BRITISH
CHAMBER OF
COMMERCE
IN CHINA
中 国 英 国 商 会

BRITISH BUSINESS IN CHINA: POSITION PAPER

2022

ABOUT THE BRITISH CHAMBERS OF COMMERCE IN CHINA

The British chambers of commerce in China are a collective of membership organisations in the Chinese mainland focused on providing advocacy, business support and networking opportunities for British business in China. We operate as independent, not-for-profit organisations with a strong and diverse membership.

The British Chamber of Commerce in China was established in Beijing in 1981 shortly after reform and opening up was launched, and the British Chamber of Commerce Shanghai extends back to 1915. For more than 100 years, the British chambers of commerce in China have brought the British business community together to help them thrive in one of the world's fastest growing markets. Our chapters across Beijing, Guangdong, Southwest China and Shanghai build a sense of community for member companies through social and informative events held across the country.

Our advocacy work seeks to promote a strong, inclusive, and prosperous operating environment for businesses of all backgrounds to succeed in China. Two important annual advocacy initiatives include the publication of the *Business Sentiment Survey* and the *Position Paper*. The former takes the pulse of British businesses in China on a series of issues, including their reflections on the past years' business environment, their most pressing market access issues and their views on current events that affect their business. Our *Position Paper* lays out the key recommendations of British business operating on the ground in China to the Chinese and the British governments and aims to improve the business environment for British companies in China.

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ABOUT THE POSITION PAPER 2022

The *British Business in China: Position Paper 2022* 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 2021-2022* with some adjustments in the data collection phase based on companies' responses. The entries are ranked in order of severity, with hiring challenges and talent development presenting the greatest challenge for British businesses, followed by navigating cybersecurity and IT regulations, and formulation and enforcement of laws and regulations. Analysis within the paper is drawn from the data provided in the *Sentiment Survey 2021/22* and industry roundtables and interviews.

Roundtables and interviews were held with British companies from Beijing, Shanghai, Guangdong, Chengdu and other regions between February 2022 and March 2022, providing input from companies across various various revenue profiles and years of experience in the market. As the COVID-19 pandemic continues into its third year, it was unsurprisingly the dominant issue underpinning many of our members' responses. The pandemic's impact was profound across all sectors, and contributed to many of our cross-cutting issues.

Exchange rate used: GBP 1 = CNY 8.33 = USD 1.33

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 chambers of Commerce in China do not assume legal liability or responsibility for the accuracy and completeness of the information provided in this paper.

CHAIRS' FOREWORD

JULIAN MACCORMAC
British Chamber of Commerce in China

RAY CHISNALL
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The British chambers of commerce in China are proud to present our *British Business in China: Position Paper 2022*. This marks the fourth edition of the *Position Paper* and provides our annual deep assessment of the business environment in China. It is a national endeavour and thus represents perspectives from British businesses operating across China.

As businesses operating in China for the past two years, many of us have been able to manage our operations, work with our suppliers, and support our people and customers with relative confidence despite prolonged disruption globally from the COVID-19 pandemic. China has stood apart as a country with both the means and determination to contain and control the spread of COVID-19. As a result, the Chinese economy has enjoyed continued growth despite the effects of the pandemic, by 2.2% and 8.1% in 2020 and 2021 respectively. Furthermore, the UK-China trade relationship continued to flourish with total trade reaching GBP 93.1 billion last year, surpassing 2019 levels.

However, the safe and mostly predictable business environment in China over the past two years has not come without a cost. China's borders have been all but closed for most travel since March 2020 and the businesses that depend on the flow of people travelling to and from China have been most severely affected. A growing sense of detachment and isolation amongst the foreign business community in China is now tangible. Many foreign nationals have now been away from families for two or more years and those leaving do so without any certainty when or even whether they will be able to return. When looking to other parts of the world, this contrast is increasingly becoming all the more striking. This forms the context for this year's Position Paper. Our *COVID-19 Impact Survey* in April 2022 highlights the extent to which business confidence has been shaken, particularly by the severity and duration of the lockdown in Shanghai.

China's commitment to a *dynamic zero-COVID-19* policy is very clear. The indications are that China will continue to stand apart in terms of COVID-19 prevention and control, and that businesses will continue to face an unpredictable period of delays and disruption, increased risk and costs. We hope control measures will change and evolve dynamically as needed, as we are seeing now, with testing and quarantine requirements for travelling to China. While we welcome such changes, it is not clear currently when and under what conditions restrictions can be further lifted or removed. As we consider the uncertainty that lies ahead, greater clarity on this specifically will help many companies better understand what to expect and better plan their businesses and manage their risks.

The chapters that follow provide rich detail and depth on the business environment for individual sectors. The main data collection phase of this Paper took place prior to the latest COVID-19 outbreaks and so they rightly focus on specifics to improve the business environment within each sector. Dedicated chapters also look into cross-sector matters drawn from our annual *Business Sentiment Survey*. Our intention is to provide substantive insight and specific recommendations, which, if taken into consideration, have the potential to significantly enhance the business environment, increase opportunities for business and deliver better outcomes for consumers and customers.

As the British chambers of commerce in China, we are working relentlessly to represent the challenges businesses are facing currently in China and support positive trade and investment between the UK and China. Located on the ground here in China, our Chambers are in a unique position to give feedback to both the Chinese and UK government on the impact that policies are having on organisations and their employees, but also the many opportunities that exist for collaboration. Our Chambers play a pivotal role in bridging dialogue between British business in China and government and in providing an informed and balanced perspective on the business environment. We welcome the growing engagement with policymakers in the UK and in China, most recently with the Ministry of Commerce and the China Council for the Promotion of International Trade, in support of our mission to advocate for British business and better trade relations. We present this Paper accordingly.

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British Chamber of Commerce Guangdong

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EXECUTIVE SUMMARY

Before the latest COVID-19 outbreaks, British business in China remained broadly optimistic about their growth prospects in 2022. In late 2021, when we published our annual British Business in China: Sentiment Survey, 85% of businesses said they were either retaining a similar amount of, or increasing, investment in the coming year.[1] *China's market potential, the gradual yet continued opening up of various sectors such as financial services and retail and consumer goods, as well as its potential for innovation and climate commitments all offer reasons for such optimism. Whilst optimism remains for the medium to long-term, it is the immediate horizon that is of greatest concern to business. Short-term business confidence has been hampered most predominantly by uncertainty as China grapples with the most recent COVID-19 outbreaks. Recent sporadic outbreaks of COVID-19 across the country and the corresponding snap lockdowns have taken away one of the things most businesses have been able to depend on: a stable and relatively predictable business environment. As a result, businesses are faced with increasing uncertainty about what the future holds for them in China.*

Most recent business sentiment surveys, including the results of our latest *COVID-19 Impact Report* published in April 2022, highlight a significant shift in confidence. Many businesses are reviewing the level of risk that they are prepared to accept. This, if left unchecked, could erode China's position as an international hub and attractive investment destination for British business.

The uncertainty and shifting sentiment amongst British business can be summarised into four broad areas of concern:

1. A lack of clarity and communication between relevant government bodies and foreign businesses with regards to policies, goals and processes across various industry sectors;
2. Low involvement and inclusion of foreign business in new opportunities, policy initiatives and pilot programmes;
3. Restricted international travel and increasing outflows of international talent affecting perceptions and preventing crucial international exchanges; and
4. A lack of communication as to how the COVID-19 policy will evolve in the coming months in order to minimise current and potential future disruptions to business and individuals.

1 'British Business in China: Sentiment Survey 2021/22', British Chamber of Commerce in China, December 2021.

LACK OF COMMUNICATION AND REGULATORY CLARITY

Regulatory uncertainty has consistently been one of the most significant concerns of British businesses operating in China. There have been a number of major policies and plans announced by the central government over the past year, including those concerning data security, after-school tutoring and private education. British businesses continue to report that in many instances these regulatory updates lack clarity and direction. Businesses are concerned with ensuring compliance in the absence either of a clear framework or timeline for implementation, and where key concepts remain un- or ill-defined (such as 'important data' and 'critical information infrastructure operator' (CIIOs) in cybersecurity legislation and 'overseas curriculum' in education regulations). In addition, a lack of involvement of industry participants in the consultation process when developing new policies often leads to confusion during implementation, undermining business confidence.

LOW INVOLVEMENT AND INCLUSION OF FOREIGN BUSINESS

Concerns over a lack of clarity and engagement between regulators and foreign business extends to the overall inclusion of foreign business in new opportunities, initiatives and pilot programs. British businesses have a wealth of experience across different industries, which, if better harnessed, could make a greater contribution in many areas of the economy, from advanced manufacturing to vocational training. This is especially the case for innovative solutions in support of China's climate change objectives, particularly in the areas of green finance and renewable energy.

The Chinese government continues to state the importance of reform and continued opening up. The British chambers welcome the government's shortening of the *Negative List for Foreign Direct Investment* and the ongoing revision of *Catalogue of Encouraged Industries for Foreign Investment* as well as the involvement of some foreign companies in standards setting processes. However, the opportunities foreign businesses are afforded is still rather limited. A number of examples — most recently in education and healthcare, including the scrutiny over 'foreign content' and restrictions placed on foreign-invested entities (FIEs) in public procurement — contribute to a growing sentiment that China's business environment is turning inwards, favouring domestic business and prioritising self-reliance, with diminishing opportunities for FIEs.

TRAVEL RESTRICTIONS AND THE IMPACT ON TALENT AND PERCEPTIONS

One of the mechanisms which China has majorly utilised to control the spread of the virus has been strict restrictions on global travel. Whilst strict entry and exit requirements and border policies have undoubtedly contributed to controlling the number of imported cases in China, respondents to the British chambers' *COVID-19 Impact Report* indicated that the lack of UK-China direct flights, difficulty obtaining visas for both employees and their dependents, and entry requirements and conditions are affecting the ability to attract and retain international talent.[2]

With no indication as to when these measures will be relaxed, increasingly long separations from families overseas combined with the significant barriers to return, has resulted in a sizable outflow of international talent and a 'brain drain' across all industries. The education industry in particular is under increasing pressure as a result, with some estimates placing the departure rate of international teachers anywhere between 40% and 60% for the coming school year. The affected schools are essential if China is to continue to attract the best talent globally and benefit from their skills and expertise.

For over two years now, the flow of people into and from China has been significantly reduced due to the pandemic. We have seen through many surveys during this period that public perception of China has declined significantly in many countries, including the UK. While many factors contribute to this change, the interruption to travel invariably weakens the strong bonds that are built from rich cultural and people exchanges. This is increasingly a cause for concern. Most people are now deprived of the opportunity to experience China first-hand and form their own perspectives that are so important for understanding and building trust.

IMPACTS OF THE LATEST COVID-19 OUTBREAKS

Although China's economy saw an impressive recovery from the initial outbreak of COVID-19 when compared with many other parts of the world, growth slowed in the

2 'British Business in China: COVID-19 Impact Report', British Chamber of Commerce in China, April 2022.

second half of 2021, in part due to sporadic COVID-19 outbreaks suppressing demand and affecting business growth. The subsequent and more recent outbreaks of COVID-19 in 2022 have further slowed growth, with local authorities scrambling to contain infections. 74% of the British businesses surveyed in our *COVID-19 Impact Report* indicated the outbreaks have had a serious or large impact on their business operations and cash flows.[3] Foreign businesses and their employees in China are anxiously awaiting a clear roadmap from the government on how current and potential future disruptions can be minimised.

We therefore provide the following recommendations to the Chinese government in order to relay businesses' messages, and contribute to positive exchanges between the government and British business.

1 AN INCLUSIVE BUSINESS ENVIRONMENT

British businesses hope to see an improved business environment that is more open, efficient and fair for foreign businesses. Our hope is that regulators will improve consultation with FIEs on important decisions and that their perspectives are considered in the development of policies and standards including cybersecurity regulations, education policies, healthcare reforms and carbon reduction plans. This will help to level the playing field to ensure fair competition, and contribute to sustainable growth across industries as a whole. We also hope that China allows foreign enterprises equal rights to participate in new opportunities and initiatives in order to allow them to contribute their expertise and strengths in a wide range of areas. We are especially concerned about cybersecurity regulations and public procurement practice over the past year.

1.1 ACHIEVE GREATER CLARITY AROUND CYBER AND DATA SECURITY LEGISLATION

Cybersecurity, and the enactment of the *Data Security Law, Personal Information Protection Law* and a number of related administrative measures and implementation rules, continue to be one of the top regulatory concerns for British business. This concern stems largely from the lack of clarity over key concepts and the absence of an established mechanism for cross-border data transfers. Businesses have reported difficulty in engaging the Chinese authorities on these key issues, in particular the key regulatory bodies of the Cybersecurity Administration of China and the Ministry of Industry and Information Technology. As international businesses often rely on cross-border data transfers to share critical insights into product performance and consumer demand with their global offices, the current ambiguity over which data may be accessed and transferred has raised concern over non-compliance. It is important that the government finalises implementation details around cross-border data transfers as soon as possible, and consults with a wide range of stakeholders when doing so. These details should allow for data essential for daily operation and R&D to flow across borders with no or minimal impediment.

1.2 AFFORD EQUAL OPPORTUNITIES TO FOREIGN AND DOMESTIC FIRMS

British business ranked public procurement as one of the biggest regulatory challenges in the latest edition of the British chambers' *Business Sentiment Survey*.[4] Foreign businesses in some sectors note that domestic firms are being favoured even more in public procurement than before. FIEs are particularly concerned with the *Review Guidelines on Government Procurement of Imported Products* (*Order 551*) issued in May 2021. Whilst the Ministry of Finance later required local governments to grant equal treatment to 'domestically produced' products regardless of whether they had been produced by local enterprises or FIEs in China, members of the British chambers have reported that there have been no material improvements in practice at the time of writing. British businesses hope that the Chinese government continues to strengthen enforcement and ensure fair treatment of foreign and domestic enterprises in procurement processes and that the requirement under China's *Foreign Investment Law* that FIEs be given national treatment in the procurement process be implemented at all levels of government in practice.

2 A TRULY 'DYNAMIC' STRATEGY TO MANAGING COVID-19

British businesses hope that the strategy for managing COVID-19 can be adapted to be truly 'dynamic' in nature, setting out predictable and proportionate measures to be implemented that minimise business and economic risk, yet protect the vulnerable in the community.

3 'British Business in China: COVID-19 Impact Report', British Chamber of Commerce in China, April 2022.

4 'British Business in China: Sentiment Survey 2021/22', British Chamber of Commerce in China, December 2021.

2.1 ADJUST INTERNATIONAL TRAVEL RESTRICTIONS AND BORDER CONTROL POLICIES

We believe it is possible for the dynamic zero-COVID policy to be adapted without compromising the protection of the vulnerable. In particular, border policies can and should be adjusted in order to allow for the resumption of a healthy inflow of international talent, whilst limiting the risks of imported COVID-19 cases from overseas. Of the utmost importance is the resumption of UK-China direct flights, with a lack of direct flights being reported as the biggest obstacle for getting people and talent into the country.[5] Secondly, we continue to call for the equal treatment of foreign nationals when entering the country. The visa and entry requirements for foreign passport holders during this time should be made more transparent and streamlined where possible. Addressing this issue is vital to protecting China's pool of international talent. It is also imperative that the government loosens restrictions on granting dependant's visas. Entry processes should also be simplified, as current requirements are overly onerous and are seen as dissuading many from coming to China. We welcome the policy announcement to shorten quarantine time for entry in some pilot cities and hope these pilots will be maintained and expanded.

2.2 ADOPT A BALANCED APPROACH TO THE ENFORCEMENT OF COVID-19 RESTRICTIONS

Whilst the importance of containing the spread of infections is understood, we believe that a more balanced approach to managing COVID-19 can be achieved. Pandemic control and prevention measures should seek to prioritise public health and well-being whilst minimising social and commercial disruption. Other priorities that should be given equal attention include allowing the public access to public services, stabilising economic growth and minimising disruptions to logistics and supply chains. Whilst we appreciate the government's policy measures thus far to smooth logistics and restore supply chains in the wake of the latest outbreaks, in practice these measures have neither been effective enough, nor are they being thoroughly and consistently implemented on a national, regional and local level.

LOOKING AHEAD

Despite the many challenges that businesses are facing as a result of the latest COVID-19 outbreaks, there remains optimism from British businesses due to the continued market potential that China possesses, with some positive regulatory developments over the past year also offering businesses further assurance. We also firmly believe that should the pandemic situation improve, optimism will be further restored.

Our wider membership highly appreciates the government's decision to delay the Individual Income Tax reform last year, which has allowed foreign business and nationals some breathing space and eased concerns over potentially greater tax burdens should the reform be put into place. However, uncertainty remains as to what will happen next after the current reprieve expires at the end of 2023, and we hope that regulators will retain some elements of tax relief in order to maintain China's position as an attractive destination for international talent.

With the 50th anniversary of diplomatic relations between the Chinese and British governments being celebrated this year, British business also hopes to see more engagement between the two governments. Last year we welcomed the announcements that the UK-China Joint Economic and Trade Commission (JETCO) and Economic and Financial Dialogue (EFD) would be resumed in 2022. We hope these two important government-level dialogues take place as planned and build on the positive momentum of the 2021 UK-China energy dialogue where there has been encouraging progress on bilateral cooperation on several areas including clean energy, and power market reform. Environmental, social and governance (ESG) is also an increasingly significant area of opportunity for bilateral economic relations, with many British businesses having well-established ESG practices and are therefore able to add value to industry as a whole by sharing their knowledge and experience.

Whilst sentiment and perceptions surrounding China in the UK have taken a negative turn in recent years, the British chambers are encouraged by our increasing engagement with certain areas of the Chinese government, especially the Ministry of Commerce and the China Council for the Promotion of International Trade. We hope this mutual dialogue and cooperation continues and that we are able to continue to facilitate communication, improve the business environment for our members, and contribute to shifting the narrative surrounding China as an international business destination back to one of opportunity and optimism.

5 'British Business in China: Sentiment Survey 2021/22', British Chamber of Commerce in China, December 2021.

CLIMATE ACTION

INTERNATIONAL CLIMATE COOPERATION

China had an eventful year in 2021 with regards to fighting climate change. The country's cooperation with its global partners has continued unabated. Its climate envoy, Xie Zhenhua, met with his U.S. counterpart John Kerry in April and September, and with the United Nations Climate Change Conference (COP26) President Rt. Hon. Alok Sharma MP in September to discuss key issues regarding global carbon reduction. In September 2021, Chinese President Xi Jinping also made the welcome announcement that China will stop funding any overseas coal power plants going forward, stepping up its global commitment to carbon reduction. Ahead of COP26, the Chinese government submitted its Nationally Determined Contributions (NDCs) which formally included goals to reach carbon peaking by 2030 and carbon neutrality by 2060. In addition, China's NDCs included a series of near-term climate targets, such as cutting CO2 emissions per unit of GDP by more than 65% from 2005 levels, and achieving 1,200 gigawatts (GW) of renewable energy by 2030.[1]

The UN Biodiversity Conference (COP 15) and COP26, held in Kunming and Glasgow in October and November 2021, respectively, once again witnessed China's and the international community's collaborative efforts to fight climate change. Gaps remain, however, in the levels of commitments of participating countries. Despite this, progress was made. In particular, the Glasgow Climate Pact, a key outcome from the COP26, reaffirmed the goal to limit the global rise in temperature to 1.5 degrees Celsius by the end of the century – as first laid out in the Paris Agreement signed in 2015. It also commits signatories to revisit and strengthen their 2030 climate commitments (NDCs), and outlines four areas of focus for action. These included Mitigation (reducing emissions), Adaptation (crisis management), Finance (delivering targets), and Collaboration (collective action).[2] On the critical issue of Finance, the Glasgow Climate Pact re-emphasised that developed countries will pledge approximately USD100 billion in annual support to developing countries to accelerate carbon reduction efforts.

Notably, China and the US (the world's two largest carbon emitters) announced in a joint declaration during COP26 that they will increase cooperation on climate regulatory frameworks, technology innovation such as carbon capture, utilisation and storage (CCUS), energy transition, the circular economy, and tackling methane emissions.[3]

However, as the President of COP26 Rt. Hon. Alok Sharma MP has emphasised, pledges that were made in Glasgow can only be accomplished if every signatory delivers on their commitments. The UK has been an example in this regard; confirming its 2030 commitments such as banning fossil-fuelled cars, forest regeneration, and creating jobs in the low-carbon sector.[4] Indeed, a recent report from the UK Government indicates that energy capacity in offshore and onshore wind have risen by just under 1GW and 0.5GW, respectively, between 2020 and 2021.[5]

Over the past year, we are pleased to see that cooperation on climate change between China and the UK, on both a business and government level, has continued to increase. Given the Chinese government's strong policy push towards a green economy, British businesses in the country are seeing increasing opportunities in a wide range of sectors including renewables, new energy vehicles (NEVs), built environment, and financial services

Many UK businesses are investing in these areas, bringing sustainable products and services, as well as technological know-how to the market, which is helping to facilitate China's green transition. Many UK companies have also

1 'Q&A: What does China's new Paris Agreement pledge mean for climate change?', Carbon brief, December 2021.

2 'The Glasgow Climate Pact', COP26, November 2021.

3 'US-China Joint Glasgow Declaration on Enhancing Climate Action in the 2020s', United States Department of State, November 2021.

4 'Net Zero Strategy: Build Back Greener', HM Government, October 2021.

5 'Energy Trends March 2022', Department for Business, Energy & Industrial Strategy, March 2022.

set their own net zero goals by 2060 although the percentage was a limited 32% and still has much room to grow, according to the 2021 edition of *British Business in China: Sentiment Survey*.[6]

At the government level, apart from the meeting between Xie Zhenhua and Rt. Hon. Alok Sharma MP, a UK-China energy dialogue was held in the second half of the year with the UK government meeting China's National Energy Administration virtually. The two sides had constructive dialogue highlighting several key areas for further cooperation, including China's power market reform, and the development of CCUS and hydrogen. We look forward to increased cooperation and exchange between the two sides.

CHINA'S CLIMATE POLICY OVER THE PAST YEAR

Over the past year, China's domestic climate policies have witnessed momentous progress – particularly when considering that it is only one year into China's 14th Five-Year Plan and its dual carbon goals. Major near-term climate targets were announced at the Two Sessions 2021. Such targets included increasing the percentage of non-fossil fuels in the country's energy mix from the current level of 15.9% to 20%, reducing China's energy intensity by 13.5% and carbon emissions per unit of GDP by 18% by 2025.[7] A raft of major climate policies have been announced since then in order to guide the country's green transition.

Most notably, a '1+N' policy framework was developed in September, 2021. Under this framework, the *Working Guidance for Carbon Dioxide Peaking and Carbon Neutrality*[8] and *Carbon Neutrality and the 2030 Carbon Peaking Action Plan*[9], released in September 2021 set the overarching policy direction. Sector-specific plans have then been subsequently released in order to ensure that the country makes steady progress in all sectors of the economy towards its climate goals. These plans include decarbonising the industrial sector, building a modern energy system, scaling up the country's hydrogen industry, enhancing its energy storage capacity, and promoting green consumption.

6 'British Business in China: Sentiment Survey 2021/22', British Chamber of Commerce China, December 2021.

7 'The Outline of the 14th Five-Year Plan (2021-2025) for National Economic and Social Development and Vision 2035 of the People's Republic of China', Xinhua News Agency, March 2021.

8 'Working Guidance for Carbon Dioxide Peaking and Carbon Neutrality in Full and Faithful Implementation of the New Development Philosophy', State Council, October 2021.

9 '2030 Carbon Peak Action Plan', State Council, October 2021.

Given the strong political will to work towards the 30-60 goals early last year, the central government notably increased pressure on local governments to keep their total energy consumption and energy intensity in check. However, coupled with China's decreasing coal stocks, rising coal prices, and increasing demand for power (driven by strong economic recovery), widespread power shortages were triggered in northeastern, eastern and southern provinces last September.

These power outages hit millions of homes and businesses. As a result, energy security has been re-emphasised. President Xi described it as being just as important as food security in this year's Two Sessions. This emphasis on energy security indicates that China will continue to utilise fossil fuels during its transitional period towards net zero. Other major changes that were introduced include the de-regulation of power prices as the government has allowed coal-generated power prices to fluctuate to a greater extent since October 2021. This represents a major step towards the marketisation of China's power market. While increasing costs for commercial and industrial users, it has also to some extent reduced the demand for coal-generated power.

At the same time, the government aims to accelerate the development of renewable power, with a key goal to building a new power system driven by renewable energy. Although 2021 was a record year in solar and wind development in China — most notably China surpassed the UK and became the world's largest offshore wind market — there are a number of barriers to increasing renewables uptake in the country. This includes renewables' indeterminacy issue, the country's insufficient trans-provincial, regional power trading, and power spot trading. The past year, however, did witness the government taking actions to overcome these issues with the launch and the expansion of several key pilots including the inter-regional spot market and green power trading.

Another major milestone in China's fight against climate change was achieved last year when the national Emission Trading Scheme (ETS) became operational. The scheme covers over 2,000 power plants which reportedly accounted for 40% of China's emissions last year. While this marks a significant step forward, there is a long way to go in order to improve the system as it is still less mature and active than other international carbon markets (especially the EU carbon market). The government will need to make clear plans about when to enrol other industries into the scheme including non-ferrous metals, steel, cement, petrochemicals, building materials, aviation, and paper-making. The participation of institutional investors is equally important and key to increasing market liquidity. Industry participants also look forward to the relaunch of China's voluntary carbon market, China Certified Emission Reduction (CCER), which would offer more incentives for businesses to invest in carbon reduction projects.

China's financial regulators have also released several policy measures in the past year in support of the country's climate ambitions, such as a Carbon Emission Reduction Facility (CERF) to encourage funding to green projects and a new green bond catalogue excluding coal-related projects[10]. The progress achieved around carbon reduction creates both demand and opportunities for UK businesses. However, in the meantime, British business continues to call on Chinese regulators to involve them equally in the development of key opportunities such as offshore wind and green finance.

CHINA'S ESG PROGRESS AND GAPS

Environmental, Social, and Governance (ESG) development is an important aspect to strengthening China's climate efforts. Whilst China generally lags behind its global peers on ESG adoption, it has been making notable progress over the past few years. We are glad to see that UK businesses are also contributing to the adoption of ESG in China. This includes businesses engaging in ESG investing, as well businesses cutting carbon emissions in their own operations and developing environmentally friendly products. The latter exists in a wide range of sectors that are minimising their carbon footprint — ranging from purchasing renewable energy, to investing in hydrogen and fuel cell vehicles, and reducing waste. Many have also been working increasingly with Chinese partners to establish and improve ESG development.

Since 2016, the Chinese government has been putting in place a regulatory framework for green finance and environmental information disclosure to facilitate ESG adoption. Chinese companies disclosing their ESG data has increased rapidly as a result of these regulatory updates. By the end of 2021, 1,147 Chinese A-share companies published their ESG reports (three times the number in 2009).[11] ESG funds have also surged in recent years. The total assets under management of ESG

10 'Catalogue of Projects Supported by Green Bonds (2021 Edition)', People's Bank of China, April 2021.

11 'Overview of ESG Reporting and its Rules for A-stock Listing', Zhonglun, April 2020.

public funds almost doubled in size from September 2020 to September 2021, reaching almost RMB 250 billion (GBP 30 billion).[12]

However, there are a number of challenges that need to be resolved in order to accelerate China's ESG development. Resolving these challenges would not only improve climate records of domestic firms, but also increase the attractiveness of the domestic equity market to foreign investors. As global investors have been increasingly focused on sustainable investments, China will have to improve its own domestic ESG reporting standards if it is to further open up its financial market and attract international investors.

The regulatory framework needs to be further strengthened in order to increase ESG adoption in Chinese companies. ESG awareness within Chinese companies is still insufficient compared to global firms, especially those from Europe, the UK, and the US. Currently, China only has a preliminary regulatory framework with limited coverage of companies — hence the low level of ESG adoption. British businesses working with Chinese firms (including local SOEs) to design decarbonisation strategies for the latter noted that local firms tend to centre their consideration around costs instead of being driven by a genuine concern for carbon reduction. Furthermore, few Chinese companies see the link between their ESG performance and market value. Without a firmer regulatory push to increase ESG awareness amongst domestic companies, most will continue to do less instead of more.

In the process of improving its regulatory framework, the Chinese government must ensure unified rules and clear guidance on ESG metrics are in place, as these are essential to regulating ESG practices and reporting. A lack of uniform rules and reporting standards are affecting the transparency and accuracy of many Chinese companies' ESG data. We therefore believe that releasing unified standards on ESG reporting as soon as possible will guide industry participants to strengthen their ESG reporting, which will also attract more foreign institutional investors. With the establishment of the International Sustainability Standards Board (ISSB) at COP26 in Glasgow, aiming to bring more consistency to global sustainability standards, China will need to increase its alignment with global standards, as well as work with foreign businesses, on the existing policy framework.

British businesses are well-placed in contributing to the improvement of China's ESG policy framework. The UK has well-developed ESG regulations, investment standards, and disclosure requirements and many British financial services companies already have ESG principles and products in place. We welcome the recent launch of a pilot program between Chinese and UK financial institutions to explore climate and environmental information disclosure. This provides the opportunity for Chinese institutions to learn from UK policies on green finance, environmental information disclosure, as well as improve ESG data quality for commercial banks, insurance, and asset management sectors. The two sides have also been collaborating on drafting guidelines and standards on green finance.[13] We welcome this progress and hope that British businesses will continue to be involved in new initiatives and standard setting processes around ESG in order to continue to make valuable contributions to China's ESG development.

12 'China ESG Development White Paper 2021', Caixin Insight, 2021.

