in a relatively fragmented regulatory system. Regulations and compliance guidelines are announced and enforced without adjustment periods, and can vary from city to city and even district to district. Special dispensations for some schools rather than all schools provides inconsistencies in the market and inconsistent oversight from the local Education Bureau. An institutions' ability to receive licences to set up specific types of institutions, hire teachers, add a new site to their group and so on can vary depending on time, place and point of information, leading to seemingly arbitrary barriers consuming resources and stifling their ability to compete. At the same time, some institutions find that elements of their brand which allowed them to flourish elsewhere are not permitted in China. The equal application of standards and legislation to all education enterprises, while also actively working with education providers to explore areas of further opening and optimisation, would encourage competition in the market, incentivising companies to improve their value for parents and students.

This challenge has been made more apparent in the aftermath of COVID-19 regulations. For example, an international school group was able to receive PU invitation letters for staff in one of their branches but not for staff in another branch in the same city, as only one of the two districts had facilitated PU letters for foreign nationals reapplying for visas. As such, the group is concerned that it cannot guarantee uniform service across its facilities for the coming academic year. Similarly, individual institutions within the same district have found they are required to follow different regulations from their peers, such as a higher number of daily temperature checks.

The uneven application of these requirements place added operational burdens on individual institutions, making the landscape less competitive. It also creates confusion around matters of compliance. Ensuring the safety of their students and the quality of their services are of paramount importance to educational institutions. As such, a clear and uniform regulatory landscape is of mutual benefit to students, parents and institutions.

2 STAFFING PRESSURES AHEAD OF THE NEW ACADEMIC YEAR

Current restrictions on travel due to the global COVID-19 pandemic have created substantial difficulties for the sector. A significant proportion of schools' staff are likely to be foreign passport holders, and travel restrictions have created both a recruitment and a retention issue. While many of their current staff have been able to return to their careers and lives in China, schools are finding it extremely difficult to rely with any certainty on employees receiving visas in a timely manner in order to be in post before the new academic year begins in September.

Significant problems exist in trying to bring staff into the country. One school has been informed that staff with valid residence permits only need to receive a verified Green QR Code from the Chinese embassy in the UK in order to be cleared for travel, but the provision of these codes is not guaranteed. Staff whose residence permits expired whilst they were in the UK may have had their employment deferred for a year, but PU letters are not currently being issued to workers who fall under this category, making it impossible for them to return. New employees, applying for a residence permit for the first

time, are required to provide both a PU letter and a Work Permit Notice. However, schools are reporting that their PU letter requests are being rejected and that the slow issuance of Work Permit Notices are making it impossible to be sure that new staff will be in place in time for September.

In addition, existing staff who have chosen to remain in China throughout the pandemic are understandably desperate to return home to visit and support family and friends. However, the current uncertainty regarding travel restrictions means that both employees and employers are unable to plan accordingly, and the risk of employees visiting the UK and being unable to return to China remains high.

At the same time, restrictions that existed before the COVID-19 outbreak remain a challenge. Currently, teachers and lecturers of foreign languages are restricted to only teaching their mother tongue or their home country's official languages.[11] This precludes many talented instructors who hold high-level degree qualifications in English and have strong skillsets from joining international schools due to their nationality. Furthermore, the visa and work permit application process is seen as opaque, with seemingly arbitrary rejections of some visa applications creating vacancies for critical roles, often at the last minute. The lack of clarity on the validity of different degree certifications in China (including vocational diplomas and online qualification such as PGCEi) have also stopped schools from hiring promising foreign talent.

11 'Trial Classification Standards for Foreign Workers in China', Ministry of Science and Technology, July 2018.

3 CONSTRAINTS ON FOREIGN PARTICIPATION IN NON-SENSITIVE AREAS OF EDUCATION

Many private-sector institutions with a focus on technical subjects bring value to the UK by educating and empowering young talent, supplementing public bodies by adding resources for niche or specialised subjects across the sciences and the arts. However, in China these institutions are limited in terms of the educational services they can provide, often instead operating as either wholly foreign-owned enterprises (WFOEs) or nongovernmental organisations (NGOs), despite the fact that neither of these structures fully capture the scope of their work. Some WFOEs report a conflict between regulations determining their role in the provision of curricula and related training materials, leading to uncertainty as to whether they could bring their products to the China market.

For example, the Ministry of Culture and Tourism's *Administrative Measures for Graded Social Arts Exams* does not seem to discriminate against foreign-owned companies in the provision of arts curricula.[12] However, the State Administration for Market Regulation does not include curricula in the scope of legitimate business activity in China. Opening the provision of curricula in niche, non-sensitive areas to private companies in order to supplement state education would foster greater innovation in education and reduce pressure on regulators to develop new curricula. Industry associations and professional bodies are often registered as NGOs, and part of their service includes the provision of continuing professional development to industry professionals around the world. This allows professionals to share latest research findings and best practice, boosting the quality of research in all of the countries in which they operate. However, despite the fact that these associations or bodies are operating in non-sensitive areas, they are not able to provide such opportunities to their networks in the Chinese mainland without going through the complicated representative office registration or temporary activity filing procedures required by the *Administrative Measures for Foreign Nongovernmental Organisations' Activities* in China.[13]

4 CHALLENGES PROTECTING INTELLECTUAL PROPERTY

Foreign companies face long timelines for completing administrative processes and limitations on their ability to

12 'Administrative Measures for Graded Social Arts Exams', Ministry of Culture and Tourism, December 2017.

13 'Administrative Measures for Foreign Nongovernmental Organisations' Activities in China', National People's Congress, November 2017.

provide a full range of materials to the Chinese market. As a result, domestic competitors have sometimes replicated foreign companies' copyrighted work and sold it as their own intellectual property (IP) while the original companies wait for their products to be approved. This discourages foreign enterprises from entering the market, limiting competition and therefore limiting innovation in the educational materials industry. In December 2020, China released an updated version of the *Copyright Law*, which clarifies copyright ownership and increases legal damages.[14] This is a welcome improvement to the business environment that benefits all enterprises. It must be enforced uniformly at all levels in order to ensure its benefits are maximised and that the business environment continues to improve.

5 DIFFICULTIES NAVIGATING CYBERSECURITY AND EDTECH REGULATIONS

The COVID-19 outbreak has led to a boom in the online education market. However, foreign investment in online education in China is significantly limited, considering the potential demand for the innovative products they would be able to provide. Foreign enterprises are also prevented from obtaining the Internet Content Provider (ICP) licence and other licenses needed to provide their products to market. Even companies operating under a variable interest entity model can find that obtaining an ICP licence takes longer and is more challenging when compared to the experiences of government-backed competitors.

Education entities, and HEIs in particular, encounter substantial operational challenges in terms of being able to access overseas knowledge centres. Internet access to virtual learning environments used by many education providers can be sporadic, limiting uptake despite the advantages they could bring to students. Their websites are often hosted on servers outside of China, which can be throttled to slow loading times, or blocked completely. A number of entities in the sector have reported that it has also become increasingly difficult to access the eduroam platform used by global universities in China, limiting the resources available to their students. The quality and breadth of knowledge provided on these platforms are one of the many reasons students across the world choose to study in the UK. They are invaluable for ensuring that academics and students have access to the latest or most authoritative research in across a range of areas, that global education institutions can align their teaching materials, and that TNE students and international students in the UK receive a uniform academic experience.

6 LACK OF CERTAINTY AROUND FUTURE TAX INCENTIVES FOR FOREIGN TALENT

Many education companies and institutions aim to hire relatively experienced professionals from abroad. These professionals normally relocate with their families to China and employers often look to provide attractive compensation packages including incentives around education, accommodation and other tax deductions from their global income. China's Individual Income Tax programme will cease being applicable in 2022, but no details have been released regarding potential replacement incentives. This has raised concerns in the industry, as businesses are unsure what benefits they can offer to staff and how attractive China will seem compared to other countries.

7 UNCERTAINTY AROUND ACCREDITATION OF ONLINE EDUCATION PROGRAMMES

The COVID-19 pandemic is still severely affecting international students' study plans, and there is significant uncertainty as to when the situation will fully normalise. The UK remains a study destination of choice for Chinese students. Before the outbreak of the COVID-19 pandemic, the China Service Centre for Scholarly Exchange (CSCSE) did not recognise or authenticate overseas degrees designed to be taught entirely online. In March 2021, CSCSE agreed to accredit diplomas or degrees granted by foreign universities even if the course had been taught entirely online, in the *Supplemental Notice on the Authentication of Foreign Degrees Received by Chinese International Students through Online Learning During the COVID-19 Pandemic* ('Supplemental Notice').[15] This was a significant improvement to policy, but there are concerns that it will not lead to long-term market opening. The Supplemental Notice warns against using COVID-19 as an excuse to provide online degree programmes that deliver poor-quality education in seek to profit from potential students. Such programmes will not be accredited by CSCSE. However, it has not published the criteria by which it will determine which programmes can be considered eligible for accreditation, leading to significant uncertainty for providers on online higher education.

14 'Copyright Law', National People's Congress, November 2020.

15 'Supplemental Notice on the Authentication of Foreign Degrees Received by Chinese International Students through Online Learning During the COVID-19 Pandemic', China Service Centre for Scholarly Exchange, April 2020.

RECOMMENDATIONS

REGULATORY CHALLENGES	RECOMMENDATIONS
1 Inconsistency and lack of clarity in the regulatory environment	▪ Ensure that regulations are applied uniformly nationwide. ▪ Work with businesses to recognise unique products or services that could benefit the development of the education system if approved. ▪ Ensure that authorities at all levels clearly publish new regulations with sufficient notice periods for companies to ensure compliance.
2 Staffing pressures ahead of the new academic year	▪ Facilitate the return of foreign teachers and lecturers to China in a safe manner before the new academic year. ▪ Allow teachers to hold positions teaching languages other than their native tongue, providing that they hold suitable teaching qualifications and post-graduate degrees in those languages. ▪ Increase the transparency of the work permit process in order to reduce hiring pressures on education institutions. ▪ Consider acceptance and transferability of overseas qualifications (e.g., PGCEi).
3 Constraints on foreign participation in non-sensitive areas of education	▪ Allow wider scope for cooperation and exchange in non-sensitive areas of education between Chinese and UK institutions. ▪ Explore the inclusion of educational curricula in non-sensitive areas as the scope of business activity.

REGULATORY CHALLENGES	RECOMMENDATIONS
4 Challenges protecting intellectual property	▪ Ensure that the Copyright Law is uniformly and strongly enforced.
5 Difficulties navigating cybersecurity and EdTech regulations	▪ Explore the creation of specialised on-campus internet access permissions that allow reputable academic institutions to access global knowledge centres and navigate other cybersecurity issues. ▪ Make the approvals system for ICP licences and other Value-Added Telecoms Services licences more transparent and open to foreign education companies.
6 Lack of certainty around future tax incentives for foreign talent	▪ Develop a new Individual Income Tax regime which ensures that China remains a competitive destination for foreign professionals.
7 Uncertainty around accreditation of online education programmes	▪ Recognise fully online degree programmes provided by globally-recognised HEIs.

Spotlight on sustainability

Education institutes are a critical element of raising a generation who care about the environment and know what actions they can take to save the planet. British schools in China are very much aware of this, and are encouraging their students to think about how to reduce their impact on the planet. Schools are cutting out their consumption of single-use plastics, increasing the number of water fountains they have on-site and reducing the proportion of meat in school meals. More importantly, they're ensuring that education on environmental protection is holistic and begins in Early Years education. Many UK HEIs are also making the switch to greener operations and greater social responsibility, committing to remove plastics, ensuring net-zero emissions, reducing waste and other core goals, often with a target date for net-zero carbon emissions.

MUTUAL OPPORTUNITIES

GROWING INTEREST IN FLEXIBLE EDUCATION STYLES

Educators and parents are increasingly interested in potential benefits of blending traditional teaching methods with more flexible teaching methods. While some institutes still encounter resistance to more creative aspects of their curriculum from parents, there is growing discussion around wellbeing and mindfulness, the importance of independent learning, new teaching methods and other similar approaches. Head teachers report that there is knowledge-sharing within the education community, allowing all institutions to develop teaching methods that best serve their students and drive an environment of innovation in the sector.

EARLY YEARS EDUCATION

The preschool education market has significant potential for British education providers. China has nearly 295,000 nurseries and for over 20 million toddlers,[16] and many parents are willing to pay a premium for British-branded nurseries and kindergartens. English as a language of instruction is not necessarily a priority, but bilingual institutions are growing in popularity. As a whole, growth in demand for British institutions in this area is expected to continue.

VOCATIONAL TRAINING AND EMPLOYABILITY

Economic challenges in 2020 led to a significant drop in demand for fresh university graduates, a shortfall that the government has made it a priority to address over the course of the year.[17] As such, there is a growing demand for both online and offline training in order to improve graduates' employability. This dovetails with an existing interest in developing soft skills, and British education institutes are well-placed to leverage existing knowledge and capabilities to develop their offerings in such skills, although challenges in bringing foreign instructors to China against the backdrop of current travel restrictions may hamper operations in the short term.

DOUBLE FIRST-CLASS PROGRAMMES

The introduction of Double First-Class funding scheme by the Ministry of Education has presented new and unprecedented growth opportunities for British universities in China. Partnerships between British and Chinese universities can enhance their international impact, knowledge-sharing capacities and respective reputation. Almost every province in China has launched a Double First-Class provincial funding scheme to support local universities and provide more opportunities for young people, and several Chinese universities in higher tier cities have received active support from their local governments to establish international campuses or Joint Education Institutes, displaying significant appetite and political will to sustain cooperation in this area.

16 'BIEA 2020 International EYFS Conference Focuses On The China Early Years Education Market', FE News, July 2020.

17 'Outline of the Objectives of the 14th Five-Year Plan and Long-term Vision for 2035 for Economic and Social Development', National Development and Reform Commission, March 2021.


YELLOWKORNER

ENERGY

AT A GLANCE:

SUB-SECTORS:

Oil and Gas

Nuclear

Renewables

Minerals

Power

KEY CHALLENGES:

- Uncertainty over role of hydrogen in the energy mix and priorities for innovation
- Unclear roadmap and insufficient impetus to transition from coal to gas
- Procurement barriers to market entry

KEY RECOMMENDATIONS:

- Provide more clarity around the future role of hydrogen in China's long-term energy strategy
- As one of the critical tasks for achieving China's goal of net-zero carbon emissions, accelerate the transition from coal to gas by limiting expansion of new coal capacity and continuing to reduce the role of coal in the energy mix, while also clarifying FIEs' role in supporting this transition
- Review procurement practices and de facto barriers to market entry in order to protect fair market practices and encourage innovation

KEY MUTUAL OPPORTUNITIES:

- Sustained demand for battery minerals and EV infrastructure
- Upskilling
- Offshore wind

STATE OF SECTOR

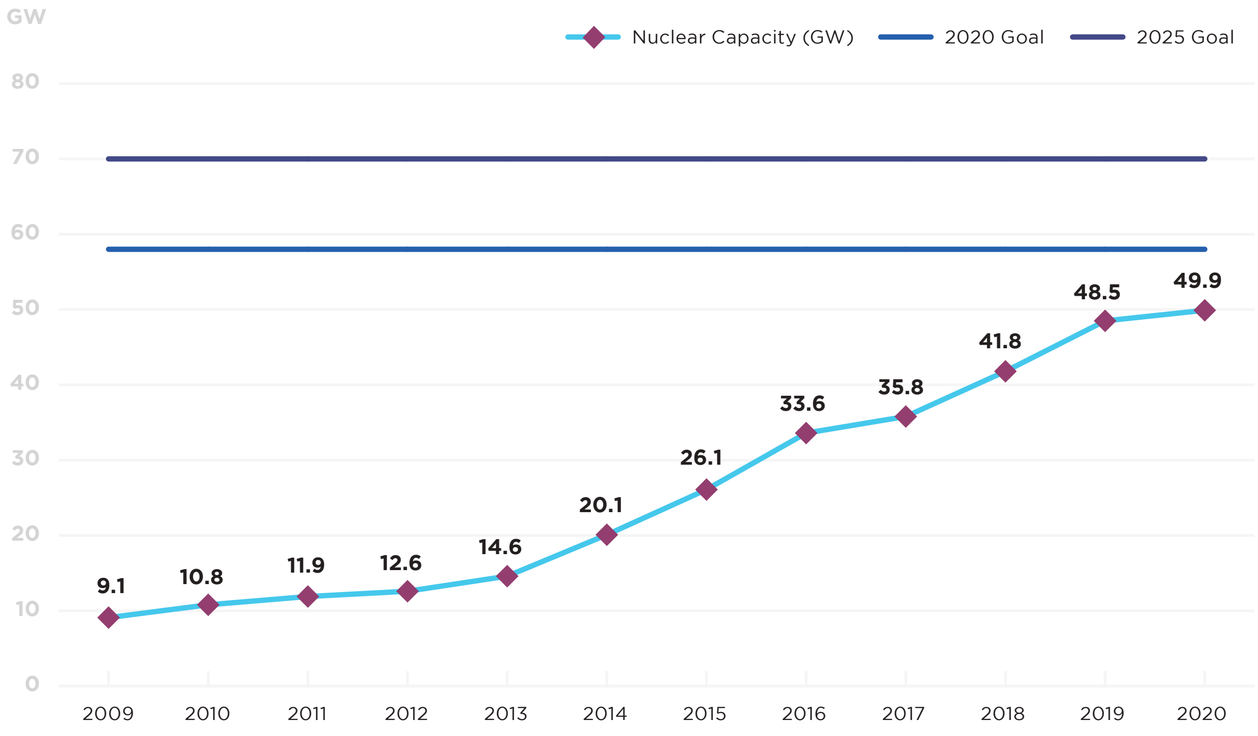
The climate crisis is arguably the biggest challenge facing the world today and it is critical that, no matter how complex the geopolitical environment, cooperation around environmental protection continues. The global energy sector, responsible for providing the necessary power to fulfil our everyday activities, will be at the heart of ensuring the future sustainability of our planet.

As the world's largest carbon emitter, China's actions will heavily determine whether we are successful or not in collectively addressing the impending climate crisis. During the UN General Assembly in September 2020, President Xi Jinping announced that China will achieve carbon neutrality by 2060 and that emissions will peak by 2030. As the world's largest carbon emitter, responsible for roughly 29% of global emissions, the pledge will have truly global implications and could reduce global warming by 0.3 degrees Celsius this century.[1] Carefully managing a steady energy transition that maintains price affordability will be critical for China to realise its climate ambitions.

By 2030, China aims to reduce carbon emissions per unit of GDP by over 65% from 2005 levels, increase the share of non-fossil fuels in primary energy consumption to around 25%, and increase solar and wind power capacity to at least 1,200 gigawatts (GW).[2] These commitments were echoed in the 14th Five-Year Plan, which stated that the proportion of non-fossil fuels would rise from current levels of 16%[3] to 20% of the energy mix and that carbon emissions per unit of GDP would drop by 18% by 2025 as China builds a cleaner, lower-carbon, safer

China's nuclear capacity

Source: National Energy Administration



1 'China's Carbon Neutral Pledge Could Curb Global Warming by 0.3°C – Researchers', Reuters, September 2020.

2 'Full Text: Remarks by Chinese President Xi Jinping at Climate Ambition Summit', Xinhua, December 2020.

3 'Analysis: China's New 2030 Targets Promise More Low-Carbon Power Than Meets the Eye', Carbon Brief, December 2020.

and more energy-efficient energy system.[4] Controlling carbon intensity and ensuring energy efficiency will be the focus for the coming five years. Yet this transition will not be easy. An exceptionally cold winter in China's northern regions at the beginning of 2021 exposed the gaps in the country's energy system and the challenges in ensuring reliable and consistent sources of energy in the coming years.

Nevertheless, the past years have seen significant movement in implementing reforms to China's energy sector and issuing new legislation to guide the market, and the rate of these policy announcements have accelerated noticeably since President's Xi's carbon neutral pledge. One of the key developments has been the expansion of the China Oil and Gas Piping Network Corporation (PipeChina), the national oil and gas infrastructure operator established at the end of 2019. Throughout 2020, it has progressed in the transfer of assets from national oil companies (NOCs) including pipelines, liquefied natural gas (LNG) import terminals and storage facilities. PipeChina has also announced that it plans to build at least another 25,000 kilometres of oil and gas pipelines by 2025 to total 120,000km across the country.[5]

The draft *Energy Law* by the National Energy Administration (NEA) echoes the market-oriented spirit behind the *Foreign Investment Law* (FIL). It signals a marked shift towards the marketisation of China's energy sector, the prioritisation of renewable energy and the separation of administrative principles between sectors of natural monopoly and those of competitive nature.[6] This is the second draft of the law, the first being released in 2007, and British energy companies would appreciate its imminent enactment, along with corresponding implementation rules and supporting policy guidance.

Renewable energy capacity, particularly in terms of wind and solar energy, will continue to increase in the next five years. Offshore wind farms will be built along China's coastlines from Shandong to Guangxi, while onshore wind power and solar power will be a feature of eight new 'clean energy bases' established across the country. The China Electricity Council estimates that the amount of wind and solar energy in the overall mix will expand by 3% in 2021, but no hard targets are provided in the 14th Five-Year Plan.[7] China's civil nuclear sector

4 'Outline of the Objectives of the 14th Five-Year Plan and Long-term Vision for 2035 for Economic and Social Development', National Development and Reform Commission, March 2021.