13 'Pilot Program on UK-China Financial Institutions Climate and Environmental Information Disclosure', Green Finance Committee of the China Society for Finance and Banking, May 2022.

AT A GLANCE: INDUSTRY REPORTS

AUTOMOTIVE

SUB-SECTORS:

Original equipment manufacturers | Automotive components suppliers

KEY CHALLENGES:

- Harmonisation of ICV standards
- Lack of clarity on data security requirements
- Concerns around the implementation of the new foreign ownership rules for passenger cars

KEY RECOMMENDATIONS:

- Increase harmonisation of Chinese standards with international standards
- Offer more clarity on implementation rules for cross-border data transfers
- Fully implement the liberalisation measure on foreign ownership in the automotive sector

KEY MUTUAL OPPORTUNITY:

- 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
- Localisation of procurement and contracting
- Lack of recognition of international qualifications and experience

KEY RECOMMENDATIONS:

- Provide more transparent and equitable approval processes for licences
- Allow international forms of contract to be used or to form the basis of amendments to Chinese forms of 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
- Digital built environment

EDUCATION

SUB-SECTORS:

K-12 | Higher education | Non-profit organisations | English language training | EdTech | Certification and accreditation bodies

KEY CHALLENGES:

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

KEY RECOMMENDATIONS:

- Remove unnecessary barriers for foreign expert teachers and dependants to return to China ahead of the the new academic year
- Improve communication and consultation ahead of regulatory changes
- Allow for a wider scope for exchange and cooperation in non-sensitive areas of education between China and the UK

KEY MUTUAL OPPORTUNITIES:

- Vocational education and training
- All-around education
- Professional development
- Niche providers
- A levels
- Interest in attending UK universities
- Distance learning

ENERGY

SUB-SECTORS:

Oil and gas | Renewables | Power | Carbon

KEY CHALLENGES:

- Barriers for foreign companies to participate in China's gas and renewable market development
- Limited access and opportunity for foreign companies to participate in China's offshore wind market
- Insufficient deregulation in China's current power market system - particularly in the spot market, inter-provincial power transactions, and green power trading
- Limited coverage and liquidity of China's national emission trading scheme (ETS)

KEY RECOMMENDATIONS:

- Continue gas market reform and enhance monitoring mechanisms to ensure execution of non-discriminatory access to gas pipelines and terminals
- Improve transparency for offshore wind development plans and bidding processes to allow the participation of multinational corporations (MNCs)
- Accelerate the construction of a unified national power market, especially the power spot market, inter-provincial transactions and the green power market
- Timely implementation of the national ETS development plan to expand its coverage and increase liquidity

KEY MUTUAL OPPORTUNITIES:

- Clean energy
- Circular economy
- Upskilling

FINANCIAL SERVICES

SUB-SECTORS:

Asset management | Insurance | Banking

KEY CHALLENGES:

- Difficulties with cross-border payments
- Lack of clarity on cyber-security laws and difficulties with navigating the Personal Information Protection Law
- High barriers to entry and difficulty navigating the rapidly evolving regulatory environment

KEY RECOMMENDATIONS:

- Streamline disclosure processes and requirements for money inflows and outflows
- Provide clarity and further guidance on the various categories of personal data with explanatory notes to supplement the legislation. Clear guidelines on implementation and consequences of non-compliance
- Clearer timelines and guidance as regards application for licences, approval, implementation and ongoing compliance requirement processes within the industry

KEY MUTUAL OPPORTUNITIES:

- Hainan Free Trade Port
- Guangdong–Hong Kong–Macau Greater Bay Area
- ESG

FOOD, BEVERAGE, RETAIL AND CONSUMER GOODS

SUB-SECTORS:

Alcoholic beverages and soft drinks | Health foods | Cosmetics | Retail and consumer goods

KEY CHALLENGES:

- Challenges with implementation of GACC *Order 248*
- Coordination and harmonisation of regulations and Guobiao (GB) standards
- Animal testing requirements for certain cosmetic products

KEY RECOMMENDATIONS:

- Extend the grace period for companies to complete the overseas registration process, allow companies to vary legal representative and other information unrelated to food safety without re-registration
- Harmonise food labelling requirements, and coordinate the implementation of different regulations and GB standards
- Amend the *Safety and Technical Standards for Cosmetics (2015)* and the *Standards of Cosmetics Registration, Filing and Inspection* to remove requirements for animal testing

KEY MUTUAL OPPORTUNITIES:

- Customer confidence in British products
- China's focus on consumption

HEALTHCARE

SUB-SECTORS:

Healthcare services | Medical technology | Pharmaceuticals

KEY CHALLENGES:

- The need to continue to improve the Volume-Based Procurement (VBP) system
- Treatment of Foreign-Invested Enterprises (FIEs) in public procurement
- Lack of clarity around cross-border data transfers

KEY RECOMMENDATIONS:

- Greater focus on value-based procurement in order to build a sustainable healthcare ecosystem
- Reinforce fair treatment in public procurement
- Provide further clarification around cross-border data transfer rules

KEY MUTUAL OPPORTUNITIES:

- Demographic trends and healthy ageing
- Innovation as a priority

LEGAL SERVICES

KEY CHALLENGES:

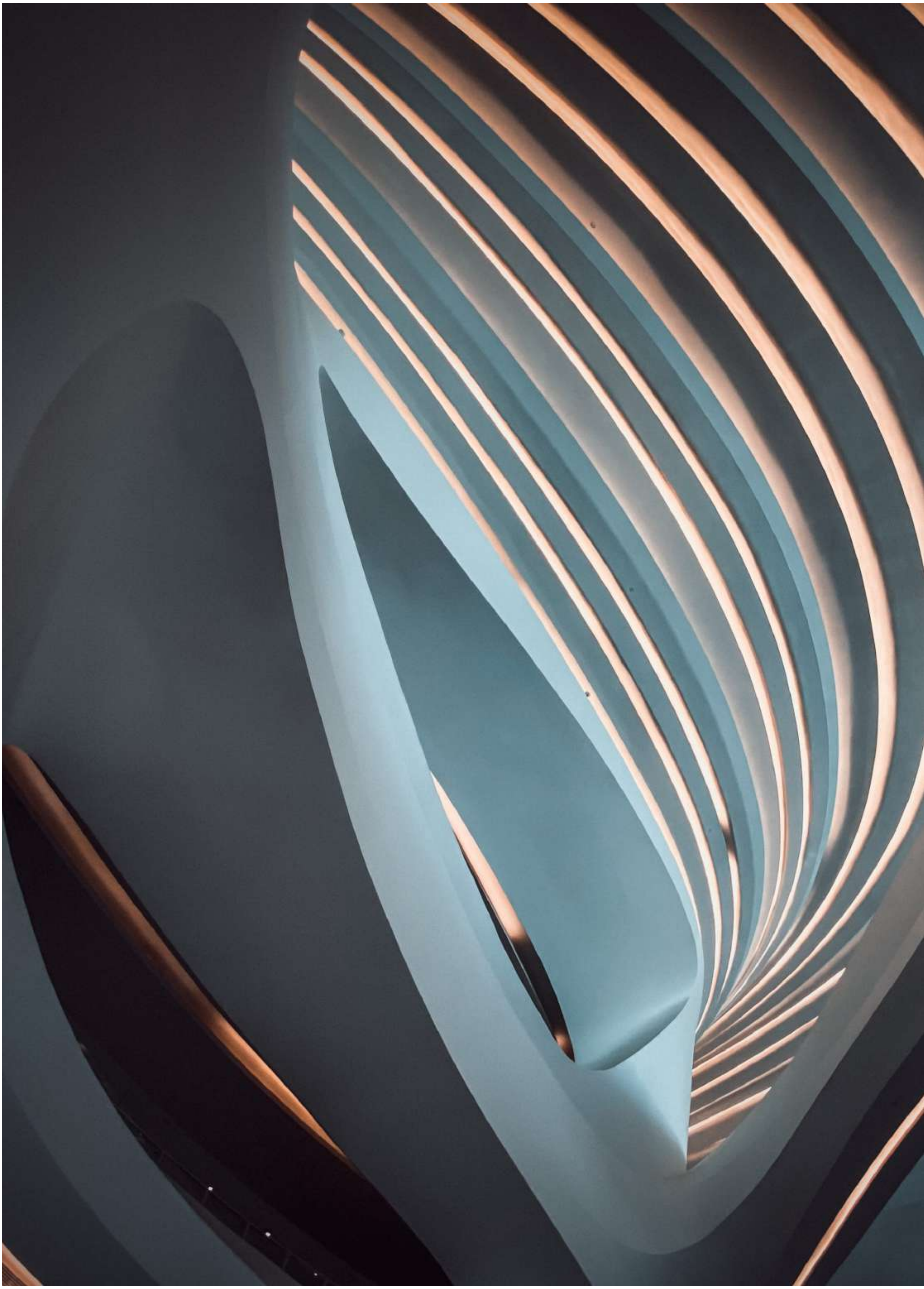
- Inability of PRC-qualified lawyers to practice Chinese law in a foreign firm
- The need to continue to improve the joint legal operations structure
- Restrictions on appearance before government agencies

KEY RECOMMENDATIONS:

- Pilot allowing Chinese lawyers joining foreign firms to keep practicing licences in certain areas that are non-sensitive and most relevant to foreign firms
- Establish uniform, nationwide rules for JLO offices that reflect the processes in place in Shanghai and expand the pilot to other cities
- Allow lawyers from foreign firms to represent their clients in meetings with government agencies, when clients require it

KEY MUTUAL OPPORTUNITIES:

- Chinese outbound investment
- ESG
- China's shifting regulatory landscape



CROSS-SECTOR CHALLENGES

HIRING CHALLENGES AND TALENT DEVELOPMENT

2021 did not bring the return of international talent to China that last year's Position Paper had hoped for.[1] In fact, hiring foreign staff emerged in the British chambers' British Business in China: Sentiment Survey 2021/22 as the single biggest cross-cutting issue for British businesses in China.[2] 43% of companies continue to face challenges in this area, with 23% seeing a net decrease in foreign employees over the past twelve months and 41% anticipating that a number of staff members will leave indefinitely within the coming year.

No single factor appears to be at the heart of this difficulty; rather, a range of COVID-19 and non-COVID-related factors have contributed to the exacerbation of concerns expressed by British businesses last year. Many firms expressed that continued difficulties surrounding bringing foreign staff to China had reduced interest from employers and employees in doing so altogether. As one Chamber member put it: 'the biggest issue [last year] was around visas and PU letters; now it is that nobody wants to come to China'.

The issues around hiring foreign talent also impact local talent development, as the shrinking international talent pool reduces the relatively robust knowledge transfer from foreign to local staff that existed before the pandemic. If this trend continues, it will have knock-on effects on China's ambition to upgrade its industries and supply chains as the process of upskilling its local workforce slows down.

As such, in order to create an environment where British businesses are able to access the talents they need, we continue to call for greater facilitation for international talents to enter China as well as for increased collaboration between China and the UK on talent development, including the mutual recognition of qualifications and collaboration on Technical, Vocational, Educational and Training (TVET).

1 CHALLENGES AROUND HIRING FOREIGN STAFF

1.1 THE IMPACT OF THE COVID-19 PANDEMIC ON HIRING FOREIGN STAFF

When it comes to COVID-related issues, flight connectivity, quarantine requirements and difficulties getting dependent visas emerged as particularly discouraging for British businesses and their international talent. Many companies' employees were significantly impacted by difficulties in travelling to and from China. The scarcity of flights to China and regular flight cancellations have been a major hurdle in entering the country: 32% of British businesses surveyed in late 2021 reported difficulties in finding and booking suitable flights.

Fewer businesses in 2021 indicated issues in securing visas for their employees than in 2020. However, the difficulty

1 'British Business in China: Sentiment Survey 2021/22', British Chamber of Commerce China, December 2021.

2 'British Business in China: Sentiment Survey 2021/22', British Chamber of Commerce China, December 2021.

in obtaining dependent visas was continually raised as an ongoing deterrent for foreign staff to relocate and work in China. For many, it has now been more than two years since they have been able to travel back to the UK to see family and friends, and the uncertainty over how long it will be before they will be able to do so again has led many to leave China indefinitely. A combination of a lack of dependents' visas and the difficulty and cost of getting staff on flights to China led one company to declare it currently 'almost impossible' to hire staff from outside of China.

Quarantine requirements for foreign arrivals also continue to deter foreign staff from travelling to China, and have contributed to a year-on-year employee attrition level as high as 50% for some businesses. While COVID-19 regulations in China remain strict given understandable concerns over potential new outbreaks of COVID-19, restrictions in the UK are now very lenient. Additionally, several of our members found issues such as the separation of families during quarantine and the lack of choice over their quarantine facilities challenging. This has led to diminishing incentives for would-be employees to consider a move to China, where freedom of movement is restricted both in terms of immediate arrival and within the country itself.

A combination of all these challenges has resulted in a foreign workforce exhausted by two years of continual restrictions, and mounting frustration at being unable to return home. Employers are struggling to find foreign staff, unable to access the talent that they require, and recruitment processes are becoming increasingly expensive and time-consuming. The overwhelming sentiment we received from British businesses was of China being a less attractive place to live and work for international talent, when compared with two years ago. As more and more staff leave their jobs to return to the UK, organisations based in China are suffering from a loss of knowledge and relevant experience.

Additionally, difficulty entering the country has also shut out highly skilled foreign technicians, engineers, and senior management over the past two years who needed to be in the country to partake in projects, provide key guidance to companies and close business deals. Their inability to come to China has led to cancellation of key projects, as well as the loss of valuable business opportunities and the ability to make any long-term plans for future projects.

1.2 THE IMPACT OF NON-COVID-19-RELATED RESTRICTIONS ON HIRING FOREIGN STAFF

Aside from COVID-19-related restrictions, administrative challenges also continue to persist in several sectors that are impacting on businesses' ability to hire the right talent: the requirement for a minimum of two years of work experience for junior staff to receive a work permit and a lack of recognition for foreign qualifications were two issues that have been frequently raised by businesses.

Many companies express frustration over being unable to hire qualified international talent due to the requirement for candidates to have two years of related work experience in order to obtain work permits, despite them being sufficiently experienced and able to bring in UK industry knowledge and skills. Some companies that usually rotate employees between different global offices to gain knowledge about different markets also commented that this requirement has made it extremely difficult to bring their more junior employees to China, whereas the process is much easier in other countries. This unfortunately blocks 'cross-cultural links, knowledge sharing and global camaraderie', as one interviewee commented.

Another long-term challenge faced by our members that has limited their talent pool is a lack of recognition of UK-awarded professional qualifications in China, cutting across many services industries, especially accounting, financial and built environment services. One of the foremost issues for the built environment sector is that 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. As such, these foreign professionals are not able to work on national design Grade A projects, which tend to be the area where British professionals excel. This limits foreign professionals' potential and opportunities in the China market and dissuades many from practicing here. Similarly, a lack of mutual recognition of professional qualifications in the accounting sector is having a comparable effect on businesses. Recognition of foreign qualifications is therefore a significant barrier to British professionals' ability to add significant value to Chinese industries. We hope that the UK and the Chinese government could accelerate the establishment of mechanisms to allow mutual recognition of professional qualifications or to allow conversion exams to take place in order to facilitate that process.

2 CHALLENGES AROUND HIRING LOCAL STAFF

Notably, challenges around hiring foreign staff are also impacting on the local workforce ecosystem. The decreasing number of foreign staff in the country means the usual transfer of knowledge and skill that take place between foreign and local talent has been greatly limited. Some interviewees emphasised the importance of foreign staff in informal training through knowledge transfer to local staff, especially in highly technical manufacturing industries. In these sectors, experiences from countries

such as the UK and Germany have helped to upskill the local workforce which has consequently contributed to upgrading the local industry.

It is for this reason that the shrinking number of overseas professionals in the country is concerning. China has been aiming to further develop its high-end manufacturing and high-tech industries, and achieve greater internationalisation of its services industries. Engaging highly-skilled foreign talent in the Chinese market will help to transfer advanced knowledge and skills from foreign to local staff and assist China's local workforce in becoming more innovative and efficient.

Furthermore, certain restrictions placed on foreign firms also present additional challenges in terms of hiring local staff. Foreign law firms in particular, raised the issue of lawyers' right to practice: it remains the case that when Chinese lawyers join foreign firms, their qualifications and licences to practice Chinese law are suspended. The result is that it is difficult for international firms to hire local lawyers who are able to practice Chinese law, or have already established themselves at local firms. It is important that the Chinese government takes steps to relax this requirement, for example by allowing Chinese lawyers joining foreign firms to keep their practising licences in non-sensitive areas. Not only will this allow for a more competitive legal market, but it will also contribute to building a more qualified legal workforce with expertise in both local and international legal practice. Similarly, and as mentioned previously, built environment companies also face restrictions on obtaining Grade A design licences, hindering their ability to participate in significant projects, which has consequently reduced their attractiveness to local talent.

3 OPPORTUNITIES TO COOPERATE ON TECHNICAL, EDUCATIONAL AND VOCATIONAL TRAINING

Technical and Vocational Education and Training (TVET) has been identified as an important tool by which to develop a highly skilled workforce suited for the fast-changing demands of the modern labour market. With TVET being promoted as a national priority at the highest levels of government, there continues to be widespread buzz throughout the British business community, especially in the education sector, regarding the potential to explore TVET as a method of developing and hiring talent in China. Additionally, this is a key area for prospective collaboration with world-leading British educational institutions at multiple stages of education, alongside qualification providers, and in teacher training.

As highlighted above, the development, hiring, and retention of talent is a long-term cross-cutting issue, which has been exacerbated by COVID-19-related challenges. These challenges are by no means unique to British business in China. The Seventh National Population Census has highlighted future educational and demographic gaps in the labour market as a whole.[3] Wider research suggests that attracting and retaining talent is the number one issue faced by companies globally,[4] and the World Economic Forum warns that the world is facing a 'reskilling emergency' estimating that one billion people require re-skilling by 2030 due to jobs being transformed by the fourth Industrial Revolution.[5]

Employer-led TVET has the potential to act as a pressure release valve by addressing local skill gaps. Furthermore, following proven British and international models, this presents an opportunity for future mutually beneficial collaboration through the development of apprenticeship links with key British industries to help meet their specific standards and needs, with paths already being explored. In this way, value is not only added locally, but British businesses, Chinese graduates, and entire industries will benefit from the production of a highly skilled workforce.

Despite the opportunity that it presents, employer-led TVET remains at the early stages of development. Generally, businesses are keen to explore this path; however, they require further encouragement and clarity on how they can contribute. Better alignment and collaboration between British education providers, qualification providers, employers, alongside relevant government departments, would contribute to creating a better understanding of the potential for expansion into this area. Furthermore, as outlined in the education section of this edition of the *Position Paper*, there are ongoing issues with localisation, finding sustainable business models, creating links with industry, addressing public perception, as well as the difficulties arising as a result of common cross-cutting issues, such as the fast-changing regulatory environment within China.

Recommendations

- Reinstate direct flights between the UK and China.
- Make it easier for foreign employees to receive visas for their dependents.
- Establish transparent and streamlined processes for entering China.
- Work towards signing mutual recognition agreements or exploring conversion exams between British and Chinese qualification bodies in certain services industries, especially in legal, financial and built environment services.
- Loosen the restriction of 2 years of professional work experience for work permits for hiring foreign talent.
- Loosen the requirement that local lawyers give up their right to practice Chinese law when they join foreign firms; allow them to keep the licence in non-sensitive areas.
- Clarify and explore industry links between British businesses and TVET providers.

3 'China needs 11.8m workers. Here's how to close its labour gap,' The World Economic Forum, 2021.

4 'Fortune/Deloitte CEO Survey,' Deloitte, Fall 2021.

5 'We need a global reskilling revolution – here's why,' The World Economic Forum, 2020.

NAVIGATING CYBERSECURITY AND IT REGULATIONS

China's regulatory framework for cybersecurity and data security continues to develop in the past year with the enactment of two major pieces of legislation, namely the Data Security Law (DSL) and the Personal Information Protection Law (PIPL). The former aims to ensure data security with the goal of protecting national and public interests, while the latter focuses on regulating the handling of personal data. These two laws, together with the Cybersecurity Law (CSL) form the fundamental legal framework for ensuring China's cybersecurity and data security. A number of administrative measures, implementation rules and national standards, although many still in draft form, were subsequently released, providing guidance on how to remain compliant with the key legislation. However, considerable gaps remain, with many businesses continuing to struggle to understand the definitions of key concepts and practicality of key requirements. This has presented significant challenges for them to ensure compliance and formulate business strategies, thereby undermining business confidence.

One of the essential concepts in the current cybersecurity legislation is 'important data', which was first raised in the CSL. Despite a raft of regulatory updates in the past year including the DSL and related regulations, there continues to be a lack of clarity over its scope. The legislation defines important data as data that may affect national security, the public interest, and the legitimate rights of domestic entities. Although a draft 'important data identification guide' was released in January 2022, it continues to define important data broadly, such as stating that it includes data relevant to China's technological capability, influencing China's global competitiveness, relating to national natural resources as well as environmental data, amongst others.[6] Many companies are still unsure whether their data will be classified as important data. The draft also states that various government departments, central and local, will draw up their own important data catalogues using the guide as a reference. However, timelines regarding the release of these catalogues are currently unclear. Companies are also concerned that this may lead to over-regulation, with a large number of local governments and various government departments authorised to come up with their own catalogues.

The same vagueness also exists around the risk assessment requirement for important data and the establishment of a data classification and categorisation system (DCCS) as mentioned in the DSL. In terms of the important risk assessment requirement, it is unclear how often these risk assessments will take place and which government departments will conduct them. The DCCS essentially requires different levels of restrictions and oversight to be applied to data being handled, based on its importance and risks around its potential leaks. However, what constitutes 'important data' is itself a result of such classification and categorisation. Companies are unsure

6 'Draft Guideline for Identification of Critical Data', The National Information Security Standardisation Technical Committee of China, January 2022.

how important data intersect with the DCCS, how they will be coordinated and therefore affect companies' compliance. An understanding of where important data sits in the DCCS, and the relationship between data protection requirements for important data and those requirements stipulated in the DCCS are important for companies to ensure compliance. While to some extent the DCCS might help businesses understand where their data is situated in China's regulatory system in terms of its levels of importance and associated risks, no finalised standards or timelines have been given on its launch either.

The confusion over another key term in China's cybersecurity framework — critical information infrastructure operators (CIIOs) — has also continued in the past year despite the publication of the *Regulations on Critical Information Infrastructure Security Protection* in September 2021. Its broad definition in the Regulations has not eased industry participants' concern, as it is insufficient for many companies to determine whether they fall under the definition; meanwhile, CIIO catalogues will likely not be released any time soon.[7]

The lack of clarity around both CIIOs and important data creates significant uncertainty for foreign businesses, given that companies that are eventually classified as CIIOs and important data handlers are subject to stricter controls and additional legal obligations. In particular, the issue leaves many foreign companies' cross-border data activities in limbo, as they cannot accurately map out the processes to follow and systems they need to put in place in order to remain compliant.

In terms of cross-border data transfers, while the CSL and DSL subject CIIO data and important data to a security review before it can be shared overseas, the PIPL sets out the terms for personal information to be sent overseas. Similar to the previous two laws, the PIPL only broadly states that CIIOs and processors that handle a certain amount of personal data need to pass the security assessment before they are allowed to send personal data outside China. The law leaves the threshold to be determined by future implementation rules.[8] British businesses welcome the release of the draft *Measures for Data Export Security Assessment* in December 2021 which contains details around security assessments to enable the cross-border export of important data and personal information, including the threshold for personal information, but still awaits the finalised version of the measures.

Furthermore, Article 38 of the PIPL states that any personal information processor that wishes to send data across borders for legitimate reasons, has to fulfill one of the three specified requirements in the law (unless the government adds new ones in the future), namely:

1. passing a security assessments conducted by the CAC, or
2. obtaining accreditation for personal information protection through a professional body, or
3. signing a contract with the data recipients based on the standard cross-border transfer contract drawn up by the CAC.

7 'Regulations on Critical Information Infrastructure Security Protection', State Council, September 2021.

8 'Draft Measures for Data Export Security Assessment', Cyberspace Administration of China, October 2021.

So far, no details around any of these three requirements have been confirmed, leading to another layer of confusion. The current regulatory framework also fails to clarify which government department and which level (central or local) is ultimately responsible for confirming which information needs to be reviewed in these security assessments for cross-border data transfers.

As a result, the lack of clarity has led to overwhelming concerns from foreign companies in a wide range of sectors, but in particular, the IT, automotive, financial services, energy and healthcare industries.[9] For many of these foreign companies, data is essential for maintaining daily operations and developing their products and services. More importantly, many multinational companies' R&D centres are situated outside China. Restrictions on cross-border data export therefore significantly reduces their overseas R&D centres' ability to access China-specific data. Without that data, it becomes extremely difficult, if not impossible, to improve, develop and deliver products and services catered to Chinese customers' needs. This also represents an added barrier for foreign-invested enterprises to compete with local companies equally, as the latter does not face such challenges with their R&D departments most likely to be in China. For the healthcare industry, with the accelerated development of digital health technology as well as the cross-border nature of that technology (and indeed modern healthcare services in general), companies' ability to protect and help Chinese patients will be significantly reduced without overseas-based professionals and technicians being able to access data held in China..

While companies have yet to determine how harsh these restrictions on their cross-border data transfer activities will end up being when details are finalised, the current ambiguity means that in order to minimise risks, many companies have chosen to reduce cross-border data export as much as possible. Chinese clients that work with foreign businesses have also been very cautious about potential cross-border data transfers, leading some to demand their foreign business partners not send data across borders at all. Ultimately, this will have a negative impact on China's business and innovation landscape as companies' global offices' ability to understand the China market and to develop new products and services depends on whether they can pool and analyse data securely and efficiently.

One factor contributing to the current confusion in China's cybersecurity regulatory landscape is the limited input from industry participants when Chinese regulators formulate cybersecurity regulations. The *Several Provisions on Auto Data Security Management (Trial Implementation)*, for example, stipulates that auto data processors should avoid sending data outside the vehicles unless necessary.[10] As one interviewee from a foreign company put it, 'This is impossible to do and clearly shows that drafters of the regulation have no good understanding of the industry.' Companies have also reported insufficient lead time for fulfilling certain requirements spelled out in this particular regulation. For example, it requires important data processors to submit risk assessment reports of their important data processing activities to the Cyberspace Administration of China (CAC) as well as Ministry of Industry and Information Technology (MIIT) by the end of 2021 while the regulation came out in August the same year. Companies have noted that it was an incredibly short timeframe in which to prepare two different reports that contain comprehensive information around data processing activities and believe that regulators should allow companies sufficient lead time to prepare and ensure compliance, should there be similar requirements in the future.

In summary, China's cyber and data security regulations have presented significant challenges to foreign participants and were ranked as the 2nd biggest challenge for British businesses in the *British Business in China: Sentiment Survey 2021/22*.[11] While companies have noted that there have been some positives that have come with the legislation, such as requirements for companies to improve their own network security as well as aiming to strengthen citizens' privacy protection, in general the overall lack of clarity around key concepts and stipulations in the legislation is hampering business operation and undermining confidence in China's business environment.

Recommendations

- Allow data important for businesses' daily operations and innovation to be sent overseas.
- Provide clarity around key concepts such as important data and CIIOs.
- Confirm how important data intersect with the DCCS.
- Seek input from industry participants, both domestic and foreign, to improve the regulatory system around cybersecurity and data security.

9 'Cross-Border Data and Innovation Report 2021', British Chamber of Commerce in China, October 2021.

10 'Several Provisions on Auto Data Security Management (Trial Implementation)', Cybersecurity Administration of China, August 2021.

11 'British Business in China: Sentiment Survey 2021/22', British Chamber of Commerce China, December 2021.

FORMULATION AND ENFORCEMENT OF LAWS AND REGULATIONS

While businesses wish to ensure compliance with both local and national laws and regulations, companies across all sectors frequently face challenges and barriers to doing so, which in turn impacts their ability to grow their businesses in China. The British Business in China: Sentiment Survey 2021-2022 revealed that enforcement of laws and regulations, transparency of the business environment, and consultation ahead of regulatory change rank among the top regulatory challenges impacting respondents' ability to do business in the Chinese mainland. Based on respondents' explanation of these challenges in the following interviews, we combine them in this chapter as 'formulation and enforcement of laws and regulations'. While they are not new issues, they are ranked as larger challenges than in the previous sentiment surveys. Additionally, nearly a quarter of respondents indicate that the enforcement of laws and regulations has worsened in particular.[12]

Many companies have linked the issue of 'enforcement of laws and regulations' in the past year with China's stringent COVID-19 control measures. For example, travel companies expressed frustration with bans from local tourism bureaus on organising any trips across provincial borders whenever there is an outbreak in the country. Companies that rely on hosting in-person events have also struggled with local pandemic control measures and too often have had to cancel events due to COVID-19 outbreaks.

Meanwhile, more generally, companies have highlighted issues with the unequal application of policies in different regions and between companies; in many cases, enforcement tends to be far stricter, and often overly so, at the community and the local levels. One example is the release of Shanghai's first Whitelist of 666 companies that were allowed to resume production from this year's COVID-19 outbreaks which should have, in theory, facilitated those companies' workers' return to workplace. However initially, in practice, not all neighbourhood committees acknowledged the policy. The unequal application of policies is not only restricted to COVID-19-related control measures, but extends to many others. For instance, since the release of the *Administrative Measures for the Government Procurement of Import Products* (hereinafter *Order 551*)[13] last year, local governments in many southern cities have reportedly restricted foreign companies from participating in public procurement altogether, although *Order 551* did not discriminate against FIEs, but rather imported goods.

A lack of consultation ahead of regulatory changes, as well as the sudden enforcement of regulations without a reasonable grace period, is a closely connected issue with enforcement of laws and regulations. In many cases, these are all contributing to a sense that the current business environment lacks transparency. Businesses across all sectors have had on-going issues with keeping up with

12 'British Business in China: Sentiment Survey 2021-22', The British Chamber of Commerce in China, December 2021.

13 'China quietly sets new 'buy Chinese' targets for state companies', Reuters, August 2021.

the fast-changing regulatory environment, with reports of last-minute notifications of new policy initiatives or amendments to existing policies contributing to a widespread perception that the regulatory environment can change from day-to-day. The Double Reduction policy issued in July 2021 for instance caught the industry by surprise, affecting both domestic and foreign companies. Due to the sudden crackdown on after-school tutoring for students in compulsory education (K9), many education companies had to downsize significantly or even move

out of the Chinese mainland shortly after the policy was promulgated. While the intention of the policy, which was to reduce pressure on students and improve their welfare, is understandable, BritCham companies believe that the policy could have been better communicated and implemented in a way that reduced the shock to the industry, such as by giving companies a grace period to be compliant.

Another key example affecting all sectors engaged in hiring foreign talent were the changes to Individual Income Tax (IIT), which were originally due to take effect on 1 January 2022 with the expected consequence of significantly increasing expatriates' cost burden, especially those with family in China.[14] While the delay of implementing the new changes until 2023 was universally welcomed by businesses, companies were only informed of it at 6pm on the eve that the new changes were intended to take effect. As a result, many had already spent a significant amount of resources preparing for the new changes. BritCham members were appreciative of the government attending to the foreign business community's concerns and adjusting the policy accordingly but hope that in the future such policy changes could be communicated in a more timely manner.

Furthermore, consultation is at times limited to a select number of domestic companies, resulting in unequal opportunities for international companies to both provide feedback as well as to prepare for new changes. One member operating within the energy sector highlighted how draft regulations to change import specifications of certain coals were only made available to a select number of associations, and thus many companies were unable to access it, or were forced to rely upon rumours in the market. Members within the auto sector also indicated that there was a disparity between the information made available to domestic and foreign firms before regulatory changes and hope that foreign companies are involved in the consultation process as well.

Overall, these issues stem from poor communication channels between business and government, resulting in businesses frequently reporting being forced to operate based upon rumours. For example, a school in Shanghai called for better communication between government and businesses, having been forced to rely upon unofficial channels in an attempt to gain clarity in respect of inconsistent COVID-19 restrictions between districts in Shanghai, including social media and rumours from parents. This not only impacted their ability to comply with crucial COVID prevention policies, but also had a negative impact upon their reputation in the eyes of their clientele.

Due to these issues, compliance with the fast-changing, and at times unpredictable, regulatory environment places a considerable strain on the resources of companies. Ultimately, this detracts from their ability to grow their business. One school gave the example of how a seemingly simple requirement to change their name would take approximately 12-14 months of work, on top of other considerable pandemic related challenges. Thus, while British businesses in China endeavour to operate in accordance with local and national laws and regulations, they would benefit from changes in the regulatory environment in order to streamline and lessen the burden of doing so.

Recommendations

- Ensure regulatory changes are communicated clearly through official channels in a timely manner.
- Strengthen enforcement and oversight at the local level to ensure equal treatment of domestic and foreign companies in public procurement.
- Engage in thorough consultation across all relevant companies, both domestic and foreign, that are likely to be affected by potential regulatory changes.
- Allow for adequate grace periods for compliance with regulatory changes.

14 'China Annual (One-Off) Bonus: What is the Income Tax Policy Change?', China Briefing, December 2021.

PUBLIC PROCUREMENT POLICY AND PRACTICES

Public procurement policy and practices were ranked as the fifth biggest regulatory challenge facing British business in 2021.[15] The *Administrative Measures for the Government Procurement of Import Products* (hereinafter *Order 551*), jointly issued by the Ministry of Finance (MOF) and Ministry of Industry and Information Technology (MIIT) in May 2021, has raised the most concern among British business, especially those in the medical technology industry. The document sets mandatory quotas for the government to procure domestic products as opposed to imported goods, including 178 types of medical devices and equipment. Although the policy does not, in principle, discriminate against domestically-produced products supplied by FIEs, in practice local governments have tended to restrict the participation of public procurement to only domestic suppliers, which has led to significant barriers for FIEs in public procurement. A number of companies also reported that this issue has been more acutely felt in smaller southern cities, including those in Guangdong and Fujian provinces. While the Ministry of Finance (MOF) released another notice in October 2021 requiring localities to grant equal treatment to 'domestically produced' products regardless of whether they are manufactured by foreign-owned or local companies, BritCham members have to date not seen any material progress in this regard. Meanwhile, there remains uncertainty as to how the words 'domestically produced' should be defined. There has been variation in the interpretation of this requirement between different localities, which has caused difficulty as although FIEs are able to have their final products produced in China, they also often source inputs from elsewhere. British business therefore hope that the government will provide more clarity on the definition of 'domestically produced products' or 'domestic goods' in order to ensure transparency and standardised enforcement in public procurement. We believe that this definition should also give recognition to the efficiency, quality and innovation that can be delivered by global supply chains.

Foreign companies in other sectors also report challenges with public procurement. British education companies, for example, are frustrated by the fact that they are not allowed to collaborate with public schools in order to deliver supplies, curricula and programmes, limiting their potential in the market and resulting in barriers to UK-China cooperation in the education sector. One company in the energy sector also noted a worrying trend where, since early 2021, national oil companies (NOCs) have increasingly started to opt for domestic suppliers despite the fact that this company had been consistently supplying equipment to the refineries run by the three NOCs in the past. There are concerns that as geopolitical tensions continue to heighten, the government and SOEs will increasingly favour domestic products and suppliers, with foreign suppliers further marginalised in the economy. In terms of bidding for public projects, one company also noted differences between domestic and foreign companies in receiving prior notice: with foreign companies often only being given rather short notice to prepare for bids, in comparison to domestic companies who usually find out about the competition much further in advance and therefore are able to be more sufficiently prepared. In order to level the playing field, we hope that the government grants equal treatment to both domestic and foreign businesses in public procurement and that the bidding processes are transparent where the same rules and notice periods are applied to both foreign and domestic businesses.

Recommendations

- Strengthen the enforcement of equal treatment of domestic and foreign firms in public procurement.
- Provide a clear definition of 'domestic goods'.
- Make the public bidding process more transparent and standardised.

15 'British Business in China: Sentiment Survey 2021/22', British Chamber of Commerce China, December 2021.

TAXATION LANDSCAPE FOR FOREIGN FIRMS AND TALENT

There have been some developments in the taxation landscape over the past year for foreign firms and talent. China continues to push ahead with the development of special cooperation zones, particularly in the Guangdong-Hong Kong-Macao Greater Bay Area, aiming to strengthen the local economy and realise diversified economic development for Macao. In particular, a number of industries in the Hengqin in-depth cooperation zone, including high-tech R&D and high-end manufacturing,[16] are eligible for a reduced corporate income tax (CIT) rate of 15% (in line with the reduced rate for high and new technology enterprises nationally, and other FTZ CIT incentives such as those in Shanghai), with other specific policies enacted concerning individual income tax (IIT), import tax, and tariffs.[17] New guidance on Guangzhou's preferential IIT policies was also issued in June last year, clarifying the rules for foreign employees receiving preferential tax treatment under the scheme announced in 2019. Under the scheme, foreign employees working in nine cities in the Pearl River Delta in specified industries are eligible for tax rebates equal to the difference between local and HK IIT.[18]

The planned changes to China's IIT regime have also been delayed until the end of 2023. As briefly mentioned above, The tax changes originally proposed, if implemented, will significantly increase tax burdens for both employees and employers, affecting China's attractiveness as a destination for foreign workers and businesses alike.[19] While the delay to implementation has given companies some breathing room, foreign companies and nationals working in China still face the uncertainty of what happens when the current reprieve expires. Meanwhile, in the *British Business in China: Sentiment Survey 2021/22*, favourable tax reductions for CIT and IIT were the most widely desired preferential policies by British businesses, supported by 45% and 37% of respondents respectively. Therefore, it is hoped that clarity can be provided on future reforms to IIT, and that preferential tax policies can be developed and implemented to improve China's ability to attract and retain both foreign investment and talent.

While foreign businesses report a generally high level of CIT in China compared to other regions such as Hong Kong (which has CIT of 16.5%, with a reduced rate of 8.25% for the first HKD 2 million in profit)[20] and Singapore (a flat 17% CIT rate),[21] the legal services industry in particular is disadvantaged in the corporate tax regime compared to domestic companies. As British legal firms are only able to operate in China as representative offices of their global firms in China, they are taxed on both individual and corporate income. This creates a significant competitive disadvantage for foreign legal firms practising in China, as local law firms establish themselves as partnerships and are only taxed at the partner level. This allows domestic firms to charge lower fees while generating the same levels of revenue, impacting the competitiveness of foreign firms, as well as their attractiveness to local talent. It is therefore hoped that taxation rules can be brought into alignment for domestic and foreign law firms in order to foster equal competition in the market.

Recommendations

- Provide clarity on future IIT policies, and continue to offer preferential IIT policies and incentives to encourage inbound foreign investment and the flow of overseas talent.
- Reduce tax burdens on foreign law firms (two layers of taxes at the company and the individual levels) so that they are not disadvantaged when competing with domestic law firms (only taxed at the individual level).

16 'Master Plan of the Development of the Guangdong-Macao Intensive Cooperation Zone in Hengqin', State Council, September 2021.

17 'Qianhai and Hengqin set to spur Bay Area', State Taxation Administration, September 2021.

18 'Individual income tax incentives for GBA - Guangzhou implementation guidance', KPMG, July 2021.

19 'China to Extend Preferential Tax Policies for Foreigners until End-2023', Reuters, January 2022.

20 'Hong Kong SAR - Corporate - Taxes on corporate income', PwC, December 2021.

21 'Corporate Income Tax Rate, Rebates & Tax Exemption Schemes, Inland Revenue Authority of Singapore', accessed March 2022.

ACCESSING OR MOVING COMPANY FINANCES

The previous editions of the Position Paper all highlighted challenges regarding accessing or moving company finances across borders, in particular sending money overseas, citing bureaucratic and unpredictable administrative procedures and challenges when attempting to contact regulators to resolve problems. Barriers remain to allow for the efficient transfer of capital and funds between companies and their subsidiaries and/or sister companies situated outside of the China mainland.

In the past year, a pilot scheme has been a promising response to gradually liberalising cross-border fund flows. A few UK companies have been involved in the program, including one British firm which is the first foreign bank to be included in a pilot scheme for MNCS for multi-currency cash pooling. The scheme aims to reduce the number of manual processes involved in the flow of cross-border funds by adjusting the overseas lending quota and making it possible for corporates to purchase foreign exchange in advance within a certain quota.[22] Results of this pilot have yet to be made public, but it should hopefully indicate positive steps towards addressing issues raised by members in previous Position Papers and Sentiment Surveys.

As this pilot has yet to benefit the wider foreign business community, our members continue to raise the difficulty of moving funds across borders over the past year and the burdensome requirements and documentation for requesting such transfers. Businesses report inconsistencies in whether cross border payments are accepted: sometimes, a payment will be allowed one time, and then refused or delayed the next time despite companies or individual having submitted the same supporting materials for these transactions. A lack of information about why a transaction has been refused or delayed is also frustrating. It would be useful if businesses were provided with more consistent feedback if transactions are rejected so as to ensure that subsequent transactions are compliant.

Recommendations

- Expand the positive precedent of the cash-pooling pilot programme to cover more foreign firms.
- Provide clearer and in-depth feedback to businesses on why their cross-border payments have been rejected, to mitigate the perceived inconsistencies when it comes to cross-border transfers.

COMPETITION WITH STATE-OWNED ENTERPRISES

Competition with state-owned enterprises (SOEs) has been a long-standing challenge for foreign businesses in China. 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 many sectors such as telecommunications, finance, energy and aviation. With China's Three-Year SOE reform under way with the aim to make SOEs 'bigger, better and stronger', there is worry that SOEs' position in the economy will only be further strengthened. Despite the welcome emergence of new opportunities in the market, particularly in green finance and clean energy projects, big SOEs continue to enjoy a dominant presence in those areas in comparison to foreign companies. For example, the past few years have witnessed record development of China's offshore wind, with major SOEs being the primary parties engaged in building projects and operating assets, with foreign companies only having minimal presence in the market despite their expertise and experience in this area.

For many companies, the challenge does not merely lie in the difficulty in competing with SOEs — given SOEs' dominance in the economy, companies too often find

22 'China pilots cash-pooling service integrating local, foreign currency management' Xinhua, March 2021.

themselves in a position of having to secure cooperation with the former in order to obtain access to these market opportunities. However, as mentioned in the 'public procurement' section, there has also been a noticeable trend of SOEs opting for domestic products and suppliers in recent years, which has led to a further decrease in opportunities available for foreign companies. Similarly, in the built environment services industry, SOEs have in many cases stepped in to rescue private developers in the past year (who are cash-strapped as a result of the crackdown on the property market over the past two years), thereby strengthening their presence in the market. British companies that provide design, engineering and architecture services have thus had to increase their reliance on SOEs in order to access market opportunities.

Businesses urge for the greater consideration of both the 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, previous rounds of reforms that had similar focuses have not resulted in any significant progress. Establishing a level playing field is vital to improving economic efficiency. The government must ensure reform measures are rigorously enforced in order to bring about real, meaningful changes in practice.

Recommendations

- Address the visible and invisible barriers that inhibit foreign businesses from fully accessing the market and competing with China's SOEs.
- Treat domestic and foreign firms equally when SOEs consider partner organisations and suppliers.

CUSTOMS REQUIREMENTS

Sporadic COVID-19 outbreaks have disrupted imports from time to time over the past year. However, the latest COVID-19 outbreaks in Shanghai are having a much more significant and prolonged impact on import companies due to ongoing port congestion, lower efficiency for customs clearance, closed warehouses and difficulty for trucks to get in and out of the Shanghai port. Businesses have also continued to report significant discrepancies in processes and requirements between ports over the past year, creating uncertainty and making it difficult to ensure compliance. Customs requirements surrounding importing books and printed materials have reportedly also been made more stringent (likely due to increased scrutiny over content), increasing both import times and administrative burdens.

Meanwhile, companies in the food and beverage sector report difficulties with two recently implemented customs regulations: the *Regulations on the Registration and Administration of Overseas Manufacturers of Imported Food (Order 248) and Measures for the Administration of Import and Export Food Safety (Order 249)*. For example, *Order 248* requires the competent authority in the overseas manufacturer's country or region to 'examine and inspect their manufacturers' and recommend the producers to the GACC for registration, in regards to 18 categories of foods.[23] As completing the registration process requires working with both the Chinese and foreign governments, and given that many overseas governments do not have prior experience with such registration, we hope the Chinese competent authorities can communicate with foreign authorities thoroughly on this matter, allow companies sufficient lead time for compliance, and also provide clear guidance.

Order 248 also requires that when changing production site, legal representative, or registration number in the country/region where the manufacturer is located, the overseas manufacturer must re-apply for registration with GACC, and the original Chinese registration number will automatically become invalid. This requirement poses a number of challenges. Firstly, the legal representative of a MNC is normally a senior staff member of that company, including its country CEO. Some companies note that their country CEOs are regularly rotated between different regions within the group. Requiring a new registration every time a legal representative is changed seems disproportionate, considering that the rotation of senior staff has no impact on food safety, and imposes significant administrative burdens on companies. In addition, businesses are unclear on what should be done in cases where production is temporarily shifted to other

23 'Regulations on the Registration and Administration of Overseas Manufacturers of Imported Food', General Administration of Customs China, April 2021.

sites, for example due to accidents, natural disasters, or other disruptions. It is hoped that more flexibility can be exercised so that when a company needs to make such changes, they are not required to reapply for registration with GACC every time.

Businesses also report a lack of clarity in regard to whether the new requirement on overseas manufacturer registration also applies to products sold in the Hainan Free Trade Port (FTP). It is hoped that an official statement on the applicability of these regulations in the Hainan FTP can be issued to provide clarity, and that the regulations exclude Hainan FTP from their scope given it is outside of the Chinese mainland customs area.

Recommendations

- Continue to improve lines of communication between GACC and businesses, with a focus on communicating changes in regulation as early as possible.
- Allow foreign food producers sufficient time to comply with the registration requirements set out in *Order 248* registration in cases where the legal representative of a company changes, or where production location is temporarily changed.
- Provide an official statement clarifying *Order 248* does not apply to products sold in the Hainan FTP.

OBTAINING BUSINESS LICENCES AND CERTIFICATES

Overall, the issue of obtaining business licences has improved year-on-year according to *British Business in China: Sentiment Survey 2021/22*. The issue was ranked 12th out of the 14 regulatory challenges impacting on members' ability to do business on the Chinese mainland in the survey, representing a drop in three places since last year. That being said, 65% of respondents reported that there has been no change in this area of concern, which indicates that other issues have worsened, as opposed to a significant reduction of barriers surrounding licences for foreign companies. Additionally, within industries which have reported long-term challenges in this area, such as the built environment sector, 85% of respondents report no-change, and none report improvement.

Regardless, challenges surrounding obtaining businesses and licences continue to be highlighted by almost all industries in the survey, and for some, this remains a dominant issue. One education member in a southern city with decades of industry experience over multiple countries described there as being 'no comparison' to China in terms of the lack of guidance and opaqueness of procedures to obtain the wide range of licences necessary for them to operate legally. Additionally, these rules and procedures can vary considerably from location to location. This lack of clarity results in significant amount of anxiety for organisations and the education member put their recommendations succinctly: 'Make the rules, write them down, and make them public.'

Unsurprisingly, given the 'Double Reduction policy' and subsequent crackdown on after-school training, many within the education sector were disproportionately affected by this issue, and were unable to complete their core business due to the inability to obtain key licences. Furthermore, companies which are desperately trying to adjust their business models report a lack of clarity regarding which licence the teaching of non-academic subjects in English should fall under. Moreover, within mainstream education providers, there were reports of pressure from increasing scrutiny from the education bureau, with companies subject to increasing inspections to ensure compliance.

The issue around obtaining business licences is closely linked with that of unfair treatment of foreign companies when compared to Chinese companies, with nearly a quarter of impacted respondents reporting in the *Sentiment Survey* that they faced additional barriers in comparison to their local counterparts. As expanded upon in the built environment section, companies within this sector have reported long-standing barriers to applying for design licences, which means they have to operate in partnership with Chinese companies in order to deliver services. While there are established procedures for domestic built environment companies to obtain design licences, no transparent processes exist for their foreign counterparts to do so. Additionally, in the legal services industry, foreign law firms report that they need to renew their business licence annually, whereas local law firms are only required to do so once every five years, thus placing an unfair burden on foreign law firms. Meanwhile, foreign firms in the financial services industry also hope market barriers are removed for FIEs to apply for certain business licences. For instance, foreign-funded banks have been permitted to apply for and obtain a Category A lead underwriting licence in the China Interbank Bond

Market (CIBM) since 2019. However, so far only two foreign lenders have obtained such licences, with the vast majority of foreign banks unable to tap into the huge market opportunities in China's CIBM. We hope the government will grant foreign banks equal rights to participate in the country's financial services market in order to support China's aim of further opening up its financial industry.

Recommendations

- Publish clear guidelines on obtaining various business licences, alongside changes to regulations surrounding business licences.
- Ensure guidelines are equitably shared, imposed, and enforced within the same provinces and industry.
- Allow foreign built environment services companies to obtain the necessary business licence (Grade A) in order to deliver services independently and compete with domestic companies on a level playing field.

INTELLECTUAL PROPERTY RIGHTS PROTECTION

Over the past few years, China has made considerable improvements in intellectual property (IP) protection. Key legislation has been amended to strengthen IP protection. Its *Patent Law*, which took effect in June 2021, has been amended in the areas of patent application, patent exploitation and commercialisation, and patent protection.[24] The new *Copyright Law*, which came into effect on the same day, was also revised in terms of penalties for infringement, burden of proof and destruction of infringing copies.[25]

We have noted that foreign companies' confidence in China's IP protection has improved in general. *British Business in China: Sentiment Survey 2021-2022* published in December 2021 found that IP is, according to respondents, the only regulatory area that has improved over the last year, consistent with the trend shown through the previous editions of Sentiment Surveys. Last year, China National Intellectual Property Administration also released The *Outline of Building an Intellectual Property Rights (IPR) Powerhouse (2021-2035)*, with a shift in focus from quantity to quality of IPR.

Nevertheless, there continues to be room for further improvement. While foreign nationals and companies have been able to win IP cases in court, some also believe that the penalties have not been significant enough to deter violations. Furthermore, China continues to need to strengthen enforcement, which currently varies between cities and regions. Companies note that it is particularly hard to obtain key evidence in smaller cities as opposed to more well-developed regions such as Beijing, Shanghai and Guangzhou. A recent study also found that around 12.5% of China's exports are estimated to be counterfeited goods.[26] BritCham's members in the food and beverage industry note that while China has established a comprehensive anti-counterfeiting regulatory system, enforcement has not been sufficiently robust.

One specific recommendation BritCham members made this year concerns the fourth amendment of *The Patent Law*. Article 42 of the law introduces a patent extension system where the term of a patent can be extended for up to five years to compensate for the time taken for drugs to obtain market authorisation. While this is a welcome development, it only applies to drugs that enter the market after 1 June 2021. British pharmaceutical companies hope this rule can be retrospective to also include new drugs marketed before 31 May 2021. Given the costly and time-consuming nature of drug development, it is important that the government give full recognition to resources and investment that have gone into the R&D process of innovative drugs – this stands true for new drugs marketed both before and after 31 May 2021. Allowing the former to benefit from the latest policy change will further demonstrate China's commitment to

24 'Understanding the Fourth Amendment of Chinese Patent Law', fieldfisher, July 2021.

25 'China's Copyright Law Amended: Key Changes', China Briefing, April 2021.

26 'Cross-border Trade in Counterfeit Goods', Rouse, February 2021.

encouraging innovation in the pharmaceutical market and is also consistent with the principle of "retrospective operation of beneficial provisions" in Chinese law.

Recommendations

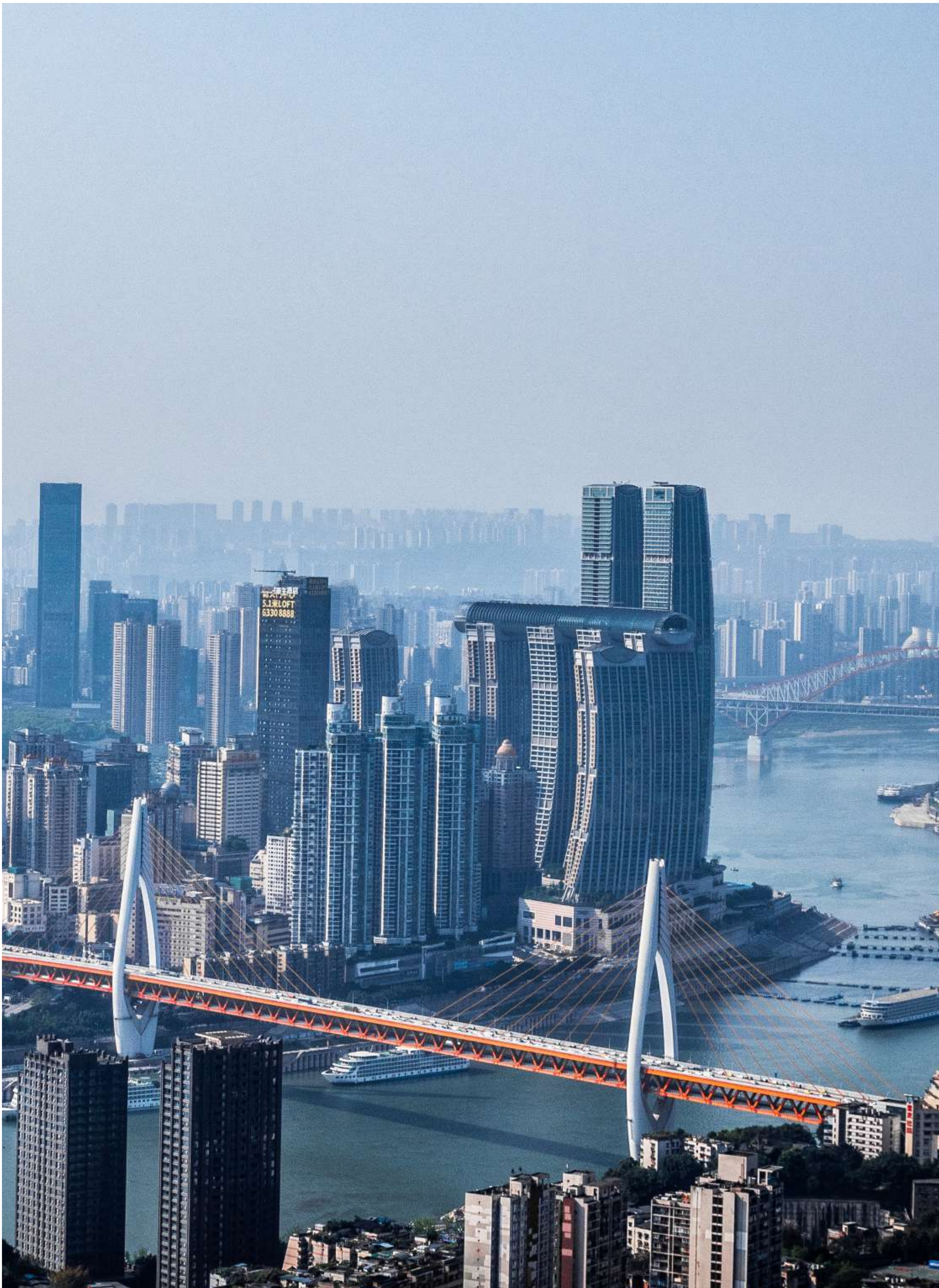
- Strengthen and standardise enforcement of intellectual property rights protection.
- The *Patent Law*: allow the patent extension term to be applied to drugs that enter the market before 1 June 2021.

RECOMMENDATIONS

KEY CHALLENGE	RECOMMENDATION
Hiring challenges and talent development	■ Reinstate direct flights between the UK and China. ■ Make it easier for foreign employees to receive visas for their dependents. ■ Establish transparent and streamlined processes for entering China. ■ Establish transparent and streamlined processes for entering China. ■ Work towards signing mutual recognition agreements or exploring conversion exams between British and Chinese qualification bodies in certain services industries, especially in legal, financial and built environment services. ■ Loosen the restriction of 2 years of professional work experience for work permits for hiring foreign talent. ■ Loosen the requirement that local lawyers give up their right to practice Chinese law when they join foreign firms; allow them to keep the licence in non-sensitive areas. ■ Clarify/explore industry links between British businesses and TVET providers.
Formulation and enforcement of laws and regulations	■ Ensure regulatory changes are communicated clearly through official channels in a timely manner. ■ Strengthen enforcement and oversight at the local level to ensure equal treatment to domestic and foreign companies in public procurement. ■ Engage in thorough consultation across all relevant companies, both domestic and foreign, that are likely to be affected by potential regulatory changes. ■ Allow for adequate grace periods for compliance with regulatory changes.

KEY CHALLENGE	RECOMMENDATION
Navigating cybersecurity and IT regulations	▪ Allow data important for business daily operation and innovation to be allowed to sent overseas. ▪ Provide clarity around key concepts such as important data and CIIOs. ▪ Seek input from industry participants both domestic and foreign to improve the regulatory system around cybersecurity and data security.
Public procurement policy and practices	▪ Strengthen the enforcement of equal treatment to domestic and foreign firms in public procurement. ▪ Provide a clear definition of 'domestic goods'. ▪ Make the public bidding process more transparent and standardised.
Taxation landscape for foreign firms and talent	▪ Provide clarity on future IIT policies, and continue to offer preferential IIT policies and incentives to encourage inbound foreign investment and the flow of overseas talent. ▪ Reduce tax burdens on foreign law firms (which bear two layers of taxes, both at the company and the individual levels) so that they are not disadvantaged when competing with domestic law firms (which are only taxed at the individual level).
Accessing or moving company finances	▪ Expand the positive precedent of the cash-pooling pilot programme to cover more foreign firms. ▪ Provide clearer and in-depth feedback to businesses on why their cross-border payments have been rejected, to mitigate the perceived inconsistencies when it comes to cross-border transfers.