5 'PipeChina's Five-Year Target Risks Shorting Energy Sector Needs', Caixin, November 2020.

6 'Energy Law (Call for Comments)', National Energy Administration, April 2020.

7 'Analysis and Forecast of China Power Demand-Supply Situation 2020-2021', China Electricity Council, February 2021.

has seen equally positive movement over the past year. In 2020, the State Council approved the construction of two new nuclear power stations, Hainan Changjiang phase two and Zhejiang San'ao phase one, each with two Hualong One reactors. This was the first approval of new reactors since 2015,[8] and China plans to build more Generation III and IV nuclear reactors in order to drive capacity up to 70 GW.[9]

The Ministry of Ecology and Environment (MEE) recently finalised long-awaited rules for China's carbon emissions trading scheme, effective from February 2021. The scheme applies to companies with emissions levels higher than 26,000 tonnes of CO2 per year, allowing them to use certified emissions reduction credits to offset as much as 5% of their total emissions. These credits come from such sources as renewable energy carbon sinks and methane recovery projects. For now, the scheme only applies to the power sector, but will be rolled out to cover petrochemicals, chemical engineering, construction, iron and steel, nonferrous metals, paper making and civil aviation.[10] British businesses expect a transparent and predictable timetable to be accessible prior to such phased enrolment.

Energy efficiency is another pillar of China's carbon neutrality campaign. China has had a long-standing focus on minimising energy wastage, with energy efficiency measures in its 2008 stimulus package leading to a drop of 19 million tonnes per year in coal consumption.[11] Since then, technical efficiency has vastly improved, rising from saving 5 Exajoules (EJ) worth of energy in 2014 to 13 EJ worth of energy in 2018.[12]

The regulatory framework governing energy efficiency remains a focus, with plans to strengthen supervision of energy efficiency in heavy industry, machinery, data centres and other organisations released in early 2020,[13] and more recently incentives created by the National Development and Reform Commission (NDRC) to encourage corporate uptake of energy and water conservation projects and energy management projects.[14] With a target in the 14th Five-Year Plan to reduce energy use per unit of GDP by 13.5% by 2025,[15] we can expect the policy framework in this area to be strengthened in the coming years.

The sector has also seen some market opening to foreign-invested enterprises (FIEs). In January 2021, the Ministry of Transport, NDRC and Ministry of Commerce jointly released the *Decision to Abolish Regulations on Foreign Investment in the Civil Aviation Industry*.[16] The original regulation, enacted in 2002, restricted the participation of FIEs in China's civil aviation sector by imposing equity caps on foreign investment in aviation jet fuel supply and services, and was sustained despite the nominal removal of such equity caps in the *Negative List for Foreign Investment* (2018). The *Notice* highlights the government's intent to ensure that revisions to the *Negative List* are fully implemented across regions and sectors. However, such openings will not benefit any businesses new to the market unless other market access barriers are removed, in particular, infrastructure access.

The Plan also encourages strong digitalisation of the sector. These digital solutions would explore 'intelligent upgrading' of fossil fuel plants, collecting information on energy use and energy efficiency, implementing 'generation-grid-load-storage' interactions, analysing energy efficiency online, developing multi-energy synergy and complementarity, and intelligently regulating of energy demand. Tax incentives or research and development (R&D) could become available for companies contributing to these areas. Pollution management is also becoming more sophisticated, with the emissions trading scheme developed to cover the trade of general emissions rights, energy use rights, water use rights and carbon emission rights.

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8 'China Stresses Keeping Prudent Monetary Policy More Flexible, Appropriate', State Council, September 2020.

9 'Country Nuclear Power Profiles: China', International Atomic Energy Agency, December 2020.

10 'Administrative Measures for Carbon Emissions Trading', MEE, January 2021.

11 'Greater Energy Efficiency Could Double China's Economy Sustainably', International Energy Agency, February 2021.

12 'E4 Country Profile: Energy Efficiency in China', International Energy Agency, February 2021.

13 'Key Work Plan for Monitoring Industrial Energy Efficiency for 2020', Ministry of Industry and Information Technology, January 2020.

14 'Implementation Opinions on Creating a Better Environment for the Healthy Development of Private Enterprises that Support Energy Efficiency and Environmental Protection', National Development and Reform Commission, May 2020.

15 'Outline of the Objectives of the 14th Five-Year Plan and Long-term Vision for 2035 for Economic and Social Development', National Development and Reform Commission, March 2021.

16 'Notice on Abolishing Regulations on Foreign Investment in the Civil Aviation Industry', Ministry of Transport, January 2020.

REGULATORY CHALLENGES

OIL AND GAS

1 UNCLEAR ROADMAP AND INSUFFICIENT IMPETUS TO TRANSITION FROM COAL TO GAS

Despite being a fossil fuel, natural gas still has a vital role to play in the energy transition. The central government has signalled its desire to accelerate the transition from coal to gas, but it is disappointing to see the sustained promotion of coal in China's overall energy strategy. While coal's share of China's energy mix is declining year-on-year, coal consumption continues to rise in absolute terms as China's energy usage grows. In the first half of 2020, as China sought to stimulate its post-COVID recovery, China permitted more coal-fired capacity (17 GW) than in all of 2018 and 2019 combined (12 GW). A further 11 GW of new coal capacity is currently in construction.[17] Plans to replace coal with natural gas are welcome, yet a continued push to develop "green coal"[18] and the "clean and efficient use of fossil fuels such as coal"[19] may slow the process of decarbonisation and the transition to gas.

The continued expansion of coal capacity is clearly at odds with China's carbon neutral agenda and has been met with a critical assessment of the NEA's commitment to environmental protection following inspections by the MEE.[20] The 14th Five-Year Plan signals greater development of natural gas infrastructure, committing to greater oil and gas exploration, development of new gas pipelines and gas storage reservoirs, and diversification and expansion of oil and gas imports. This is in part driven by a growing focus on energy security. However, despite an overall target for energy capacity to reach an equivalent of 4.6 billion tonnes of standard coal, there is no specific target for natural gas production.[21] Coal is still positioned as a strategic base for China's energy security: in separate statements, the NEA[22] and President Xi[23] have both signalled that coal consumption will be lowered in the run up to 2030, but that it will remain a 'bottom line' source of energy. As such, there are questions as to how this intersects with the goal of achieving a carbon peak by 2030 and neutrality by 2060. The fundamentals behind the concept of the 'clean use of coal' and its appropriateness for the '30-60' goals should be reconsidered. British businesses therefore remain uncertain as to the exact role gas will play in China's energy mix and how foreign firms can contribute to this transition.

The creation of PipeChina to improve access for industry participants to pipelines, LNG import terminals and storage facilities was a welcome development for British businesses. This has the potential to reduce the dominant hold of NOCs over China's national pipelines and separate transportation from production, improve the transparency of the natural gas market and lead to a more market-oriented approach to managing the sector. Questions remain among businesses, however, on opportunities for third-party access rights to LNG terminals and how exactly PipeChina will permit foreign entities to participate, whether independently or through joint ventures (JVs). As a monopoly over China's pipeline infrastructure, more clarity is needed to uphold indiscriminate equal access rights for foreign businesses.

17 'A New Coal Boom in China: New Coal Plant Permitting and Proposals Accelerate', Global Energy Monitor, June 2020.

18 'Notice on Printing and Distributing the "Guiding Opinions on Energy Work in 2020"', National Energy Administration, June 2020.

19 'Outline of the Objectives of the 14th Five-Year Plan and Long-term Vision for 2035 for Economic and Social Development', National Development and Reform Commission, March 2021.

20 'The Sixth Central Ecological and Environmental Protection Supervision Group Report on the Inspection of the National Energy Administration', Ministry of Ecology and Environment, January 2021.

21 'Outline of the Objectives of the 14th Five-Year Plan and Long-term Vision for 2035 for Economic and Social Development', National Development and Reform Commission, March 2021.

22 'China to Cut Coal Use Share Below 56% in 2021', Reuters, April 2021.

23 'Xi Calls for Joint Efforts to Tackle Climate Change at US-Led Virtual Summit', Caixin Global, April 2021.

NUCLEAR

2 PROCUREMENT BARRIERS TO MARKET ENTRY

The continued advancement of China's civil nuclear market will be critical to China's decarbonisation agenda. However, new suppliers to the domestic nuclear market face a procurement environment that grants explicit preference to local solutions through a complicated regulatory framework and licensing requirements. For example, suppliers of nuclear fuel must obtain an import licence for their product in order to be able to execute a contract, which can create uncertainties. Diversifying supply of such resources would allow the government to hedge against supply shocks and strengthen overall energy security.

There are also technical requirements to entry that serve as de facto barriers to new market entrants, placing artificial limits on competition and innovation in the market. In order to supply equipment and machinery to nuclear power stations, companies must have a Civil Nuclear Safety Regulations (HAF) licence. HAF certification is only granted to companies with established product references outside of China. While this has not been a barrier to entry for international companies with localised operations and established international references when certification was based on existing international technical requirements, the development of China's indigenous Generation III nuclear power plants establishes new technical requirements for certification that present an added barrier to entry for foreign companies, especially where product specifications are unique to China and there is no existing international reference.

Innovation through competition is critical to create new, cost-efficient technologies and enhance safety. Market opening and integration of international standards will help ensure the efficient and safe development of nuclear energy in China.

RENEWABLES

3.1 INSUFFICIENT MECHANISMS FOR COMMERCIAL AND INDUSTRIAL SECTOR RENEWABLE ENERGY CONSUMPTION

China's power market has seen significant growth in the past few years. The increasing adoption of distributed generation (DG) solar has been a particular point of interest in China's renewables market. However, the sparse coverage of DG solar in particular in the draft *Energy Law* has generated uncertainty around its growth as financial subsidies are removed. For instance, in October 2017 the NEA issued the *Notice on Pilot Schemes for the Market Trading of Distributed Generation*, which laid out a plan to create platforms that facilitate electricity trading directly between distributed power plants and end users in major cities, while permitting power grid enterprises to charge transmission fees with a price approved by local authorities.[24] However, few pilot projects have been announced and the market awaits concrete progress. Escalated government support stimulating the marketplace for DG local electricity production and consumption would be well-received. With the draft *Energy Law* focusing on locally-sited clean power for local consumption, additional non-financial policy support for self-consumption industrial zone renewable power would benefit policymakers and electricity consumers alike.

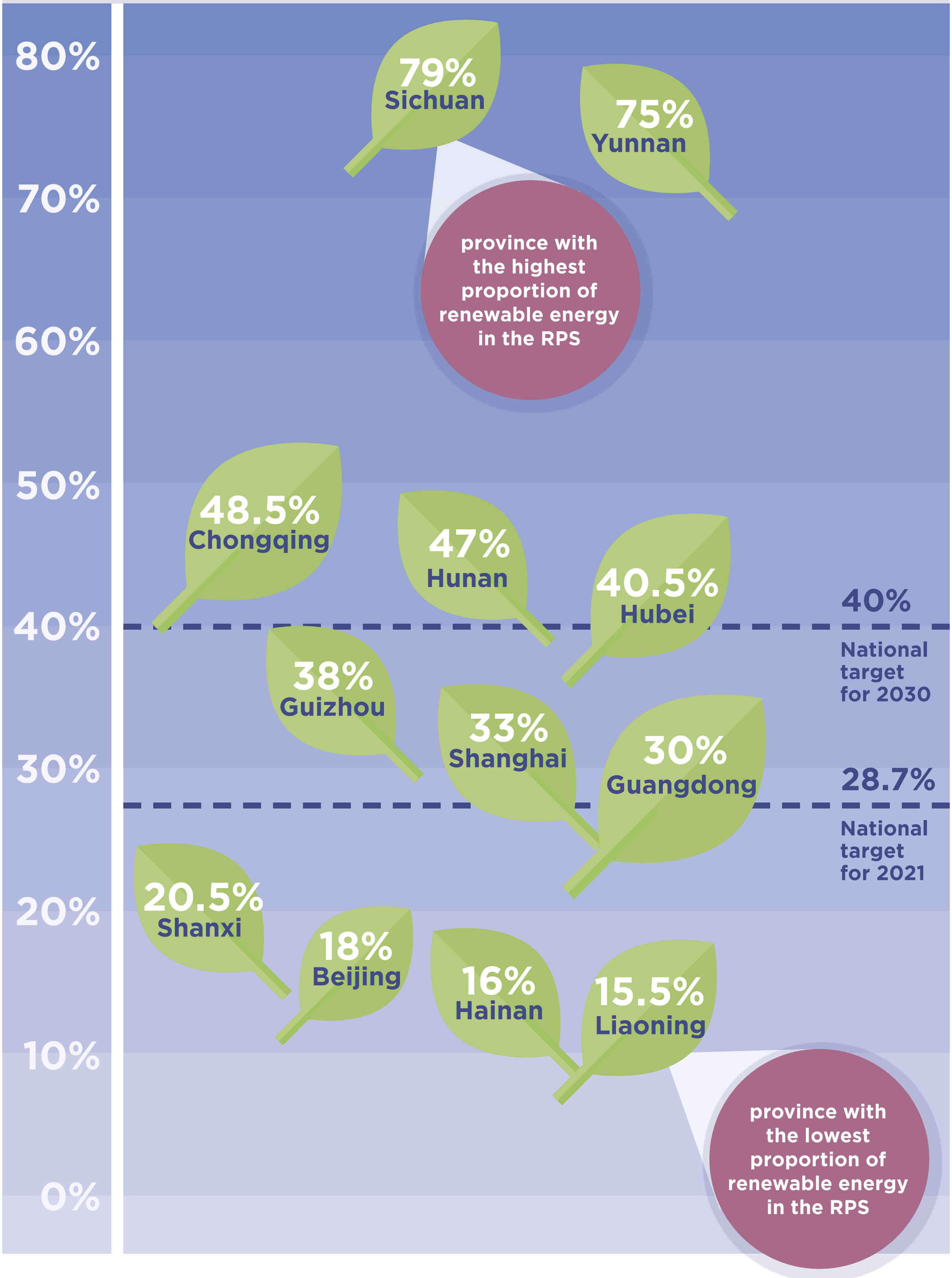
Local integrated energy solutions in the form of microgrids pose another opportunity for facilitating the commercial adoption of renewable power, creating reliable sources of renewable energy that can be scaled to match the needs of the client. Successful applications of microgrids in communities and businesses across the world have already proven its suitability for meeting net-zero carbon emission goals. The 14th Five-Year Plan highlights that China will be exploring the construction of smart microgrids.[25] However, no specific policy framework yet exists in China to guide manufacturers and support the further development of this area. More details on the role of microgrids in contributing to the '30-60' timeline would ensure that these solutions can effectively satisfy market demand for access to renewable energy. Companies eagerly await clarity regarding the policy framework that will be introduced to support the deployment of these localised energy solutions in China.

Another significant advancement in the development of the renewable power market and electricity sector

24 'Notice on Pilot Market Trading of Distributed Generation', National Energy Administration, October 2017.

25 'Outline of the Objectives of the 14th Five-Year Plan and Long-term Vision for 2035 for Economic and Social Development', National Development and Reform Commission, March 2021.

Target proportion of renewable energy in some provinces' energy mix as per the RPS in 2021



is the proposed Renewable Portfolio Standard (RPS) mechanism, as outlined in the draft *Energy Law* and implementation measures in the draft *Notice on the Weighting of Responsibility for Renewable Energy Power Consumption in 2021 and Expected Targets for 2022-2023*.[26] This sophisticated policy instrument concurrently deepens renewable power demand across the power value chain – increasing ownership and responsibility sharing of market participants to contribute to a more sustainable power system – while also alleviating the financial subsidy burden on the Ministry of Finance (MOF). Under the RPS framework, provincial power grid operators, electricity retail companies and certain industrial and commercial electricity consumers will each have a compulsory target for renewable electricity consumption. Beijing and Guangdong, for example, have targets of 18% and 30% respectively for 2021. If implemented, regulators would aim to have unified renewable energy power consumption reach 40% of total national consumption by 2030.

While this policy is well received conceptually within the market, the necessary enabling mechanisms, marketplaces, and governing rules are currently unclear and immature. For instance, the absence of a transparent accounting ledger for the Green Energy Certificate (GEC) – the tradable certificate representing the environmental attributes associated with one megawatt hour (MWh) of renewable power electricity – raises concerns regarding potential for double counting, miscounting, and unintentional non-compliance. A transparent and auditable GEC marketplace (primary and secondary) covering issuance, flows through the electricity value chain, trading and retirement will provide greater clarity and confidence to market participants. Meanwhile, while utility-scale solar and wind power generators qualify to issue GECs, which also carry a market-based monetary value and replace the MOF's subsidy payments, DG clean power generators do not. British businesses are unsure of the reasoning behind this decision, as a more equitable policy treatment would be to allow DG clean power generation to qualify.

Lastly, these solutions all allow businesses to purchase renewable energy attributes or physical renewable electricity, but gaps remain which potentially hinder RPS fulfilment and enterprises' renewable power procurement objectives. Many businesses attach great importance to purchasing large-scale renewable power, while also enjoying associated cost savings. FIEs increasingly consider market accessibility to low cost renewable power when evaluating locations for their next manufacturing facility or data centre. With solar and wind power generation now reaching price parity with the wholesale power market, it is time for renewable power to have unfettered access to power trading markets and to be differentiated from non-renewable power, either in the form of tradable GECs, a green premium or a penalty on non-renewables. This advancement in power market rules would greatly support commercial and industrial consumers' capability to fulfil their RPS mandated quota, and would allow market-driven, unsubsidised demand for renewable power to flourish.

3.2 UNCERTAINTY OVER ROLE OF HYDROGEN IN THE ENERGY MIX AND PRIORITIES FOR INNOVATION

British businesses welcome the latest draft *Energy Law* by the NEA and were pleased to see hydrogen redefined as an energy carrier for the first time, rather than as a hazardous chemical. This is an encouraging development, but with the law yet to be finalised, hydrogen's role in China's energy strategy remains unclear. Some British companies in China have the capabilities to produce green hydrogen through electrolysis, utilising wind and solar power, and produce blue hydrogen using carbon capture and storage. Hydrogen's commercial potential as an alternative energy source is creating strong interest, but much of the technology remains experimental. Innovative solutions in direct air capture, low-carbon production methods for hydrogen and storage will be needed in order to scale for local or national grids.

Hydrogen also has potential widespread applications in the adoption of fuel-cell electric vehicles (FCEVs). China currently operates the world's largest new energy vehicle (NEV) market, but the sector would benefit from more widespread adoption of FCEVs powered by hydrogen. This would complement the growing use of battery electric vehicles (EVs), while reducing strain on the national grid and benefiting consumers with faster refuelling times. Many local governments have already released plans to roll out hydrogen refuelling stations (HRS), but foreign players frequently come up against opaque land approvals and HRS operating certification processes, preferential treatment of Chinese companies and apparent unequal access to local subsidies. This challenging operating environment discourages adoption of hydrogen in mobility and foreign investment, counter to China's sustainability objectives.

The world is pivoting towards hydrogen, and governments will need to maximise innovation of the energy in order to realise its potential. China's 14th Five-Year Plan highlights the need to establish future industry

26 'Draft Notice on the Weighting of Responsibility for Renewable Energy Power Consumption in 2021 and Expected Targets for 2022-2023', Huaxia Energy Net, February 2021.

incubation and acceleration programmes for hydrogen fuel development.[27] In order to fully utilise the knowledge and capabilities of current market players, clarity is needed on the government's ambitions for hydrogen in the energy mix and the market enablers with which it will foster technological innovation in commercial applications. British businesses would appreciate the publication of a dedicated long-term hydrogen industry development plan, including the clear positioning of hydrogen's role in China's energy transition, the administration body responsible and the harmonisation of standards across the supply chain, in order to drive down the cost line of hydrogen and boost adoption.

MULTI-SECTOR

4.1 NEED FOR A ROADMAP TO ILLUMINATE THE PATH TO CARBON NEUTRALITY BY 2060

Although President Xi has committed to carbon neutrality by 2060, the 14th Five-Year Plan and other documents produced since his announcement provide few details on China's path to net-zero. Expediting the publication of these details would help market entities anticipate expected changes to the energy landscape and adjust their business models accordingly. This is particularly important in terms of supply chain stability, as the earlier companies can adjust to new requirements and priorities, the more secure supply chains will be in the long term. Allowing input from a businesses in the formulation of new policies in this roadmap would help ensure these practical concerns are considered, as well as widen the net for innovative solutions that can help regulators reach the 2060 goal.

There are several areas in which more detail would be particularly valuable. More details around the target proportions of different sources of China's energy mix and the timelines for meeting these targets are vital to help companies adjust and understand how they can contribute to the market. One example is the plan for hydrogen, as mentioned above. While the People's Bank of China has released some initial information around the role of financial services in green development,[28] questions also remain on the details of how companies can effectively use the emissions trading scheme and green finance opportunities in order to accelerate their own decarbonisation goals, as well as the decarbonisation goals of the industry as a whole.