KEY CHALLENGE	RECOMMENDATION
Competition with state-owned enterprises	■ Address the visible and invisible barriers that inhibit foreign businesses from fully accessing the market and competing with China's SOEs. ■ Treat domestic and foreign firms equally when SOEs consider partner organisations and suppliers.
Customs requirements	■ Continue to improve lines of communication between GACC and businesses, with a focus on communicating changes in regulation as early as possible. ■ Allow foreign food producers sufficient time to comply with the registration requirements set out in *Order 248*. ■ Remove or adjust the requirement to re-apply for registration in cases where the legal representative of a company changes, or where production location is temporarily changed. ■ Provide an official statement clarifying that requirements of *Order 248* do not apply to products sold in the Hainan FTP.
Obtaining business licences and certificates	■ Publish clear guidelines on obtaining various business licences, alongside changes to regulations surrounding business licences. ■ Ensure guidelines are equitably shared, imposed, and enforced within the same provinces and industry. ■ Ensure that the procedures to apply and retain business licences are equal between Chinese and foreign firms.
Intellectual property rights protection	■ Strengthen and standardise enforcement of intellectual property rights protection. ■ The *Patent Law*: allow the patent extension term to be applied to drugs that enter the market before 1 June 2021.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INDUSTRY REPORTS

AUTOMOTIVE

AT A GLANCE

SUB-SECTORS

Original equipment manufacturers

Automotive components suppliers

KEY CHALLENGES

- Harmonisation of ICV standards
- Lack of clarity on data security requirements
- Concerns around the implementation of the new foreign ownership rules for passenger cars

KEY RECOMMENDATIONS

- Increase harmonisation of Chinese standards with international standards
- Offer more clarity on implementation rules for cross-border data transfers
- Fully implement the liberalisation measure on foreign ownership in the automotive sector

KEY MUTUAL OPPORTUNITY

- Robust demand for premium and luxury vehicles

STATE OF THE SECTOR

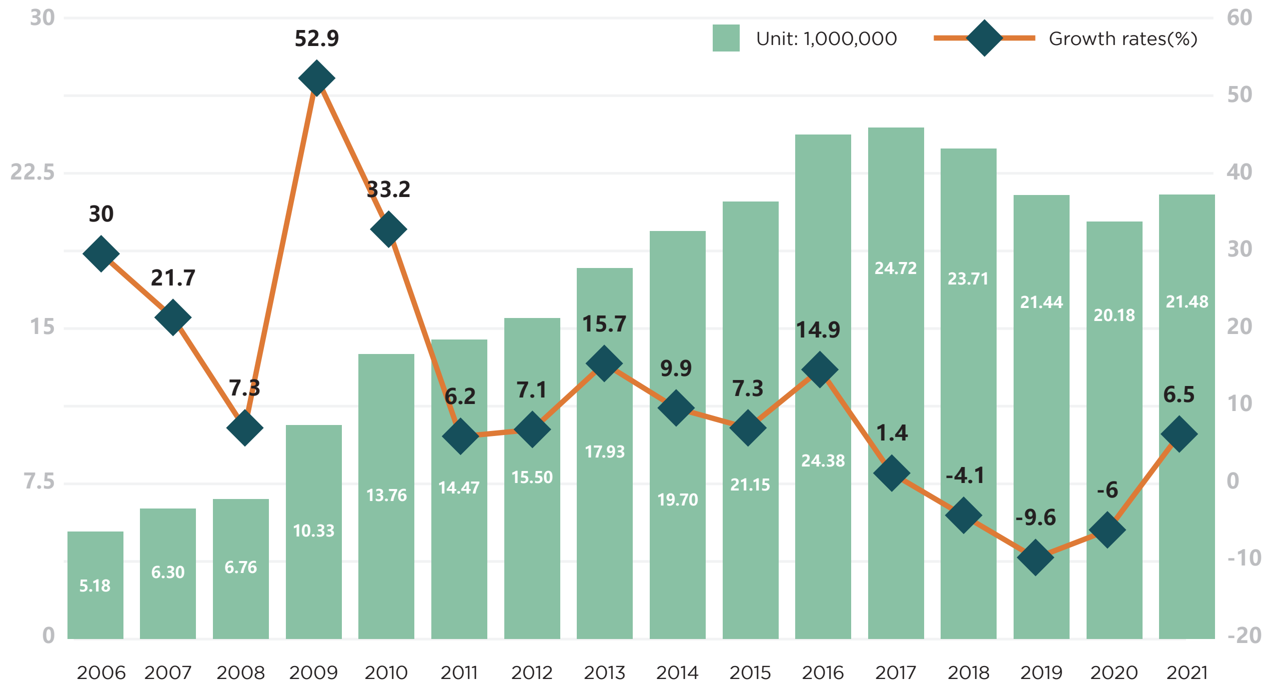
China's automotive sector experienced another year of strong growth in 2021. Sales and production of passenger cars both surpassed 21.4 million, increasing by 6.5% and 7.1% respectively from the previous year.[1] The fastest recovery came in the first quarter of the year given the low base of early 2020. The semiconductor shortages nevertheless weighed on the sector, especially in the third quarter, causing growth to slow down between July and September. Although the problem eased slightly at the beginning of 2022, the geopolitical tensions resulting from the Ukraine-Russia conflict and the recent COVID outbreaks in late March 2022 are going to prolong the difficulties.

In terms of auto trade, China's total imports of foreign cars decreased by 6.1% last year, totalling 939,000 units.[2] There was however, a slight increase in China's imports of UK cars, while British car exports into other major markets such as the US and Japan dropped by 10.5% and 36.1% respectively.[3] British premium and luxury cars, in particular, benefited from the strong demand in the Chinese market, and reported better performance in China than in other global markets.

With China's double carbon goals, various sectors are prioritising decarbonisation. The country's roadmap to carbon neutrality states that it will continue to increase New Energy Vehicles (NEVs) market share as opposed to gasoline-powered vehicles and increase the use of electric vehicles in public transport.[4] The *Development Plan for NEVs*[5] released at the end of 2020 also stipulates that the sale of China's NEVs should reach 20% of the

China's Passenger Car Sales and Growth Rates Bewteen 2006 and 2021

Source: China Association of Automobile Manufacturers



1 'China Association of Automobile Manufacturers the Sales of Passenger Cars in the Chinese Market in 2021 Was 214.82 Million, Representing an Increase of 6.5%, Compared to the Year Before', The Beijing News Auto, January 2022.

2 'China's Auto Imports Market of 2021', China Automobile Dealers Association, February 2022.

3 '2021 (Full Year) Britain: UK Car Production and Exports', Car Sales Statistics, January 2022.

4 'China 2030 Carbon Peak Action Plan', State Council, October 2021.

5 'The Development Plan for New Energy Vehicles (NEV) (2021-2035)', General Office of the State Council, October 2020.

total sale of new cars by 2025. In 2021, this figure already reached 13%. Despite the Chinese government's plan to phase out subsidies for NEVs - cutting them by 30% at the beginning of 2022 and withdrawing them completely by year-end – the NEV industry's growth is expected to continue, with some estimating that NEVs will account for 50% of China's yearly automobile sales by 2030.

China is a global leader in terms of NEV production and sales. As a result of the strong government support over the past two decades, there has been a notable boost in research and production capacities and the development of a home-grown supply chain.[6] China's local brands are enjoying great success, with Tesla being the only foreign automakers in the China's top 10 best-selling NEV brands,[7] although the country's auto industry is still dominated by foreign brands overall, which account for 56% of the market share.

Following Chinese president Xi Jinping's 2018 announcement that China will gradually eliminate its cap on auto companies' ownership, 2022 saw the removal of the last remaining restrictions on the industry, being the foreign shareholding limit on passenger cars. In February 2022, BMW became the first Western foreign carmaker that benefited from this development when, with the green light of the National Development and Reform Commission (NDRC), it acquired 75% of the stake in its Chinese joint venture. This is an encouraging development but will rely on continued robust enforcement to make the regulatory change meaningful.

As China's auto industry is becoming not only cleaner but also smarter, vehicles are generating large amounts of data on a daily basis. This will only accelerate with the development of intelligent and connected vehicles (ICVs), another key area of growth for the sector. As part of China's efforts in regulating data protection in recent years, regulators are increasingly paying attention to how data is handled in the automotive sector. The *Data Security Law (DSL)* and *Personal Information Protection Law (PIPL)*, two consequential pieces of legislation impacting China's data security landscape were enacted in 2021, and have had a significant impact on the auto industry. While movements on data regulations to a large extent represent an improvement to China's data privacy landscape, some elements of the current regulatory framework have, nevertheless, brought uncertainty for industry participants.

6 'How China Put Nearly 5 Million New Energy Vehicles on the Road in One Decade', The International Council on Clean Transportation, January 2021.

7 'China NEV Sales Drop 18.6% in January after Subsidy Cut', Reuters, February 2022.

KEY CHALLENGES

1 HARMONISATION OF ICV STANDARDS

Apart from NEVs, intelligent and connected vehicles (ICVs) are another key area where China's automakers are seeing increasing opportunities. Since many UK and European foreign companies conduct their R&D activities outside of China, typically in Europe, many of their products including ICVs need to comply with European industrial standards and regulatory requirements. With China still putting in place its own regulatory framework on ICVs, British businesses hope that in this process, the Chinese government increases harmonisation with international standards, thereby reducing the need for foreign carmakers to customise products in order to comply with a different regulatory and standards system in China. Such alignment would also facilitate Chinese brands entering third markets.

2 LACK OF CLARITY ON DATA SECURITY REQUIREMENTS

China has tightened regulations on data privacy in recent years. The increasing amounts of data generated in vehicles means that the auto industry is being put under increasing scrutiny in terms of how they handle data and ensure data security. While movements on data regulations to a large extent indicate an improvement to China's data privacy landscape, foreign industry participants are also concerned about the lack of clarity in legislation.

In particular, the absence of implementation details around cross-border data transfer requirements lead to questions about what data needs to go through security assessments before being transferred overseas, and the procedures and responsible government departments for carrying out these assessments. This has caused many foreign companies to minimise cross-border data activities until regulators clarify implementation rules.

Such constraints have had a particularly negative impact on foreign companies compared to domestic ones. FIEs' R&D centres are often located outside China and rely on receiving data from the China market to gain critical insights into customer preferences and product performance. British business therefore hope that more clarity is provided on the implementation details of cross-border data transfers as soon as possible, and that regulators involve foreign Original equipment manufacturers (OEMs) in discussions when formulating policies. Meanwhile, given foreign OEMs' needs in regard to global R&D and daily operation related activities, essential data, e.g., VIN and environmental data for accident investigation, should be allowed to flow across borders in order to improve innovation and productivity.

It is also hoped that when future implementation rules are published, companies are given sufficient time to ensure compliance. Following the *Several Provisions on the Safe Management of Auto Data (For Trial Implementation)*[8] which were released in August 2021, important data processors were required to submit risk assessment reports of their important data processing activities to the Cybersecurity Administration of China (CAC) and the Ministry of Industry and Information Technology (MIIT) by the end of the year. Companies have noted that it was an incredibly short timeframe in which to prepare two different reports containing comprehensive information around data processing activities and hope that regulators will allow companies sufficient lead time to prepare and ensure compliance, should there be similar requirements in the future.

3 CONCERNS AROUND THE IMPLEMENTATION OF THE NEW SHAREHOLDING RULES FOR PASSENGER CARS

While automotive OEMs welcome the scrapping of the shareholding limit on the industry in 2022, any agreements to increase foreign shareholding in passenger cars still need to be approved by the NDRC on an individual basis and a new business licence can only be issued after such an approval. Currently, despite the first successful ownership change of the Brilliance China Automotive, concerns remain around the NDRC's willingness to continue to approve similar deals in the future. British automotive OMEs hope that the government fully implements the new liberalisation measure and facilitates foreign carmakers' decisions to raise stakes in their joint ventures going forward.

4 STRICT BORDER CONTROLS CAUSE DIFFICULTIES IN CERTIFICATION TESTS FOR NEW CAR MODEL LAUNCH

Although China's auto market has outperformed many other major markets in the past two years, resulting in rising sales for foreign auto companies, COVID-19 has nevertheless had negative impacts on certain aspects of the auto market. China's strict border restrictions mean that when foreign carmakers are launching new models, UK-based technicians that are familiar with them are unable to enter the country to facilitate certification tests. This is problematic as without passing these tests, new models will not receive the approval from China Quality Certification Centre and Ministry of Environment and Ecology which is necessary before a model can be marketed.

As these tests are currently conducted at the Tianjin Automotive Test Center (TATC), which also has offices in Europe, British businesses have suggested that tests should also be allowed to take place in TATC's Europe office. This will not only reduce the delay in shipping new cars from Europe to the test centre in China, but also ensure that foreign companies' Europe-based technicians can attend these tests and respond to any issues on the spot.

5 LACK OF FIES' INVOLVEMENT IN GOVERNMENT DECISION-MAKING

British automotive companies also hope that equal treatment is granted to foreign and domestic players when it comes to consultation on setting industrial standards and policies. Many have noted that draft regulations are often first circulated for comments within the government and domestic companies. Foreign companies in contrast are the last to be consulted on potential new policies. As the Chinese government promises to level the playing field for domestic and foreign companies, it is essential that regulators involve them in the decision-making processes equally and make sure policies and standards reflect a wide range of stakeholders in order to ensure fair competition.

6 CONCERNS AROUND PARALLEL IMPORTS

2020 saw China switch from the fifth to the sixth emissions standards. Following the change, imported vehicles could only enter the market if they met the new environmental standards. This had consequently resulted in a large number of automobiles being stranded at the port before receiving clearance. Since May 2021, some models have managed to clear customs procedures and enter the market. However, many British importers are concerned about parallel-import automobiles in the market due to a lack of consumer protection and after-sale services, which affects consumers' experiences with the brands.

8 'Several Provisions on the Management of Automobile Data Security (for Trial Implementation)', Cyberspace Administration of China, August 2021.


6:00-23:00

KEY RECOMMENDATIONS

KEY CHALLENGE	RECOMMENDATION
1 Harmonisation of ICV standards	▪ Increase harmonisation with international standards so as to reduce the need for foreign carmakers to customise products in order to comply with a different regulatory and standards system in China.
2 Lack of clarity on data security requirements	▪ More clarity should be provided on the implementation details of cross-border data transfers as soon as possible. ▪ Data essential to facilitating R&D activities and daily operation, such as VIN and environmental data for accident investigation, should be allowed to flow across borders in order to improve innovation and productivity. ▪ Include foreign companies in consultation around formulating cybersecurity rules.
3 Concerns around the implementation of the new shareholding rules for passenger cars	▪ Fully implement the new liberalisation measure on foreign shareholding and facilitate foreign carmakers' decisions to raise stakes in their joint ventures.
4 Strict border controls disrupt certification tests in new model launch	▪ Certain luxury car models are only sold in China in a limited number. The government should allow the CCC certification to take place in TATC's Europe office or allow recognition of test results taken in test laboratories in Europe in accordance with ECE regulations.
5 Lack of FIEs' involvement in government decision-making	▪ Equal treatment should be granted to both foreign and domestic players when it comes to consultation on setting industrial standards and policies.
6 Concerns around parallel imports	▪ Limit parallel imports to allow better consumer protection.

KEY MUTUAL OPPORTUNITY

ROBUST DEMAND FOR PREMIUM AND LUXURY VEHICLES

China's economic recovery from COVID-19 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 in the two years following the initial outbreak. Despite the challenges facing car companies as a result of the latest COVID outbreaks since late March 2022, the industry should continue to boom once the recent wave is contained. Many British OEMs and importers that focus on offering a unique driving experience through luxury high-performance vehicles will continue to be well-placed to cater to the growing demand in China.

BUILT ENVIRONMENT SERVICES

SUB-SECTORS

Architecture

Project management

Construction

Real estate

Engineering

Spatial planning

KEY CHALLENGES

- Barriers to obtaining appropriate design licences
- Localisation of procurement and contracting
- Lack of recognition of international qualifications and experience

KEY RECOMMENDATIONS

- Provide more transparent and equitable approval processes for licences
- Allow international forms of contract to be used or to form the basis of amendments to Chinese forms of 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
- Digital built environment

STATE OF THE SECTOR

2021 remained a challenging year for China's real estate sector. In particular, a crisis triggered by some major Chinese property developers' debt defaults further dampened prospects for the market and reduced sales as well as prices. According to data from China Real Estate Information Corporation (CRIC), a local data provider of the real estate industry, sales among China's top 100 real estate developers witnessed an average drop of 3.5% in 2021 compared with 2020. Over 80 per cent of those developers failed to meet their annual sales targets.[1]

Growth in new construction and land purchasing also fell by over 10% Y-o-Y after the 'three red lines' policy was introduced to restrict developers' borrowing capability, depending on their liability, debt, or cash ratios. Other policies tightened restrictions on the use of pre-sales proceeds, reduced the number of land auctions to just three times a year, and gave window guidance to banks instructing them to limit mortgage lending.

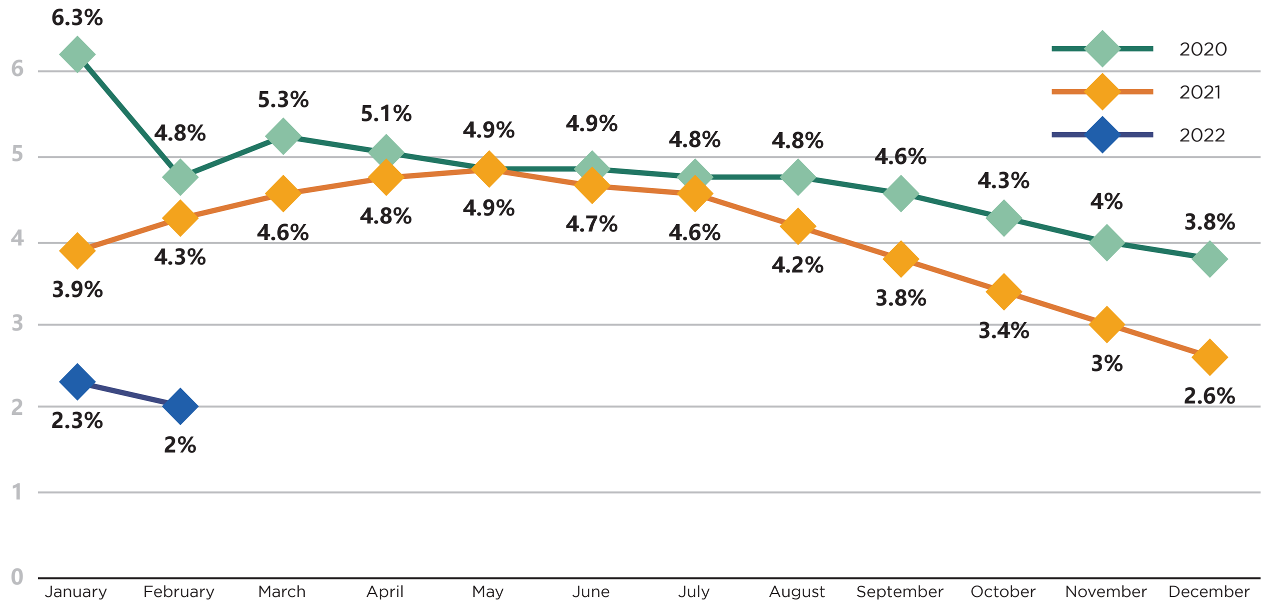
Floor space under construction contracted by 35% Y-o-Y in December 2021, and the number of new properties started to decline by 31%. However, completions have picked up in early 2022, suggesting developers were making a push to complete properties that were nearly finished.

In line with this, the growth in real estate investment was 4.4% Y-o-Y, the lowest since 2015. Real estate investment was strong before the pandemic, and supported the economic recovery from COVID-19, but has since declined throughout 2021.

Other property-related policy measures were also proactively introduced in early 2021 when the authorities were confident about the economic recovery and started to look at debt levels in key sectors. These measures tightened the property market and slowed down its growth. The market downturn continued despite some marginal easing in property measures during the second half of 2021. For example, some cities loosened purchasing requirements and support, accelerating mortgage approvals which bolstered the market; slightly loosened credit support to developers; and instructed SOEs to buy up assets from distressed developers. The five-year

Newly Built House Prices Y-o-Y Change (% increase)

Source: Tradingeconomics



Note: In China, the Housing Index is measured by the year-on-year change in the index of newly built residential buildings in 70 medium and large cities. The index is calculated by the weighted average method and the weight of each city is based on its population.

1 'Explainer: What's Going on in China's Property Market?', China-briefing, January 2022.

loan prime rate (LPR), which is typically used to price mortgages, declined by 5bps in January - the first move in nearly two years. Meanwhile, the PBOC has pushed banks to increase the volume of mortgage lending. However, so far, there has not been a significant change in direction, for example, lowering down payment requirements in the mortgage market in particular localities.

The real estate sector is expected to continue to drag on the economy in 2022, adding to other challenges. However, as of early 2022, we do not expect a sharp change in policy direction, especially financial and credit policies, as the authorities continue to stress that the property market will not be used to stimulate economic growth.

While these developments undoubtedly have affected British companies, we are still optimistic about the role British business can play in the built environment sector 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 2020, UK construction services exports to China alone totalled GBP 73 million (RMB 604 million).[2] 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.

Previous editions of the *British Business in China: Position Paper* highlighted some encouraging general market liberalisations that had positive implications for the built environment services sector. The *Foreign Investment Law*[3] and the draft *Tendering and Bidding Law*[4] both signalled a greater focus on ensuring a level playing field between domestic and foreign firms operating in China. Unfortunately, there were few updates to these steps and no new significant initiatives have been finalised yet, possibly due to the need to focus on managing the COVID-19 outbreak. As such, the built environment sector in China remains 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 October 2021,[5] 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) 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.

2 'UK trade in services: service type by partner country, non-seasonally adjusted', Office for National Statistics, January 2022.

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

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

5 'Negative List for Market Access', National Development and Reform Commission, October 2021.

KEY CHALLENGES

1 BARRIERS TO OBTAINING APPROPRIATE DESIGN LICENCES

This challenge has remained largely unaddressed since last year's paper. For British built environment services companies in China, barriers to obtaining licences remain a key concern. Despite providing a significant level of knowledge and capabilities to many projects across China, the contributions of foreign firms are not recognised in the final account of the work provided due to their status as consultants (irrespective of the level of their contributions). As such, engineering firms applying for Grade A licences are still unable to use projects in which they played a consulting role as part of their track record necessary to successfully apply for a licence.

Businesses were encouraged by a pilot program that allowed foreign-invested enterprises to circumvent this difficulty by receiving a Grade B design licence 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 several other cities. However, the approval process is lengthy, uncertain and relatively opaque, making it difficult for foreign businesses to understand the levels of resources that would need to be dedicated to it. Some estimates conclude that the process may take anywhere between six months to four or five years. With most upcoming market opportunities and the bulk of firms' expertise lying in Grade A projects, waiting for that length of time is a troubling prospect for many British companies.

2 LOCALISATION OF PROCUREMENT AND CONTRACTING

During the past few years, British Chamber members have seen increasing use of full or quasi-public tendering approaches being applied even on privately funded projects. Whilst this is often used to make the process more transparent and auditable, which is to be commended, too often it is also used to apply requirements that foreign firms struggle to comply with (e.g., the requirement for a specific licence or qualification) or to apply evaluation criteria and/or fee levels that deter foreign firms from bidding.

In addition, we are also seeing much greater imposition of local forms of contract, many of which do not meet the international norms expected by clients. Previously, the International Federation of Consulting Engineers (FIDIC) standard form contract was widely accepted, but now we see more local authorities moving contract registration online – and in doing so they restrict or prevent any adjustment of contract terms and conditions. This has unfortunately resulted in the return of two different forms of the contract being used on a project; one to comply with Chinese registration requirements and another to meet client and contractor needs.

3 LACK OF RECOGNITION OF INTERNATIONAL QUALIFICATIONS AND EXPERIENCE

This challenge remained the same for 2021. Requests for proposals in China often require that team leaders are national design grade A registered, to ensure they have a suitable level of experience and training. In several built environment disciplines, most notably engineering, architecture and urban or spatial planning, the credentials of UK-qualified professionals are not currently recognised in China, even though 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.

While some individuals have managed to receive an individual licence after translating and presenting overseas qualifications, for the most part, applicants have been unsuccessful. 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. It is uncertain whether, in cases where foreign firms are eligible to upgrade from a Grade B to Grade A licence based on their own track record, they can also fulfil certain staffing requirements due to this lack of recognition. We are encouraged by indications from some local governments that avenues to facilitate 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 extend to nationwide operations and that recognition under those initiatives will cover the full spectrum of built environment qualifications.

KEY RECOMMENDATIONS

KEY 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 can 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 Ministry of Natural Resources within a reasonable period of time.
2 Localisation of procurement and contracting	**PROCUREMENT**	■ Ensure procurement is transparent, fair to all and does not impose undue requirements or restrictions as a means of blocking foreign bidders.
	CONTRACTING	■ Allow either international forms of contract to be used and registered or alternatively allow amendments to be made to the online local versions.
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 like their counterparts trained in China are able to work on the same grade of projects, particularly at the grade A level.

KEY MUTUAL OPPORTUNITIES

SUSTAINABLE CONSTRUCTION

There are still vast opportunities in the field of sustainable construction in 2022 and beyond. 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 reach the 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 to contribute technical knowledge, enhance risk management and promote health and safety. UK educational establishments not only produce high-calibre apprentices and graduates but could also engage Chinese institutions to share capabilities and knowledge. For example, British firms report that many of the local graduates with engineering degrees that they

hire require significant further training to have their project management, cost management, quantity surveying and other such skills formally certified. Providing transnational education programmes in these years could improve the talent pool for the industry.

SPECIALISATIONS IN MODULAR CONSTRUCTION

Same as in the previous year, there are still significant opportunities for modular construction and pre-casting, 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 which will increase the demand for new facilities. British and Chinese firms should collaborate to develop the sector, sharing experience, knowledge, and best practice. The UK has significant experience in large scale modular projects (especially in the build-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. There remains substantial scope for bilateral partnerships to bring similar types of sustainable builds to China.

DIGITAL AND SMART TECHNOLOGY

The built environment and especially the construction industry has lagged behind many other sectors regarding applying technology in order to improve efficiency and productivity. Outside of the application of modular and pre-cast techniques in specific applications (e.g., roads and high-speed rail), construction still largely uses skills and techniques which have remained unchanged for many decades.

Both China and the UK have seen increases in the application and potential for all aspects of the digital built environment. There remains substantial opportunities yet to be explored through the application of new technologies across the sector. This will require changes to the current regulatory systems in China, for example, to allow the application of Building Information Management (BIM) across the whole project cycle including for all approvals & permits.

EDUCATION

AT A GLANCE

SUB-SECTORS

K-12

Higher education

Non-profit organisations

English language training

EdTech

Certification and accreditation bodies

KEY CHALLENGES

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

KEY RECOMMENDATIONS

- Remove unnecessary barriers for foreign expert teachers and dependants to return to China ahead of the the new academic year
- Improve communication and consultation ahead of regulatory changes
- Allow for a wider scope for exchange and cooperation in non-sensitive areas of education between China and the UK

KEY MUTUAL OPPORTUNITIES

- Vocational education and training
- All-around education
- Professional development
- Niche providers
- A Levels
- Interest in attending UK universities
- Distance learning

STATE OF THE SECTOR

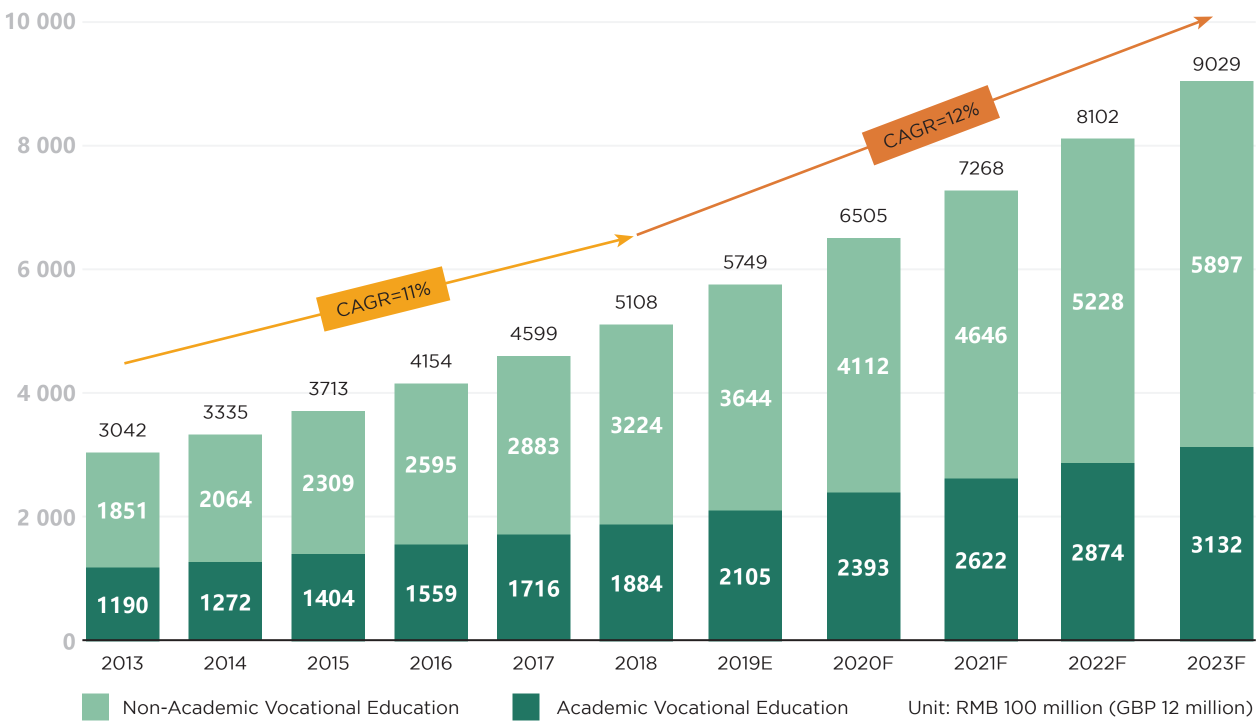
Over the past year, the education sector has been rocked by paradigm shifting reforms. Many of these reforms have been long-awaited, but nonetheless have had widespread impact on the entire sector. This has had a negative effect both on the sentiment of British organisations in market and future opportunities.

75% of education sector respondents in the British Chambers of Commerce's *British Business Sentiment Survey* stated that business became harder in 2021; making education one of the hardest hit sectors compared to a baseline of 64%.[1] 47% cited regulatory factors as the reason for worsening sentiment with 50% of companies seeing the market closing. This has resulted in the education sector having the biggest drop in intended Chinese expansion, with only 46% of respondents indicating that China is their top priority for 2022, compared to 66% in 2021,[2] suggesting regulatory changes have significantly reduced the attractiveness of the market to British companies.

The principal regulatory challenges concern the *Opinions on Reducing Students' Burden from Excessive Homework and After-School Tutoring* (also known as the Double Reduction policy) and *Implementing Regulations on the Private Education Promotion Law*[3]. The former, seeking to curtail the after-school and online tutoring industry in China and improve in school provision, led to an one-day drop of 100 billion USD on the New York Stock Exchange in September. The latter, attempting to ensure

China's Vocational Education Market Size, 2013-2023F

Source: Deloitte Research and Analysis (2018)



1 'British Business in China: Sentiment Survey 2021-22', The British Chamber of Commerce in China, December 2021.

2 'British Business in China: Sentiment Survey 2021-22', The British Chamber of Commerce in China, December 2021.

3 'Implementing Regulations on the Private Education Promotion Law', State Council, May 2021.

the non-profit nature during the compulsory years of education in China (6-15 years old) and restricting unrestrained profit seeking by private institutions,[4] has led to British private schools abandoning market entry or long-term expansion plans,[5] while leaving associated subsectors such as publishers and examination boards with far fewer opportunities for growth.

The Double Reduction policy aims to address long-existing concerns over student welfare due to excessive homework and academic competition. This is in line with previous reforms in the Chinese education system, which promote the concept of 'all-round education', moving away from performance-orientated education.[6] While educators welcome regulatory changes aimed at improving student welfare and the quality of education, when added to the accumulative effects of the on-going pandemic, the increase in workload and uncertainty in schools and the wider sector, can run counter to the joint interests of both China and the UK in heightening global standards of education and student wellbeing.

By far the most affected area of the sector by the double reduction policy are subject-based after-school private tutoring institutions and online tutoring companies. As a result, the number of online academic curriculum-based tutoring institutions overall has been slashed by 84.1%, and the number of offline centres by 83.8% by December 2021, marking significant progress in curbing 'disorderly' expansion of the after-school tutoring market.[7] These institutions are now required to register as non-profit organisations and reapply for government approval. Additionally, they are strictly prohibited from providing tutoring on weekends, national holidays, and school holidays, as well as also impacted by the prohibition of the use of overseas curricula. However, there is still room for partnership with non-subject focused extracurricular training in areas such as art and sport.[8] Many companies, fighting for revenue and survival, have pivoted to adult education, parent education, careers-oriented courses and non-academic subjects but the demand is weaker and success uncertain.

Pandemic-related challenges have also shown no sign of abating in the past year, and has had a disproportionate

4 'Governments Encouraged to Give Private Schools More Support', State Council, June 2021.

5 'China's Private Education Crackdown Hits Two International Schools', Caixin Global, December 2021.

6 'Opinions on Further Reducing the Burden of Homework and After-school Training for Students in Compulsory Education', Venture Education, August 2021.

7 'Minister of Education Reviews the Handling of NPC Proposals', Ministry of Education, December 2021.

8 'An Analysis of Opinions on Further Reducing the Burden of Homework and After-school Training for Students in Compulsory Education', Venture Education, August 2021.

impact on this sector due to the reliance on foreign teachers. While many schools report progress in some areas, the accumulation of two years of border restrictions are contributing to staff shortages due to unprecedented strains on hiring, return, and retention of foreign talent. Negative perceptions of comparatively stringent pandemic restrictions, the expense of already limited flights and quarantine spaces, alongside visa restrictions including the inability to obtain dependent visas are all barriers to hiring. Schools are competing over a reduced talent pool within China, forcing some to compromise on hiring less qualified and experienced teachers while having to increase their pay and benefits. Many schools are caught in a vicious cycle, with the stain of staffing shortages responsible for high attrition rates. For this reason, schools have expressed concerns with the ability to continue to deliver high quality courses and student progress. Furthermore, for international schools serving the children of international experts, the issue around the loss of international talent is also impacting on the recruitment of children who are eligible for admission to these schools (foreign passport holders). More and more families are relocating out of China due to the response to the pandemic and few are replacing them.

While the aforementioned all-round education space is one potential area of opportunity, the buzzwords on everyone's lips in China in 2022 are vocational education. Vocational training is being heavily promoted under the 14th Five-Year Plan (2021-2025) in order to increase China's capacity for innovation.[9] According to the Ministry of Education (MOE), "2022 is a critical year for the development of China's vocational education, and improving the quality and social status of vocational education are the top priorities."[10] The promotion of vocational training is mainly aiming to address the lack of skilled and educated workers, in particular targeting migrant workers and rural areas with low high school enrolment rates,[11] as currently around 70% of the Chinese workforce has no high school education. A target has been set to increase 40 million skilled workers during the 14th Five-Year Plan perod. As part of the plan, the government will eliminate vocational school tuition and provide financial support to rural students. Additionally, the policy will impact middle school graduates, as, according to the plan, 50% of middle school graduates will enroll in technical schools instead of academic high schools.[12] This may be a rich area of opportunity for Sino-British collaboration if the appropriate models can be established that incentivises both sides to build something sustainable for the long-term.

There are a number of qualifications which are contributing to improving the quality of teaching in China, including PGCEi qualifications and developing partnerships and mentoring between local and international teachers/schools. The new International Qualified Teacher Status (iQTS) is also currently being piloted and is due for wider roll-out in September 2023.[13] If recognised in China, this would be an excellent opportunity to make high quality training accessible around the world and increase the global pool of quality teachers and support global mobility within the teaching profession, while perfectly aligning with the MOE's prioritisation of improving the standards of the teaching workforce.[14]

Despite tighter regulation, private education continues to be an integral sub-sector of the Chinese education system with strong government support. British schools can still enter the Chinese market and be involved in the running of schools outside compulsory education in accordance to the foreign investment law and any other relevant regulations.[15] Additionally, local governments have been encouraged to offer more policy support to high-qualuty private schools, including subsidies, tax breaks, and priority in land use, to encourage their development.[16]

For the past four years, British education organisations in China have cited "market potential" in the sentiment survey as the number one reason to increase investment in the country. This potential continues to exist simply by virtue of the size of China's population, new policies aimed to increase birthrates, the centrality of education to Chinese parent's spending, and the growing middle class. That being said, the past year has seriously tested the patience of many companies in market who are now focusing on other regions and countries such as South-east Asia, India and North Africa. As British companies become more cautious about China, they are far less likely to risk committing to an area that has been green-lighted such as vocational education, wary that any growth or profit can be slashed overnight through regulatory changes.

9 'China to ramp up vocational training', The State Council Information Office, January 2022.

10 'MOE Press Conference Introduces Measures to Improve Vocational Education', Ministry of Education, February 2022.

11 'China to Ramp Up Vocational Training', The State Council Information Office, January 2022.

12 'What is the Future of China's Vocational School Drive?', The Diplomat, December 2021.

13 'Introducing the International Qualified Teacher status (iQTS) Pilot', Department of Education (UK), February 2022.

14 'MOE Calls for High-Quality Education at 2022 National Education Conference', Ministry of Education, January 2022.

15 'The Modified Private Education Promotion Law', Venture Education, May 2021.

16 'Governments Encouraged to Give Private Schools More Support', The State Council, June 2021.

KEY CHALLENGES

1 RECRUITMENT PRESSURES AHEAD OF THE NEW ACADEMIC YEAR

Issues of international retention, staff recruitment, and student enrolment have become paramount challenges facing K12 schools in China. As demand for foreign staff is both increasingly unmet by the limited numbers entering China from abroad, and further threatened by a dwindling number of foreign passport-holders in China, the employee vacuum is a serious challenge to culture and operation for some, developing into a genuine existential threat for others.

One major contributing factor is the difficulty and unreliability of getting teaching professionals across borders and into the Chinese mainland. This difficulty, wrought by a number of factors operating simultaneously, includes the repeated cancellation (not to mention exponentially growing price) of flights from overseas, unfulfillable and expensive pre-flight COVID testing requirements, too-quickly expiring documentation, significant bureaucratic extensions to visa requirements – in one estimate the total time required for visa processing has grown from approximately 4-8 weeks to 4-7 months – stringent restrictions to bringing dependents into the country, a general lack of clarity in the process for bringing new staff in and a concomitant decrease in the attractiveness of China as a destination for teaching professionals, particularly as the original coming changes to tax affect the attractiveness of remunerative packages at the same time (see point 2).

Further contributing to the crisis is the significant rise in annual staff turnover in many parts of the sector. One such example is in international schools, where annual staff turnover has risen to 40% (2021-2022) as compared to 16-18% pre COVID-19 as staff in country chafe at domestic travel restrictions and difficult quarantines and grow increasingly anxious to visit families and dependents who remain outside the country. In 2021 over 400 teachers were working in country without their families as consulates refused to grant visas to dependents: it seems unlikely that many in this position will opt to stay long-term.

All of this has in turn had an adverse effect on student enrollment and recruitment. In addition to the large number of university students overseas who cannot return it is also worth noting a gradual decrease in student enrolment at international schools of 30% (2020-2021) and further down of 35% (2021-2022). This is largely due to the reducing number of foreign passport holding families who remain across all sectors.

The impact of these challenges cannot be overstated: without functioning schools for their children, foreign experts, business leaders and entrepreneurs from all countries will question their ability to remain in China. This consequently will have a direct impact on business expansion, unemployment, the good will and support of many long-term supporters of the country, and the growth of a new generation of foreigners who understand the country.

2 INCONSISTENCY AND LACK OF CLARITY IN THE REGULATORY ENVIRONMENT

While experiences vary according to context and sub-sectors, the one clear point of consistency is that all parts of the education sector continue to experience a high and hampering degree of inconsistency in terms of regulation and its local application. Companies have been facing challenges brought about by both recent legislation and government directives (most markedly from the *Private Education Law*, the Double Reduction strategy, and pandemic directives from local governments), and a perceived increase in compliance-related scrutiny, including markedly increased visits and inspections, and demands for paperwork from education bureaus. Common themes across all these sub-sectors are: an experience of rules inconsistently applied across organisations and regions, a lack of consensus and direction within the government regarding implementation rules of a new policy, very tight and often costly turnaround on compliance, and fuzzily expressed rules.

As school groups and other networks continue to develop and mature in the region and share practice and experiences at a deeper level, these inconsistencies are becoming ever-more apparent, with similar institutions and organisations receiving different treatment according to city and district, unevenly applied pandemic-related regulations or even, it seems, the individual members of staff in a given educational bureau.

Delays in communication and last-minute notification as well as a lack of transparency of some requirements are exacting serious costs in both revenue and reputation as education organisations are forced to change direction and provision, sometimes within a matter of hours' notice. Some training centres, for example, have reported not being prioritised for vaccinations, then being told at the eleventh hour that they must implement them within the day or risk closure, while others report similarly last-minute insistence that classes must adhere to strict time limits or curfews. This has caused frustration for both educators and parents especially as timelines for implementation are unclear, and channels for receiving regulatory updates are often highly informal: some organisations citing WeChat group messages and parents as their earliest reliable sources for updates on regulations.

3 CONSTRAINTS ON FOREIGN PARTICIPATION IN EDUCATION

The Double Reduction strategy and *Private Education Law* of 2021 brought into sharp focus many grey areas which English-speaking education organisations have long been negotiating, and raised key questions regarding the roles of foreign teachers and content within the wider Chinese education system. Although Higher Education has remained broadly unaffected, and some across the whole sector have cautiously welcomed the potential for both reducing the burdens of stress and overscheduling on Chinese students and better assuring the quality of education provision across the board, the two regulations together have nevertheless sculpted a landscape of uncertainty for many. Key questions are around what is acceptable within school provision, curriculums, what roles international teachers should be playing within schools and what room remains for international expertise within a model founded on the principles of common prosperity and growing ideological impetus.

Among the most adversely affected are those in the many market-defined 'bilingual' schools who have up to now been delivering dual Chinese and international curriculum and are now struggling to understand the extent of new directives on MOE approval for all teaching materials, requirements that all the international courses have to be approved and overseas curriculum cannot be used and that all students in the compulsory phase experience a full Chinese curriculum and are adequately prepared for high school entrance exams (zhongkao) and new strictures on the scope of international staff roles.

In EY and K12 contexts more generally, although it is clearer to all that English teachers should be teaching English, a great deal of uncertainty remains about the scope and practicalities of implementation. Many schools and kindergartens make use of Content and Language Integrated Learning (CLIL) curriculums in which students learn English through the study of other subjects, leading many within the industry calling for clearer guidelines on how to manage this.

Additionally, more rigorous censorship rules and implementation requirements for almost all education providers (and a tendency for some local authorities to over-interpret regulations) further impedes the development of curriculums across the industry and leaves external providers to wonder if they can introduce their products to the Chinese market. Meanwhile, some working in English language training report a perception that English teaching is being stifled, limited, censored and downgraded in importance and prestige, while those working in extracurricular education remain confused about the extent to which they may or may not be able to contribute to the country's newly stated prioritisation of all-round education. While it is worth acknowledging that there are some significant positives to both the greater levels of scrutiny and compliance, and the move towards more holistic education, these regulatory changes have ushered in, both the ongoing gap in certainty that exists between current pronouncements and the way they are being interpreted, and the increased inspections many in the industry are experiencing some have now reached a point where operations, strategic planning and daily teaching are being seriously impeded.

4 UNCERTAINTY ABOUT THE SHORT- AND MEDIUM- TERM FUTURE

While long-term confidence remains broadly positive across most parts of the sector, uncertainties brought on by the pandemic and regulatory changes over the past 12 months are leading some members to have serious concerns about their financial security over the short and medium term. Within EY and K12 sub-sectors and some EdTech companies, the implications of the *Private Education Law* look set to require some profound restructuring of existing models for language, teachers and curriculum in order to achieve compliance with sweeping new changes, while the pandemic and Double Reduction strategy continue to pile pressure onto training centres and other external education providers. A perception of hardening geopolitical attitudes has also come into play, as reducing international communities question their medium- and in some cases long-term welcome in the country.

5 CHANGES TO TAX INCENTIVES AND REQUIREMENTS ON CONTRIBUTIONS TO SOCIAL SECURITY FUND FOR FOREIGN STAFF

In the education sector, there was notable relief this year about the postponement to these changes, but an awareness that when they do arrive in 2023, the impact of changes in individual income tax are likely to be profound on the sector. As well as the general expectation of depressed wages and/or employment packages common to all sectors, changes to the way school fee-related employment benefits are taxed threaten to further affect both student and staff recruitment, as international parents potentially expected to shoulder more of the fee burden independently may seek cheaper alternatives, and teaching families faced with significantly less attractive packages consider destinations outside China. While the postponement offers the sector a better chance to plan ahead and seek alternatives, in the current climate of uncertainty and concerns about staffing, and the continued opacity of what the true detail and implications of the changes will be, low confidence continues to affect morale in many educational sub-sectors, and the attractiveness of China as a destination for international teaching talent. Meanwhile, companies have also pointed out that social security fund contribution requirements for foreign nationals vary with regions and have increased expats' living costs in many cases. We therefore suggest that expats pay into social security fund according to need.

6 CYBERSECURITY AND RESTRICTIONS TO EDTECH

While there have been some helpful developments in supporting IP, cybersecurity, IT restrictions and licensing continue to cause difficulties for some in the market, particularly the limitations on internet content provider (ICP) licenses for organisations trying to shift to direct-to-consumer models. One solution to this has been to create joint ventures, but the necessity of working with a local partner to operate in China feels like a step backwards in the opening up of the market.

Those shifting to domestic platforms appear to be experiencing fewer problems in this area than those more dependent on international ones. In EdTech, new regulations about foreign curriculum and overseas teachers are causing some complexities around compliance, especially in curriculum areas related to all-round education where the rules remain as yet unclear.

7 RECOGNITION OF OVERSEAS QUALIFICATIONS

The biggest impact on overseas qualifications has been the cancellation of overseas exams following COVID-19 lockdowns, which continue to cause disruption to assessment globally, and look set to create more acute and location-specific uncertainty this year as China's COVID strategy becomes increasingly distinct from other regions. In all-round education, the 2019 MOE requirement for music training schools and centres to get formal training licenses continues to exact an administrative burden, exacerbated by changing rules in the face of the Double Reduction strategy which appears to have shifted supervision for all-round education to the Ministry of Culture and Tourism, leaving many organisations in a state of abeyance while they await clearer instructions. Meanwhile overseas art exams remain on negative lists in free trade zones in several areas across China, while very similar professional qualifications for teaching staff (such as PGCE, PGCEi and QTS) continue to be treated differently in terms of visa requirements and work permits.

KEY RECOMMENDATIONS

KEY CHALLENGE	RECOMMENDATION
1 Recruitment pressures ahead of the new academic year	▪ A work permit is already a valid document of approval. Therefore, eliminating PU letters for all foreign workers and dependents who have been issued work permits and who are fully vaccinated, would significantly simplify and expedite the process, allowing routine business to continue without delays. All incoming teachers and dependents are fully vaccinated and must undergo pre-flight tests and then three weeks of quarantine during which there is ongoing testing. PU letters can then be issued for all other categories of visitors who do not have work permits. ▪ Currently only Chinese-produced vaccines are recognised as valid vaccinations, and this should be extended to include all vaccines recognised as effective by the WHO. ▪ Giving priority visas for foreign expert teachers could save 4-8 weeks. ▪ Inform Chinese Embassies/Consulates globally to allow dependents of foreign expert workers to obtain visas. The policy is currently very inconsistently applied. ▪ Quarantines on entry have been very effective. Expanding quarantine accommodations will allow for more international flights and reduce waiting time and flight cost. ▪ Offer considerable government support to arrange charter flights. BritCham has looked into charter flights, but the costs, risks and other logistical issues, make it a seemingly unsurmountable issue.

KEY CHALLENGE	RECOMMENDATION
2 Inconsistency and lack of clarity in the regulatory environment	■ Offer a grace period for implementing large-scale (non-pandemic-related) changes to policy. ■ Provide clearer protocols for policy-related communication between education organisations and local bureaus. ■ Ensure parity of experience between foreign and domestic companies. ■ Offer formal updates on the implications of new policies and clearer timelines for implementation.
3 Constraints on foreign participation in education	■ Ensure greater clarity and consistency on how recent regulations will be implemented across the country. ■ Allow wider scope for exchange and cooperation in non-sensitive areas of education between China and the UK.
4 Uncertainty about the short- and medium- term future	■ Offer public assurance and acknowledgement of the value of foreign education organisations to China's development, and its alignment with some of the MOE's stated aims. ■ Communicate formally with groups most affected by recent legislation (for example, so called 'bilingual schools') to explore mutually beneficial strategic planning. ■ Recognise international courses and allow them to be used in private schools.

KEY CHALLENGE	RECOMMENDATION
5 Changes to tax incentives and requirements on contributions to social security fund and for foreign staff	■ Ensure greater clarity on how changes will impact school fees and the IIT arrangements after 2023. ■ Ensure IIT rules are such that China remains competitive as an attractive destination for foreign talent. ■ IIT rates should be designed in a way to reflect the fact that many organisations in the sector are non-profit in order to increase its attractiveness to international talent. ■ Social security fund contribution requirements for foreign nationals vary with regions and have increased expats' living costs in many cases. We suggest expats pay into social security fund according to need.
6 Cybersecurity and Restrictions to EdTech	■ Extend the scope of ICP licenses. ■ Ensure greater clarity and consistency on cybersecurity and IT restrictions in the country.
7 Recognition of overseas qualifications	■ Offer clarification for providers of qualifications for all-round education on license application process. ■ Give more recognition to foreign art qualifications. ■ Review and rationalise professional teaching qualifications for visas by, for example, expediting acceptance of the UK's coming iQTS qualification.

KEY MUTUAL OPPORTUNITIES

VOCATIONAL EDUCATION AND TRAINING

While there is clearly central government support for the improvement of vocational education in China, there was a mostly cautious response from members about what sustainable opportunities this might actually lead to for UK providers. Chinese institutions want practical programmes (in Chinese), effective teacher training (in Chinese), and clear proof of the value and demand of qualifications to employers. Any offering will need to be localised to such a degree that will likely resemble an entirely new product, local providers would prefer to pay for a brand-name association rather than co-create and co-profit long-term from a joint project, and the somewhat necessity of a local partner will mean decision-making and control will always lean inwards.

The truly huge opportunity in vocational education is for UK manufacturers, pharmaceutical companies, and other high-tech and innovative British companies working in China to work with British qualification providers and local Chinese vocational colleges to make the connection between qualification, training and employment so inseparable that it also becomes essential.

ALL-ROUND EDUCATION

The State Council outlines its goal of ensuring "green, healthy and civilized school culture" encapsulating moral, intellectual, physical and labour education. This along with the Double Reduction strategy which aims to aid mental health and stress coping strategies in learners and move them towards more holistic models of education can be perceived as a positive shift towards ensuring the well-being and wider development of students beyond academics. It has both raised the profile and prestige of all-round education and left a considerable shortfall in providers, particularly experienced professionals in sports and the arts, as well as offering potential scope to share some of the UK's well-developed curricular provision in personal, social and emotional learning . However, it also raises some interesting questions as to in which areas international teachers and organisations can operate. Within this model there is room for those with international expertise to contribute by providing much of the research and groundwork already undertaken internationally in many of these fields, though without further clarity, the threat remains that those moving into this field risk future regulatory crackdowns or licencing uncertainty.

PROFESSIONAL DEVELOPMENT

Continuing shortages in international teaching staff has opened up opportunities in country for online teacher training and other professional qualifications, particularly as universities continue to develop and extend their online provision in the wake of the pandemic. Some in the industry report that China is currently a booming market, despite the ongoing inconsistencies in the way these professional qualifications are recognised in terms of work permits.

There are also opportunities for companies that offer practical professional development for both educators and administration staff. These qualifications and courses must, ideally, be delivered in person, have either some or all of the course in Chinese, and align with national regulations and understandings.

NICHE PROVIDERS

There continue to be opportunities for niche providers who can work closely with a Chinese partner or small team in country. Areas such as careers education, special education needs training and outdoor education qualifications are all underdeveloped in country and areas where demand from expertise in the UK is high. The challenge is to create sustainable business models, likely blending both in person meetings and online components, where each party is well-protected to deliver on what they do best.

A LEVELS

With ongoing travel restrictions and increasing diversity in approaches to assessment in the wake of the pandemic, opportunities to take A-Levels in country continue to be highly attractive in the market. External examiner training, and a resumption of the positive partnerships in assessment developing pre-COVID, for example the mutual recognition of IB and ITS certification in the UK and China may have space to develop (although they are subject to MOE approval).

INTEREST IN ATTENDING UK UNIVERSITIES

Interest in attending UK universities remain high among Chinese students despite the challenges relating to the COVID-19 pandemic. In 2021, 14,000 Chinese students were accepted into programs in the UK. Over 28,000 Chinese applicants were living in Britain last year, an increase of 17% on 2020 levels. Chinese students so far have made up the largest international student cohort in the country, contributing significantly to UK's higher education sector. We are hopeful that Chinese students will continue to be interested in and benefit from international education in UK universities.

DISTANCE LEARNING

Although there is no official recognition on UK HE distance degree programmes from Chinese MOE, distance learning has played an important role in China's higher education system since the pandemic. The MOE has since relaxed its policy on accepting qualifications earned through distance learning during the pandemic period, there might be more opportunities for the UK HE sector to explore further in this field, particularly in the TNE field where in-person teaching required has been severely affected due to the travel restrictions.

ENERGY

AT A GLANCE

SUB-SECTORS

Oil and gas

Renewables

Power

Carbon

KEY CHALLENGES

- Barriers for foreign companies to participate in China's gas and renewable market development
- Limited access and opportunity for foreign companies to participate in China's offshore wind market
- Insufficient deregulation of China's power market — particularly in the power spot market, inter-provincial power transactions, and green power trading
- Limited coverage and liquidity of China's national emission trading scheme (ETS)

KEY RECOMMENDATIONS

- Continue gas market reform and enhance monitoring mechanisms to ensure non-discriminatory access to gas pipelines and terminals
- Improve transparency for offshore wind development plans and bidding processes to allow the participation of MNCs in China's renewable market development
- Accelerate the construction of a unified national power market, especially the power spot market, inter-provincial transactions and the green power market
- Timely implementation of the national ETS development plan to expand its coverage and increase liquidity

KEY MUTUAL OPPORTUNITIES

- Clean energy
- Circular economy
- Upskilling
- Green mining

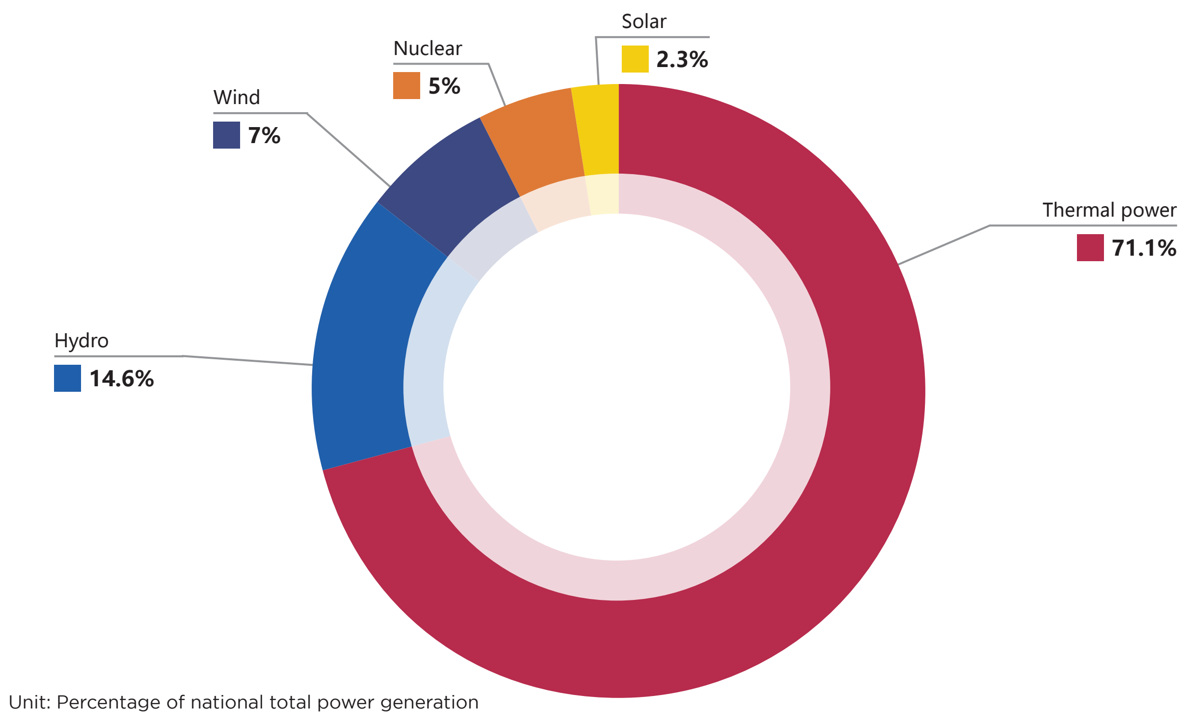
STATE OF THE SECTOR

The year 2021, which marked the first year of China's 14th Five-Year Plan period (FYP) and the start of its efforts towards its carbon peaking and carbon neutrality goals, witnessed a series of 14th FYPs released in its energy sector. Although no energy intensity target was set in China's latest 2022 Government Work Report, policies released over the past year all set out clear policy directions for achieving the country's climate targets as mentioned in the 14th FYP. These include increasing the percentage of non-fossil fuels in the country's energy mix from the current level of 15.9% to 20%, reducing China's energy intensity by 13.5% and carbon emissions per unit of GDP by 18% by 2025.[1]

Notably, an overarching policy framework around China's '30-60' dual carbon goals — the commonly referenced '1+N' carbon policy package — started to take shape with the release of the *Working Guidance for Carbon Dioxide Peaking and Carbon Neutrality in Full and Faithful Implementation of the New Development Philosophy*[2] *and Carbon Neutrality,* and the *2030 Carbon Peaking Action Plan*[3] in October 2021. In accordance with policy directions set in these two key policy documents, the government has been releasing sectoral decarbonisation plans and supporting policies that have covered the power, industrial, and transport sectors, amongst others. A series of 14th FYPs have also been released on various aspects of China's carbon reduction efforts, such as building a modern energy system, promoting green consumption, conserving energy, developing energy storage and hydrogen technology.

China's Power Generation in 2021

Source: National Nuclear Safety Administration



1 'The Outline of the 14th Five-Year Plan (2021-2025) for National Economic and Social Development and Vision 2035 of the People's Republic of China', Xinhua News Agency, March 2021.

2 'Working Guidance for Carbon Dioxide Peaking and Carbon Neutrality in Full and Faithful Implementation of the New Development Philosophy', State Council, October 2021.

3 '2030 Carbon Peak Action Plan', State Council, October 2021.

Meanwhile, many regions went through a 'decarbonisation campaign' last year, which started in the second quarter with the goal to restrict local energy consumption and energy intensity. The campaign reached its peak in the third quarter when rising coal prices and local attempts to cap energy consumption led to widespread power outages. The power shortages have caused serious disruptions to the local economy, as a result of the slowdown in factory activity, affecting a wide range of industries from construction, to manufacturing and petrochemicals.

The subsequent release of the '1+N' carbon policy ushered in at least three positive changes: firstly, it excludes renewable power and fuels used as feedstocks from being counted in China's total energy consumption cap; secondly, it stipulates that the 14th FYP period will be a transitional period to shift China's 'dual control' system from controlling total energy consumption and energy intensity toward capping total carbon emissions and carbon emission intensity. The shifts have increased harmonisation with international practices and should guide localities and enterprises to focus more on their carbon footprint instead of total energy consumption, as well as to encourage them to pivot towards renewable energy sources.[4] Thirdly, there is an increased emphasis on the balance between decarbonisation and economic development and the importance of an orderly transition — we hope this new approach will provide foreign investors with more predictability concerning China's decarbonisation pathways going forward.