4.2 LACK OF INVOLVEMENT OF FOREIGN BUSINESSES ON FORMULATING NEW POLICIES AND STANDARDS SETTING

The involvement of foreign enterprises in China's energy standards setting processes has always been critical to ensuring industrial safety and the internationalisation of China's standards. This will be especially critical as China's roadmap to net-zero continues to be formulated and the *Energy Law* comes into force. As the NEA and MEE work to formulate more granular implementation measures to guide each area of the energy sector, all players in China's energy markets, regardless of country of origin, will be critical to helping China achieve its decarbonisation goals and ensure energy security.

Foreign energy companies, however, have long faced barriers to participating in China's standards setting processes. They do not enjoy equal rights in competing for organisational positions in standards committees, and are limited to serving as 'observing members' which curtails their ability to participate fully in and contribute to standards commissions and from contributing their expertise in areas such as hydrogen standards and industrial safety standards. The *Notice of the State Council on Several Measures on Promoting Further Openness and Active Utilisation of Foreign Investment* states that foreign enterprises should enjoy the same treatment as domestic companies in the process of drafting of national standards and providing opinions on the implementation of standards in China.[29] This was reaffirmed in the FIL, which stipulates that foreign companies have equal right to participate in China's standards setting,[30] and British businesses strongly encourage that regulators include a broader swathe of business representatives in future formulations of standards.

27 'Outline of the Objectives of the 14th Five-Year Plan and Long-term Vision for 2035 for Economic and Social Development', National Development and Reform Commission, March 2021.

28 'Press Conference on Building a New Development Pattern for Financial Support for Coordinated Regional Development', State Council Information Office, April 2021.

29 'Notice on Several Measures on Promoting Further Openness and Active Utilisation of Foreign Investment', State Council, January 2017.

30 'Foreign Investment Law ', State Council, March 2019.

RECOMMENDATIONS

	REGULATORY CHALLENGE	SUB-SECTOR	RECOMMENDATION
1	**Unclear roadmap and insufficient impetus to transition from coal to gas**	**OIL AND GAS**	▪ Accelerate the transition from coal to gas by limiting expansion of new coal capacity and focus on reducing the role of coal in the energy mix. ▪ Clarify the definition of Clean Coal and the decarbonisation roadmap of the coal industry as China progresses towards it 2060 net-zero goal. ▪ Grant foreign enterprises equal third-party access to gas infrastructure including transportation and storage management.
2	**Procurement barriers to market entry**	**NUCLEAR**	▪ Ensure that the principle of non-discrimination is applied when reviewing import licence applications for nuclear fuel from foreign suppliers. ▪ Review procurement practices and de facto barriers to market entry in order to protect fair market practices and encourage innovation.
3.1	**Insufficient mechanisms for commercial and industrial sector renewable energy consumption**	**RENEWABLES**	▪ Pilot more large-scale distributed energy projects and grant equal opportunities for foreign companies to utilise their own integrated solutions in managing the distribution of renewable energy along national grids. ▪ Provide greater clarity around the policy framework for the deployment of localised energy solutions in China. ▪ Further refine the Renewable Portfolio Standard mechanism with the inclusion of a transparent and auditable Green Energy Certificate marketplace.

REGULATORY CHALLENGE	SUB-SECTOR	RECOMMENDATION
3.2 Uncertainty over role of hydrogen in the energy mix and priorities for innovation	**RENEWABLES**	■ Officially categorise hydrogen as an energy carrier and clarify the national administration body responsible. ■ Provide more clarity around the future role of hydrogen in China's long-term energy strategy and policy measures that will be used to maximise innovation in the sector. ■ Ensure foreign companies have equal access at a local level to supply fuel cell charging infrastructure and obtain policy incentives.
4.1 Need for a roadmap to illuminate the path to carbon neutrality by 2060	**ALL**	■ Publish more details on the policy measures China intends to implement in order to reach net-zero emissions by 2060, including the key milestones for shifting to clean energy sources and development of the carbon emissions trading scheme.
4.2 Lack of involvement of foreign businesses on formulating new policies and standards setting	**ALL**	■ Grant equal access for all enterprises to participate in China's standards committees and in competing for organisational positions.

MUTUAL OPPORTUNITIES

SUSTAINED DEMAND FOR BATTERY MINERALS AND EV INFRASTRUCTURE

Owing to a sustained policy drive from the central government, EVs are accounting for a rising share of China's passenger and consumer automotive sales. A recent plan aims to encourage the proportion of new energy vehicles to reach 20% of total vehicle sales by 2025.[31] This rising demand is causing challenges for battery manufacturers in securing the necessary minerals for production. Cobalt and other such minerals have vital roles to play in the energy transition, and the need to secure reliable supply chains is critical to ensuring sustained growth of the EV sector. British organisations that trade in and disseminate information on commodities can play a vital role in the energy transition. They can also add immense value to the sustainability of supply chains through promoting and upholding higher health and safety standards in countries where minerals are mined.

Increased demand for EVs, and therefore for the development of EV infrastructure, could also generate significant opportunities for the development of EV charging stations. As of September 2020, China had built 42,000

31 'Regular Briefing on Policies of the State Council (November 3, 2020)', State Council, November 2020.

charging stations and nearly 1.5 million charging piles across China.[32] However, more are needed in order to meet burgeoning demand. 63 million more charging stands will be needed to provide enough coverage for China's drivers over the next 10 years, creating a RMB 1 billion (GBP 111 million) market.[33] Regulators are actively encouraging further investment and innovation to address current weaknesses in China's current EV infrastructure, such as disparities between product standards for EVs produced in different regions of China. There is ample room for companies to develop competitive and effective solutions for the market, provided that all market entities are granted equal access.

UPSKILLING

As China's energy system undergoes the transition away from coal and fossil fuels to cleaner energy sources, the country's labour force will need to simultaneously undergo a transition of its own to ensure that it has the skillset necessary to carry out this transition. The need to upskill China's labour force is important for regional governments and enterprises alike. Equipping employees with the skills they need for the energy transition will promote the reduction of carbon emissions, decarbonise industrial clusters and repurpose local economies across China. There are ample opportunities for British businesses to deliver training programmes for employees in fossil fuel industries. These often combine training around project management, digital & technology, health, safety security, environment & quality (HSSEQ), asset optimisation and decarbonisation. Companies are also providing employees in local firms with soft skill training, such as leadership, communication and mental health awareness.

OFFSHORE WIND

China's offshore wind sector continues to see sustained growth and policy support. In the first half of 2020, China added 1 GW of grid-connected installed capacity and began 12 GW of new construction as of September.[34] In 2019, 2.5 GW were installed, raising the country's total to 7 GW, equalling 23% of the world's total capacity.[35] The government has signalled its desire to make the sector more market-oriented with subsidies for new wind capacity ending at the end of 2021, although little changed in revisions to the *Encouraged List for Foreign Investment* on previous years.[36] Between 2021 and 2025, development of offshore wind farms along the length of China's coastline will be a priority in China's plan to develop a modern energy system. Despite a highly competitive market and geological challenges, such as soft seabed in many stretches of China's coastline, opportunities remain for British businesses, particularly those involved in industry supply chains. Floating wind generation is also a niche in which the UK excels. It has seen notable development in sites off the coast of Scotland and would be well-suited to be deployed in China's untapped deep waters. Continuation of collaboration between China and the UK to develop floating turbines would be of mutual benefit.[37]

CORPORATE POWER PURCHASE AGREEMENTS

As in most countries, industrial activity is the largest source of pollution in China. It is critical that concerted effort it made to decarbonise industrial facilities as soon as possible. Facilitating corporate power purchase agreements for renewable energy in light manufacturing or as part of the energy supply for more energy-intensive facilities could be one part of the overall strategy to make China's factories greener. Such strategies have already been adopted by some well-known large multinational companies, and are important elements of these companies' targets to reach net-zero emissions. Trialling such agreements would also help increase consumption of renewable energy, maximising the benefits of China's immense installed capacity.

32 'Regular Briefing on Policies of the State Council (November 3, 2020)', State Council, November 2020.

33 'Can China Build Enough EV Charging Infrastructure?', Nikkei Asia, May 2020.

34 'Floating Turbines and China Push Global Offshore Wind Market', Engineering News-Record, November 2020.

35 'China's Offshore Wind Energy Efforts Gain Ground', REVE, January 2021.

36 'Catalogue of Encouraged Industries for Foreign Investment (2020)', National Development and Reform Commission, December 2020.

37 'Engineers Team Up on Floating Turbines Projects', China Daily, August 2019.

FINANCIAL SERVICES

AT A GLANCE

SUBSECTORS:

Asset management

Banking

Commodities

Insurance

Private equity

KEY CHALLENGES:

- Inability to use globally-held assets to fulfil licence requirements
- Limitations of QDII quotas in terms of maximum allocated capital, allocation process and accessibility
- Difficulties with cross-border payments

KEY RECOMMENDATIONS:

- Allow FIIs to use assets held by their parent companies or other globally-held assets to fulfil capital requirements for licence applications
- Refrain from arbitrarily restricting applications for an increase of a company's QDII quota
- Expand recent pilot schemes to help all multinational companies more efficiently manage global capital

KEY MUTUAL OPPORTUNITIES:

- ESG Investing
- Investment Opportunities in Hainan
- Greater Bay Area

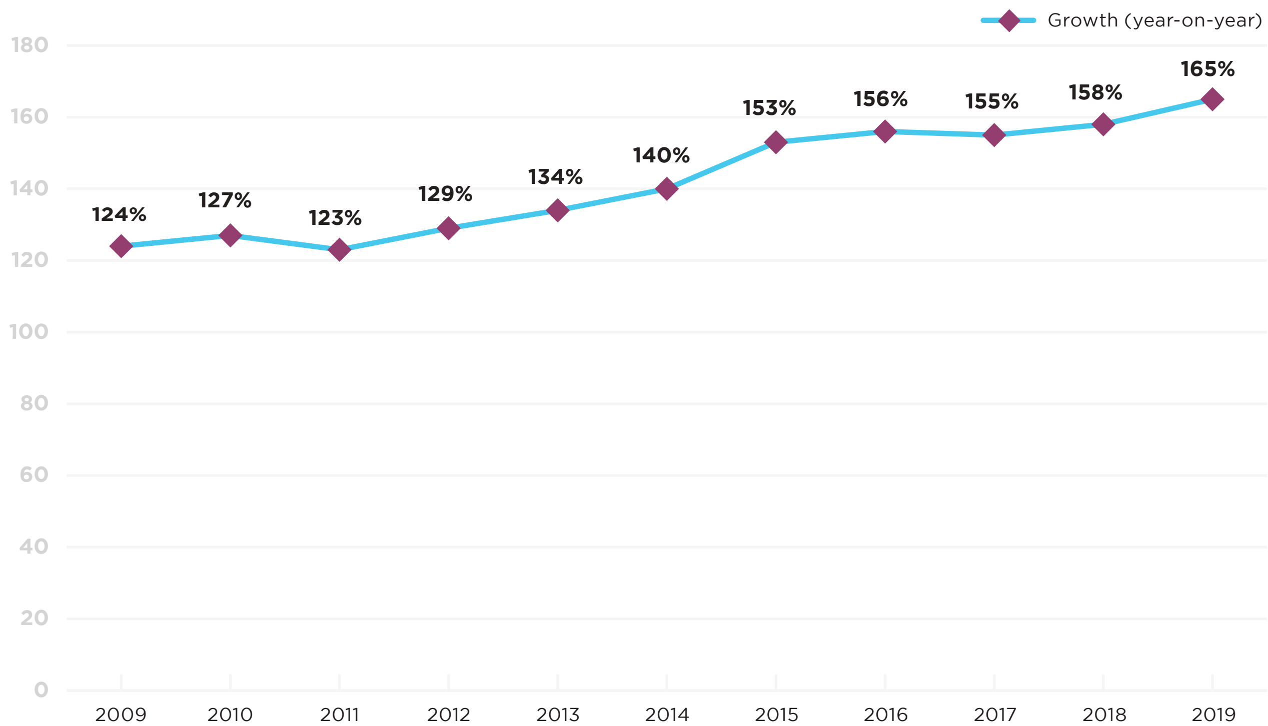
STATE OF SECTOR

Despite the extraordinary difficulties of 2020 as a whole, China's financial markets saw strong growth. The total assets of all financial institutions operating in the Chinese mainland reached RMB 353 trillion (GBP 39 trillion).[1] Banks – and the Big Five banks in particular – hold 91% of these assets and thus continue to dominate the financial landscape, but they also grew the most sluggishly year-on-year. Securities remain the smallest element of China's financial services sector, but grew the most rapidly. 18 million new investors joined the Shenzhen and Shanghai stock exchanges in 2020 and the CSI 300 Index rose by 27%, significantly outpacing other indexes,[2] while the holdings of securities companies rose 25% year-on-year to RMB 10 trillion (GBP 1 trillion). Over the course of 2020, insurance companies grew their total assets by 13% to RMB 23 trillion (GBP 3 trillion). However, the vast majority of assets are held by domestic enterprises, whereas the overall market share of foreign institutional investors (FIIs) is estimated to be just above 1%.[3]

The sector has nevertheless seen notable market openings to foreign investment in 2020, largely driven by the *11 Measures* issued in 2019.[4] Since 2018, over 100 foreign banks and insurance companies have received approval to establish operations in China.[5] Among them are industry leaders in the British financial services sector, who have

Domestic credit to the private sector (% of GDP)

Source: International Monetary Fund



1 'Total Assets of Financial Institutions at the End of 2020 Total RMB 353.19 Trillion', People's Bank of China, March 2021. Assets held by the People's Bank of China are not included in this figure, but the assets of overseas branches of Chinese banks are.

2 'Millions of New Investors Piled Into Mainland Chinese Stock Markets in 2020', CNBC, January 2021.

3 'China's Finance World Opens Up to Foreigners, Sort of', Bloomberg, March 2021.

4 'Relevant Initiatives to Further Expand the Opening Up of the Financial Sector', State Council, July 2019.

5 'State Council Information Office Transcript of Press Conference Q&A', China Banking and Insurance Regulatory Commission, March 2021.

received or are in the process of applying for licences for pension insurance, mutual funds, securities firms and other new business. Other FIIs have received licences to establish the first wholly foreign-owned enterprise (WFOE) operating as an insurance holding company, futures business, money broker and ratings agency, to name a few examples.

Offshore investment into the Chinese mainland has also been made easier. Upper limits on investment quotas for the Qualified Foreign Institutional Investor (QFII) and the *Renminbi* Qualified Foreign Institutional Investor (RQFII) have been scrapped, allowing foreign institutions greater access to Chinese stocks and bonds.[6] In September 2020, the QFII and RQFII were combined into the Qualified Foreign Investor (QFI) scheme, which featured a simplified application process, more relaxed assets under management (AUM) requirements in exchange for general requirements around experience and financial solvency, and a broader investment scope. Investors can now use QFI to invest in wholly foreign-owned Private Fund Managers (WFOE PFMs), although details on investing in other areas, such as certain derivatives, have not been published.

Similar investment mechanisms may also be adjusted to better suit the needs of foreign investors. The State Administration of Foreign Exchange (SAFE) is considering a pilot reform plan for the Qualified Foreign Limited Partnership (QFLP) scheme, expanding the scope of investment, simplifying registration procedures, facilitating capital exchange, and exploring cross-border investment and financing management models for private equity investment funds.[7] It is also holding a joint trial initiative with the People's Bank of China (PBOC) to allow certain multinational companies, including one British multinational, to convert their *renminbi* funds into other currencies, facilitating movement between global offices. In March 2021, it was also announced that southbound trading on the Bond Connect was 'getting close' to fruition, although no clarity has been provided yet on how open it will be to participation.[8]

As China begins to implement the 14th Five-Year Plan, its aim is to build a modern, stable and sustainable financial sector that supports the real economy and helps drive high-quality development.[9] The government has recognised that further opening up to FIIs is essential to support this end. However, FIIs still have to navigate significant challenges in the China market. In banking alone, although seven new foreign banks entered the market in 2020, three foreign banks have exited China and 36 branches of foreign banks have closed.[10] One high-profile American asset manager scaled back plans to open a WFOE mutual fund company.[11] Geopolitical tensions between the US and China have created significant uncertainty for FIIs, particularly around questions of compliance with conflicting directives. Nevertheless, financial services companies are the most optimistic of all British businesses in China about prospects for 2021.[12]

6 'Regulations on the Administration of Domestic Securities and Futures Investment Funds by Foreign Institutional Investors', State Administration of Foreign Exchange, May 2020.

7 'Press Conference on Foreign Exchange Balance Data for the First Three Quarters', State Council Information Office, October 2020.

8 'China 'Getting Close' to Southbound Bond Connect', Reuters, March 2021.

9 'Outline of the Objectives of the 14th Five-Year Plan and Long-term Vision for 2035 for Economic and Social Development', National Development and Reform Commission, March 2021.

10 'The Situation for Foreign-Invested Banks in a Wave of Branch Closures: BEA, HSBC Close 25 Branches, Accounting for Nearly 70%', Phoenix News, December 2020.

11 'Vanguard Scraps China Mutual Fund Plan And Pivots to Ant Tie-Up', Bloomberg, March 2021.

12 'British Business in China: Sentiment Survey 2020-2021', British Chamber of Commerce in China, December 2020.

REGULATORY CHALLENGES

MULTI-SECTOR CHALLENGES

1.1 INABILITY TO USE GLOBALLY-HELD ASSETS TO FULFIL HIGH CAPITAL REQUIREMENTS

While the *11 Measures* were a significant opening to foreign investment, the high level of AUM required of FIIs to enter the market or expand their current offering remains a challenge. For example, principal shareholders are required to hold RMB 200 million (GBP 22 million) in minimum required capital in order to establish an FMC.[13] A PFM that wishes to convert into an FMC must also have managed an average of RMB 2 billion (GBP 222 million) in AUM in the three years before the application is made.[14] Once foreign companies have successfully converted into a mutual fund, they must then increase their AUM to RMB 20 billion (GBP 2 billion) to satisfy requirements for a Qualified Domestic Institutional Investor (QDII) licence.[15] Until this AUM requirement is achieved, they are unable to conduct outbound investment and cannot consider fundraising requests from associated private equity institutions.

The China offices of foreign firms are largely unable to use globally-held assets to satisfy these requirements for new licences. While the importance of remaining solvent and acting as a responsible player in financial markets is recognised, the current system requires multinational players to commit a relatively large amount of capital to their China operations irrespective of their ability to efficiently access capital from their global network. Foreign insurance companies cannot use their parent company's resources or other globally-held assets to satisfy the required minimum of RMB 33 billion (GBP 4 billion) in order to form a WFOE, JV or subsidiary.[16] This requirement is so large that smaller foreign players can find it difficult to enter the market at all, despite strong internal solvency measures.

Some companies have obtained exceptions to this for other licences, allowing them to include globally-held assets gained from Chinese onshore bonds to support their application to enter the China Interbank Bond Market (CIBM). Therefore, it should be possible for all FIIs to be able to use global assets to support a wider range of licence applications, at least up to a certain amount. In applications for a domestic funds custodian licence, the China Securities Depository and Clearing Corporation may be willing to accept a 'Letter of Commitment' from either the parent company or the local entity in lieu of a capital requirement of RMB 40 billion (GBP 4 billion) for mainland European banks with strong global balance sheets. This avenue remains closed for British banks, but these precedents demonstrate that, for companies with an impressive reputation and demonstrable track record, some level of flexibility should be possible going forward.

1.2 LIMITATIONS OF QDII QUOTAS IN TERMS OF MAXIMUM ALLOCATED CAPITAL, ALLOCATION PROCESS AND ACCESSIBILITY

2020 saw some positive movement in terms of QDII quotas, as RMB 83 billion (GBP 9 billion) worth of QDII quotas were issues by SAFE last year.[17] The year prior, no significant quotas had been released and, of those that were, none were issued to foreign financial institutions. Current quotas are severely limited compared to the scope of services British FIIs are able to provide. They have not kept pace with economic growth, rising household wealth and divestment needs in China, and the unpredictability

13 'Securities Investment Fund Law', China Securities Regulatory Committee, December 2012.

14 'Official Reply of the State Council on Issues concerning Fund Management Companies Managing Retail Funds', State Council, December 2013.

15 'Trial Administrative Measures for Overseas Securities Investments by Qualified Domestic Institutional Investors', China Securities Regulatory Commission, February 2014.

16 'Revised Administrative Regulations of the People's Republic of China on Foreign-invested Insurance Companies', State Council, May 2013.

17 'China Issues Third Round of QDII Quotas This Year', Fund Selector Asia, December 2020.

of increases in the quotas disrupt FIIs' ability to create long-term business strategies. This discourages them from fully committing themselves to the China market.

Furthermore, PFMs do not currently have access to the QDII scheme. While it is understandable that small fund houses with limited investment experience may not be suitable for inclusion on the scheme, there are PFMs with significant experience and overseas investment capabilities. The inclusion of qualified and reputable PFMs would allow them to raise the competitiveness of overseas products offerings, ultimately benefitting Chinese investors.

1.3 DIFFICULTIES WITH CROSS-BORDER TRANSACTIONS

Due to their expertise in international markets and their global network, a large proportion of British FIIs work relies on a stable cross-border transaction system. Current controls on cross-border capital movement creates substantial operational barriers that make it difficult for them to provide services and cooperate with sister branches outside the Chinese mainland effectively. Although these barriers affect all foreign-invested enterprises (FIEs) in China, financial services' companies are more affected than most due to their proximity to the financial system. Small and medium-sized (SME) companies are particularly exposed to the consequences of long approval times to transfer money cross-border, as it affects their ability to alleviate short-term liquidity pressures effectively.

British businesses welcome multiple statements from SAFE that cross-border transfer processes will become more streamlined. A recent pilot project allowed a number of companies, including one FIE, to move funds from a subsidiary in one country to another more easily.[18] They anticipate that this will prove to be a beneficial force both for the companies involved and for the financial system as a whole, and would encourage the government to broaden out the pilot scheme to cover all companies as soon as possible.

1.4 DIFFICULTIES ESTABLISHING BUSINESS AND INVESTMENT ADVISORY SERVICES

British FIIs have considerable knowledge and capabilities in international investment markets, and are in a strong position to advise clients on optimising their investment strategies. However, the requirements for an investment advisory licence provides barriers to them offering a full range of services. Firstly, to obtain an investment advisory licence, three eligible members of staff are required to each have a consecutive three-year track record in investment management. However, there may be knowledgeable and experienced staff or new recruits who have three years non-consecutive investment management experience or have obtained the bulk of their experience in more varied or junior roles, complicating qualified companies' ability to provide these services despite the strong experience of its staff. It can be particularly challenging for FIIs attempting to establish a new office in the Chinese mainland to find staff who satisfy these requirements, and could deter potential market entrants despite market openings.

Secondly, PFMs are currently only able to provide advisory services to domestic clients, as no guidelines for providing advisory services to overseas clients other than QFIs under the same control as the PFM are available. Many FIIs use intra-group service agreements in order to directly connect their clients with the office in their network best-placed to meet that client's needs. These restrictions thus limit the commercial benefit of China offices to global financial services firms, and create an additional hurdle for global entities interested in investing in China. British FIIs have a strong network with such global investors and, should these barriers be removed, can continue to guide them into the China market.

1.5 CHALLENGES NAVIGATING REGULATORY FRAMEWORKS IN A RAPIDLY EVOLVING SECTOR

Companies note that the strength of the current regulatory system in China largely lies in its expertise in regulating the banking system. The dominance of banking in China's financial environment makes this a necessity. However, businesses note that the complexity of the insurance and securities sectors, particularly with the constant emergence of new products and processes within the industry, can make these industry subsectors equally challenging to regulate. The current divide in the legal framework between banking and insurance on one side and asset management on the other can also create unavoidable regulatory fragmentation. Businesses would encourage CBIRC and CSRC to work with the industry to further develop the administrative and legal framework governing the insurance sector in particular, and to ensure it remains responsive to emerging capabilities within the sector.

18 'PBOC and SAFE Will Make the Holistic Use of Crossborder Funds for Multinational Companies More Convenient', State Administration of Foreign Exchange, March 2021.

Different investment mechanisms

into and out of China for institutional investors

Offshore → Onshore

- QFI
- QFLP
- CIBM Direct
- Bond connect*

Offshore ← Onshore

- ODI Quota
- QDII
- QDLP
- QDIE
- QDII2**

Onshore ↔ Onshore

- WFOE PFM
- WFOE FMC
- Wealth Connect***
- Insurance Connect****
- Stock Connect

*	Bond connect southbound mechanism may come in mid-2021
**	QDII2 not yet confirmed, will allow outbound investment by individuals
***	Wealth connect not yet confirmed, will link the Greater Bay Area
****	Insurance connect not yet confirmed, will link the Greater Bay Area

BANKING

2.1 INABILITY TO PARTICIPATE IN THE TREASURY FUTURES MARKET

In February 2020, CBIRC announced that qualified commercial banks and insurance institutions will be able to participate in treasury bond futures trading. Currently, the five largest state-owned banks have been granted the opportunity to access the market on a pilot programme. It is imperative, particularly in a financial system dominated by a small number of large financial institutions, that a diverse range of state-owned and private banks, both domestic and foreign, are granted equal and open access to this new opportunity. This has significant advantages for the further maturation and stabilisation of the economy. Firstly, it would provide another important avenue for qualified commercial banks to hedge against interest rate risks without adding other risks to the market, given their existing participation in the derivatives market and proven risk management capability. More importantly, it will diversify and deepen China's treasury futures market, support interest rate liberalisation and enhance commercial banks' capability to support the real economy.

2.2 CONTINUING LIMITED ACCESS TO LEAD UNDERWRITING LICENCES FOR THE BOND MARKET

FIIs held a total of over RMB 3 trillion (GBP 333 billion) in the CIBM at the end of 2020, and it remains of interest as a key investment platform. The ability of foreign banks to underwrite the vast majority of bonds, however, remains limited. Only two foreign lenders obtained Type-A licenses to lead the underwriting of corporate debt issued by non-financial institutions in the CIBM in 2019. There has been some opening in 2020, but none in Medium-Term Notes, Commercial Papers or other areas of interest for foreign banks. Granting foreign banks the ability to become lead underwriters for these debt instruments is critical to maintaining a healthy and competitive financial sector, and supports China's aim of further opening the bond market so that it can better finance the real economy at lower cost.

INSURANCE

3.1 BARRIERS TO PROVIDING NEW PENSION INSURANCE PRODUCTS TO THE MARKET

Recent market openings have now allowed FIIs to enter the pension insurance market. However, pension insurance companies must receive approval from CBIRC before they launch new products, such as enterprise annuity products. Rapid and innovative responses to market trends are critical in China's financial services industry, and slowing the launch process for FIIs could lead to companies losing out to competitors who, due to solely domestic ownership structures or better government relations, often receive quicker approvals.

Allowing products to go to market more quickly will create more competition and improve the quality of market-driven innovation, complementing CBIRC's own efforts to explore new opportunities in the pension insurance market, such as the tax-deferred pension insurance pilot project. It is understood that regulators are interested in further developing this pilot to include more products. Pension insurance will be a critical element of supporting China's aging population and achieving the goals of Healthy China 2030. British companies encourage CBIRC to let FIIs bring their knowledge and capabilities to the market through inclusion in such pilot projects.

3.2 REQUIREMENT TO ESTABLISH A BRANCH IN EVERY LOCALITY IN WHICH INSURERS HAVE CLIENTS

Traditional insurance companies, both domestic and foreign, who focus on offline service provision are required to establish a branch in every locality in which they have clients if they possess a national licence. Initially, this was due to regulators' concerns that clients who felt poorly treated would not be able to easily seek answers from their insurance provider if they did not have a local presence. However, recent rules issued on internet insurance business allow internet insurance providers to forgo a local presence for each client.[19] This allows them to focus on core operations in a single office, whereas traditional insurance companies must invest a significant amount of capital in establishing multiple offices, inhibiting their ability to grow and reinvest their revenue in improving their products.

3.3 NEED FOR EQUAL TREATMENT OF ALL REINSURANCE COMPANIES IN FINAL VERSION OF C-ROSS PHASE II

There has been some signalling from the CBIRC that the China Risk Oriented Solvency System (C-ROSS) will be updated in order to make it a fairer, more equitable and more effective mechanism. However, C-ROSS Phase II has yet to be finalised. The current rules instil a credit risk charge to offshore foreign reinsurance companies that is double the credit risk charge applied to domestic reinsurance companies, defeating the purpose of global risk diversification. British reinsurance companies encourage regulators to ensure that foreign offshore reinsurance companies are treated equally to domestic reinsurance companies sunder the final iteration of the system, and that credit risk ratings are based on the strength of a company's financials and its solvency system going forward.

ASSET MANAGEMENT

4.1 LACK OF GUIDANCE ON HOW TO APPLY FOR PENSION MANAGEMENT COMPANY LICENCES

Asset management companies welcome the stipulation in the *11 Measures* that allows foreign financial institutions to establish or invest in pension management companies. However, CSRC has yet to publish the implementation rules that will provide companies with the directions they need to support China's pension system. British businesses are eager to begin the process, but cannot make investments until detailed instructions are provided.

4.2 ESTABLISHMENT OF FIIS AS SIGNIFICANT SHAREHOLDERS AT THE GROUP LEVEL RATHER THAN AT THE INDIVIDUAL OR FUND LEVEL

In China, foreign fund managers find that short swing profit rules in practice are more restrictive for them than for local fund managers. Holders of 5% or more of a companies' shares cannot sell said shares for six months.[20] These rules exist in several jurisdictions, but in most of these other markets exceptions are made for asset management companies, as through handling these shares on

19 'Supervisory Measures for the Internet Insurance Business', China Banking and Insurance Regulatory Commission, December 2020.

20 'Securities Law', Asset Management Association of China, December 2019.

behalf of clients they are likely to reach the 5% threshold sooner than other entities. In China, however, the 5% threshold is usually calculated for FIIs at the group level, whereas for domestic institutional investors the threshold is usually calculated at the fund level. This restricts the number of clients to whom that FIIs can offer a particular listing, relative to domestic institutional investors.

4.3 EQUITY CAPS ON FOREIGN OWNERSHIP OF LISTED COMPANIES

Despite the raising or outright abolition of equity caps for foreign investors in financial institutions, a ceiling remains for foreign investment in A-Shares. Foreign investors are currently allowed to collectively own no more than 30% of companies which are traded on the Shanghai and Shenzhen Stock Exchanges – although in practice sales to foreign investors through stock trading links with Hong Kong stop when total foreign ownership reaches 28%.[21]

China's regulators are currently making great efforts to strengthen its stock exchanges and improve the quality of its listed companies. It is estimated that foreign investors currently own only 7% of the total free-float China A-share market cap.[22] They are significantly interested in deepening their participation in the A-shares market, in turn supplying more capital to the most promising and innovative Chinese companies. There are no foreign ownership limits on companies listed on the London Stock Exchange. Companies and financial systems thrive when they have access to the greatest possible range of investors, and removing these limits would help fuel innovation in the Chinese economy.

4.4 SOME UNCERTAINTY ON THE SCOPE OF QFI

The replacement of the QFII and RQFII schemes with the QFI mechanism is a welcome step towards opening of the financial services sector. QFIs have access to a relatively broad range of investment opportunities through the channel, in terms of both equity and fixed income. However, access to some products, such as exchange cash bonds, derivatives and bond funds, has yet to be greenlit by the regulators. The PBOC, SAFE and CSRC have indicated that QFIs will be able to invest in these products soon, but the *Matters Related to FIIs Investing in China's Bond Market* currently remains in draft form.[23] Furthermore, commodity futures have not yet explicitly been opened to QFIs. The opening of a full range of instruments to QFIs, in addition to a clear implementation timetable in order to help companies ensure that the necessary processes are in place, would ensure that opening of the financial sector delivers the expected benefits for FIIs.

PRIVATE EQUITY

5.1 INABILITY TO FORM JOINT VENTURES WITH ACQUIRED COMPANIES

There has been minimal movement in the private equity regulatory environment from last year. Foreign private equity firms have few options available to them when they wish to become the majority shareholder in a listed company in China. They are unable to form Sino-foreign JVs, and instead must utilise variable interest entities or contractual structures. However, these provide less legal certainty for the parties involved, reducing the attractiveness of investing capital into promising Chinese businesses.

5.2 RESTRICTIONS ON INVESTING IN RMB-DENOMINATED FUNDS

Private equity WFOEs are unable to fully invest in the market, due to their inability to invest in RMB-denominated funds. Only having access to USD-denominated funds means they are restricted from investing in industries on the *Negative List for Foreign Investment*.[24] This limits their opportunities to grow, but also limits the range of funding sources available to Chinese investors and to businesses seeking investment. Furthermore, capital controls on USD-denominated funds hinder the efficiency with which private equity firms can operate and reinvest. While the sector should be monitored for malpractice, foreign and domestic firms should be treated equally by regulators and granted equal access to the market.

21 'Scientific Beta Excludes China A-Shares from Smart Beta Indicator', ETF Stream, April 2019.

22 'China A-shares: FAQs, facts, and figures', UBS, November 2020.

23 'Call for Comments on Related Matters on Investment into China's Bond Market by Foreign Institutional Investors', People's Bank of China, September 2020.

24 'Negative List for Foreign Investment', Ministry of Commerce, June 2020.

RECOMMENDATIONS

REGULATORY CHALLENGE	SUB-SECTOR	RECOMMENDATION
1.1 Inability to use globally-held assets to fulfil licence requirements	**ALL**	■ Reduce capital and AUM requirements to more sustainable levels. ■ Allow FIIs to use assets held by their parent companies or other globally-held assets to fulfil capital requirements for licence applications. ■ Continue to reduce other barriers to licence acquisition.
1.2 Limitations of QDII quotas in terms of maximum allocated capital, allocation process and accessibility	**BANKING** **ASSET MANAGEMENT**	■ Refrain from arbitrarily restricting applications for an increase of a company's QDII quota. ■ Allow qualified and reputable PFMs to access QDII schemes.
1.3 Difficulties with cross-border payments	**ALL**	■ Expand recent pilot schemes to help all multinational companies more efficiently manage global capital. ■ Continue exploring methods to reduce fees and waiting times for cross-border payments.
1.4 Difficulties establishing business and investment advisory services	**ASSET MANAGEMENT** **PRIVATE EQUITY**	■ Provide the necessary guidelines for PFMs wishing to offer advisory services to overseas clients. ■ Allow for greater flexibility regarding business advisory employees, within reason.

REGULATORY CHALLENGE	SUB-SECTOR	RECOMMENDATION
1.5 Challenges navigating regulatory frameworks in a rapidly evolving sector	**ALL**	▪ Ensure that government, businesses and other industry experts cooperate to allow regulatory mechanisms to manage the sector holistically as innovative new products continue to be developed.
2.1 Inability to participate in the Treasury Futures market	**BANKING**	▪ Allow the participation of foreign banks in the Treasury Futures market.
2.2 Continuing limited access to lead underwriting licences for the bond market	**BANKING**	▪ Grant more foreign banks lead underwriting licences for debt instruments.
3.1 Barriers to providing new pension insurance products to the market	**INSURANCE**	▪ Streamline and expand the approvals process for new pension insurance products to the market in order to stimulate innovation.
3.2 Requirement for insurers to establish a branch wherever they have a client	**INSURANCE**	▪ Allow insurers to cover clients regardless of location.
3.3 Need for equal treatment of all reinsurance companies in final version of C-ROSS Phase II	**INSURANCE**	▪ Ensure that foreign offshore reinsurance companies not penalised merely due to their location under C-ROSS Phase II. ▪ Calculate credit risk ratings on the basis of a company's financials and solvency system.

REGULATORY CHALLENGE	SUB-SECTOR	RECOMMENDATION
4.1 Lack of guidance on how to apply for pension management company licences	**ASSET MANAGEMENT**	▪ Publish detailed guidance on the steps required to receive a pension management licence.
4.2 Establishment of FIIs as significant shareholders at the group level rather than at the individual or fund level	**ASSET MANAGEMENT**	▪ Measure shareholding thresholds for short-swing profit rules at the individual or fund level rather than at the group level. ▪ Consider using pathways such as Non-Voting Depositary Receipts to increase foreign funding sources in the A-Share market.
4.3 Equity caps on foreign ownership of listed companies	**ASSET MANAGEMENT**	▪ Raise equity caps on foreign ownership of listed companies.
4.4 Some uncertainty on the scope of QFI	**ASSET MANAGEMENT**	▪ Provide more details on the scope of activity allowed under QFI, and ensure that QFIs are granted access to a full range of financial instruments, including commodity futures, cash bonds and bond funds.
5.1 Inability to form joint ventures with acquired companies	**PRIVATE EQUITY**	▪ Allow private equity firms to use a greater variety of ownership structures when acquiring companies.
5.2 Restrictions on investing in RMB-denominated funds	**PRIVATE EQUITY**	▪ Align regulation of USD-denominated funds and RMB-denominated funds.

MUTUAL OPPORTUNITIES

ESG INVESTING

Environmental, social and governance (ESG) investing continues to be an area of rapid growth for China. Financial institutions are creating more and more ESG products, with 47 ESG mutual funds and exchange traded funds in China with RMB 48 billion (GBP 5 billion) in AUM as of June 2020.[25] Businesses and shareholders are also increasingly aware of the benefits of environmentally sustainable growth and strong corporate governance, and the focus afforded to environmental protection in the 14th Five-Year Plan was supplemented by a pledge to further develop green finance.[26] Demand is currently driven by large institutional investors and High-Net-Worth Individuals, but a lack of understanding of ESG issues and standardised investment practices currently limits more widespread uptake of ESG investment.[27] Many British financial services companies already have ESG principles and products in place, can provide advice on how to establish and navigate carbon trading systems and other green finance mechanisms, and can help investors understand the best way to align return on investment with responsible investment decisions.

25 'ESG Investing Gaining Ground in China', The Asset, December 2020.

26 'Outline of the Objectives of the 14th Five-Year Plan and Long-term Vision for 2035 for Economic and Social Development', National Development and Reform Commission, March 2021.

27 'ESG Investing Gaining Ground in China', The Asset, December 2020.

INVESTMENT OPPORTUNITIES IN HAINAN

The opportunities present in the future of Hainan as a business hub is of some interest to FIIs. A joint notice from PBOC, CBIRC, CSRC and SAFE outlined 37 policies for developing and opening the financial services sector in the province. [28] There are plans to cover some key areas of interest for FIIs, including facilitated cross-border transfers, the allocation of RMB 33 billion (GBP 4 billion) in QDLP quotas[29] and other commitments to market opening for banking, insurance and asset management. While more information is needed, the region is seen to have considerable potential.

In addition, expansion of the healthcare sector in the province could lead to interesting opportunities for the insurance sector, as the combination of high quality healthcare products and insurance products could help satisfy growing demand for better healthcare provision in China. The province is also experimenting with new tax structures that are would benefit FIIs, and could further improve the attractiveness of China as an investment destination should these structures be rolled out across the nation.

INNOVATION TO MEET DEMOGRAPHIC PRESSURES

The need to strengthen medical and pension systems was a recurring topic in the 14th Five-Year Plan. As China's social security framework continues to come under pressure from an aging population, the government has highlighted the need to develop a multi-level, multi-pillar pension insurance system and standardise the development of the third pillar.[30] British companies can offer expertise in managing private pension funds and developing innovative pension products, particularly in terms of different forms of pension product, product functions, investment targets, digitalisation of the sector and so on. Their contribution will be critical to allowing the third pillar pension system to develop and mature.

GREATER BAY AREA

With China's economic balance shifting southward, optimism around the potential of the Greater Bay Area (GBA) as a financial hub continues. Shenzhen and Guangzhou were respectively the third and fifth richest cities in the Chinese mainland in 2020,[31] while Hong Kong remains a key centre for finance, commerce and trade. The proposed GBA wealth connect is of particular interest. When implemented, it will create a zone of more than 450,000 high-net-worth families with an aggregate of at least RMB 3 trillion (GBP 300 billion) in investable assets across Guangdong, Hong Kong and Macau.[32] This would make the GBA the world's wealthiest region. More details are expected to be released on the programme in 2021, and FIIs look forward to understanding how they can further participate.

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28 'Opinions on Financial Support for Hainan's Comprehensive Deepening of Reform and Opening Up', China Banking and Insurance Regulatory Commission, March 2020.

29 'China Approves $5 Billion Quota for Hainan's QDLP Pilot Program', Caixin Global, April 2021.

30 'Outline of the Objectives of the 14th Five-Year Plan and Long-term Vision for 2035 for Economic and Social Development', National Development and Reform Commission, March 2021.

31 'Top 10 Chinese cities by GDP for First Three Quarters of 2020', China Daily, December 2020.

32 'Get Ready for Wealth Management Connect in the GBA', Deloitte, November 2020.