Although the power crunch has resulted in increasing power costs, it has also triggered something positive — the deregulation of power prices for the commercial and industrial sectors. On 12 October, 2021, the NDRC released a policy to remove the catalogue pricing scheme for commercial and industrial consumers.[5] Although in the short term it will raise power costs, it will lead more commercial and industrial (C&I) power users to participate in the power market in the long run and start to more actively manage their fluctuating power costs.

We highlight below several key policy and market developments in the past year in major sub-sectors of interest before presenting BritCham members' main concerns and recommendations for regulators to continue to improve the business environment and accelerate reforms in the sector.

1 OIL AND GAS

The power crunch experienced last year has prompted the government to re-emphasise energy security, describing it as being as important as food security in its *2022 Government Work Report*. The National Energy Administration (NEA) also ranked energy security as their top work priority for 2022.[6] This focus on energy security means consumption of fossil fuels, especially domestic coal, oil and gas, will continue to feature in China's energy strategy for a long time to come.

Given that natural gas is a cleaner fossil fuel in comparison to coal and oil, its importance as a transition energy is maintained in the *2030 Carbon Peak Action Plan.* The plan sets out goals including accelerating domestic gas exploration and production, and facilitating coordinated development between gas and other energies. This position was later expanded on in the *14th FYP for a Modern Energy System*, which states that as part of the plan to enhance stability and security of its energy supply chains, China will increase natural gas production to over 230 billion cubic metres a year by 2025.[7] It will also increase gas storage capacity to 55-60 billion cubic metres (i.e., 13% of total gas consumption) by 2025. This will be achieved by further developing underground storage facilities and LNG terminals, among other measures. Additionally, the NEA's 2022 work priorities require steady progress on natural gas marketisation (including merging the provincial gas pipelines into a centralised body, PipeChina) and an equal and open regulatory environment for third parties to access gas transport infrastructure. This point was later reiterated in the government's latest policy document on building a unified national market which covers a unified national gas market and promises third parties equal access to gas infrastructure.

2 RENEWABLES

China aims to reach 1,200GW of wind and solar capacity by 2030. The strong policy push has injected significant momentum into investment in renewable energy and green technology over the past year. Although China had already been a leader in solar and wind prior to President Xi's announcement of dual carbon goals in 2020, the last two years saw a record number of solar photovoltaic (PV)

4 'Viewpoints of Two Sessions What Changes Will Be Brought by the Shift from 'Dual Control' of Energy Consumption to 'Dual Control' of Carbon Emissions', State Grid News, March 2022.

5 'Notice on Further Deepening the Market-oriented Reform of On-grid Tariffs for Coal-fired Power Generation', National Development and Reform Commission, November 2021.

6 '2022 List of Top Work Priorities for Energy Regulation', National Energy Administration, January 2022.

7 '14th Five-Year Plan for a Modern Energy System', National Energy Administration, March 2022.

and wind facilities installed across the country. According to bp's Statistical Review of World Energy 2021, China saw the biggest growth in installed renewable energy capacity in 2020, with its increased solar PV and wind capacity accounting for around half of the newly added global total.[8] China's total PV and wind capacity also reached 306GW and 328GW respectively by the end of the year, up 20.9% and 17% from 2020.[9] By the end of 2021, China's renewable energy capacity surpassed 1,000GW, contributing to 43.5% of its total power generation capacity, and 76.1% of newly added capacity.[10]

2.1 OFFSHORE WIND DEVELOPMENT

China's offshore wind development has been particularly impressive as many rushed to complete projects before the feed-in-tariffs expired at the end of 2021. According to the NEA, the country installed 17GW of new offshore wind capacity in 2021 (as opposed to the global added total of 28GW), with the country's total capacity reaching 26GW, making up over half of the global total (54GW). This made China the world's biggest offshore wind market, and the UK a remote second place whose capacity sits around 10GW as of early 2022.

Shandong, Zhejiang and Guangdong provinces in particular have been leading offshore wind development in China and set their own offshore wind installation goals for the 14th FYP period. Guangdong province alone, for example, aims to reach 18GW of offshore wind capacity by 2025. In December 2021, the province also saw the country's first floating wind turbine platform, as well as the world's first typhoon-resistant, Sanxia Yinling Hao go online with an installed capacity of 5.5MW per unit. The unprecedented floating wind turbine is located in Yangjiang Shapa wind farm which will be China's first GW-scale (1.7GW) wind farm once all of its projects are completed. With China's 18,000km coastline, and economic activities concentrated in the eastern regions, we expect offshore wind to continue to expand in the country's eastern coastal areas and move further towards deep waters.

2.2 HYDROGEN

Hydrogen can be deployed in a broad range of scenarios to generate power or to be used as feedstocks with little to no carbon emissions. It is therefore mentioned as one of the 'future industries' in China's 14th Five-Year Plan, believed to be one of the most important technologies for China to achieve net zero. In particular, given that renewable power and hydrogen in the transport sector will greatly support the decarbonisation of mobility, Hydrogen Fuel Cell Vehicles (HFCV) have been a focus for advancement in China's *Development Plan for New Energy Vehicles (NEVs) (2021-2035)*. In 2021, China produced 1777 fuel-cell vehicles, a growth of 48.2% from the previous year, pushing its total ownership toward 10,000 units, supported by a network of over 200 hydrogen refuelling stations (HRSs).

The roll-out of a pilot program for fuel-cell vehicles and HRS city clusters has given further impetus to the scaling-up of China's HFCV industry. Since September 2021, under the four-year national program, five city clusters—the Beijing-Tianjin-Hebei cluster, Guangdong, Hebei and Henan provinces, and Shanghai—have been selected for HFCV demonstration projects where local governments could be awarded up to RMB 1.7 billion (GBP 204.3 million) if they reach specified targets to advance the research and development of HFCVs. Prior to this national program, many local provinces and cities had also released their own HFCV industry development plans.

A highly-anticipated national *Medium- and Long-Term Plan for the Development of the Hydrogen Industry (2021-2035)* was released in early 2022, laying out the government's vision on how the industry will be further developed going forward. It is in this document that hydrogen was formally defined as energy. It states that China will create a hydrogen supply system consisting largely of industrial by-product and renewables-generated hydrogen by 2025, and accelerate the growth of both hydrogen-fuelled vehicles and stations with the aim of having 50,000 units of HFCV during the same period. In the run-up to 2035, the country will also strive to form a relatively comprehensive hydrogen supply chain where hydrogen is used in transportation, energy storage, the industrial sector, as well as in other areas.

Meanwhile, the British Chamber is delighted to see that one of the world's largest hydrogen electrolysis plants was launched by Shell and its joint venture partner Zhangjiakou City Transport Construction Investment Holding Group Co. Ltd. (ZJK JT) in January 2022. The 20MW project provided over 75% of the green hydrogen supply for HFCVs in Zhangjiakou over the course of the

8 'Statistical Review of World Energy 2021', bp, October 2021.

9 'The National Energy Administration Holds a Press Conference, Publishes the Conditions of Parallel Operation and Other Information of Renewable Energy Sources in 2021 and Answers Questions', National Energy Administration, January 2022.

10 'The National Energy Administration Holds a Press Conference, Publishes the Conditions of Parallel Operation and Other Information of Renewable Energy Sources in 2021 and Answers Questions', National Energy Administration, January 2022.

2022 Beijing Winter Olympics, greatly contributing to efforts for hosting a more sustainable Olympics Games.

3 POWER

Contributing to around half of China's carbon emissions,[11] the power sector is key to realising China's climate ambitions. According to the country's *14th FYP for a Modern Energy System,* China aims to significantly increase its consumption of non-fossil fuels, including raising their contribution to total power generation from current levels of 29% to 39% by 2025. This will be achieved by accelerating the development of wind and solar energy, hydroelectric, and nuclear power (the capacity of which should reach 70GW by 2025) as well as other renewable energy sources, such as bio-energy, according to the plan.

Last year saw a raft of new policies released at both national and local levels with the aim of accelerating the power market reform and building a new type of power system comprising mainly of renewables. The reform encompasses several aspects — increasing renewables uptake, enhancing the grid's ability to 'shave the peak' and 'fill the valley', building a unified power market, involving a wide range of energy entities, and enabling inter-provincial transactions of renewable power.

According to the China Electricity Council (CEC) in 2021, around 3,800 billion kilowatt-hours (kWh) of power was traded in various electricity trading centres in China — accounting for 45.5% of the country's total consumption of electricity that year. More provinces also started to pilot in-province power spot markets and inter-provincial power trading in 2021. The government published new rules for inter-provincial power spot trading in November 2021, expanding a previous scheme of cross-provincial excess renewable power trading to include more types of power (including coal-fired and nuclear) and a wider region (covered by the State Grid and Inner Mongolia Power Group).[12] Direct green power purchase was also made possible last year with 259 market entities participating in the transactions, facilitated by grid and power exchanges. The *Guiding Opinions on Accelerating the Development of a National Unified Power Market System,* which came out in early 2022 signalled that China will continue to accelerate the reform, with emphasis laid on strengthening its mid- and long-term power trading, supporting the spot market, as well as improving the ancillary market.[13]

Meanwhile, in order to absorb more renewable power into the grid and increase the reliability of power supply through it, power storage is an equally indispensable component of the power system. The *2030 Carbon Peaking Action Plan* sets a target of building 30GW of new-type power storage capacity by 2025, and the *14th Five-Year Plan for New Power Storage* also encourages power storage enterprises to participate in power trading as independent entities.

It is also worth-mentioning that BritCham member company bp, set up a joint venture in early 2020 to develop electric vehicles (EVs) charging networks across China, and achieved carbon neutral for all its charging stations in May 2021. These charging stations have been providing local drivers with China's first carbon-neutral EV charging services that has been verified by an accredited third party.

11 'Executive Summary of the Energy Sector Roadmap to Carbon Neutrality in China', International Energy Agency, February 2022.

12 'Interpretations of Trading Rules of Inter-provincial Power Spot Trading (Trial)', China5e, November 2021.

13 'Guiding Opinions on Accelerating the Construction of a Unified National Power Market System of the National Development and Reform Commission and National Energy Administration', National Development and Reform Commission and National Energy Administration, January 2022.

4 CARBON MARKET – NATIONAL EMISSION TRADING SCHEME (ETS)

Another major milestone was achieved in 2021 when China launched its national emission trading scheme (ETS) in January - commencing trade in July. This built on several years' efforts of setting up regional carbon market pilots in the country. These regional pilots, established in Beijing, Tianjin, Shanghai, Chongqing, Hubei, Guangdong and Shenzhen beginning in 2013, had enrolled more than 2,900 companies and traded 483 million tonnes of carbon emission allowances (CEA) for a total of RMB 8.62 billion (GBP 1.0 billion) as of the end of 2021. Studies have shown that a 16.7% reduction in carbon emissions were achieved between 2013 to 2015 through these regional pilots.[14]

Since 2017, preparations have been underway to build a national carbon market. Its launch in 2021 marked a significant moment in China's carbon reduction campaign. The national scheme covers around 2200 power plants with emission levels higher than 26,000 tonnes of CO2 in any year between 2013 and 2019. These companies were allocated 4.5 billion tonnes of CEAs in 2021, of which 179 million tonnes were traded for a total of RMB 7.68 billion (GBP 922 million).[15] Up to 5% of one company's allowance can also be offset by China Certified Emissions Reductions (CCERs), which are voluntary carbon credits certified by the Chinese government based on a company's emission reduction activities.

By the end of 2025, China also aims to enrol another seven sectors into its ETS, namely steel, non-ferrous metals, cement production, building materials, petrochemicals and chemicals, aviation, and paper production. These sectors cover around 70% of the country's total emissions and, once included in the national carbon market, should accelerate China's carbon reduction progress. Although China's carbon price of RMB 54.2 (GBP 6.5) per tonne is considerably lower than that in Europe, the focus on enhancing data quality, calibration of emission factors, and ensuring robustness of the monitoring, reporting and verification mechanism (MRV) should further increase China's alignment with international ETS markets.

China's energy industry remains one of the most promising sectors for British businesses. With the rapidly improving landscape and significant market opportunities, driven by a strong political will to achieve sustainable growth, British companies are generally positive about what the market has to offer. Financial measures and incentives have also been rolled out to direct capital into green technology and projects in the past year. This includes a new green bond catalogue excluding coal-related projects,[16] and a new lending facility to encourage lending to green projects and technology. In the British chambers' *British Business in China: Sentiment Survey 2021/22*, 53% of respondents in the energy sector were optimistic about their growth prospects in 2022, with 80% of them predicting 2021 revenues to either equal or surpass pre-pandemic levels.

However, as will be explained in the following section, foreign firms continue to be restricted from fully participating in the market. In offshore wind, for instance, there has been minimal participation of MNCs despite the rapid development of the industry in the past few years. The government also needs to continue to press ahead with reforms of the natural gas and power markets, further improve the carbon market, and offer more support measures to emerging industries and green technologies.

14 'The Effectiveness of China's Regional Carbon Market Pilots in Reducing Firm Emissions', PNAS, December 2021.

15 'Review and Outlook of the Chinese Carbon Market (2022)', Tanjiaoyi.com, March 2022.

16 'Green Bond Endorsed Projects Catalogue (2021 Edition)', The People's Bank of China, April 2021.

KEY CHALLENGES

1 NATURAL GAS

We believe natural gas is a relatively clean fossil fuel and an indispensable transitional energy to support China's delivery of carbon peaking and carbon neutrality goals. While policy updates mentioned in the last section are commendable, we hope that the government continues to acknowledge natural gas's importance in China's energy transition, as stated in the '1+N' policy framework. Meanwhile, it is necessary to identify supervising authorities, accelerate the development of the gas trading market, gas futures contracts, as well as the market-based pricing reform in order to create better market conditions and encourage third-party participation. We believe that multinational companies should be afforded equal opportunities to access pipelines and terminals as domestic companies, which can be achieved by enhancing supervising mechanisms. Only by introducing more competition and equal treatment of different market entities will there be increased efficiency optimisation and structurally lowered gas prices, thereby increasing end-use demand as well as gas supplies.

In terms of equal access to gas infrastructure, the establishment of PipeChina in late 2019 and its increasing activities last year, including the increasing number of contracts awarded to third parties on LNG terminal slots, are welcome developments. However, further improvements can be made in areas such as information sharing and granting equal access to domestic and foreign companies. PipeChina will need to disclose information such as the pricing and usage terms in order to help investors understand the capacity in a region. The absence of such commercial information creates challenges for businesses who want to make informed investment decisions. With China implementing the gas market reform and aiming to increase natural gas supplies and reduce barriers for investors, it is essential that a more transparent environment be created to further encourage third-party participation.

2 RENEWABLES DEVELOPMENT

2.1 OFFSHORE WIND

Although China's renewable energy market continued to grow last year, BritCham members continue to call for equal opportunities for foreign companies to participate in the market. So far, in the area of offshore wind, despite an addition of 12.7GW new capacity last year, the presence of MNCs has been minimal in the overall operator portfolio. EDF is the only business involved, with a very small equity share in a Guangdong asset. It is hoped that the government will provide more transparency over the development plans, competition rules, and resource allocation processes around offshore wind development rights, which would allow MNCs to capitalise on the enormous market opportunities. With China increasingly looking to develop offshore wind in deep waters, and considering the UK's expertise in floating wind generation, UK businesses are well-suited to help with development in China's largely untapped deep waters. Continuing collaboration between China and the UK in this area, such as building demonstration pilots, would be of mutual benefit.

2.2 HYDROGEN

It is also hoped that China accelerates policy, regulatory and standard systems to support the production, transportation, storage and refuelling of hydrogen in order to realise its great potential in decarbonising the transport and industrial sectors.

Currently, despite steady progress in several hydrogen demonstration projects, there are a number of challenges that need to be addressed in order to achieve economies of scale for the industry. Firstly, although now defined as energy, hydrogen also continues to be defined as a 'dangerous chemical' and is subject to stringent safety measures. This has resulted in the lack of a single administrative body to regulate activities around its development, use, and transport — giving rise to the issue of overregulation and confusion over regulating authorities. Although the *Mid- and Long-Term Plan for the Development of Hydrogen (2021-2035)* states that China will explore renewables-based hydrogen production and storage in hydrogen refuelling stations (HRSs), current regulations have yet to allow such power-to-hydrogen practices, which are common in a number of other countries.

Secondly, although China is the world's largest producer of hydrogen, it produces hydrogen mostly from coal regasification and gas reforming, as well as other various industrial processes.[17] Going forward, we believe that green and blue hydrogen will play a bigger role in China's decarbonisation process and will be deployed in more regions. (Green hydrogen is generated by using renewable energy while blue hydrogen is produced from natural gas and supported by carbon capture and storage.) In particular, green hydrogen is essential to reducing overall emissions and its production should therefore be accelerated. We believe that this goal can be achieved by offering more support measures for such projects, such as lower tariffs for renewable energy used to produce hydrogen. For some industrial sectors, the government should also consider using more blue hydrogen and combine it with carbon capture, utilisation and storage (CCUS) given the difficulty to achieve full electrification in these sectorss.

Hydrogen delivery is another challenge that currently limits the potential of the industry. Given hydrogen's low density, its transportation has been costly. While transporting liquid and solid hydrogen costs less, the technology has not yet fully matured to a point where large scale production of hydrogen in these two forms is possible. Instead, gaseous hydrogen has been the most common form of hydrogen use in China. However, whilst Class IV vessels are best suited to transport gaseous hydrogen as they are lighter and can store more hydrogen than Class III vessels, they are also more expensive and difficult to manufacture, which has led to low domestic demand.[18] In order to build a scalable hydrogen supply chain, the government needs to strengthen efforts to improve relevant infrastructure and standards including vessels and HRS, as well as to reduce their costs.

3 CARBON CAPTURE, UTILISATION AND STORAGE

Given China's large fossil fuel reserves, they will continue to be powering China's economic growth to a large extent in the near future. This highlights the central role that CCUS will play in China's decarbonisation efforts as it can be used to offset the impact of carbon emissions in a wide range of hard-to-abate sectors such as in coal-generated power plants, steel, and petrochemical industries.

China's *2030 Carbon Peaking Action Plan* states that the country will continue to advance research, demonstration programmes, and industrial application in CCUS technology and increase international cooperation in the area. Currently, China has around 40 CCUS demonstration programs, either in operation or under construction, with a capacity of capturing three million tonnes of CO2 per year.[19]

However, China's CCUS technology is still at its early stage of commercialisation and most of the projects are of small scale. Given its high cost, few enterprises are willing to invest in it, except for a small number of oil producers that are using the technology to enhance their oil recovery rate. Therefore, concrete policy measures, from subsidies, tax credits to the carbon market mechanism, are needed to scale up CCUS deployment — especially in the industrial sector, and to promote the development of a safe and viable CCUS industry. China also needs to strengthen the construction of relevant CCUS infrastructure, including transportation, storage, and network infrastructures. A comprehensive regulatory system also needs to be put in place to regulate different processes throughout the CCUS deployment (such as its construction, operation, supervision, and termination), as well as to set industry standards ranging from project development to accreditation of low-carbon products.

4 POWER MARKET REFORM

A major focus of China's current energy transition has been its power market reform. The past year has witnessed a spate of new policies released at speed. Whilst these policies have set clear goals of increasing the development of renewables, improving the ancillary market, and building a unified power market, we believe that the government will need to prioritise the following areas in order to speed up market liberalisation:

17 'China sets green hydrogen production target in national development plan', iHSMarkit, April 2021.

18 'Hydrogen Storage Sees Moderately Advanced Development and High-pressure Hydrogen Storage Has Been Realized as a Priority', Pingan Securities, December 2021.

19 'China CCUS Annual Report (2021) — Research on China's CCUS Pathways, Chinese Academy of Environmental Planning, Institute of Rock and Soil Mechanics of Chinese Academy of Sciences', and the Administrative Center for China's Agenda 21, July 2021.

4.1 THE NEED TO ESTABLISH AN INTEGRATED GREEN POWER TRADING MARKET

The green power trading pilot established last year marks a remarkable step towards China's climate goals, with 259 power generators and corporate buyers from 17 provinces trading a total of 7.95 billion kWh of electricity. However, there is still a long way to go before renewable power purchase agreements become scalable between power generators and C&I customers. Currently, the total traded volume of green electricity in 2021 was only 1% of the total green power generated in the country last year. As a result, green power trading needs to be expanded going forward.[20] As more and more green power has been generated on the supply side, and demand for it has also increased significantly, it is critical that the government further improves the scheme and allows free and regular green power trading to take place in the power market.

Furthermore, there also needs to be better coordination of the three different markets — namely green power, Green Electricity Certificates (GECs), and China Certified Emission Reduction (CCER) to avoid double-counting of green attributes. Double-counting exaggerates renewables' contribution to power generation — which can lead to the issue of green washing — and could therefore slow down society's actual progress towards carbon neutrality.

4.2 INSUFFICIENT INTER-PROVINCIAL POWER TRANSACTIONS

The establishment of several regional and provincial power trading centres, especially the Beijing and the Guangzhou power exchange centres (PECs), have facilitated inter-regional and inter-provincial power trading over the years. In 2021, 1.24 trillion kWh of power was traded in the Beijing PEC with a Y-o-Y increase of 7.3%, whilst 67 billion kWh was traded in the Guangzhou PEC (marking a significant growth of 90.9%). However, the amount of power trading across provinces is still rather limited due to a number of barriers, including differences in trading rules, cross-provincial transmission costs, as well as generator configuration and transmission networks in different regions. More importantly, the national grid still dominates the purchase and sales of cross-provincial electricity, limiting the scale of direct purchases between industrial and commercial users, and power generators. In 2021, only 18.6% of the total traded electricity in the power exchange centres are inter-provincial.[21] In order to increase inter-regional and provincial power trading, which would allow more renewables-generated power in China's western and northern regions to be exported to eastern regions, the government needs to take steps to align trading and power generating, transmission standards, and unify rules of power exchanges across various regions, as well as further liberalise the market.

20 'China Kicks off its Green Electricity Trading', The Sino-German Energy Partnership, September 2021.

21 'Profile of Transactions in the Chinese Power Market in 2021', China Electricity Council, January 2022.

4.3 IMMATURE POWER SPOT TRADING MECHANISMS

In 2021, Liaoning, Jiangsu, Anhui, and Henan provinces, and Shanghai, became the second batch of provinces and city to pilot the power spot market reform, joining the first batch of eight provinces including Guangdong, Zhejiang, Shandong, and others. However, the market design of China's power spot market is still being developed and further improvements are required. Guangdong's spot market, for example, only includes coal-fired power generators and has only been conducted on a trial basis. We hope that trading will be conducted more regularly with power prices being determined daily and more market participants — such as power storage entities and virtual power plants (VPPs) — allowed to enter the power market.

5 CARBON MARKET

While the progress on the national ETS has been encouraging, China's ETS is still in its infancy. Its traded carbon allowances, for instance, only account for 3.9% of the total allowances in the national market last year, as opposed to the 417% turnover rate in the EU equivalent.[22] The following is a number of areas which we recommend the government continue to improve on.

Firstly, China currently adopts a rate-based approach for allocating CEAs with no absolute cap on its emissions. Going forward it will need to tighten up its overall carbon emission quota in order to achieve substantial carbon reductions. In particular, whilst China will continue to use coal for power generation for energy security reasons (whilst also restricting its use in industrial sectors), we believe the quota needs to be strengthened for coal-fired power plants if China is to achieve its 14th FYP energy goals. The MRV system must also continue to be enhanced to ensure emission data is accurate. We look forward to the government enrolling other sectors as planned, publishing relevant timetables and CEA allocation methodology in a timely manner so that emitters understand how to best prepare.

Meanwhile, as a lack of participation in the market of financial institutions has limited market liquidity, the government needs to work towards enrolling institutional investors into the market to help facilitate transactions, connect supply and demand, better determine carbon pricing, and scale up carbon reduction and neutralisation projects.

Industry participants also look forward to the relaunch of CCERs, which were suspended in 2017 due to a low trading volume. In November 2021, it was announced that the Beijing Environment Exchange will soon launch a CCER trading platform.[23] The news is greatly welcomed as the restart of CCERs will increase demand for carbon offsets, encourage investment into renewable energy and other green projects, and thus further incentivise foreign companies to contribute to China's green transition. BritCham members are interested in participating in the CCER market and in contributing to China's carbon reduction efforts.

We believe that China needs to be better prepared for the alignment with global carbon markets, which includes harmonising rules with international standards and increasing cooperation with other exchanges in Europe. The COP26 last year set new rules around international carbon trading, which allows governments to trade carbon credits and eliminate double counting. This underlines the global nature of the fight against climate change and the increasing international consensus around it. Especially with Cross-Border Carbon Adjustment Mechanism (CBAM) coming close to implementation under the Green Deal in Europe, it is in China's interests to take early steps to align standards as, under the CBAM, China's imports into the EU will also be subjected to carbon tax. The earlier China takes action to prepare, the easier it is for China's domestic manufacturers to retain their international competitiveness.

Last but not least, China will need to put in place a harmonious system of regulatory standards including those on energy storage, hydrogen, and others, to push for decarbonisation at a faster pace. The centrality of data to understanding China's carbon emissions and effective climate actions means the country also needs to develop a systematic approach to manage and gain insights into its data on carbon emissions - making sure such data can be recorded, reported, and traced. This is important both for the industry as a whole and for individual organisations as the latter are increasingly setting their own net zero goals and need to fulfil their ESG requirements. However, it will not be possible to do so without data. Apart from a better understanding of emission data, companies would also like to know how China's carbon price will change in the future. Although China's current carbon pricing is low, it is likely to rise significantly in the future. Therefore, a scientific way of estimating the price must be found to enable businesses to predict costs and prepare for the future.

22 'Review and Outlook of the Chinese Carbon Market (2022)', Tanjiaoyi.com, March 2022.

23 'Commodities 2022: China's carbon market to expand, build capabilities', S&P Global, January 2022.

KEY RECOMMENDATIONS

KEY CHALLENGE	RECOMMENDATION
1 Natural gas	▪ Tighten the carbon quota for coal-fired power plants and enhance the monitoring, reporting and verification (MRV) system. ▪ Continue non-discriminatory third-party access to gas infrastructure by enhancing monitoring mechanisms on PipeChina. ▪ Continue to articulate in relevant implementation policies the role of gas in building a clean energy system. ▪ Take actions in detecting, monitoring and improving the measurement of methane emissions, and work towards reducing corporate methane emissions.
2 Renewables	▪ Increase foreign companies' opportunities to participate in China's offshore wind market including managing assets. ▪ Increase production of green hydrogen. ▪ Accelerate industrial decarbonisation demonstration programs based on hydrogen. ▪ Allow power-to-hydrogen to be conducted at hydrogen refuelling stations (HRS). ▪ Aim to lower costs of hydrogen logistics and infrastructure including transporting vessels and HRSs.
3 CCUS	▪ Offer financial and taxational policy support for CCUS projects. ▪ Develop CCUS-related standards from project development to accreditation of low-carbon products.

KEY CHALLENGE	RECOMMENDATION
4 Power	■ Improve the power spot market and allow more market participants to take part. ■ Facilitate scaled direct renewable power purchase agreements (PPA) between power generators and C&I customers. ■ Facilitate direct power purchase in inter-provincial power transactions.
5 Carbon market	■ Increase participating industries in China's carbon market to include institutional investors. ■ Publish clear timelines of when seven other industries and institutional investors will be enrolled in China's carbon market. ■ Harmonise standards with international carbon markets. ■ Develop a systematic approach to understand and manage data on carbon emissions.

KEY MUTUAL OPPORTUNITIES

CLEAN ENERGY

With China's focus on making its energy use cleaner, including increasing natural gas consumption, and boosting investment in clean energy, such as solar, offshore wind, and nuclear, opportunities in participating in China's energy market are ample for UK businesses. If the government continues to improve equal treatment of foreign companies in the market, UK companies should be able to benefit from the increasing demand for natural gas, nuclear power, and renewable energy as well as the decreasing costs of solar and wind power in China. Beneficiaries not only include oil and gas, and civil nuclear companies, but also smaller UK suppliers of cables, valves for clean energy projects, and facilities as well as quality control service providers. With the UK's strength in these areas, companies are well placed to participate in the market and be part of China's drive towards carbon neutrality.

CIRCULAR ECONOMY

China's carbon neutrality ambition is prompting the country to build a circular economy. As metal recycling reduces energy consumption and carbon emissions, the demand for it will grow phenomenally as China's heavy industry also goes through decarbonisation. Whilst Europe and the UK have tremendous experience in the area, China still has a long way to go to increase its capacity of metal recycling. This offers promising opportunities for UK companies to offer their expertise and add capacity to the industry.

UPSKILLING

As China's energy system undergoes its 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 and technology, health, safety security, environment and 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.

GREEN MINING

Achieving net-zero requires a company to remove carbon emissions from its entire value chain, including those produced in their own business operations (scope 1), purchased electricity and heat (scope 2), and those generated by suppliers and end-users (scope 3). Without green mining, net-zero goals cannot be achieved in many fast growing industries including renewables, battery and EVs, as they involve the deployment of a wide variety of metals and minerals, such as lithium, nickel, copper, aluminium. Echoed by the International Energy Agency, a report released in 2021 outlined the critical role minerals will play in the global energy transition. There is an urgent call that capital, investment, innovation and skills are required to modernise the mining sector in order to build a net-zero sustainable future.