FOOD, BEVERAGE, RETAIL AND CONSUMER GOODS

AT A GLANCE

SUB-SECTORS:

Alcoholic beverages

Catering

Cosmetics

Frozen foods

Hygiene and personal care

KEY CHALLENGES:

- Challenges with customs clearance procedures
- A need to update food safety standards ahead of the GB 2760 revision
- Deviation from international product standards

KEY RECOMMENDATIONS:

- Streamline customs procedures to reduce the amount of time goods are held in port
- Streamline and standardise the food safety approvals process for new additives, as well as new ingredients and packaging and other food-related items
- Exclude recommended standards from market surveillance and supervision, leaving assessments on the performance and function of products to the market

KEY MUTUAL OPPORTUNITIES:

- Policy focus on boosting the consumer market
- Brand Britain

STATE OF THE SECTOR

The food, beverage, retail and consumer goods industries in 2020 was hit by unprecedented challenges as the effects of COVID-19 impacted the market. Overall retail sales dropped by 34% year-on-year but still reached RMB 39 trillion (GBP 4 trillion), due to strengthening consumer confidence and the resurgence of economic growth in the latter half of the year.[1] Nominal GDP per capita for 2020 remained level at RMB 72,000 (GBP 80,000) year-on-year, while annual urban disposable income per capita rose slightly to RMB 44,000 (GBP 50,000).[2]

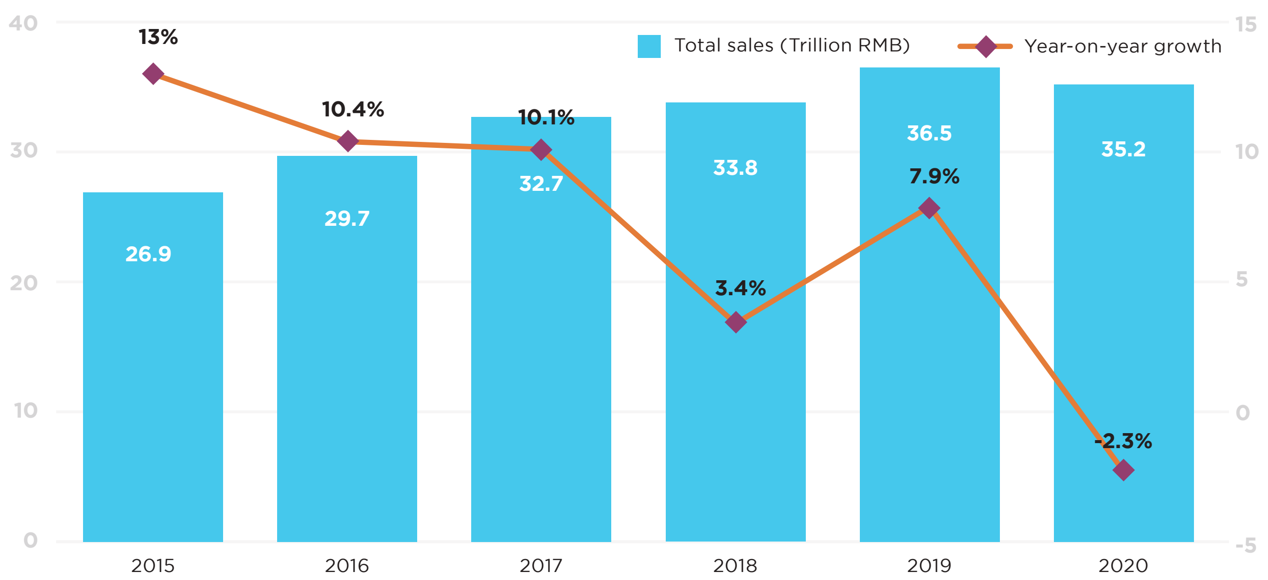
The food and beverage (F&B) sector performed relatively strongly over the year. Total profits for F&B retail totalled RMB 620 billion (GBP 70 billion), with agri-food and food manufacturing earning RMB 380 billion (GBP 40 billion) while profits in beverages increased to RMB 240 billion (GBP 30 billion).[3] Meanwhile, the catering industry reached almost RMB 4 trillion (GBP 444 billion) in total revenue, although this was down 17% on 2019.[4]

While this is positive news for the prospects of the sector, UK F&B exports of whisky, salmon, cheese and other popular products to China were relatively weak in 2020. China remains the UK's sixth-largest market for F&B exports, but growth was flat in the first half of the year and dropped in Q3.[5] The key exception to this was pork, where a slight increase in the volume of exports coupled with an increase in pork prices to generate GBP 51 million (RMB 460 million) in sales. This is likely driven by higher demand due to the effects of African Swine Fever on domestic pork stocks and a drive to replenish pork reserves and ensuring food security. As a result, it could remain an opportunity for the sector for some time.

In 2020, the F&B industry has seen some troubling developments from a regulatory standpoint. While most restrictions relating to COVID-19 have been lifted, COVID-19 control measures on F&B imports, particularly around seafood and cold food, have caused significant

China's total annual retail sales of consumer goods from 2015 to 2020 and growth rates

Source: National Bureau of Statistics



1 'Total Retail Sales of Consumer Goods Up 4.6% in December 2020', National Bureau of Statistics, January 2021.

2 'Market Entry Guide 2021', British Chamber of Commerce in China, March 2021.

3 'Profits for the Food Industry between January and December 2020', Ministry of Industry and Information Technology, February 2021.

4 'Total Retail Sales of Consumer Goods Up 4.6% in December 2020', National Bureau of Statistics, January 2021.

5 'Export Snapshots Q3 2020', Food & Drink Federation, December 2020.

disruption to F&B companies attempting to ensure these products are in stock in order to meet consumer demand. In April 2021, the *Administrative Measures for the Safety of Imported or Exported Food* was released,[6] increasing the power of customs to block imports where the food-stuffs or the packaging could be carrying health hazards. However, the law does not address the impracticality of requirements that cold-chain importers in particular currently face in order to prove that their products are not carrying COVID-19 or other harmful pathogens.

Throughout the year, draft laws were released for comment around food safety supervision,[7] food labelling and safety standards,[8] although none have been finalised yet. Elements of the draft laws contradict existing regulations, creating uncertainty in terms of what preparations companies should be making in order to remain compliant.

Retail sales, excluding automobiles, catering, food and beverages, reached RMB 29 trillion (GBP 3 trillion).[9] Sales of daily commodities, cosmetics and medicines expanded year-on-year, while demand for items that were less likely to be considered necessities – such as clothing, jewellery, home appliances and furniture – declined. In addition, average prices in urban areas shrank in 2020.[10] This is relatively unsurprising, considering the widely-reported skittishness on the part of consumers throughout the early part of the year. The return to positive growth in sales in August 2020 and strong growth forecasts for 2021 have driven optimism that consumer confidence will fully rebound this year. Growth of cross-border e-commerce in the first quarter of 2021 reached 47% year-on-year,[11] with robust online sales in the same quarter of 2020 precluding a low base effect. One estimate places growth of the retail market for 2021 at 8%, with a compound annual growth rate of 10% between 2021 and 2025.[12] However, there are concerns that consumer confidence may be overestimated. Year-on-year growth of retail sales in January and February 2021, when adjusted to account for the low base effect, shows that retail sales are growing much more slowly than industrial output.[13]

Nevertheless, foreign retail businesses have considerable reason to remain optimistic about demand. Policymakers are attempting to upgrade domestic consumption, which could lead to greater interest in foreign retail products, which are often priced at a premium. The 14th Five-Year Plan also pledges to optimise digital and green consumption, reducing tariffs, enhancing cross-border e-commerce platforms and making recycling and disposal mechanisms for consumer goods more sustainable. [14] At the same time, however, there may be increased policy support for the development of innovative 'national champions' that produce high-quality products among China's own domestic companies, particularly in high-end consumer goods such as cosmetics, clothing, home textiles and electronic products.

There have been other positive policy movements for foreign retail and consumer goods companies in China. British companies report that the challenges posed by 'professional consumers', who bulk-buy products in order to find typos on labels or defects and sue in order to win damages, have lessened. In March 2021, the National Medical Products Administration also removed stipulations that all cosmetics must be tested on animals in order to gain approval in China.[15] This has allowed British cosmetics, many of which actively ensure they are made without harming animals, to enter the market more easily. In terms of protection of intellectual property (IP), welcome revisions to both the *Patent Law*[16] and the *Copyright Law*[17] were released in 2020. In particular, the *Patent Law* strengthens regulators' enforcement powers against bad faith filings. Both laws, if uniformly enforced, could add to significant improvements to the IP landscape that have already been made.

6 'Administrative Measures for the Safety of Imported or Exported Food', General Administration of Customs, April 2020.

7 'Administrative Measures for the Supervision of the Quality and Safety of Food-Related Products', State Administration of Market Regulation, July 2020.

8 'Administrative Measures on Food Safety Standards', National Health Commission, September 2020.

9 'Total Retail Sales of Consumer Goods Up 4.6% in December 2020', National Bureau of Statistics, January 2021. This figure excludes automobiles, catering services, grain, oil, foodstuffs, beverages, tobacco and liquor.

10 'After Five Years of Premiumisation, COVID-19 Delivers Deflation in China FMCG', Bain & Company, December 2020.

11 'A Director at the Foreign Trade Department of the Ministry of Commerce Discusses the Foreign Trade Situation for the First Quarter of 2021', Ministry of Commerce, April 2021.

12 'Retail Market in China by Product and Distribution Channel - Forecast and Analysis 2021-2025', Technavio, January 2021.

13 'China's Retail Sales of Consumer Goods Up 33.8% in Jan-Feb 2021 Due to Extremely Low Base', CGTN, March 2021.

14 'Outline of the Objectives of the 14th Five Year Plan and Long-term Vision for 2035 for Economic and Social Development', National Development and Reform Commission, March 2021.

15 'Administrative Regulations for the Registration and Filing Information for Cosmetic Products', National Medical Products Administration, February 2021.

16 'Decision on Amending the *Patent* Law', State Council, October 2020.

17 'Copyright Law', National People's Congress, November 2020.

REGULATORY CHALLENGES

FOOD AND BEVERAGE

1 CHALLENGES WITH CUSTOMS CLEARANCE PROCEDURES

Difficulties navigating government information portals to find the most recent guidelines on importing products remains a challenge for British importers. If an importer is operating under outdated information and consequently fills out a form erroneously, it can lead to strict penalties, increasing the final cost of a product and undermining their competitiveness. However, requirements often change rapidly, are not clearly posted and do not always take practical concerns into consideration. This has been particularly true for products coming in through cold chains, where additional guidelines issued in 2020 related to COVID-19 control measures affected the approval of products. For example, all products are required to have undergone polymerase chain reaction (PCR) testing to ensure they aren't carrying COVID-19. However, importers report that they are unable to find any laboratories that can conduct PCR tests on their products quickly enough for the test to be valid once it reaches Chinese ports.

In addition, products are often held in customs for extended periods of time, sometimes up to three months in inadequate storage facilities, affecting companies' sales projections. There is significant variation between the type and quality of services offered depending on the port used. Established government hotlines can be a useful resource when companies have specific queries, but companies have reported that their calls are frequently unanswered, causing significant frustration.

2 A NEED TO UPDATE FOOD SAFETY STANDARDS AHEAD OF THE GB 2760 REVISION

Guobiao (GB) standards generally align with the UN's Codex Alimentarius and other international standards at a basic level, reducing the need for British businesses to adjust their products specifically to satisfy Chinese regulatory requirements in many cases. However, there are still some areas in which GB standards restrict British businesses from efficiently offering a full range of products to market, particularly as producers search for unique ingredients and innovative new offerings.

Businesses understand that determining the safety of new ingredients can require time, but would urge regulators to make the process more streamlined and standardised. Some products that have been safely consumed in the UK or other countries for years have not been able to enter the China market as they do not neatly align with existing GB standards. The revision of the *Standards for the Use of Food Additives (GB 2760)* is a valuable opportunity for regulators to further optimise the F&B environment in order to increase innovation, market dynamism and the range of choices available to consumers. [18]

3 TARIFFS ON ALCOHOLIC BEVERAGES

With the exception of tariffs on whisky, which have been reduced from 10% to 5%, tariffs on imports of many alcoholic beverages remain at 10% or higher. A 40% tariff on imported cider reduces the attractiveness of the China market to foreign brewers, despite the relatively limited domestic production of domestic hard cider and the lack of domestic supply of the particular apples needed to brew cider in China. Similarly, tariffs on most other alcoholic beverages, including gin and hard seltzers, remain at 10%, despite these products having a comparable or lower alcohol content compared to whisky. Tariffs as a whole distort the market, creating artificial challenges for foreign companies and reducing the competitiveness of existing players in the market, to the ultimate detriment of the consumer.

18 'Draft Standards for the Use of Food Additives and 12 Other Draft National Standards for Food Safety', National Health Commission, March 2021.

4 CHALLENGES ENSURING COMPLIANCE WITH NEW LABELLING REQUIREMENTS

Two draft measures on food labelling, the *General Rules on the Labelling of Pre-packaged Foods (GB 7718)*[19] issued by the National Health Commission and the *Administrative Measures for the Supervision of Food Labelling*[20] issued by the State Administration for Market Regulations (SAMR) are expected to come into effect soon. However, the two drafts do not entirely align, creating some confusion as to how companies are expected to label their products. For example, the Administrative Measures outline specifications in terms of font colour and size, and require that imported products' packaging bear both the legal name of the product manufacturer in the country of origin and the name of the company importing the product into China, even if the importer is a subsidiary of the original manufacturer. However, none of these requirements are mentioned in GB 7718, leading to confusion around what compliance measures must be taken. Removing requirements for Chinese sister offices of overseas product manufacturers to duplicate logos of their overseas and Chinese offices would remove the potential for errors and confusion. Failing this, alignment between the two regulations or an explicit indication of which regulation prevails in the text of both regulations would add clarity to the operating environment for F&B companies.

The *Administrative Regulations for the Registration of Overseas Producers of Imported Foods* released in April further complicate labelling compliance.[21] The Administrative Regulations divide imported food products into 'high' and 'low' risk categories. Depending on which category they fall under, overseas food producers must provide certain information to the General Administration of Customs (GAC), after which they will receive a registration number that must be displayed on labels. However, a number of critical items remain unclear, including the period of time within which companies must complete registration, the capacity GAC has to process a high number of registrations before implementation at the beginning of 2022, the areas that will be covered in subsequent Implementation Measures and the requirements for display of the registration number on labels.

For all of the above challenges, the grace period granted to allow companies to adjust their production processes and to allow GAC to process applications ahead of the registration deadline seem relatively short. Extending the adjustment period, providing guidance on how to adjust to the new regulations and granting some leeway for minor errors would help companies transition between the old and new labelling requirements.

RETAIL AND CONSUMER GOODS

5 DEVIATION FROM INTERNATIONAL PRODUCT STANDARDS

British consumer goods companies that manufacture and sell everything from footwear to everyday household appliances find it difficult to resolve conflicts between standards formulated in China with international standards. When a country's standards do not fully comply with World Trade Organisation Agreement on Technical Barriers to Trade (WTO/TBT) principles, foreign companies are faced with additional obstacles to doing business, spending unnecessary resources to navigate barriers to approval. The Standards Administration of China (SAC), operating under SAMR, is the central body responsible for developing and disseminating the country's national standards.

According to the revised *Standardisation Law* issued by SAC in 2018, products must comply with mandatory standards, and progress has been made in recent years in streamlining and consolidating mandatory national standards.[22] Standards have been grouped into five categories: national standards, industry standards, local standards, social organisation standards and enterprise standards.

However, voluntary requirements around these categories have been included in China's market surveillance processes in order to support China's mandatory standards. This means that voluntary standards are in effect *de facto* mandatory standards, thereby making companies liable to penalties if they fail to meet them. These voluntary standards are generally oriented towards domestic manufacturers, however, and diverge from international standards, creating operations challenges for foreign companies.

As part of the authorities' efforts to reform its standardisation system, the government is prompting and enhancing the implementation of the self-declaration of conformity

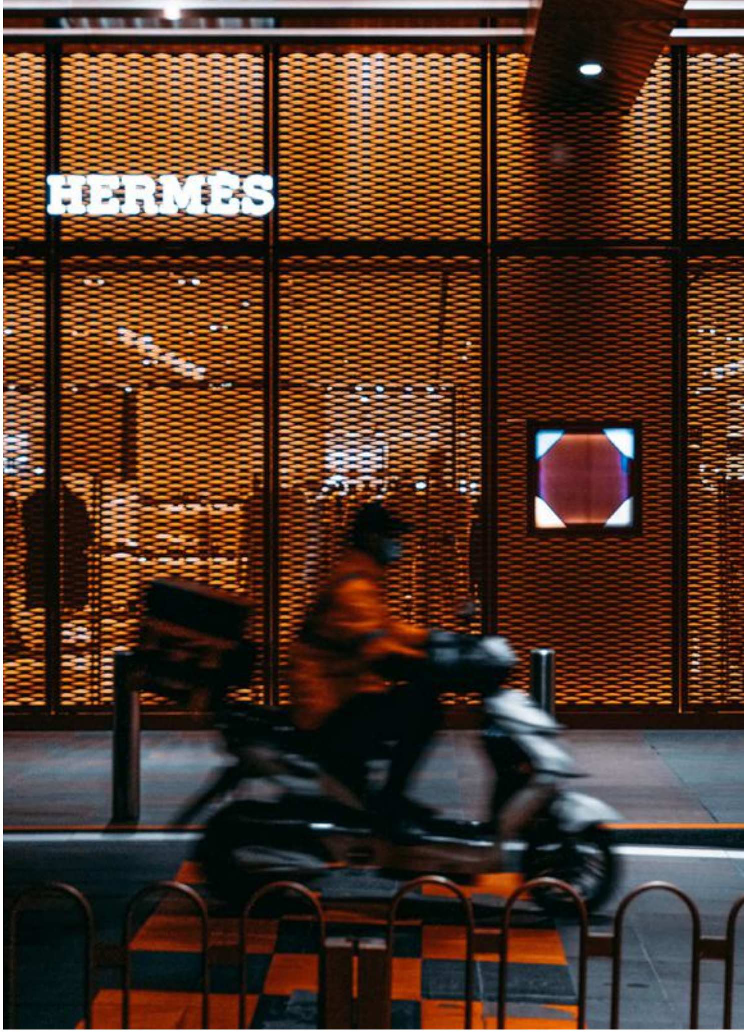
19 'Draft Limits for Food Contaminants and 13 Other Draft National Food Safety Standards', National Health Commission, December 2019.

20 'Draft Administrative Measures of the Supervision of Foodstuff Labelling', State Administration for Market Regulation, July 2020.

21 'Administrative Regulations for the Registration of Overseas Producers of Imported Foods', General Administration of Customs, April 2021.

22 'Standardisation Law', National People's Congress, November 2017.

(SDOC) mechanism for enterprise and social organisation standards. While British businesses and retailers welcome the opportunity to participate in market surveillance and the development of standards, companies express frustration towards the overlap between the SDOC system and existing certifications and approvals. Products that have already passed compulsory certification schemes hold the China Compulsory Certification mark, which clearly indicates to consumers that they are safe and comply with national standards and requirements. The SDOC mechanism therefore causes additional complexities for businesses and unnecessarily increases costs for manufacturers and consumers. Furthermore, through the SDOC mechanism, third party associations are permitted to assess the quality of companies' standards and issue rankings. British retailers express concern about the methodology of these rankings, which can have a significant influence over consumer demand, particularly the potential for these ranking associations to favour domestic enterprises.



6 CHALLENGES AROUND IP

To address the concerns of businesses over IP rights across all sectors of China's economy, regulators have taken proactive steps to strengthen protections of IP, remove counterfeit goods from the market and increase penalties for infringements. Businesses have seen material improvements, highlighted by IP falling from one of the top three challenges two years ago to among the least challenging issues in the *British Business in China: Sentiment Survey 2020-2021*.[23] However, retailers continue to see IP infringements on their brands, designs and patents, and have expressed concern about the sale of copycat and counterfeit goods online and offline, as well as challenges in receiving the appropriate compensation in damages.

Although the *E-Commerce Law* and wider government action have strengthened IP protection on official platforms,[24] the definitions for an e-commerce business operator and an e-commerce platform operator do not apply to social media platforms, leading to widespread sales of counterfeit goods on social media channels. As a result, private group chats and personal accounts that facilitate the sales of fake products have not received the same government attention around IP protection, and IP infringement of recognised British brands continue to proliferate.

British retailers have also experienced difficulties in proving the amount of counterfeit goods that have entered the market when claiming damages. The calculation of damages by the infringer is based only on the sales volume of the product and the prices of fake products alleged by the counterfeiter, which are often far lower than the total amount of illegally gained profits. Even if the infringer is found to be in large possession of copycat or counterfeit goods, it is usual for them to claim that no illegal products have been sold, making it extremely difficult for the trademark owner to prove the amount of goods that have entered the market. Furthermore, because accessories and individual components of counterfeit goods are not classified as counterfeit, manufacturers of moulds and parts of counterfeit goods are able to avoid enforcement and continue to engage in counterfeiting. Similarly for patent infringements, court proceedings can be slow – largely due to a high administrative requirements and the sheer number of cases submitted to overstretched courts – and damages awarded are relatively low, meaning that there are no strong disincentives around patent infringement in China.

23 'British Business in China: Sentiment Survey 2020-2021', The British Chamber of Commerce in China, December 2020.

24 'E-Commerce Law', National People's Congress, August 2018.

RECOMMENDATIONS

REGULATORY CHALLENGE	SUBSECTOR	RECOMMENDATION
1 Challenges with customs clearance procedures	**FOOD AND BEVERAGE**	▪ Streamline customs procedures to reduce the amount of time goods are held in port. ▪ Ensure that local authorities refrain from publishing new regulations without reasonable notice. ▪ Ensure that customs guidelines are easily accessible. ▪ Standardise the conditions in which goods are kept in customs ports.
2 A need to update food safety standards ahead of the GB 2760 revision	**FOOD AND BEVERAGE**	▪ Streamline and standardise the food safety approvals process for new additives, as well as new ingredients and packaging and other food-related items.
3 Tariffs on alcoholic beverages	**FOOD AND BEVERAGE**	▪ Reduce tariffs on other alcoholic beverages in line with the reduction of tariffs on whisky.
4 Challenges ensuring compliance with new labelling requirements	**FOOD AND BEVERAGE**	▪ Ensure that GB 7718 and the draft *Administrative Measures for the Supervision of Food Labelling* are fully aligned, and provide a period of leniency as companies transition to the new requirements. ▪ Extend the time period in which overseas food producers can register ahead of implementation of the *Administrative Regulations for the Registration of Overseas Producers of Imported Foods*.