FINANCIAL SERVICES

AT A GLANCE

SUB-SECTORS

Asset management

Banking

Insurance

KEY CHALLENGES

- Difficulties with cross-border payments
- Lack of clarity on cyber-security laws and difficulties with navigating the *Personal Information Protection Law*
- High barriers to entry and difficulty navigating the rapidly evolving regulatory environment

KEY RECOMMENDATIONS

- Streamline disclosure processes and requirements for money inflows and outflows
- Provide clarity and further guidance on the various categories of personal data with explanatory notes to supplement the legislation. Clear guidelines on implementation and consequences of non-compliance
- Clearer timelines and guidance as regards application for licences, approval, implementation and ongoing compliance requirement processes within the industry

KEY MUTUAL OPPORTUNITIES

- Hainan Free Trade Port
- The Guangdong–Hong Kong–Macau Greater Bay Area
- ESG

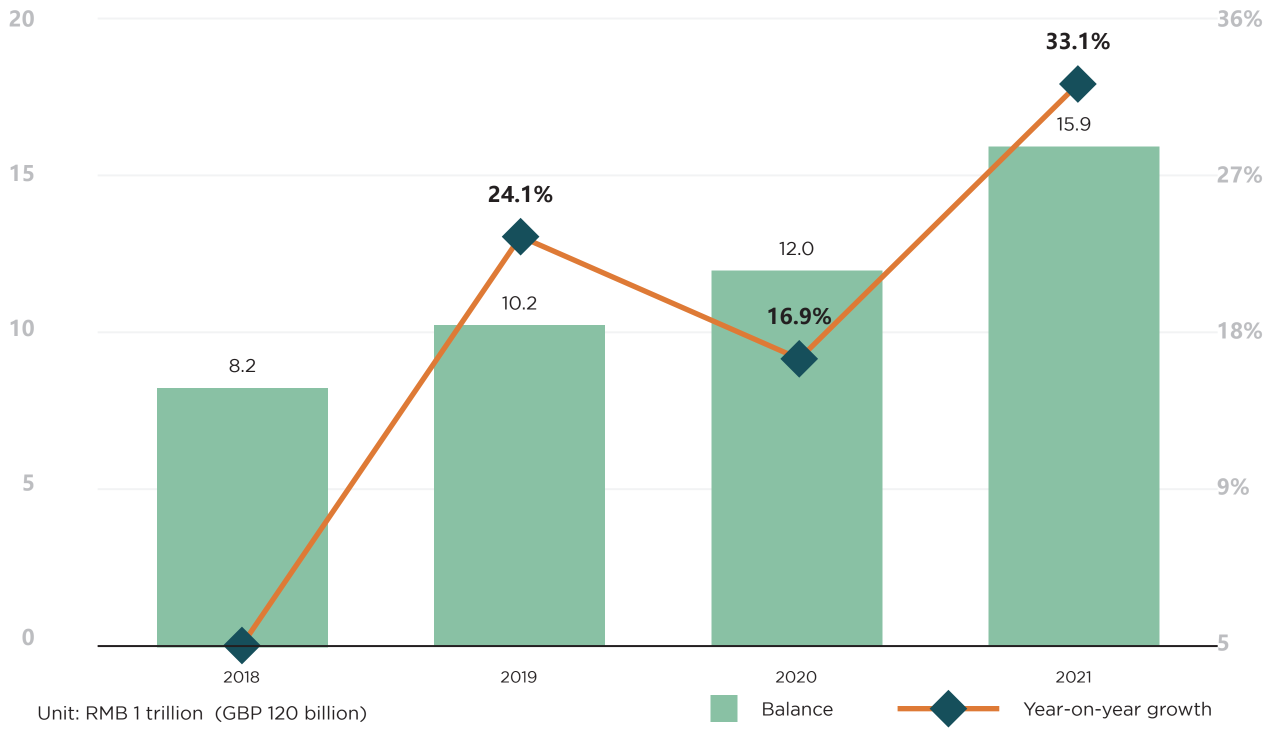
STATE OF THE SECTOR

While the world continued to battle the impact of COVID-19, the outbreak of new variants, and the challenges brought along with them, China's economy continued to see some of the highest growth amongst the world's major economies in 2021[1] with gross domestic product (GDP) up by 8.1% from the previous year, with an average two-year growth of 5.1%.[2]

China's total outward direct investment totalled GBP 109.2 billion (RMB 924.9 billion) in 2021, a 9.2% year-on-year increase.[3] Despite the ongoing pandemic and geopolitical tensions, China's foreign direct investment (FDI) hit a record high totalling RMB 1.15 trillion (GBP 120 billion) in 2021, expanding 14.9% year-on-year.[4] This record expansion in offshore investment into the Chinese mainland is in part thanks to the continued market openings and the Qualified Foreign Institutional Investor (QFII) program, with the year 2021 seeing the highest number of approvals on record by the China Securities Regulatory Commission (CSRC) with 101 overseas institutions receiving approval to partake in the program.[5] The shortened *Special Administration Measures (Negative List) for Foreign Investment Access (2021 Edition)*[6] and the *Special Administrative Measures (Negative List) for*

China's Total Green Credit Balance, 2018-2021

Source: People's Bank of China



1 'China Economic Quarterly Q4 2021', PricewaterhouseCoopers, February 2022.

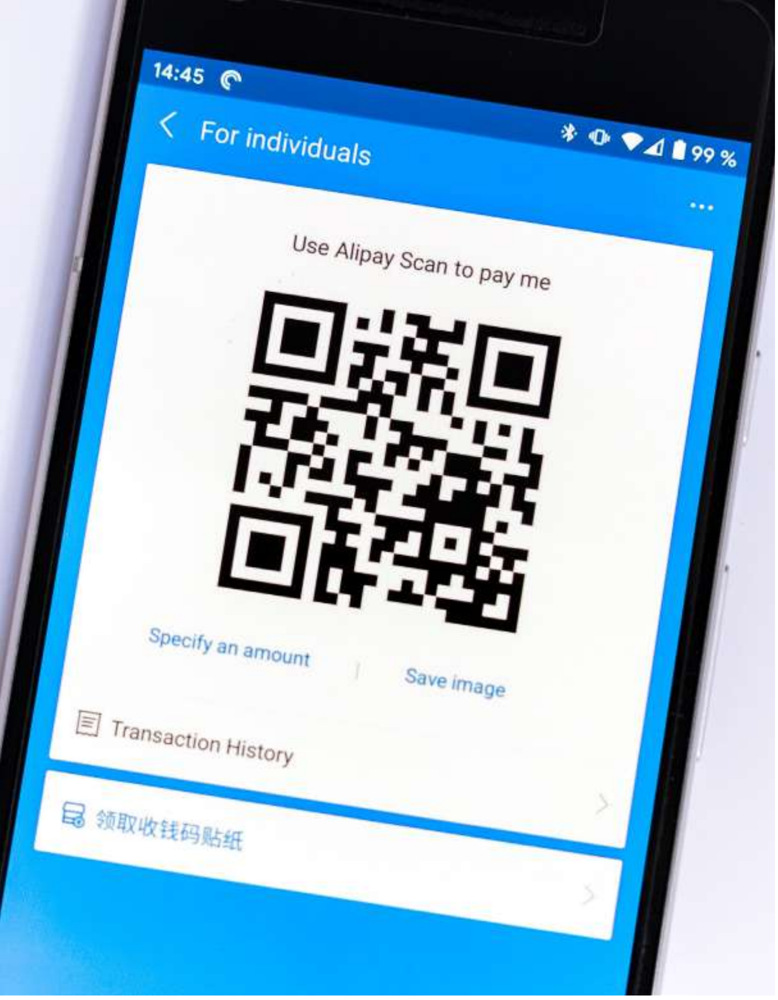
2 'Statistical Communiqué of the People's Republic of China on the 2021 National Economic and Social Development', National Bureau of Statistics of China, February 2022.

3 'Higher Investment Growth Was Observed in Belt and Road Region; Health Care and Life Sciences Sector in Europe and North America was Popular - EY Releases the Overview of China Outbound Investment of 2021', EY Greater China, February 2022.

4 'Economic Watch: China FDI Inflows Hit Record High in 2021', Xinhua, January 2022.

5 'China Opens Doors to Foreign Finance Companies, But Can They Prosper?', Caixin, November 2021.

6 'Special Administration Measures for Foreign Investment Access (Negative List) (2021 Version)', National Development and Reform Commission and the Ministry of Commerce, December 2021.



Foreign Investment Access in Pilot Free Trade Zones (2021 Edition)[7], which came into effect on 1 January 2022 and further reduced limitations on foreign direct investment in China, serves as further encouragement that FDI will continue to expand in the coming 12 months, which the British chambers of commerce in China welcome.[8]

At the end of 2021, the total assets of financial institutions operating in the Chinese mainland had reached RMB 382 trillion (GBP 45.9 trillion), an 8.1% increase Y-o-Y.[9] Assets held by banking institutions made up the largest element of China's financial services sector, totalling RMB 344.8 trillion (GBP 41.4 trillion). Whilst assets held by securities institutions remained the smallest element of China's financial sector, totalling RMB 12.3 trillion (GBP 1.4 trillion), securities institutions also saw the biggest year on year growth at 21.2%.

The Chinese securities market could see further growth in 2022 as a result of the further opening up to foreign companies seen in 2021, with J.P. Morgan becoming the first foreign firm to fully own a securities brokerage in China.[10]

15 November 2021 also saw official trading commence on the Beijing Stock Exchange, with the Beijing Stock Exchange becoming the third national stock exchange in the Chinese mainland behind Shanghai and Shenzhen. As of April 2022, the Shanghai Stock Exchange was the third largest in the world with market capitalisation standing at a total of RMB 46.5 trillion (GBP 5.6 trillion), followed by the Shenzhen Stock Exchange as the seventh largest in the world with market capitalisation of RMB 34.5 trillion (GBP 4.1 trillion).[11]

Similarly, China's insurance market remains one of the largest in the world, second only to the US insurance market.[12] Whilst the total assets held by insurance institutions saw the most sluggish growth Y-o-Y in 2021 at 6.8% when compared to banking and securities institutions,[13] the total primary insurance premiums received by insurance companies saw a 4.0% increase from the previous year, reaching a total of RMB 4 trillion in 2021.[14]

This continued growth, expansion and regulatory opening up in the financial services sector has not gone unnoticed by British businesses. British businesses in the financial services sector report higher than average optimism about their prospects for the coming year in China, with a greater number of financial services companies increasing investment in China compared to other sectors.[15] Continued growth in the financial services sector will turn on whether there is continued relaxation of restrictive policy on foreign investment and entrance to the financial services market, a clearer regulatory framework and the increased ability for companies to innovate and introduce new service offerings in a quick and efficient manner so as to react to changes in the market.

7 'Special Administrative Measures (Negative List) for Foreign Investment Access in Pilot Free Trade Zones (2021 Edition)', National Development and Reform Commission and the Ministry of Commerce, December 2021.

8 'China Opens Doors to Foreign Finance Companies, But Can They Prosper?', Caixin, November 2021.

9 'Total Assets of Financial Institutions Reached 381.95 Trillion Yuan at End-2021', People's Bank of China, March 2022.

10 'J.P. Morgan Receives Approval From The China Securities Regulatory Commission For Registration Of Full Ownership Of J.P. Morgan Securities (China) Company Limited, The Bank's Securities Venture', J.P. Morgan, August 2021.

11 'Statistical Communiqué of the People's Republic of China on the 2021 National Economic and Social Development', National Bureau of Statistics of China, February 2022.

12 'Industry Report: Financial Services, China, 1st Quarter 2022', The Economic Intelligence Unit, 2022.

13 'Total Assets of Financial Institutions Reached 381.95 Trillion Yuan at End-2021', People's Bank of China, March 2022.

14 'Statistical Communiqué of the People's Republic of China on the 2021 National Economic and Social Development', National Bureau of Statistics of China, February 2022.

15 'British Business Sentiment Survey 2021-2022', British Chamber of Commerce in China, December 2021.

KEY CHALLENGES

MULTI-SECTOR CHALLENGES

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

QDII quotas have continued to see positive movement in 2021, with the State Administration of Foreign Exchange (SAFE) approving the largest value of quotas in the scheme's history.[16] RMB 259 billion (GBP 31 billion) in quotas were approved in the period between December 2020 and December 2021,[17] compared to the previous year where SAFE granted only RMB 83 billion (GBP 9 billion) in QDII quotas. An additional five institutions were also allocated QDII quotas between December 2020 and December 2021.

Despite the welcome increase in the granting of QDII quotas, challenges remain due to restrictions on the maximum allocation capacity, lock-up periods, fund repatriation restrictions and caps on quotas, which constrain the ability of a QDII fund to grow and fundraise effectively. These restrictions reflect the cautious approach taken to managing outbound money flows; however, loosening these restrictions would allow companies to better allocate assets and risks, increase liquidity and diversify portfolios. Additionally, more flexibility would allow QDII funds to better react to changes in global market conditions and investor sentiment.

1.2 DIFFICULTIES WITH CROSS-BORDER PAYMENTS

There are still substantial barriers to the efficient and timely transferring of capital and funds between companies and their subsidiaries and/or sister companies situated outside of the Chinese mainland. Whilst this issue is not specific to the financial services sector, given their close proximity to the financial system, financial services companies are more affected, and smaller companies in particular often experience short term liquidity issues as a result. The strict disclosure requirements (on both an institutional and personal level) detailing where money is flowing to and why also impact financial services companies' short-term liquidity due to the lengthy approval process.

British businesses are, however, encouraged by the continued effort by SAFE to introduce pilot projects aimed at streamlining cross-border transfer processes, so as to allow a more efficient process by which companies can make cross-border payments between subsidiaries. It is also encouraging to note that the business volume of cross-border payments in 2021 totalled over RMB 79.6 trillion (GBP 9.6 trillion) with over 3.3 million transactions being handled through China's RMB cross-border payment system, a 75.9% increase in value and 51.6% increase in number of transactions from the year before.[18]

1.3 CHALLENGES NAVIGATING REGULATORY FRAMEWORKS IN A RAPIDLY EVOLVING SECTOR

The financial regulatory system in China remains strong, with particular strength and expertise in regulations applicable to the banking system. However, businesses in other sub-sectors within the industry, such as the insurance, asset management and securities sectors, still face considerable difficulties in entering and navigating the regulatory environment.

Businesses are encouraged by the announcement of pilot programs and the expansion of existing pilot programs, which indicates a willingness to open up the market and remain responsive to the evolving industry. Pension

16 'China's SAFE Awards $10.3bn Worth of New QDII Quotas', Regulation Asia, June 2021.

17 'China grants fresh QDII quota', FSA, December 2021.

18 'China's RMB Cross-Border Payments Soar in 2021: Report', Global Times, April 2022.

insurance companies, in particular, are encouraged by China Banking and Insurance Regulatory Commission (CBIRC)'s announcement in regards to expanding pilot programs of exclusive commercial pension insurance nationwide and allowing pension insurance companies to participate in the pilot programs, thereby expanding the program participants from the original six domestic insurers.[19] However, the program itself presents many challenges in terms of capital input requirements, costs and regulatory barriers to establishing branches across the mainland.

Businesses would encourage CBIRC and CSRC to continue to communicate, with businesses within the industry subsectors, working to overcome any communication barriers presented by COVID-19, to ensure that the financial services sector continues to grow. We call for clearer timelines and guidance as regards application for licences, approval, implementation and ongoing compliance requirement processes within the industry, so as to provide greater confidence to businesses – both those already in the Chinese mainland financial industry, and those considering entry. This would allow businesses to strategically plan their approach in the market and better service their clients.

Whilst the importance of ensuring that companies are responsible players within the financial industry is recognised, regulatory authorities should remain open to innovative approaches, products and services being introduced into the market. Foreign financial services companies have a wealth of international expertise that would provide a valuable contribution to discussions and working groups, and would welcome the opportunity for increased engagement with regulators in shaping the domestic market. This input would help the continuing development of the domestic financial services industry and its infrastructure.

1.4 DIFFICULTY IN ATTRACTING FOREIGN TALENT AND SETTING UP OPERATIONS IN CHINA

The government has stated that it intends to introduce measures to open up the financial sector and attract foreign investment. This will require financial services organisations to relocate staff with relevant expertise and experience to China as part of their entry and/or growth in the market.

Whilst many international organisations in the sector are interested in making investments into the set-up of operations in China, they are reluctant to do so whilst current COVID-19 restrictions remain in place. In the Chamber's recently conducted flash survey on the impact of recent COVID-19 outbreaks on businesses, 36% of surveyed financial services firms indicated that if the current COVID-19 restrictions remained in place for the next year, they would see a reduction in local (China) operations.[20] Members in this sector are also finding it increasingly difficult to attract foreign talent, both due to restrictions on entry and exit from the country, and due to a lack of certainty in obtaining entry approval for key staff to relocate. Global travel restrictions, difficulty obtaining visas and stringent entry requirements and conditions were the top 3 most cited aspects of the dynamic zero-COVID policy that have impacted the financial services industry's ability to attract and retain foreign talent.[21] Such investment plans usually have a long lead time between planning and actual implementation, and an indication of a time-scale for the resumption of international travel and easing of border restrictions would support these organisations in planning such investments.

1.5 CYBERSECURITY AND THE PERSONAL INFORMATION PROTECTION LAW (PIPL)

We welcome the introduction of the PIPL on 1 November 2021. However, since its introduction, there has been confusion as to the meaning of some aspects of the PIPL and what the resulting obligations are for data handlers. The precise implications for failing to implement and comply with the rules are unclear, as are the guidelines for correct implementation and how compliance will be enforced. This lack of clarity, combined with stringent data localisation requirements and potential long waits for data transfer approvals, results in foreign companies in China having to adopt a more conservative approach to operating their businesses in China, leading to increased costs in ensuring compliance and a general decrease in operational efficiency.

Members have expressed a desire to see further guidance issued on the various categories of personal data and explanatory notes on some of the definitions included within the legislation. Further clarity on data transfers outside of China, which based on the current understanding of the legislation may have a detrimental impact on the banking and insurance sector in particular, is also

19 'CBIRC Issues Notice on Expanding the Exclusive Commercial Pension Insurance Pilot Programs', China Banking and Insurance Regulatory Commission, February 2022.

20 'British Business in China Survey: Impact of COVID-19 Report', British Chamber of Commerce in China, April 2022.

21 'British Business in China survey: Impact of COVID-19 Report', British Chamber of Commerce in China, April 2022.

necessary. Members hope that by having greater clarity as to definitions under the legislation (including a narrow scope of what is classified as 'important data'), clear implementation and compliance guidelines and greater flexibility regarding cross-border data flows between affiliated businesses, data and sensitive information can be adequately protected without companies facing disproportionate compliance risks, inflated operational costs and loss of efficiency.

1.6 FINTECH

Fintech is already playing a crucial role in the evolution and delivery of financial services globally. Chinese and foreign financial service providers, regardless of financial services sub-sector, will all need to adopt fintech in some form as part of their service delivery to enable them to compete locally and globally.

Authorities have adopted a cautious approach to fintech companies, with a record fine of RMB 18.2 billion (GBP 2.2 billion) being imposed on Alibaba Group in April 2021, and implementation of regulations which serve to restrict the use and development of fintech products. These strict regulations, combined with the lack of clarity regarding cybersecurity, cross-border payment and digital currency regulations currently in place, has made it difficult for companies to leverage the opportunities in this sector and for fintech businesses in particular to establish themselves within the market.

Despite this restrictive and cautious approach towards fintech companies, the recent release of the *Fintech Development Plan for 2022-2025* by the People's Bank of China is an encouraging sign that the development of the fintech sector and its role in China's financial services industry remains a key focus and priority for the Chinese government.[22] The approval by the Chinese government of PayPal Holding Inc. becoming the first foreign operator with total control of a payment platform within the Chinese mainland[23] also serves as encouragement for overseas fintech companies looking to enter the Chinese market.

Members are hopeful that as part of the opening up of the financial services sector, organisations are not only given greater clarity in regards to the regulatory framework in which they are operating, but are also given greater access to the most innovative fintech solutions to help them compete in the marketplace. By removing barriers to market entry by overseas fintech players, the development of and innovation by domestic service providers and the financial services industry in China as a whole would quicken. We would welcome the introduction of measures to encourage more foreign fintech organisations to establish a presence in China, and we believe that foreign fintech companies have a wealth of technology, management systems and experience that can help China continue to develop its financial services and fintech sector.

1.7 GREEN FINANCE

China's transition to green energy cannot be achieved without green finance, and expanding green finance and mobilising capital will be crucial to driving low-carbon investment. It is estimated that in order to achieve China's net zero objectives by 2060, there will need to be approximately GBP 12.3 trillion (RMB 102.5 trillion) in capital expenditure by 2060.[24] It is estimated that RMB 2.2 trillion (GBP 264.4 billion) of green reinvestment is needed annually in the current decade to achieve China's carbon peak by 2030, and RMB 3.9 trillion (GBP 468.8 billion) in the period from 2031 to 2060 in order to reach the carbon neutrality target by 2060.[25]

China's green finance development continues to accelerate, with GBP 71.3 billion (RMB 603.9 billion) in green bonds being issued in the financial year of 2021, versus GBP 33 billion (RMB 279.6 billion) the year before.[26] In November 2021, the People's Bank of China launched its Carbon Emission Reduction Facility (CERF) providing financial institutions with low-interest loans in order to reduce carbon emissions.[27] This plan, however, excludes foreign banks, resulting in all business going to Chinese banks.

Our members are committed to a greener and more sustainable future, but they find reporting on ESG and sustainability to be challenging due to different policies which can sometimes be conflicting. We would welcome a move towards more unified policies, and our members who report on a global basis could provide a valuable contribution towards that unification process.

22 'PBC issues <Fin-tech Development Plan (2022-2025)>', People's Bank of China, January 2022.

23 'PayPal Becomes First Foreign Firm in China with Full Ownership of Payments Business', Reuters, January 2021.

24 'GREEN CAPEX Making infrastructure happen', Goldman Sachs, October 2021.

25 'China Boosts Green Finance in Pursuit of Carbon Neutrality', State Council, July 2021.

26 'China Green Bond Issuances Set to Cross $100B Mark in 2022', S&P Global Market Intelligence, January 2022.

27 'Banks Get Funds to Help Cut Carbon Emissions', State Council, January 2022.

Furthermore, providing a clearer framework for ESG reporting would have a positive effect on investment: certain investment KPIs now include a sustainability aspect, and ESG investment strategy requires comparable and measurable data in order to analyse the prospects of an investment. The current lack of clarity on reporting on ESG and sustainability has often resulted in these investments being paused. Additionally, the large capital demands will require innovation and diversification in the financial services industry. We believe foreign banks have a part to play in reaching carbon neutrality by 2060 and would welcome a pilot project to allow foreign financial service companies the opportunity to participate and contribute to the wider development of China's green financial system.

BANKING

2.1 CONTINUED LIMITED ACCESS TO THE CHINESE GOVERNMENT AND INTERBANK BOND MARKET

Offshore investment into Chinese government bonds and China's Interbank Bond Market (CIBM) have slowed in 2021, with foreign investors holding RMB 2.5 trillion (GBP 300.4 billion) in Chinese government bonds at the end of December 2021.[28] Despite this slowing, the CIBM remains of interest as a key investment platform with international investors preferring China's government bonds due to China's higher credit rating and the relatively stable value of the renminbi when compared to the currencies of developed countries.[29] The proportion of bonds held by overseas investors sat at 3.5% at the end of June 2021, a 2.1% increase since June 2017.[30]

The ability of foreign banks to underwrite the vast majority of bonds remains limited. Despite announcements by the Financial Stability Committee of the State Council in 2019 that foreign-funded banks were permitted to apply for and obtain a Category A lead underwriting licence in the CIBM, so far only two foreign lenders have obtained such licences. 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.

Foreign banks would also welcome the opportunity to partake in the pilot programs introduced for trading Chinese government bonds on the China Financial Futures Exchange. These pilot programs are currently only available to domestic banks, and as a result the market liquidity and diversification is not as deep or as wide as it could be with the introduction of foreign players.

2.2 DIGITAL CURRENCIES

There are reportedly more than 261 million people in possession of a personal e-CNY account as of 31 December 2021, with total transactions reaching RMB 87.5 billion (GBP 10.5 billion) and China's central bank officially piloting the digital yuan for global users during the Winter Olympics.[31] In April 2022, China's central bank announced that the e-CNY pilot program will be rolled out in more domestic cities, following on from successful testing in the original 10 pilot cities.[32]

However, foreign banks have not been asked to be involved in the ongoing development surrounding digital currencies. Given their international footprints, and experience in dealing with digital currencies being piloted in other countries, they feel they could make a valuable contribution to the work being undertaken in China.

INSURANCE

3.1 BARRIERS TO PROVIDING ONLINE INSURANCE PRODUCTS

The industry welcomed the issuance of new rules in 2020 permitting internet insurance providers to forgo a local presence for each client,[33] however the ability for an insurance company to have an online service offering is subject to strict solvency and asset requirements. These, again, appear to favour larger insurers, and the reality

28 'Offshore Investments in Chinese Govt Bonds Slowed in 2021 on Diverging Policy', Reuters, January 2022.

29 'Investing in China's Interbank Bond Market: A Handbook', NAFMII and ICMA, September 2021.

30 'Investing in China's Interbank Bond Market: A Handbook', NAFMII and ICMA, September 2021.

31 'PBC's Viewpoint on Pilots of e-CNY: 260 Million Personal Wallets Have Been Opened with a Turnover of over RMB87.5 Billion', The Paper, January 2022.

32 'China to Pilot Digital Yuan in More Cities', State Council, March 2022.

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

is that currently very few companies can meet these requirements, which generally excludes small-medium enterprises from the market.

Increased digitalisation, the COVID-19 outbreak, and increasing demand for different product offerings highlights the need for flexibility so as to enable the insurance sector to develop, transform and utilise technology to increase their service offerings and react to customer needs. British businesses are eager to be able to increase their service offering within the Chinese mainland, and this would be best facilitated by the removal of indirect barriers to entry as an online insurance provider. This could be achieved by removing nominal asset and solvency thresholds and replacing them with ratios which can be applied to companies of any size, thereby levelling the playing field, encouraging competition and allowing small-medium enterprises to enter the market.

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 physical branch in every locality in which they have clients if they possess a national licence. The process for obtaining approval for each branch is also difficult and has significant capital requirements. This prevents insurance providers from being able to reinvest revenue in improving products and service offerings. Members would welcome the further relaxing of requirements so that more domestic and foreign insurance companies alike are able to better service the market.

ASSET MANAGEMENT

4.1 UNCERTAINTY ON THE SCOPE OF QFI

Businesses welcomed the consolidation of the QFII and RQFII schemes into the QFI mechanism, and in particular opening up the ability for QFIs to trade commodity futures, commodity options and stock index options, provided these are listed and traded on futures trading venues approved by the State Council or CSRC.[34] Despite this, ambiguity still exists surrounding which underlying derivative markets and products a QFI can invest into.

The consolidation of the QFII and RQFII schemes is also viewed as an encouraging step towards simplifying the capital repatriation process; however, ambiguities around tax filing, the timeline for repatriation and clearance procedures mean that in practice businesses continue to face challenges throughout this process.

Members call for greater clarity, requesting that each individual exchange publish a list of the products which can be invested in, as well as provide clarification in regards to the actual implementation timeline, the taxation system on such investments and the capital repatriation process. Greater clarity would increase foreign investor confidence in investing capital in China and help alleviate the administrative uncertainty in doing so.

4.2 THE SHANGHAI LONDON STOCK CONNECT

We welcome the release of the consultation paper in December 2021 by the China Securities Regulatory Commission to expand the scope of the stock connect and in particular the proposal to allow UK companies to raise capital in the Chinese domestic market through the issuing of Chinese Depositary Receipts (CDRs).

However, there has not been the uptake hoped for by UK and Chinese companies in issuing depositary receipts following the launch of the stock connect in 2019. As of December 2021, only four Chinese companies were reported as being listed on the London Stock Exchange, whilst no UK listed firms had issued CDRs in Shanghai.[35] This may be reflective of challenges encountered by both UK and Chinese companies and should be investigated further. In particular, current CSRC securities regulations prevent LSE premium-listed issuers from being able to raise capital from the Chinese domestic market, which may impact on the attractiveness of being listed on the Shanghai Stock Exchange.

34 'Provisions on the Regulation of the Depositary Receipt Business under the Stock Connect Scheme between Domestic and Overseas Stock Exchanges', China Securities Regulatory Commission, February 2022.

35 'Shanghai-London Stock Connect to Include Germany, Switzerland', Reuters, December 2021.

KEY RECOMMENDATIONS

KEY CHALLENGE	SUB-SECTOR	RECOMMENDATION
1.1 Limitations of QDII quotas in terms of maximum allocated capital, allocation process and accessibility	**ALL**	■ Increase the maximum allocation capacity under QDII quotas. ■ Reduce lock-up periods, caps on quotas and restrictions on fund repatriation.
1.2 Difficulties with cross-border payments	**ALL**	■ Continue exploring methods to reduce fees and waiting times for cross-border payments. ■ Streamline disclosure processes and requirements for money inflows and outflows.
1.3 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. ■ Provide clearer timelines and guidance for licence applications, approvals, implementation and ongoing compliance requirement processes. ■ Ensure ongoing communication between regulatory authorities and businesses to assist in approval and application processes. ■ Allow foreign companies to participate in working groups in the financial services sector to contribute to the continuing growth and shaping of the Chinese market. ■ Continue the development of pilot programs.