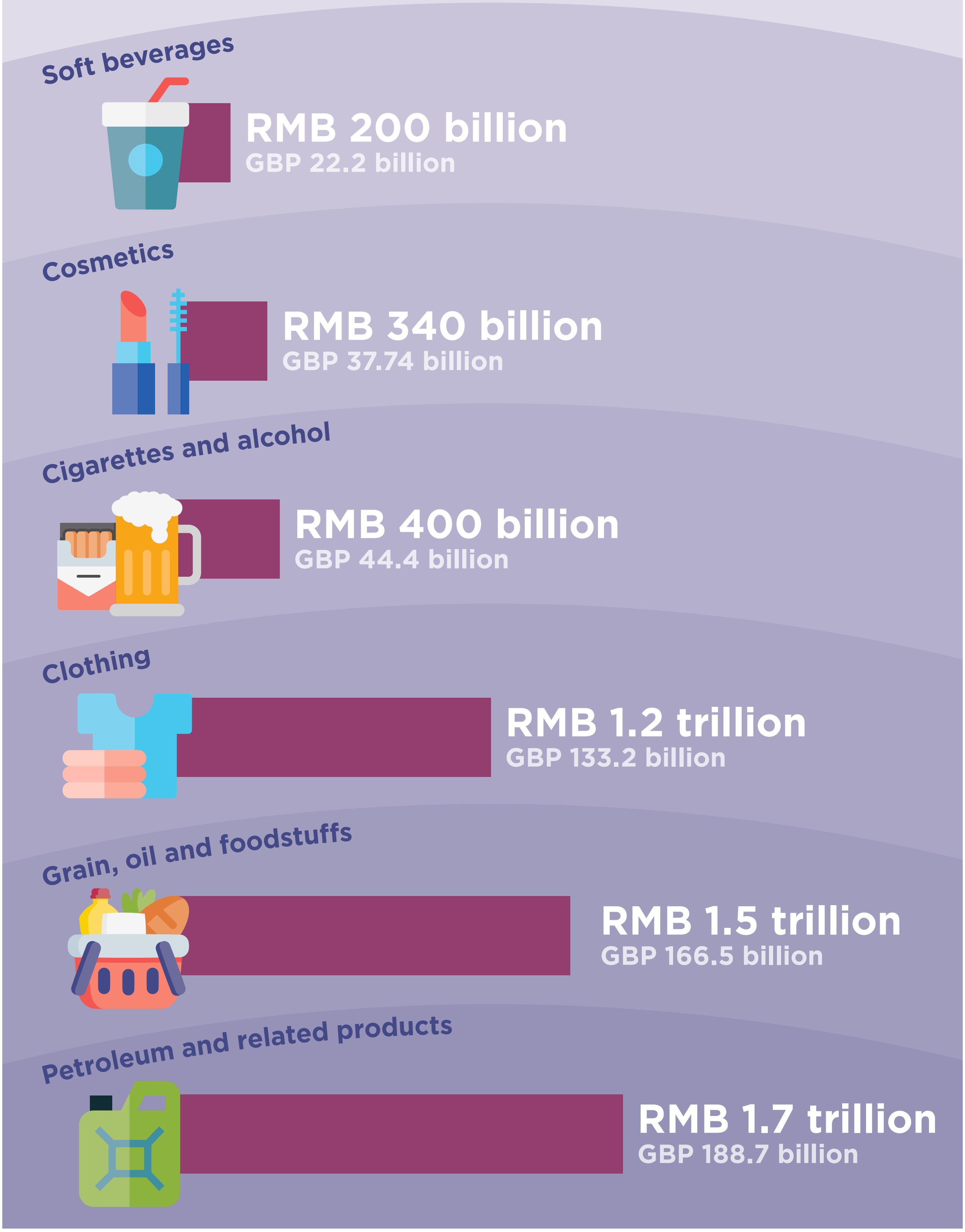
REGULATORY CHALLENGE	SUBSECTOR	RECOMMENDATION
5 **Deviation from international product standards**	**RETAIL AND CONSUMER GOODS**	▪ Exclude recommended standards from market surveillance and supervision, leaving assessments on the performance and function of products to the market. ▪ Limit the scope of the SDOC mechanism to mandatory national standards adopted by enterprises. ▪ Ensure full transparency and impartiality between foreign and domestic companies in the process of ranking enterprise standards.
6 **Challenges around Intellectual Property**	**RETAIL AND CONSUMER GOODS**	▪ Develop and implement administrative measures to enhance the supervision of IP infringements on social media platforms. ▪ Consider the size of inventories of counterfeit goods and counterfeit accessories and parts when calculating the amount of damages for infringement cases.

Spotlight on sustainability

Plastic pollution is an urgent problem that must be addressed in the fight against climate change. It is believed that by 2040, there may be as much as 600 million metric tonnes of plastic in the ocean,[25] impacting marine life and entering food chains. British F&B, retail and consumer goods companies are taking concrete steps to reducing their own contributions to plastic waste. Companies are ensuring that packaging is completely recyclable, while also increasing their own use of recycled materials during the production process. Tea producers are developing biodegradable teabags, and manufacturers of hygiene, health and beauty products are shifting to focus more on concentrated forms of their products in order to limit the size of plastic packaging. All of this is contributing to wider goals, particularly for large multinational companies, to reach carbon neutrality or a higher standard of sustainable production within the next 20 years.

25 'Plastic Rubbish Flowing Into the Seas Will Nearly Triple by 2040 Without Drastic Action', National Geographic, July 2020.

China's retail sales in 2020



MUTUAL OPPORTUNITIES

POLICY FOCUS ON BOOSTING THE CONSUMER MARKET

British F&B and consumer goods traditionally are aimed at urban middle class consumers and premium markets. Growth of interest in premium spirits, luxury wear, high-quality hygiene, health and beauty products and other goods is likely to continue as the economy keeps growing and consumer confidence strengthens after the COVID-19 outbreak. This trend may be underpinned in the next five years by the priority that the Chinese government has placed on enhancing the strength of domestic consumption, putting more money in the pocket of the consumer in order to shift to a high-quality growth model. Beyond increasing disposable income, foreign companies may also see further optimisation of e-commerce platforms, support for innovative products and continued improvement of the business environment.

BRAND BRITAIN

British products continues to enjoy a strong reputation for quality in the China market. A recent study found that two thirds of Chinese consumers were buying more British-made products now than they were five years ago, and a similar number would be willing to pay a premium for a British-made product.[26] A British product was more likely to be considered good value for money, of high quality, internationally respected and able to afford more status to the consumer. This tallies with other sectors, such as the growth in Chinese students choosing to study in the UK due to British higher education institutions' reputations for academic excellence.[27] This appreciation for British culture, product quality, creativity and innovation is a critical selling-point for British goods companies.

26 'Made in Britain', Barclays, March 2021.

27 'Chinese Students Consider UK Study Over US', The PIE News, August 2020.

HEALTHCARE

AT A GLANCE

SUB-SECTORS:

Cosmetics

Healthcare services

Medical devices

Pharmaceuticals

KEY CHALLENGES:

- Restrictions on human genetic research and obtaining relevant data
- Pricing pressures and decision-making processes around VBP, the NRDL and the NEDL
- Difficulties obtaining licences for foreign healthcare professionals

KEY RECOMMENDATIONS:

- Loosen restrictions on activities involving human genetic resources and relevant data-sharing
- Balance the need to drive down prices with that to drive innovation when implementing the VBP system
- Explore signing Mutual Recognition Agreements to allow registered nurses and doctors to operate in both countries, or provide an English-language version of the requisite examination

KEY MUTUAL OPPORTUNITIES:

- Innovation as a priority
- Healthcare technology
- Demographic trends and healthy aging

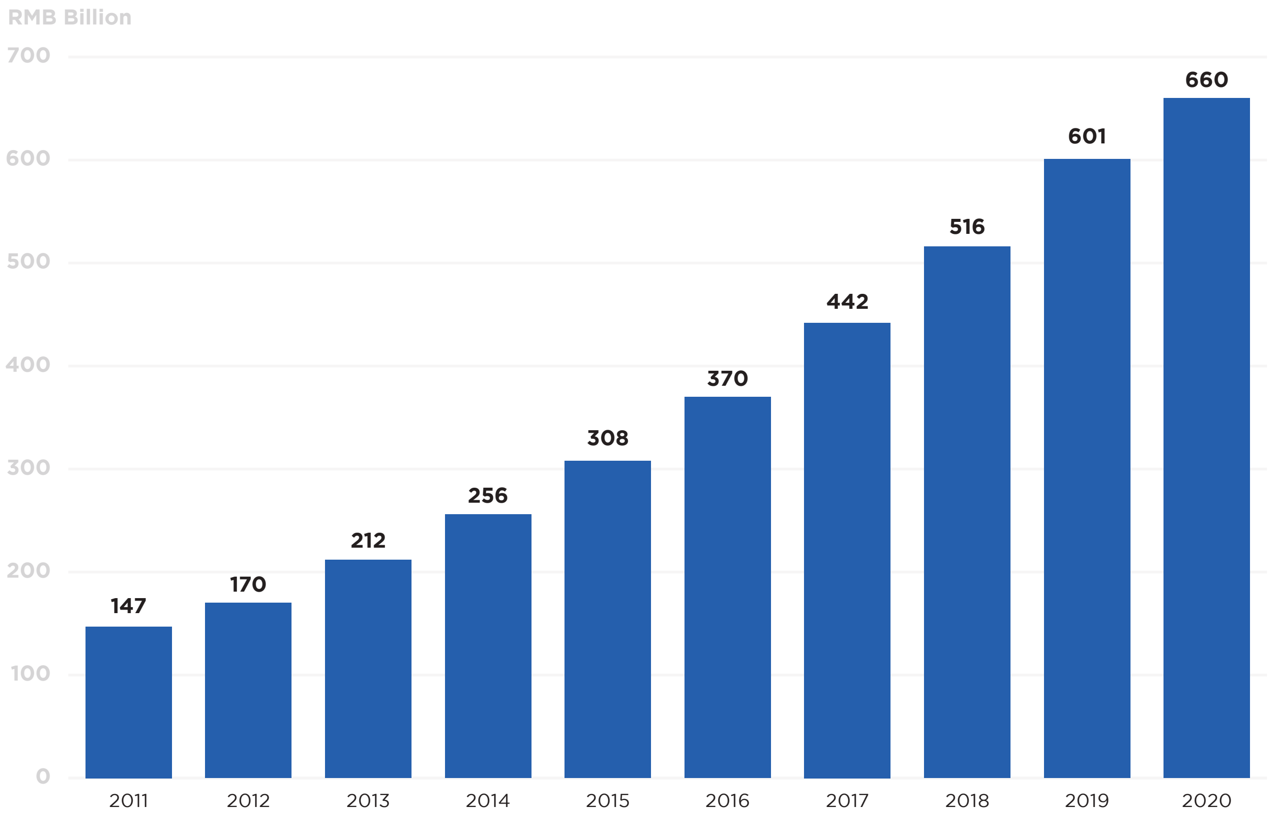
STATE OF THE SECTOR

Driven by public criticism over the quality, affordability and accessibility of China's healthcare services in the early 2000s,[1] China's government has been seeking to reform its healthcare system since 2009. Total healthcare expenditure as a percentage of GDP increased year-on-year from 5% to 6.4% between 2009 and 2017,[2] as China tried to establish a basic, universal health system and ensure a more affordable, efficient and equitable delivery of health services across the country. In recent years, the government has continued to roll out a raft of policy measures to deepen the reform, with significant impacts felt by both domestic and foreign market participants.

As a continual focus of the reform has been to drive down costs of drugs and medical devices for consumers, systems such as the 'two-invoice' system and volume-based procurement (VBP), have been put into operation to ensure that prices remain low. As of the end of 2020, China's National Health Security Administration (NHSA) has held three rounds of VBP with 112 drugs included in the scheme and an average price cuts of 54%.[3] While the 'two-invoice' system and VBP initially mainly targeted pharmaceutical products, the government is also gradually rolling out the same arrangements in the medical devices sector.[4] The release of high-value medical

China medtech and consumables market size

Source: China Medtech Bluebook, Simon Kucher & Partners



1 'What Can We Learn from China's Health System Reform?', The BMJ, June 2019.

2 'What Can We Learn from China's Health System Reform?', The BMJ, June 2019.

3 'Reduce Medical Costs for People Through Normalised and Institutionalised Measures - Centralised Procurement Will Gradually Cover Various Types of Drugs', Economic Daily, January 2021.

4 'Opinions on the Centralised Purchase of Coronary Stents and Relevant Supporting Measures', National Health Security Administration, December 2020.

consumables reform measures in 2019 indicates major changes for the industry,[5] with particular implications for the future registration, procurement and distribution of high-value medical consumables. With the initial round of the national centralised tender program for coronary stents carried out in November 2020,[6] more high-value medical consumables are expected to be covered by the VBP scheme going forward, requiring medical supply businesses to adapt rapidly and radically. The National Reimbursement Drug List (NRDL), which has been updated annually since 2017, saw 119 new drugs included last year. A small number of these were developed by British companies.

Meanwhile, foreign pharmaceutical companies in China, including those from the UK, have benefitted from a series of regulations aimed at speeding up the review and approval process for new drugs as well as facilitating innovation. A 'priority review' process to expedite approvals for innovative drugs, the ability to use overseas trial data to support licence applications in China[7] and the creation of the Market Authorisation Holder (MAH) system, allowing drug innovators to receive regulatory approval for new products without also being registered manufacturers,[8] all demonstrate increased support for an innovative and competitive industry. These policies have led to tangible benefits. Foreign companies have noted that approvals for drugs and vaccines have continued to accelerate, especially for innovative and urgently-needed drugs in areas such as rare and chronic diseases. For example, 48 new drugs passed drug approval in 2020, up from six in 2016.[9] 31 of them were approved through 'priority review', while eight were imported.[10]

Similar trends are taking place in the medical devices industry. China's newly revised *Regulations on Supervision and Administration of Medical Devices*,[11] which will come into effect on the 1st June 2021, also have a particular focus on encouraging innovation, with foreign medical devices companies as potential beneficiaries.[12] One provision stipulates that when applying for marketing authorisation, if a product will first be launched in China, foreign manufacturers seeking approval for innovative imported medical devices no longer need to present the country of origin (COO) approval, which simplifies the application process for foreign manufacturers and creates incentives for them to choose China as their first destination to launch innovative medical devices. The regulations also extend the MAH system to the medical devices sector. This permits MAHs to contract local partners to manufacture their products, thereby allowing both domestic and foreign medical devices companies to focus on R&D without spending too much time on obtaining manufacturing approval.[13]

Significant regulatory changes in China's cosmetic industry in the past year have also in some ways improved the regulatory environment for overseas cosmetic companies. Starting from May 2021, cosmetics no longer needs to be tested on animals in order to gain approval in China. This grants British cosmetics, many of which actively ensure cosmetics are made without cruelty to animals, market access.[14] The implementation of the new *Cosmetic Supervision and Administration Rules* (CSAR)[15] in 2021, means that the process of obtaining market approval for cosmetic products has been streamlined, as an increased number of cosmetics only need to go through a notification process instead of more time-consuming registration.[16] However, uncertainties still remain as businesses await the release of supporting regulations for CSAR, which will clarify more specific matters, such as conducting clinical trials for cosmetics.

At the same time, many other developments in China's health market also continue to boost foreign investors and companies' confidence in the industry. In March 2021, Premier Li Keqiang reiterated China's readiness to improve market access for foreign companies in elderly care

5 'Opinions on Reforming the Management of High-Value Medical Consumables', State Council, July 2019.

6 'China's Centralised Purchasing Leads to 90 pct Drop in Price of Coronary Stents', Xinhua, November 2020.

7 'Opinions on Deepening the Reform of the Review and Approval System and Encouraging the Innovation of Drugs and Medical Devices', State Council, October 2017.

8 'China's MAH System and Bringing New Drugs to Market', Pharma Boardroom, November 2019.

9 'How Is China's Drug Approval Agency Outpacing International Counterparts? It's Complicated', Mercatus Center, March 2019 and 'With 45 New Drug Approvals in 2019, Friendly FDA is Here to Stay', Fierce Biotech, January 2020.

10 'The Epidemic Will Not Stop China's Pace of Innovation; Among the 48 Approved New Drugs, 'Priority Review' Accounts for 65%', 21st Century Business Herald, December 2020.

11 'Regulations on the Supervision and Management of Medical Devices', National Medical Production Administration, February 2021.

12 'Regulations on the Supervision and Management of Medical Devices', National Medical Production Administration, February 2021.

13 'Impact of the Growing Marketing Authorization Holder Pilot Program in China's Medical Device Industry', K&L Gates, April 2021.

14 'Administrative Regulations for the Registration and Filing Information for Cosmetic Products', National Medical Products Administration, February 2021.

15 'Cosmetic Supervision and Administration Rules', State Council, June 2020.

16 'China's New Cosmetics Regulations to Reduce Red Tape for Businesses in 2021', China Briefing, July 2020.

provision and pensions funds and insurances.[17] China's new rules on public listing in ChiNext, which no longer requires companies to obtain approval from the China Securities Regulatory Commission (CSRC), have facilitated the listing of a number of pharmaceutical and medtech companies in the past year, including foreign-invested enterprises. Policies encouraging the development of private hospital sector also spell opportunities for foreign investment. By the end of 2020, there were 35,000 hospitals in China, 12,000 of which were public, while 24,000 private.[18] With 'medical institutions' added to the *Catalogue of Encouraged Industries for Foreign Investment ('Encouraged Catalogue')* in 2019,[19] foreign-invested medical institutions can play a bigger role in delivering high-quality medical services to Chinese patients.

A spate of regulations relating to Hainan Free Trade Port published in the past year, such as the *Opinions on Particular Measures to Relax Market Access in Order to Support the Construction of Hainan Free Trade Port*,[20] all have a strong emphasis on developing Hainan's services industry, especially its healthcare services. In particular, measures have been introduced to further develop Bo'ao Lecheng International Medical Tourism Pilot Zone, including allowing clinical real-world data to be used in registering imported medical products.[21] If followed through, these policies should make Hainan's health industry increasingly attractive for foreign investment.

Despite these improvements, however, foreign professionals, investors and companies still face certain restrictions in the industry. For example, the medical institutions sector is not yet fully open, with foreign-invested hospitals still restricted to Sino-foreign joint ventures with a 70% shareholding limitation for foreign parties. As it is stated in China's 14th Five-Year Plan that China intends to attract more foreign capital and keep pushing for greater openings in a number of Chinese industries, including its healthcare sector, China's government must continue to optimise the regulatory environment if more foreign capital is to enter the healthcare industry and contribute to the upgrading and innovation of the sector.

17 'Li Keqiang: Welcome Foreign Elderly Care Provision Enter the Chinese market', National Development and Reform Commission, March 2020.

18 'Statistical Communiqué on National Economic and Social Development in 2020', National Bureau of Statistics, February 2021.

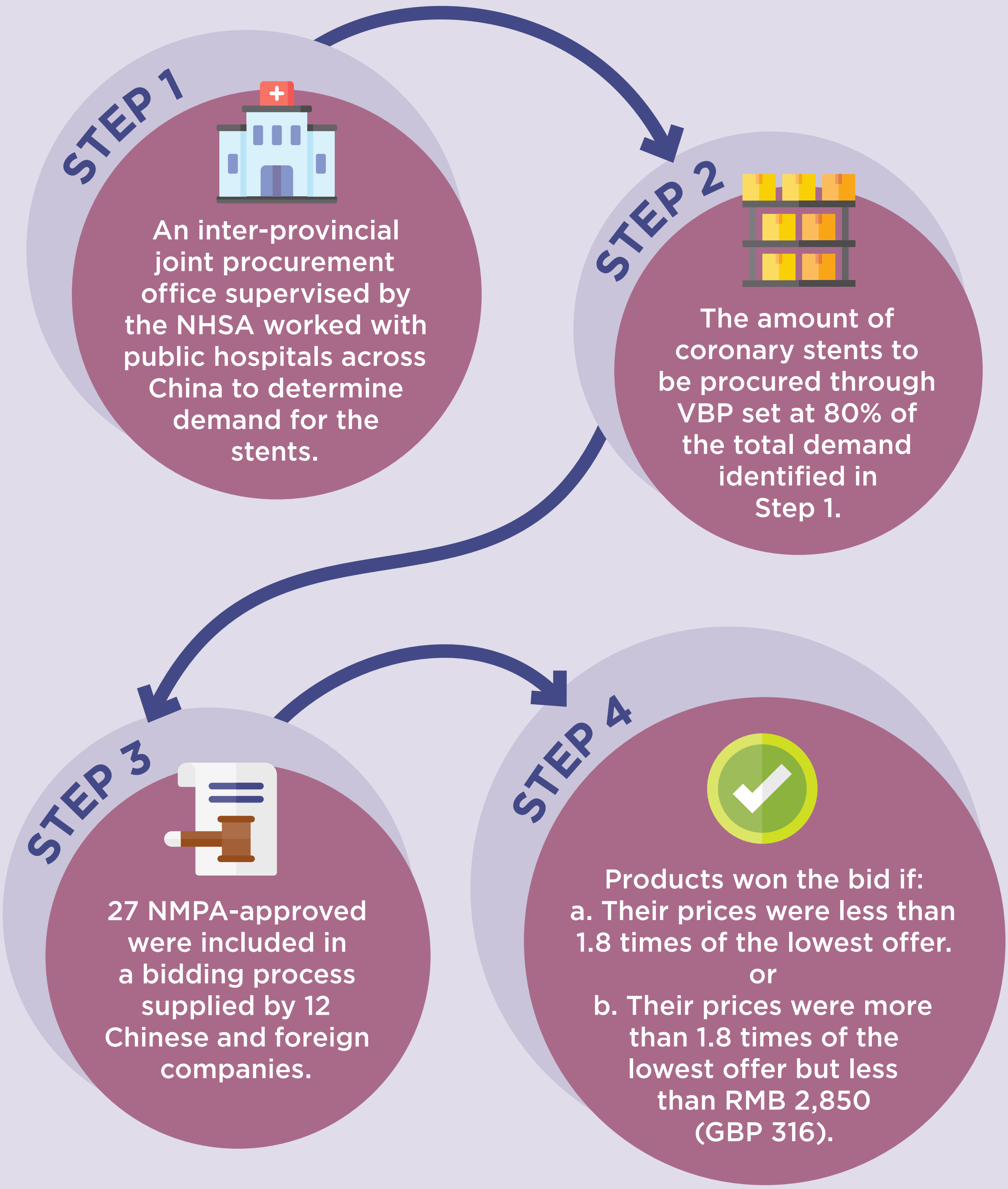
19 'Catalogue of Encouraged Industries for Foreign Investment', National Development and Reform Commission, December 2020.

20 'Opinions on Particular Measures to Relax Market Access in Order to Support the Construction of Hainan Free Trade Port', National Development and Reform Commission, April 2021.

21 'Regulations on the Hainan Free Trade Port's Bo'ao Lecheng International Medical Tourism Pilot Zone', Standing Committee of the People's Congress of Hainan Province, June 2020.

How could volume-based procurement (VBP) work for high-value medical consumables?

Case study: Coronary stents were the first medical device to be included in the central VBP system. Prior to this, only drugs were procured through the system at the national level. The initial round of VBP for drug-eluting coronary stents was carried out in Tianjin in November 2020.



REGULATORY CHALLENGES

1 RESTRICTIONS ON UTILISING HUMAN GENETIC RESOURCES AND THE SHARING OF RELATED DATA

British healthcare companies in China have expressed concern over the significant restrictions they face around utilising human generic resources and obtaining human genetic data. The *Administrative Regulations on Human Genetic Resources (HGR)*, which came into effect in 2019, sharply restricts the ability of foreign parties to engage in activities that involve human genetic resources or obtain relevant data.[22] Any foreign entity that wishes to engage in scientific research and clinical trials involving human genetic resources will have to partner with a Chinese institute and first seek approval from the Ministry of Science and Technology (MOST). Entities in China must also file a request with MOST before they can transfer data to foreign parties. British businesses have also reported that the implementation of the regulations has been much wider in scope than what is stipulated on paper. Some interpretations of the regulations have been overly cautious, and foreign-invested enterprises have not been allowed to conduct research on a wider range of human material. The 2020 edition of *Negative List for Market Access* further prohibits 'activities surrounding human genetic resources' unless approval is obtained,[23] slowing, if not outright restricting, the development of private investment and private innovation in this area. These developments add serious operational difficulties to a broad range of foreign companies, including foreign pharmaceutical, medical devices, cosmetic companies as well as hospitals which in many cases, rely on human genetic research and related data to either develop their products or provide tools for diagnosis and treatment of patients.

2 CHALLENGES AROUND THE VBP SYSTEM, NATIONAL REIMBURSEMENT DRUG LIST (NRDL) AND NATIONAL ESSENTIAL DRUG LIST (NEDL)

In 2016, the VBP system was introduced nationally to further drive down prices of generic drugs. Starting from September 2018, the government planned to also apply the system to high-value medical consumables.[24] While the motivation for adopting VBP is understandable, with its singular focus on price and little consideration of value or quality, the system has also presented the industry with significant challenges, including in the area of medical technology. So far, as pharmaceutical and medical devices companies have had to cut drug prices significantly in order to win bids in procurement, there have been concerns that it may produce an incentive for companies to compromise quality of products to make lower prices more profitable. Low prices should not be the only metric used to understand the value of a product, and regulators should consider how the system can better incentivise innovation. While the government has so far introduced a range of measures to spur innovation in the healthcare industry, the current procurement system in some ways discourages innovation, which normally requires higher R&D spending and more resources. Procurement strategies must be adjusted to ensure that the long-term benefits of investing in high-quality, sustainable and often more economical products for both patients and administrators are actively considered in government decision-making.

Another policy measure causing similar pricing pressure has been the publication of the NRDL. Although many international pharmaceutical companies have shown an

22 'Administrative Regulations on Human Genetic Resources', State Council, May 2019.

23 'Negative List for Market Access', National Development and Reform Commission, December 2020.

24 'Prices of High-Value Medical Consumables to be Controlled', State Council, July 2019.

interest in having their products listed in the NRDL, which can help secure a bigger market share,[25] they have had to drive down prices of innovative drugs dramatically over the course of their negotiations with the Chinese government to successfully do so. Last year's negotiation over NRDL inclusion saw 119 new drugs enter the list, with an average decrease in price of 51%.[26] This calls the sustainability of long-term operations in the market into question. In the government's drive to lower drugs costs, both domestic and foreign companies' interests must be considered to ensure a more sustainable and healthy market environment for all market players. However, British businesses recognise the government's efforts in recent years to improve the NRDL's evaluation and negotiation system, adopting measures such as the Dynamic Adjustment mechanism and the Healthy Technology Assessment (HTA) to make sure the whole process is more evidence-based. Businesses hope that the government will continue in this direction, further improving decision-making processes around the NRDL.

Meanwhile, although the NHSA has made notable progress in including more drugs for treating rare diseases in the NRDL, the current focus on 'ensuring basic needs' means that drugs which are particularly expensive are not currently considered, as they would impose a heavy burden on both public health insurance and patients themselves. The establishment of a government-led multi-channel funding system, where basic medical insurance provides the main source of funding and is supplemented by major illness insurance and commercial health insurance, as well as charities and other social organisations, could be an effective solution for this problem. This could increase patients' access to drugs for rare diseases and improve the overall quality of medical care.

Similarly, when deciding which drugs should be added to the NEDL, the government should take into account the clinical demands of treating chronic diseases, the elderly and children, and ensure that drug research and development process is reflected in drugs' prices. Drugs that are safe, cost-effective, easy to use and high in clinical value should be included in NEDL in order to meet the demand of medical institutions at all levels and increase their accessibility to patients. At the same time, in accordance with the goal to encourage innovation in medical industry, the government should continue to support the development of innovative drugs and vaccines for serious, chronic and infectious diseases, and further streamline registration processes in order to meet urgent clinical needs.

3 DIFFICULTIES OBTAINING LICENCES FOR FOREIGN HEALTHCARE PROFESSIONALS

Foreign professionals have seen few changes to their ability to receive licences to operate in China. In order to practice, foreign nurses have to pass China's Registered Nurse examination, which is not available in English. This makes working in China almost impossible for foreign nurses who do not speak perfect Mandarin. Although this problem is currently not faced by foreign doctors, who are able to practise in China irrespective of their level of Chinese, the draft *Administrative Measures for the Practice of Foreign Doctors in China* published by the National Health Commission (NHC) in January 2020,[27] requires foreign doctors who intend to practise in China for the long-term to pass the NHC exam in Chinese as well which, if it comes into effect, will make it harder for British doctors to obtain licences in China in the future. The strength of medical training in the UK makes UK-trained health professionals valuable additions to medical teams around the world. Recognising British qualifications and making it easier for British-qualified nurses and doctors to practise in China will allow them to more efficiently utilise their skills, and also help China a greater variety of highly skilled workers through access to global talent pools.

25 'Market Trends and Updates: New Pharmaceutical Policies Have Dramatically Changed the Landscape in China', AmerisourceBergen, August 2020.

26 'New National Reimbursement Drug List Comes Into Effect on 1st March With an Average Decrease in Price of 50%', State Council, January 2021.

27 'Draft Administrative Measures for the Practice of Foreign Doctors in China', National Health Commission, January 2020.

Another issue facing foreign doctors in China has been the number of medical sites they are permitted to practise in. Although the *Interim Measures for the Administration of Short-term Medical Practice of Foreign Physicians in China*,[28] which governs foreign doctors' practice in China unless the draft *Administrative Measures* are implemented, permit senior employees to work at more than one healthcare facility, in practice, they face difficulty to do so. This prevents organisations from deploying doctors effectively, especially in emergencies, and blocks them from undertaking the rotational experience that many regard as integral to developing the experience they need. It is encouraging that Beijing's municipal government has in recent years permitted doctors to practise at different work sites within the city. The draft *Administrative Measures* presents an opportunity to broaden this to a national level, allowing private medical facilities to provide the best possible service across their sites.

At the same time, with the growth of China's economy and the expansion of China's middle class, there is a growing demand for a broader range of health services. In 2019, 2% of the Chinese population were diagnosed with depression and 5% with anxiety,[29] but the country was short of 430,000 mental health counsellors.[30] China's *National Nutrition Plan (2017-2030)* also mentions the need to train more professional nutritionists.[31] Currently, there is no regulatory framework to support the licensing of overseas therapists, counsellors and nutritionists in China. Exploring ways to facilitate the registration of overseas professionals will bring more international expertise and capacity into the industry and help meet the increasing demand for mental health counselling and nutritional consultation in China.

4 POTENTIAL REGULATORY CHANGES FOR UK COSMETIC COMPANIES

The new CSAR has brought a number of positive changes to the cosmetics industry. Cosmetic products are now divided into two categories – special and general cosmetics. Only special cosmetics are required to be registered, while a larger number of general cosmetics only need to complete a simplified notification procedure. This improves market access for foreign cosmetic companies, speeds up import cycles and consequently reduces logistical and administrative costs. However, in order to facilitate the CSAR's implementation, around 30 supporting regulations will be put in place by the NMPA, which will further shape the regulatory landscape of the cosmetic industry. British businesses note that some of these regulations may create more difficulties for their operations. For example, the *Cosmetic Efficacy Claim Evaluation Guidelines* largely bans read-across of data between products using similar formulas for the purpose of efficacy testing,[32] with only multi-shade makeup products eligible for exemption. The read-across technique should be expanded to also include products that only have minor differences in fragrances and preservatives. The current regulation precludes cosmetics manufacturers from using what is common practice in many other industries around conducting efficacy evaluations and safety assessments. Not allowing read-across will not only lead to repetitive tests that increase costs, but also put pressure on limited testing resources and delay timelines.

5 LIMITED IMPLEMENTATION OF INCENTIVES FOR HEALTHCARE DESPITE ITS STATUS AS AN ENCOURAGED INDUSTRY

The Chinese government is actively seeking foreign investment in private medical institutions, as per the *Encouraged Catalogue*.[33] One area that has yet to be actioned is tax. Foreign-invested hospitals are currently taxed at 25%, which is the highest corporate tax rate. At the same time, lower tax rates are available for many industries that are strategically encouraged, such as high-tech and certain integrated circuits production enterprises, which are taxed at 15%. According to the *Opinions on Promoting the Sustainable, Healthy and Orderly Development of Private Hospitals*,[34] 'for-profit' private hospitals should be able to enjoy the same tax rate as small-sized enterprises, which currently sits at 20%. However, this policy has yet to be implemented. Private medical institutions play a unique role in providing high-quality healthcare and relieving pressure on public services. Therefore, incentivising foreign investment into the sector would strongly support critical policy aims.

28 'Interim Measures for the Administration of Short-term Medical Practice of Foreign Physicians in China', (former) National Health and Family Planning Commission, January 2016.

29 'NHC: China's Population Suffering from Depression Reaches 2.1%', Beijing Daily, December 2020.

30 'Report on Mental Health Issue in China (2017-2018)', Social Sciences Academic Press (China), January 2019.

31 'National Nutrition Plan (2017—2030)', State Council, July 2020.

32 'Cosmetic Efficacy Claim Evaluation Guidelines', National Medical Products Administration, April 2021.

33 'Catalogue of Encouraged Industries for Foreign Investment', National Development and Reform Commission, December 2020.

34 'Opinions on Promoting the Sustainable, Healthy and Orderly Development of Private Hospitals', National Health Commission, June 2019.

RECOMMENDATIONS

REGULATORY CHALLENGE	RECOMMENDATION
1 Restrictions around human genetic research and data-sharing	▪ Loosen restrictions on foreign parties' ability to utilise human genetic resources for scientific research and clinical trials, and to obtain human genetic data.
2 Challenges around the VBP system, the NRDL and the NEDL	▪ Balance the need to drive down prices with incentivisation of innovation when implementing centralised procurement systems. ▪ Keep improving the evaluation system for NRDL inclusion, making it more evidence-based. ▪ Further improve the NEDL to ensure it includes drugs that relieve pressure on clinics when treating chronic diseases, the young and the elderly. ▪ Support the development of innovative drugs and vaccines for serious, chronic and infectious diseases. ▪ Expand 'early and pilot implementation' policy to cover innovative drugs and vaccines.
3 Difficulty obtaining healthcare services licences	▪ Explore signing Mutual Recognition Agreements to allow registered nurses and doctors to operate in both countries, or provide an English-language version of requisite examination. ▪ Allow foreign doctors to work on more than one site. ▪ Develop an effective framework that attracts overseas therapists, counsellors and nutritionists to work in China.
4 Potential regulatory changes for UK cosmetic companies	▪ Allow cosmetic efficacy read-across between products with the same base formula but minor differences in colourants, fragrances and preservatives.
5 Limited implementation of incentives for healthcare despite its status as an encouraged industry	▪ Implement measures, such as tax incentives, to encourage foreign investment in medical institutions.

Spotlight on sustainability

The healthcare industry typically consumes large amounts of energy and resources, while also producing significant levels of emissions and waste. As China continues on its path to achieve carbon neutrality by 2060, British healthcare companies and hospitals in the country have also set their own zero carbon emission goals and launched sustainability initiatives to make sure they minimise their impact on the environment. They have focused on measures such as reducing greenhouse gas emissions, using environmentally-friendly resources, and improving waste recycling and water preservation systems to incorporate the principle of sustainability into various aspects of their daily operations. A green healthcare industry not only contributes to improved environmental standards, but also a more sustainable development of the industry itself that delivers better outcomes for patients.

MUTUAL OPPORTUNITIES

INNOVATION AS A PRIORITY IN CHINA'S HEALTHCARE REFORM

In China's current process of healthcare reform, strengthening the country's capacity to tackle NCDs and other serious diseases through providing innovative medical solutions continues to be a core priority for the government. British healthcare companies have traditionally been a leading force in driving R&D and innovation in life sciences. They are well positioned to produce innovative medical solutions urgently needed by Chinese patients. In particular, the capabilities of UK firms in genomics research is particularly noteworthy, and it has used genomics in clinical care for rare diseases and some cancers.[35] There is considerable scope for the two countries to deepen exchanges and co-operation in innovative drugs and therapeutics in treating rare diseases that will benefit both sides.

INCREASINGLY HEALTH-CONSCIOUS MIDDLE CLASS

With remarkable improvements to their living standards in the past four decades, people in China, and especially the country's 400 million middle class, have become increasingly health-conscious. This trend has been further reinforced by the COVID-19 outbreak, which highlighted both the importance of high-quality healthcare services as well as day-to-day health and hygiene. Greater awareness in the middle class of nutritional and mental health also leads them to seek out health services beyond traditional disease treatment. Quality medical care and consultations from private medical institutions are becoming increasingly popular.[36] China's decision to add 'medical institutions' to the *Encouraged Catalogue* in 2019 has facilitated foreign capital's movement into China's medical institutions sector,[37] generating significant opportunities for British companies that strongly benefit Chinese consumers. Moreover, the UK can partner with China in the training of medical professionals (especially general practitioners), hospital managers, engineers specialising in medical devices, nurses and elderly care staff. This would create a greater exchange of knowledge and experience, to the benefit of both countries' health sectors.

DEMOGRAPHIC TRENDS AND HEALTHY AGING

China's population has been aging rapidly. According to the country's latest national census, the number of people aged 60 or older has reached 260 million, representing

35 'Future of UK Life Sciences: How to Reshape the Industry for the 2020s', The Economist Intelligence Unit, January 2020.

36 'China Healthcare Outlook Hospital Investment Trends in China', North Head, February 2021.

37 'China Healthcare Outlook Hospital Investment Trends in China', North Head, February 2021.

18.7% of China's total population and an increase of 5.4% from 2010.[38] This has created growing demand for higher quality healthcare for its elderly population. A national strategy to proactively respond to this demographic challenge, as mentioned in China's 14th Five-Year Plan,[39] will lead to enormous opportunities for companies to facilitate healthy aging. For example, there has been growing interest in adult vaccination programmes due to the increasing awareness of disease prevention and healthy aging. A wide range of stakeholders, including the government, pharmaceutical and vaccine companies, medical service providers and insurance companies are expected to explore innovative mechanisms to achieve goals set out in Healthy China 2030.

HEALTHTECH

Digitalisation can alleviate some of the pressures caused by difficulties providing medical care to more remote areas. Telemedicine and teleconsultation can allow one doctor to contact patients quickly, regardless of location. Similarly, the harnessing of artificial intelligence and big data can decongest, streamline and personalise services. China's healthcare industry has seen an increasing level of digitalisation in recent times. In 2019, it also legalised online prescription-drug sales through the *Drug Administration Law*, giving patients in more remote areas greater access to high-quality drugs.[40] Uptake in familiarity with health-tech in China has further increased in the wake of the COVID-19 outbreak, and the industry is worth GBP 24 billion (RMB 210 billion).[41] British healthtech developers are recognised for creating innovative, high-quality products. NHS Digital, for example, has developed a broad range of programmes that aim to deliver the best care to patients, including allowing them to check symptoms and getting help online. It also provides NHS staff with important information about patients so that they can tailor their care to patients' need. With full access to the market, British healthcare companies will be able to provide China with agile solutions that contribute to both public awareness campaigns about healthy lifestyle choices and the overall improvement of China's healthcare system.

38 'The Acceleration of Population Ageing Presents Both Challenges and Opportunities', State Council Information Office, May 2021.

39 'Outline of the Objectives of the 14th Five-Year Plan and Long-term Vision for 2035 for Economic and Social Development', National Development and Reform Commission, March 2021.

40 'Drug Administration Law', State Administration for Market Regulation, August 2019.

41 'Learn More About Our Industry', Association of British Health Tech Industries, April 2020.

LEGAL SERVICES

AT A GLANCE

KEY CHALLENGES:

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

KEY RECOMMENDATIONS:

- Pilot allowing licences in certain areas that are non-sensitive and most relevant to foreign firms, such as commercial and corporate work, particularly in M&A, funds formation, financial regulatory and anti-trust areas
- Allow lawyers from foreign firms to represent their clients in meetings with government agencies, when clients require it
- Increase flexibility of the joint operations models, in particular reducing barriers to entry, such as minimum numbers of lawyers, length of operating history of the local partner and location of the joint operations. Improve the ability of foreign partners to control and share the profits they earn

KEY OPPORTUNITIES:

- Further alignment of standards
- ESG
- Chinese outbound investment

STATE OF SECTOR

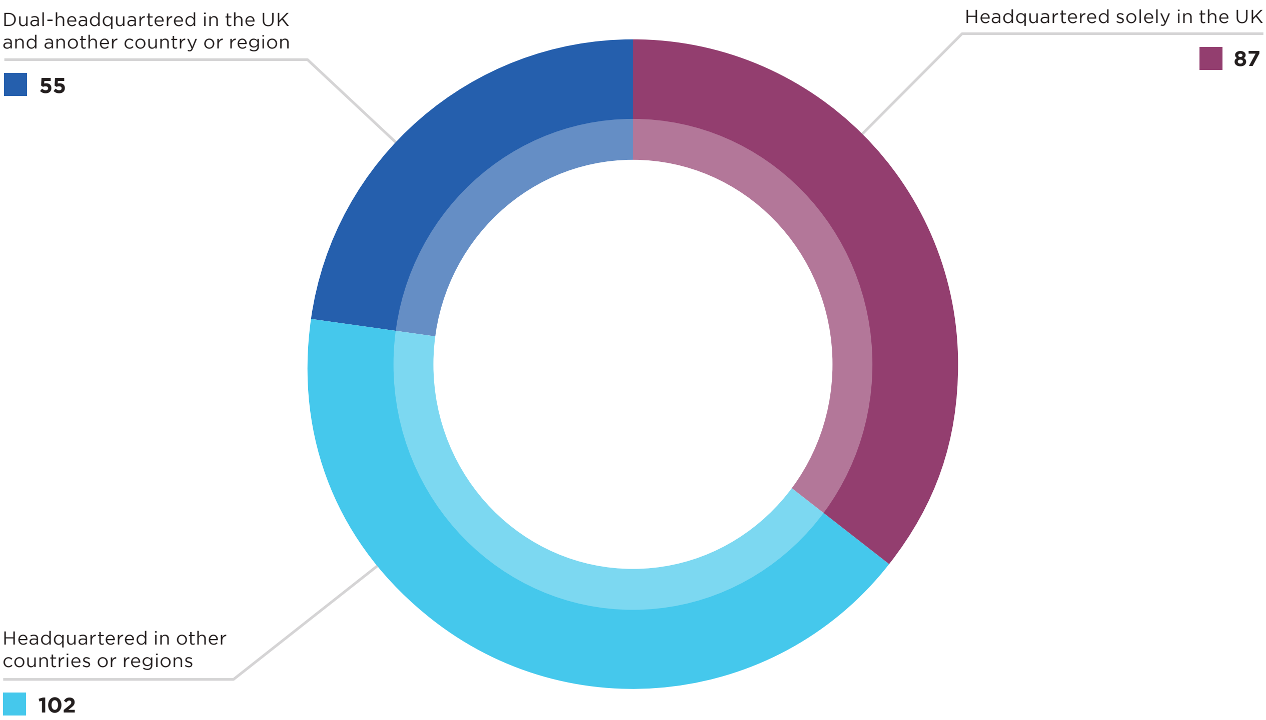
One year on from the peak of the COVID-19 outbreak in China, domestic activity in the legal landscape in China has picked up slightly as economic growth accelerates.[1] On average, law firms across the Chinese mainland report that revenue increased by an average of 0-25% between 2019 and 2020,[2] driven by rising demand for domestic mergers and acquisitions, restructuring and non-performing loan portfolio transactions in particular.[3]

By contrast, cross-border activity – and particularly outbound activity – has slowed somewhat due to an uncertain business environment and travel restrictions caused by the pandemic,[4] severely constraining the market for foreign legal firms, many of which specialise in such areas. Foreign firms represent less than 1% of the total number of representative offices in-country,[5] and of the thirty largest law firms in China, only two are international brands.[6]

Beijing and Shanghai are the most popular locations for British law firms, with 15 firms operating foreign representative offices in Beijing and a similar number in Shanghai.[7] This count, it should be noted, does not include firms

Number of partners working in the top 30 international law firms in the Chinese mainland in 2020 by global headquarters

Source: Asian Legal Business



1 'Asia Business Law Survey', Asia Business Law Journal, January 2021.

2 'Asia Business Law Survey', Asia Business Law Journal, January 2021.

3 'Legal Market Overview in China', Legal 500, March 2021.

4 'Asia Business Law Survey', Asia Business Law Journal, January 2021.

5 'Statistical Analysis of the Status of Lawyers and Basic Legal Services Work in 2019', Ministry of Justice, June 2020

6 '2020 ALB China 30 Largest Law Firms', Asian Legal Business, November 2020. One is headquartered in the United Kingdom, while the other is headquartered in Hong Kong and is the result of a merger between Chinese, Australian, and British firms.

7 'Announcement No. 9', Ministry of Justice, November 2020.

that chose alternative paths to establish a presence on the Chinese mainland, such as holding a Swiss Verein structure with a local partner or registering as a Hong Kong-based entity.

The regulatory landscape remains relatively restrictive for foreign law firms in China in 2021, with substantial constraints on the ability of lawyers employed by foreign firms to provide the full breadth of their expertise to market. There have been some signals of greater opening. Firstly, legal practitioners licenced in Hong Kong or Macao holding PRC passports and meeting other qualifying criteria will be eligible to seek qualification to permit them to practice law in specified cities in the Greater Bay Area (GBA)[8] as part of the *Closer Economic Partnership Agreement* (CEPA), which provides access for some companies registered in Hong Kong to the mainland China market. It is not yet clear whether this represents a first step towards opening up of the legal services sector that might be extended to foreign firms, whether through the Hong Kong or Macao offices of those firms or as a broader market opening policy to all firms. Further details are awaited, including when and in what form this opening might occur.

Secondly, the Ministry of Commerce released a plan in August 2020 to further develop China's trade in services, committing to "expanding the scope of opening up in an orderly manner", among other pledges.[9] The ultimate aim of the plan is to improve the competitiveness of China's services industries and upgrade the quality of its economic development. This is reiterated in the 14th Five-Year Plan, which echoed commitments to establish a negative list for trade in services (with the implication that the market will be more open for all services except those specified in the list) and support foreign investment in service sectors more generally. However, there are currently no specific measures related to the opening up of the legal services sector in the plan. As such, the ability of British law firms to bring their expertise in legal practice and experience in managing international business activities to the Chinese mainland remains limited.

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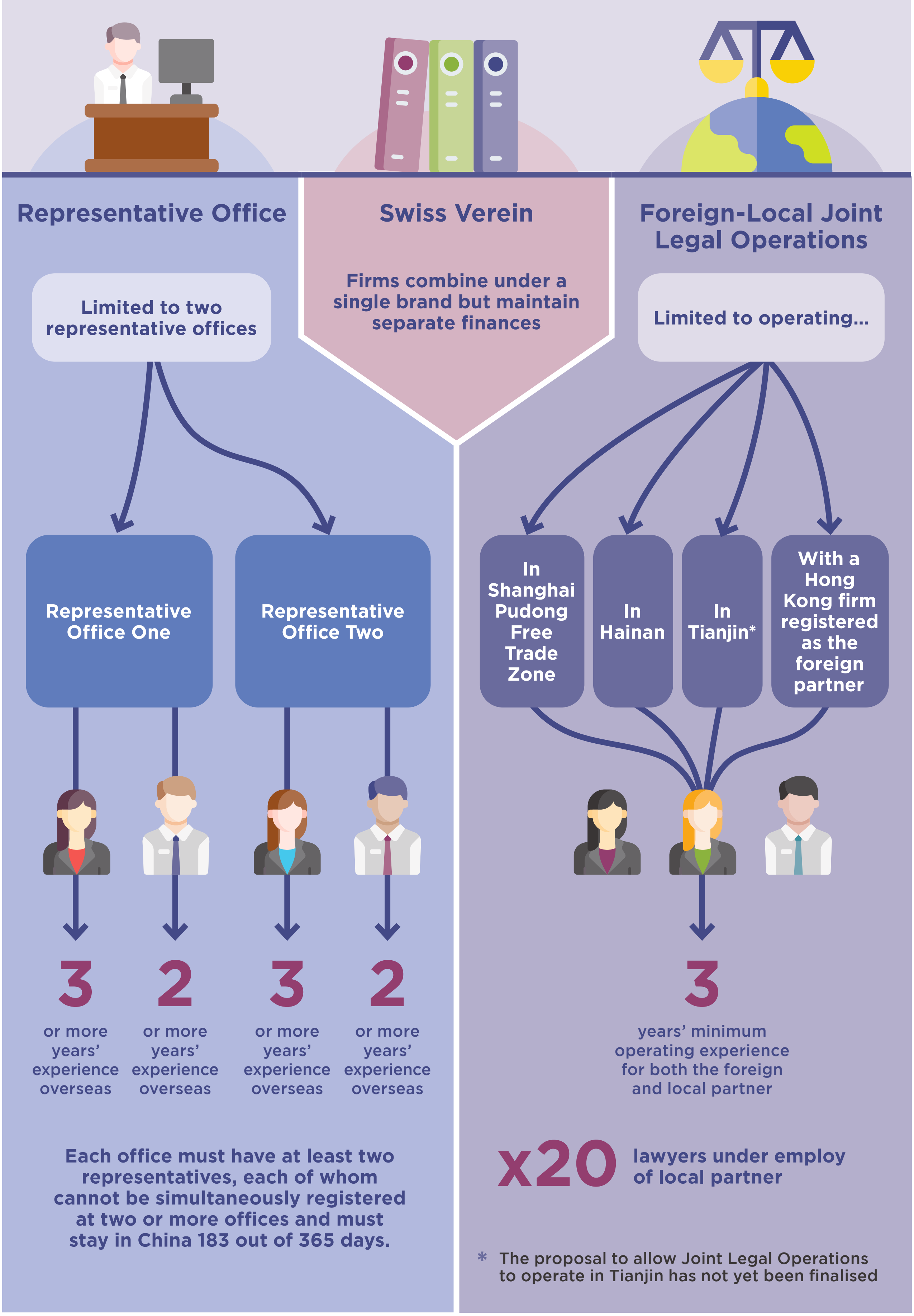
8 'Decision Authorising the State Council to Launch a Pilot Project for Legal Practitioners from Hong Kong and Macao to Obtain Mainland Practice Qualifications and Engage in the Legal Profession in Nine Cities within the Greater Bay Area', National People's Congress, August 2020.

9 'General Pilot Programme for Comprehensively Deepening the Innovative Development of Trade in Services', State Council, August 2020.

Foreign Law Firms Entering China



REGULATORY CHALLENGES

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

In China, the right of PRC-qualified lawyers to practise Chinese law is suspended while they are employed by foreign law firms. As such, foreign firms cannot issue opinions on PRC law without entering into an arrangement with a local firm, in which the local firm services clients' domestic needs. These arrangements can be inefficient, increasing start-up costs for China branches and therefore reducing firms' competitiveness.

Such limitations on PRC-qualified personnel fully operating in the sector, as well as restrictions on appearing before Chinese courts and tribunals, increase the difficulty of attracting and retaining talent for foreign law firms. This results both in an artificial limit on the competitiveness of foreign law firms and a barrier to the experience of foreign law firms in managing cross-border business activities from diffusing into the local legal ecosystem.

Furthermore, foreign passport-holders are barred from obtaining PRC legal practising certificates, regardless of training or experience. It must be highlighted that no such restrictions exist in the UK. Any English-qualified lawyer can practise English law, and there are no restrictions on PRC law firms opening offices and employing English-qualified lawyers of any nationality to advise on English law in the UK.

2 RESTRICTIONS ON APPEARANCE BEFORE GOVERNMENT AGENCIES

Foreign firms continue to be generally prohibited from appearing or participating in meetings between their clients and Chinese mainland government authorities. Where permissibility is not clear, firms typically err on the side of caution and decline the opportunity. Clients would benefit from their China-based foreign lawyers being able to appear before certain government agencies, particularly in such areas as product licensing, regulatory compliance, approvals and registrations and intellectual property protections.

These restrictions may prohibit clients from selecting the most appropriate lawyer or legal firm. This could be especially problematic in cross-border transactions. If, for example, a client has a preference for a foreign firm with experience in the non-China market but needs to bring in an additional counsel who is not familiar with the case, this may result in inefficiencies and additional costs.

3 RESTRICTIONS ON OWNERSHIP AND OPENING STRUCTURE

Foreign firms are currently limited to two representative offices in China. Some firms have navigated this by partnering with local firms. However, certain restrictions means this option is not suitable for all foreign law firms. In particular, the inability to operate as a single firm and the significant barriers to entry make the decision to establish joint operations a considerable investment in terms of both time and capital. These costs dissuade some large firms from entering the market, and make it virtually impossible for smaller firms to do so.

Some municipalities have created alternative solutions to JV partnerships. The Shanghai Free Trade Zone allows foreign-local joint operations, permitting co-marketing and shared referrals. However, there are several criteria that present challenges including that the joint operations must be located in the premium Pudong area, and both the foreign representative office and the local partner must have a minimum of three years' operating history. Furthermore, the local partner must have no fewer than 20 lawyers. These conditions and restrictions on management and profit-sharing rights in relation to the joint operations limit the attractiveness of this option. Although the Shanghai Municipal Bureau of Justice indicated in 2018 that it would consider expanding the scheme to the rest of the city, there has been no further progress on this.[10]

10 'Freehills to Offer Legal Services in Shanghai Pilot Free Trade Zone', State Council, August 2019.

Similarly, in Hainan, foreign-local joint operations may be established if the PRC partner employs at least 20 lawyers, both partners have a minimum of three years' operating history and neither partner has been subject to administrative punishment in the past three years. Tianjin may soon allow the same joint operations, subject to further specified regulations.[11] The CEPA is subject to some similar stipulations, and is limited to representative offices of Hong Kong firms.

Other domestic and foreign firms have combined through a Swiss Verein structure, in which the two entities maintain separate finances but share resources in such areas as business strategy, branding and IT systems. Importantly, blocking the sharing of profits forces the local entity to fund all operations independently and dilutes the shared interest in client referrals. Shared IT systems are further threatened by measures in the *Cybersecurity Law* which could affect local and foreign partners' ability to share data with each other.[12] Some firms have reported the process of establishing a Swiss Verein to be was long and bureaucratic, and would prefer to adopt and operate through a single entity.

4 THREATS TO ABILITY TO MAINTAIN CLIENT CONFIDENTIALITY

Foreign law firms have reported that audits of their Beijing representative offices have become more commonplace in the past few years. During these on-site inspections, regulators have made requests that potentially endanger client confidentiality, such as asking law firms to provide letters of engagement for review.

There have also been reports from representative offices of foreign firms in Beijing of regulators subjecting them to greater levels of scrutiny through periodic audits than, for example, offices in Shanghai. Whilst inspection is fully expected in any jurisdiction, audits which often result in mundane matters being highlighted for rectification exacerbate the already challenging operating environment.

5 UNEQUAL TAX TREATMENT

Chinese tax regulations treat foreign law firm representative offices like permanent establishments, despite their actual status as representative offices of a partnership. This means that foreign firms effectively bear two layers of tax – the one placed on any profit of the representative office and the Individual Income Tax (IIT) placed on their representatives and employees. The model made available to PRC firms to establish a partnership is not available to foreign firms. This is significant as a PRC partnership itself is not taxed. Partners instead pay tax on partnership income, which has a considerably lower marginal rate than IIT. As such, PRC firms can generate the same level of net income as their equivalents in foreign firms while charging lower fees to clients, impacting the competitiveness of foreign firms as well as their ability to attract and retain talent.

6 OFFICE LICENCE AND HR RESTRICTIONS

To set up a representative office, a foreign law firm must both demonstrate a 'need' to do so and wait three years before they are eligible to apply to open an additional office. This limits firms' opportunities for growth and contrasts with requirements in the UK, where Chinese firms may establish multiple offices with relative ease. In addition, the processes of changing representatives, particularly chief representatives, of a foreign representative office, transferring foreign lawyers between overseas and PRC offices and hiring foreign lawyers are bureaucratic and time-consuming, and have become progressively more burdensome. Firms report that many of these registrations can now easily take a year, compared to a few months previously. Therefore, resourcing decisions must be made long in advance of need, and foreign firms are artificially less agile than their domestic counterparts.

Furthermore, a foreign law firm with two representative offices in the Chinese mainland must have at least two registered representatives associated with each office, and these representatives are not permitted to be registered with both offices simultaneously. Furthermore, registered representatives must physically be in China for a total of at least 183 days in the calendar year. These requirements increase the operating costs and administrative burdens of foreign firms, particularly for those with two representative offices. Law firms are increasingly adopting remote working strategies, allowing them to become more efficient and broaden their operations. Non-resident partners can work in law firms in the UK, granting firms access to a wider range of senior professionals with the experience or talent they need, even if those other individuals have other commitments that limit their ability to relocate. This improves the potential and efficiency of law firms in the market, to the ultimate benefit of both professionals and clients.

11 'Response to Proposal No. 0458 of the Second Session of the 14th Municipal Political Consultative Conference', Tianjin Bureau of Justice, May 2019.

12 'Cybersecurity Law', Cyberspace Administration of China, November 2016.

RECOMMENDATIONS

REGULATORY CHALLENGE	RECOMMENDATION
1 Inability of PRC-qualified lawyers to practice Chinese law in a foreign firm	▪ Pilot allowing licences in certain areas that are non-sensitive and most relevant to foreign firms, such as commercial and corporate work, particularly in M&A, funds formation, financial regulatory and anti-trust areas.
2 Restrictions on appearance before government agencies	▪ Allow lawyers from foreign firms to represent their clients in meetings with government agencies, when clients require it.
3 Restrictions on ownership and operating 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 the local partner and location of the joint operations. ▪ Improve the ability of foreign partners to control and share the profits they earn.
4 Threats to ability to maintain client confidentiality	▪ Revise audit requirements to not include the provision of letters of engagement or other documents that expose confidential information, or grant firms ample time to redact such information. ▪ Ensure that the focus of audits remains on firms' operations, qualifications and other matters that concern their ability to serve clients, rather marketing and branding.
5 Unequal tax treatment	▪ Bring taxation of foreign representative offices and partners in line with that of their domestic law firm counterparts.
6 Office licence and HR restrictions	▪ Align the ease of setting up a representative office and employing representatives for foreign firms in China that Chinese firms enjoy in the UK. ▪ Remove minimum requirements for the number of representatives registered with a foreign law firm's representative office, or allow representatives to be registered with more than one representative office simultaneously. ▪ Allow foreign law firms to engage non-resident partners as representatives.

MUTUAL OPPORTUNITIES

FURTHER ALIGNMENT OF STANDARDS

As China becomes increasingly involved in conversations around international standards, we are seeing a concurrent convergence between regulations and standards set in China and regulations and standards set in other markets. A prime example is data and cybersecurity, where Chinese data standards bear striking similarity to the General Data Protection Regulation (GDPR). Should this convergence continue, international firms with their global networks would be well placed to provide clients with comprehensive briefings on navigating standards requirements, particularly when it comes to cross-border operations or partnerships. This would in turn strengthen the ability of their clients, both in China and overseas, to make strategically sound decisions for their business.

ESG

Companies in China are becoming increasingly interested and invested in Environmental, Social, Governance (ESG). The environmental aspect of ESG is particularly prevalent in conversations, owing to China's own commitments to environmentally sustainable development. However, interest in reforming corporate governance in China, particularly in terms of granting minority stakeholders more influence in corporate oversight, is growing. British law firms have a breadth of experience across all three elements of ESG, and can help companies ensure that their ESG investment or compliance decisions are as informed and effective as possible.

CHINESE OUTBOUND INVESTMENT

Despite economic pressures from the COVID-19 pandemic, China's outbound foreign investment in 2020 increased to RMB 860 billion (GBP 95 billion).[13] Companies in China continue to have a strong appetite for investing in third markets, and in many cases use English law as the legal system of choice for overseas operations. As such, British law firms are uniquely placed to provide advice to companies going outbound, with a strong intrinsic understanding of English law and a network of global offices that can support outbound companies in all of their investment destinations. With strong economic growth predicted for China in 2021, we expect that demand for this expertise will continue.

13 'Growing 3.3% to USD 132.9 billion, Chinese Outbound Investment Achieved Positive Growth in 2020', State Council, January 2021.

ACRONYMS

AI	Artificial Intelligence
AUM	Assets Under Management
CEPA	Mainland and Hong Kong Closer Economic Partnership Arrangement
CIBM	China Interbank Bond Market
CICPA	Chinese Institute for Certified Public Accountant
CIIO	Critical Information Infrastructure Operator
C-ROSS	China Risk Oriented Solvency System
CSAR	Cosmetic Supervision and Administration Rules
CSCSE	China Service Centre for Scholarly Exchange
CSRC	China Securities Regulatory Commission
DCS	Dual Circulation Strategy
ESG	Environmental, Social, Governance
ETS	Emissions Trading System
EU	European Union
F&B	Food and Beverage
FDI	Foreign Direct Investment
FIE	Foreign-Invested Enterprise
FII	Foreign Institutional Investor
FIL	Foreign Investment Law
FINL	Negative List for Foreign Investment
FTZ	Free Trade Zone
GAC	General Administration of Customs
GB	Guobiao
GBA	Greater Bay Area
GDPR	General Data Protection Regulation
GPA	Government Procurement Agreement
GPL	Government Procurement Law
GW	Gigawatts
HTA	Healthy Technology Assessment
ICAEW	Institute of Chartered Accountants in England and Wales
ICE	Internal Combustion Engine
ICV	Intelligent Connected Vehicle
IIT	Individual Income Tax
IP	Intellectual Property
JV	Joint Venture
LNG	Liquefied Natural Gas
MAH	Market Authorisation Holder
MEE	Ministry of Ecology and Environment
MIIT	Ministry of Industry and Information Technology
MLPS	Multi-Level Protection Scheme
MNR	Ministry of Natural Resources
MOF	Ministry of Finance
MOHURD	Ministry of Housing and Urban-Rural Development
MOST	Ministry of Science and Technology

NDRC	National Development and Reform Commission
NEA	National Energy Administration
NEDL	National Essential Drug List
NEV	New Energy Vehicle
NGO	Non-Governmental Organisation
NHSA	National Health Security Administration
NOC	National Oil Companies
NRDL	National Reimbursement Drug List
OEM	Original Equipment Manufacturer
PBOC	People's Bank of China
PCR	Polymerase Chain Reaction
PFM	Private Fund Manager
PHEV	Plug-In Hybrid Vehicle
QDII	Qualified Domestic Institutional Investor
QFII	Qualified Foreign Institutional Investor
QFLP	Qualified Foreign Limited Partnership
RQFII	Renminbi Qualified Foreign Institutional Investor
SAC	Standardisation Administration of China
SAFE	State Administration of Foreign Exchange
SAMR	State Administration for Market Regulations
SGP	Special General Partnerships
SME	Small and Medium-Sized Enterprises
SOE	State-Owned Enterprise
TNE	Transnational Education
VATS	Value-Added Telecommunications Services
VBP	Volume-Based Procurement
WFOE	Wholly Foreign-Owned Enterprises
WTO/TBT	World Trade Organisation Agreement on Technical Barriers to Trade

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BRITISH CHAMBER OF COMMERCE IN CHINA

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