KEY CHALLENGE	SUB-SECTOR	RECOMMENDATION
1.4 Difficulty in attracting foreign talent and setting up operations in China	**ALL**	▪ Formulate clearer entry/exit regulations for management of COVID-19. ▪ Implement a clearer and more streamlined process for obtaining entry approval and visas for foreign talent to enter China. ▪ Provide a framework or suggested pathway and timeline for return to normal travel.
1.5 Cybersecurity and the Personal Information Protection Law	**ALL**	▪ Clarify and provide further guidance on the various categories of personal data, with explanatory notes to supplement the legislation. ▪ Provide a narrow definition of 'important data'. ▪ Provide clear guidelines on implementation and consequences of non-compliance. ▪ Develop a streamlined approval process for data transfer to reduce wait times. ▪ Include provisions for cross-border data flows between affiliated businesses.
1.6 Fintech	**ALL**	▪ Provide further clarity on the existing regulatory framework for fintech services. ▪ Remove restrictions on foreign fintech companies entering the market.

KEY CHALLENGE	SUB-SECTOR	RECOMMENDATION
1.7 Green finance	**ALL**	▪ Unify policies to allow for ESG reporting. ▪ Collaborate with foreign businesses to ensure that the policy framework regulating green finance and ESG is in keeping with global standards. ▪ Permit foreign banks to participate in pilot programs in the development of China's green financial system, including the Carbon Emission Reduction Facility launched by the PBOC.
2.1 Continued limited access to the Chinese government bond and interbank bond markets	**BANKING**	▪ Continue to increase the number of licences granted to foreign banks to become lead underwriters of bonds. ▪ Allow foreign banks to participate in pilot programs for trading Chinese government bonds on the China Financial Futures Exchanges.
2.2 Digital currencies	**BANKING**	▪ Invite foreign banks to participate in the ongoing development of digital currency, to contribute the experience and knowledge gained from engaging in other pilot programmes around the world.
3.1 Barriers to providing online insurance products	**INSURANCE**	▪ Remove indirect barriers to market entry by replacing nominal asset and solvency thresholds and replacing them with ratios that can be applied to companies of any size.
3.2 Requirement to establish a branch in every locality in which insurers have clients	**INSURANCE**	▪ Streamline the application and approval process for foreign-invested and foreign insurance providers to obtain branch licences.

KEY CHALLENGE	SUB-SECTOR	RECOMMENDATION
4.1 Uncertainty on the scope of QFI	**ASSET MANAGEMENT**	■ Publish a list of products which can be invested in on each individual exchange. ■ Provide greater clarity in regards to taxation on such investments. ■ Provide greater clarity on the capital repatriation process.
4.2 The Shanghai-London Stock Connect	**ASSET MANAGEMENT**	■ Allow LSE premium-listed issuers to raise capital from the Chinese domestic market, thereby increasing the attractiveness of the Shanghai Stock Exchange and encouraging uptake of the program.

KEY MUTUAL OPPORTUNITIES

HAINAN FREE TRADE PORT

Hainan, and the opportunity for it to become one of the next major business hubs, remains of interest to foreign financial service providers, particularly in the private equity industry. XXinhua reported that total foreign investment into Hainan was up 16.2% Y-o-Y, amounting to GBP 2.6 billion (RMB 22.3 billion) in 2021.36 The number of foreign-invested enterprises established in Hainan also skyrocketed, increasing 92.6% Y-o-Y, with a total of 1,936 enterprises being established in 2021.[36] The region has considerable potential, and its attractiveness to foreign players and foreign talent in the financial services market could be furthered by the introduction and implementation of tax structures which benefit FIIs, other FDI incentives, further information on development plans and policy frameworks, and continued and increased development of infrastructure in the area.

THE GUANGDONG–HONG KONG–MACAO GREATER BAY AREA

The Greater Bay Area (GBA) continues to establish itself as a potential financial hub, contributing approximately 11% of China's economy despite occupying less than 1% of China's land mass.[37] The GBA has a combined GDP of GBP 1.2 trillion (RMB 10.2 trillion), and accounts for over one-fifth of China's high-net-worth households.[38] Shenzhen and Guangzhou were respectively the third and fourth richest cities in the Chinese mainland in 2021,[39] while Hong Kong remains a key centre for finance, commerce and trade with regional headquarters of over 1,400 multinational enterprises.[40]

The GBA Wealth Management Connect (WMC), launched in October, enables residents in Hong Kong, Macao, Shenzhen, Guangzhou and seven other pilot cities in Guangdong province to make cross-border investments in

36 'Foreign Capital Surging in Hainan Free Trade Port', State Council, February 2022.

37 'Greater Bay Area in China - Statistics & Facts', Statista, August 2021.

38 'China launches Wealth Management Connect for GBA', China Business Law Journal, December 2021.

39 'Top 10 Chinese cities by GDP in 2021', China Daily, March 2022.

40 'Foreign-Affiliated Companies in Hong Kong', Census and Statistics Department, The Government of the Hong Kong Special Administrative Region', April 2022.

RMB-denominated wealth management products issued by participating banks. The GBA, and in particular the WMC programme, presents a wealth of opportunities for the financial services industry, the development of infrastructure, and continued internalisation of the RMB, by allowing mainland investors to use RMB to directly invest in financial products in Hong Kong and Macao.

Foreign investors have an important role in the advancement of Chinese capital markets, improving liquidity and reducing volatility.[41] FII's look forward to increased openings of the WMC programme to include additional cities, introduction of further eligible wealth management products that can be traded, and reduced restrictions on promotion of eligible funds by overseas banks located in Hong Kong.

ESG

The concept of Environmental, Social and Governance (ESG), which was once a trend, has gained significant traction and is now of considerable importance to companies globally. ESG investing continues to be an area of rapid growth for China as China strives towards achieving its net zero objectives by 2060. The total assets under management of ESG public funds almost doubled in size from September 2020 to September 2021, reaching almost RMB 250 billion (GBP 30 billion).[42] The United Kingdom's ESG regulations, investment standards and disclosure requirements are well developed, and many British financial services companies already have ESG principles and products in place. As a result, Members are well placed to provide advice on how to establish and navigate such systems and standards, and can help investors and regulators alike understand the best way to align return on investment with responsible investment decisions, standardise reporting frameworks, and work towards a greener, more sustainable and socially responsible future.

41 'Sandbox to Bridge: The Role of the Greater Bay Area in Connecting China with Global Asset Management Insight Report', World Economic Forum, September 2021.

42 'China ESG Development White Paper 2021', Caixin Insight, 2021.

FOOD, BEVERAGE, RETAIL AND CONSUMER GOODS

AT A GLANCE

SUB-SECTORS

Alcoholic beverages and soft drinks

Health foods

Cosmetics

Retail and consumer goods

KEY CHALLENGES

- Challenges with implementation of GACC *Order 248*
- Coordination and harmonisation of regulations and Guobiao (GB) standards
- Animal testing requirements for certain cosmetic products

KEY RECOMMENDATIONS

- Extend the grace period for companies to complete the overseas registration process, allow companies to vary legal representative and other information unrelated to food safety without re-registration, and clarify by issuing public notice that labelling requirements do not apply to products sold in the Hainan FTP
- Harmonise food labelling requirements, and coordinate the implementation of different regulations and GB standards
- Amend the *Safety and Technical Standards for Cosmetics (2015)* and the *Standards of Cosmetics Registration, Filing and Inspection* to remove requirements for animal testing

KEY MUTUAL OPPORTUNITIES

- Customer confidence in British products
- China's focus on consumption

STATE OF SECTOR

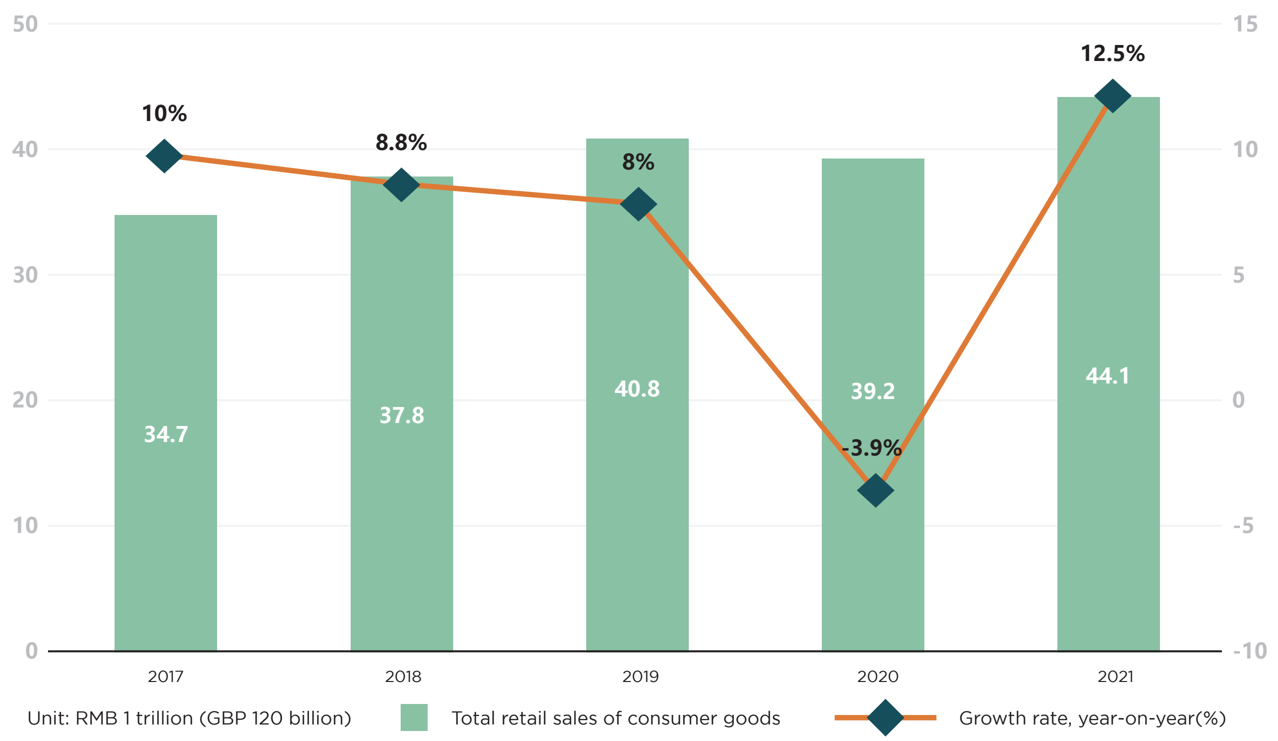
FOOD AND BEVERAGE

The food and beverage (F&B) sector performed strongly in 2021, recording profits of GBP 74.36 billion (RMB 618.7 billion), representing a Y-o-Y growth of 5.5%. In particular, producers of alcoholic and non-alcoholic beverages recorded extremely strong profit growth of 24.1% year-on-year, reaching GBP 31.77 billion (RMB 264.3 billion).[1] This correlates with strong performance in the catering sector, which recovered from 2020's slump with growth of 18.6%, to reach total revenues of GBP 563.7 billion (RMB 4.69 trillion).[2]

UK F&B export data paints a similar picture: of the UK's top 10 export destinations, only two (China and France) recorded an increase in export values over the period 2019-2021. While sales of pork, the UK's top export to China, fell by 14.3% year-on-year in 2021, exports of whisky and salmon surged by 84% and 194.3% respectively, bringing total exports to GBP 802.8 million (RMB 6.7 billion), 2.9% higher than in 2019. Strong growth in UK exports in this sector to China are reflected in the fact that UK's F&B trade deficit with China narrowed to less than GBP 18 million (RMB 149.8 million) in 2021.[3] The British chambers of commerce in China's *Sentiment Survey* conducted in November 2021 suggests that businesses are similarly confident in market growth – 58% of respondents in the F&B sector reported that they were "optimistic" about the business outlook in the sector for the next year, compared to only 12% who were pessimistic. A majority of respondents (54%) also reported that they would increase their investment in China over the next year.[4]

Total Retail Sales of Consumer Goods and Growth Rates, 2017-2021

Source: Statistical Communiqué of the People's Republic of China on the 2021 National Economic and Social Development



1 'Benefits of Food Industry During January-December 2021', Ministry of Industry and Information Technology, March 2022.

2 'Total Retail Sales of Consumer Goods in 2021 Grows by 12.5%', National Bureau of Statistics, January 2022.

3 '2021 Trade Snapshot', Food and Drink Federation, March 2022.

4 'British Business in China: Sentiment Survey 2021/22', British Chamber of Commerce in China, December 2021.

From the regulatory perspective, new regulations (*Regulations on the Registration and Administration of Overseas Manufacturers of Imported Food,* a.k.a. *Order 248,* and *Measures for the Administration of Import and Export Food Safety,* a.k.a. *Order 249)* announced by General Administration of Customs of the People's Republic of China (GACC) in March 2021, have had significant impacts on foreign companies in the sector.[5] Although the new regulatory requirements aim to improve food safety, businesses have struggled with the relatively short time period given for compliance, especially due to the continued effects of COVID-19 on the response times of foreign competent authorities.

IP issues and counterfeiting remain areas of concern for businesses in the F&B sector, being a long-term issue for foreign businesses. The State Administration for Market Regulation (SAMR) announced that it would solicit feedback on a proposed amendment to the *E-Commerce Law* in late August 2021[6], increasing penalties for e-commerce platforms who fail to respond quickly to credible reports of counterfeiting. The draft law adds new penalties which may be imposed in serious circumstances where platforms fail to tackle copyright infringement, including restriction of business operations or revocation of operating licenses. However, as of May 2022 this amendment has not been promulgated.

RETAIL AND CONSUMER GOODS

In 2021, total retail sales of consumer products in the Chinese market reached GBP 5.3 trillion (RMB 44.1 trillion), a 12.5% increase Y-o-Y, and a 3.9% average growth rate over the last two years. Of that figure, sales of non-automotive consumer products made up GBP 4.8 trillion (RMB 39.7 trillion) (90%), up 12.9% Y-o-Y. Without adjusting for price changes, overall retail sales of consumer products increased by 10.7% Y-o-Y in real terms. Final consumption spending increased its contribution to economic growth by 5.3 percentage points, to 65.4%. National online retail sales of GBP 1.6 trillion (RMB 13.1 trillion) were recorded in 2021, an increase of 14.1% Y-o-Y.[7]

5 'Regulations on the Registration and Administration of Overseas Manufacturers of Imported Food (GACC Order 248) ', General Administration of Customs China, April 2021.

6 'Announcement of the State Administration for Market Regulation on Soliciting Comments on the Decision on Amending the E-Commerce Law of the People's Republic of China (Draft for Solicitation of Comments) ', State Administration for Market Regulation, July 2021.

7 'Total Retail Sales of Consumer Goods in 2021 Grows by 12.5%', National Bureau of Statistics, January 2022.

Due to the ongoing effects of the COVID-19 pandemic, the Chinese economy's digital transition continued to gather pace. Mergers and acquisitions were the primary method through which firms expanded their retail operations. The new retail model – a technology and big data-driven paradigm that facilitates the merging of online and offline retail omnichannels – has progressively gained traction as e-commerce and cutting-edge technology reshape the retail business model. This new retail paradigm integrates both online and offline retail (O2O), eroding the distinction between conventional and online shopping through technical advancements.

China has also increased its support for cross-border e-commerce growth in recent years. 27 new cities were added to the list of cross-border e-commerce pilot zones in February 2022, bringing the total to 132.[8] The retail market has also seen significant liberalisation over the last two years, with formerly restricted industries such as e-commerce, petrol stations, and pharmaceutical retailing now open to foreign businesses on a trial basis.[9] According to China's five-year plan for 2021-25, the government will focus on supporting household consumption through expanded welfare provision, among other initiatives. The 'common prosperity' drive announced in 2021 will aim to increase the size of the middle class, which will boost consumption in the long term[10], although foreign investors in other sectors are also concerned about the regulatory upheaval that was associated with common prosperity. Macroeconomic constraints such as a shortage of liquidity, upward pressure on pricing, and institutional concerns continue to constrain the growth of China's retail sector. RMB depreciation has also impacted the retail industry, particularly multinational corporations with extensive operations in China.[11] China's adherence to a 'zero-COVID' strategy will continue to lead cities to impose mobility restrictions in response to local outbreaks, which will hold back offline retail and consumption in 2022. In addition to economic pressures and public health challenges, political risks remain high for foreign firms, especially the threat of consumer boycotts. Any deterioration in international relationships will cause considerable uncertainty among UK businesses in retail.

8 'Official Reply of the State Council on Approving the Establishment of Integrated Pilot Zones for Cross-Border E-Commerce in 27 Cities and Regions Including Ordos (G. H. [2022] No. 8)', State Council, February 2022.

9 'EMIS Insights China Consumer Goods and Retail Research Report (2021 Q2)', EMIS Insights, 2021.

10 'Industry Report: Consumer goods and retail 1st Quarter 2022', The Economist Intelligence Unit, 2022.

11 'EMIS Insights China Consumer Goods and Retail Research Report (2021 Q2)', EMIS Insights, 2021.

KEY CHALLENGES

FOOD AND BEVERAGE

1.1 CHALLENGES IN IMPLEMENTATION OF GACC ORDER 248

Regulations on the Registration and Administration of Overseas Manufacturers of Imported Food (GACC Order 248) was promulgated in April 2021 and came into effect on 1 January, 2022. This regulation requires most producers of food products for import to complete 'foreign producer registration', and producers of 18 specified groups of products must be recommended for registration by competent authorities in their country. As completing the registration process for these 18 groups of products requires working with both the Chinese and foreign governments, and given that many overseas governments do not have prior experience with similar registration processes, we hope the Chinese competent authorities can communicate with foreign authorities thoroughly on this matter, and allow companies sufficient lead time for compliance whilst also providing clear guidance.

A further issue identified by members was Article 19 of *Order 248*, which requires that when changing production site, legal representative, or registration number in the country/region where the manufacturer is located, the overseas manufacturer must re-apply for registration with GACC, and the original Chinese registration number will automatically become invalid. This requirement poses a number of challenges. Firstly, the legal representative of a MNC is normally a senior staff member of that company, including its country CEO. Some companies noted that their country CEOs are regularly rotated between different regions within the group. Therefore, requiring a new registration every time a legal representative is changed seems disproportionate, considering that the rotation of senior staff has no impact on food safety, and could impose significant administrative burdens on companies. In addition, businesses are unclear on what should be done in cases where production is temporarily shifted to other sites, for example due to accidents, natural disasters, or other disruptions. It is hoped that more flexibility can be allowed when a company needs to make such changes, and that they will not need to reapply for registration with GACC every time these circumstances arise.

Businesses also report a lack of clarity around whether the new requirement on overseas manufacturer registration also applies to products sold in the Hainan Free Trade Port (FTP). It is hoped that the Hainan FTP is excluded from the scope of these regulations as it is outside of the Chinese mainland customs area, and that this matter can be clarified through an official statement on the applicability of these regulations in the Hainan FTP.

1.2 COORDINATION AND HARMONISATION OF REGULATIONS AND GUOBIAO STANDARDS

The regulatory authorities have carried out industry research and public consultation on the revision of GB7718 (*National Food Safety Standard – General Rules on Prepackaged Food Labelling*), GB28050 (*National Food Safety Standard – General Rules on Nutrition Labelling of Prepackaged Food*), and *Administrative Measures for Food Labelling (Draft for Comments)* during 2019-2021. However, there are inconsistencies in the detailed requirements, transition periods, implementation time, and so on. In order to reduce the frequency of label change and thus avoid unnecessary waste, we hope that different regulatory authorities can work together to eliminate these inconsistencies before the official release of the new regulations and standards.

1.3 DIFFERENTIAL TREATMENT OF DOMESTIC AND IMPORTED HEALTH FOODS WITH IDENTICAL INGREDIENTS

In accordance with Article 76 of the *Food Safety Law*, and Articles 9 and 45 of the *Provisions for the Registration and Recording of Health Foods*, the following health foods shall be registered with the government departments governing food and drugs under the State Council: health foods that use raw materials other than those included in the catalogue of raw materials for health foods; and health foods being imported for the first time. However, health foods which are being imported for the first time, and which are categorised as vitamin supplements, minerals or other nutritious substances, only need to be reported to these government departments for recording. In 2021, five raw materials, including coenzyme Q10, were newly included in the catalogue of raw materials for health foods. This is because these raw materials all have corresponding healthcare functions, and are not categorised as vitamin supplements, minerals or other nutritious substances. Therefore, products containing those five raw materials, which are being imported for the first time, shall be registered in line with the aforesaid regulatory requirements.

However, according to the *Product Dosage Forms and Technical Requirements for the Recoding of Five Raw Materials of Health Foods Including Coenzyme Q10*, for domestic producers of health foods containing any of the five newly included raw materials, only a unilateral product recording is required. It is recommended that the regulators accelerate the revision of the *Food Safety Law of the People's Republic of China*, the *Provisions for the Registration and Recording of Health Foods,* and other relevant regulations, and adopt the same management process for both health foods being imported for the first time and domestically-produced health foods, so as to meet the demands of consumers for diversified products and markets, and to facilitate fair trade.

1.4 TARIFFS ON IMPORTED WHISKY

Businesses report that the reduction of the tariffs on whisky from the most favoured nation (MFN) rate of 10% to the interim duty rate 5% has resulted in strong growth of imported whisky sales since 2017. However, British businesses hope that tariffs on whisky imports could be further reduced to 0 in the future, which would create a win-win scenario. Firstly, it would help encourage domestic whisky consumption and improve its sales, as whisky can be priced more competitively; on the other hand, it would also, through increased whisky consumption, create conditions for China's local whisky industry to develop and flourish, and meet the Chinese people's diverse demands for alcohol consumption. As the latest COVID-19 outbreaks has dealt a heavy blow to domestic consumption, further lowering tariffs for whisky would also support post-COVID-19 economic recovery along with other measures, especially the recovery of catering, bars and retail industries as well as import companies.

1.5 A LACK OF PROTECTION OF LOT CODES WHERE THEY EXIST

China has very strict regulations concerning food labelling and the protection of such labels from any tampering or damage. However, these mandatory regulations do not extend to lot codes which record 'traceability information' on beverage alcohol products. Currently these original manufacturers' lot codes are not protected by Chinese law from being tampered with.

In order to ensure that products are traceable for food security reasons, many international beverage alcohol brands normally put lot codes on their products. However, decoding often takes place to remove those codes during parallel imports. Parallel import is a practice of importing goods from a lower-priced market to a higher-priced market via a third party to capitalise on commercial margin opportunities. Decoding is used as a way of reducing a brand owner's ability to find the source of parallel imports. This brings significant commercial and reputational risk to the international brand owners as well as reduces their ability to ensure food safety and protect consumer interest when food security issues arise. Therefore, we believe that the government should strengthen protection of lot codes where they exist, including outlawing and sanctioning the tampering with/removal of original brand owners'/manufacturers' lot codes from alcohol products, making illegal the sale of items of which lot codes are removed and banning importation of products with damaged lot codes, if such lot codes exist.

1.6 CHALLENGES WITH CUSTOMS CLEARANCE PROCEDURES

Businesses continue to report significant discrepancies between ports, both in terms of interpretation of regulations and the level of service provided. For example, companies note that with the same documentation, their imported goods can clear customs easily in some ports but not in others. It is hoped that customs procedures and enforcement could be standardised to reduce difficulties and delays encountered when needing to move operations between ports and improve efficiency.

COSMETICS

A number of new pieces of legislation relating to the cosmetics industry have come into effect over the past year, including measures for supervising and administering cosmetics production and operation and those for children's cosmetics specifically, regulations relating to cosmetic registration and filing, as well as more specific technical guidelines for safety assessment and standards for efficacy claim evaluation. These new measures have had a significant impact on the industry, with some of the new requirements adding considerable compliance costs for companies in the sector.

2.1 REPORTING OF SAFETY INFORMATION OF RAW MATERIALS

Significant challenges exist in the reporting of safety information of raw materials for cosmetics. Firstly, certain raw material manufacturers have tended to be uncooperative. Many small and medium-sized manufacturers involved in supplying materials for imported products do not have a physical presence in China, therefore lacking an understanding of the requirements of the safety information form; some are also unwilling to authorise cosmetics companies to submit their safety information. Secondly, the technical requirements of the safety information form are currently very unclear. There is, as yet, no unified understanding between raw material manufacturers, or between raw material manufacturers and cosmetics companies, concerning definitions such as 'raw material components', 'impurities', and 'substances with potential safety risks' in cosmetics as stipulated in Chinese regulations. In fact, there has been substantial divergence in some cases, which can have a huge impact on the registration and recording of cosmetics companies, affecting a large number of products. On the practical level, the recording system has an automatic matching function which means if companies submit codes for the safety information of their products' raw materials, the system will match and compare the raw material information in the product formula (submitted by cosmetics enterprises) and that submitted through the platform (by raw material manufacturers). A number of companies reported that they have been required to make adjustments due to the inconsistencies of these two sources of information.

Therefore, we suggest that the government strengthens publicity and increases implementation efforts for Chinese laws and regulations among cosmetic raw material manufacturers, and adds a foreign language interface to the raw material information reporting system. The National Institutes for Food and Drug Control, in collaboration with industry experts, should formulate unified guidelines for the reporting of raw material components and impurities so that raw material manufacturers and cosmetics companies adopt the same principles for information reporting. Furthermore, we suggest that the safety information of raw materials submitted by raw materials manufacturers is not subject to review during registration and recordation processes; instead, we believe that it should be used to monitor products' risks after marketing. For products that have already been registered or recorded, if there are ways to prove that raw material manufacturers and the amount of raw materials in the products remain unchanged, those products should not be asked to re-register or re-record.

2.2 ANIMAL TESTING REQUIREMENTS FOR CERTAIN COSMETIC PRODUCTS

Since 1 May, 2021, companies can be exempted from submitting toxicological test reports, provided that the manufacturers of general cosmetics for import have obtained Good Manufacturing Practice (GMP) certificates issued by the competent authority of the country (region) where they are located, and the safety risk assessment results can fully confirm product safety. However, animal testing is still required for certain groups of general cosmetics (e.g., products with a pH value below or equal to 3.5, acne treatment rinse-off products, anti-wrinkle rinse-off products, and products for children's use), products that use new cosmetic ingredients which have not completed their three years of required monitoring, special cosmetics, and new raw materials for cosmetics.

It is suggested that the *Safety and Technical Standards for Cosmetics (2015)* and the *Standards of Cosmetics Registration, Filing and Inspection* should be amended as soon as possible, allowing the replacement of the toxicological test report with a safety assessment report for eligible general products. Moreover, as the registration system already includes a huge number of cosmetics for children and special cosmetics, as well as their toxicological test results, it is suggested that a complete safety assessment be conducted for these products, followed by a correlation analysis of the safety assessment and animal testing. On the basis of reliable results from the correlation analysis, compulsory animal testing should be gradually phased out. Another recommendation is to speed up the validation of OECD's in vitro test methods for new cosmetic ingredients, and include such methods in the *Safety and Technical Standards for Cosmetics*.

2.3 LIMITED SCOPE OF PRODUCTS ELIGIBLE FOR EQUIVALENCE EVALUATION

According to the *Standards for Cosmetic Efficacy Claim Evaluation*, which came into effect on 1 May 2021, companies are only permitted to conduct equivalence evaluation on makeup products with multiple shades, and the number of products for sampling inspection shall be no less than 20% of the total quantity of the series of products. . Furthermore, equivalence evaluation may not be conducted on products which claim efficacy for acne treatment, skin nourishment, and skin repair. According to the new regulations, companies are required to carry out efficacy tests on products with very minor differences in formula, which not only results in a significant increase in the cost of efficacy evaluation, but also puts considerable pressure on the existing limited resources for efficacy evaluation, thus leading to delays in product launch. In order to improve the efficiency of cosmetics companies and reduce unnecessary burdens, it is recommended that the permitted scope of equivalence evaluation be expanded, based on experimental validation — equivalence evaluation should be permitted for products with minor adjustments to essence, pigments, preservatives or other trace protective ingredients, as well as to products of multiple shades with efficacy claims of acne treatment, skin nourishment, and skin repair. Consistent with what is required in the existing regulations, the number of products for sampling inspection shall be no less than 20% of the total quantity of the series of products; where the total quantity is less than five, it shall be counted as five.

2.4 PERSONALISED CUSTOMISATION FOR COSMETICS

Consumer segmentation and personalised customisation have become the mainstream of global market development. In the cosmetics industry, consumers also want to choose suitable cosmetics based on their skin type and personal preferences. At present, some countries (such as France, Japan and South Korea) have formulated guidelines for the personalised customisation of cosmetics, allowing some registered companies to carry out pilot programs. However, in China each product must be registered or recorded before it enters the market, and factories manufacturing cosmetics must obtain cosmetics production licenses. These mandatory legal requirements impede the development of personalised cosmetics. It is recommended that regulations on the personalised customisation of cosmetics suitable for China's conditions should be formulated, on the basis of understanding the regulations, guidelines and practices of other countries in this area. In addition, it is suggested that enterprises with high quantitative credit ratings should be permitted to carry out pilot programs for selected product categories with relatively low safety and quality risks, in the eligible pilot zones for reform and opening up (for example, the Shanghai Free Trade Zone in Pudong District).

RETAIL AND CONSUMER GOODS

3.1 CROSS-BORDER E-COMMERCE POLICIES FOR OTC DRUGS

China is considered to have one of the strictest registration regimes for OTC drugs: it generally takes five years for a product registration to be applied for and approved. Although the *Measures for the Administration of Drug Registration*, promulgated in 2020, suggest that OTC drugs will be subject to separate registration and approval, the accompanying systems and regulations have not been officially formulated. We hope the government can accelerate the reform of the OTC drug registration system so that industry participants can gain a better understanding of the market. Meanwhile, China has also opened a cross-border e-commerce pilot for OTC drugs, which offers major benefits to enterprises and has reduced the cost of OTC drugs to Chinese consumers. It is hoped that the government will accelerate the promotion of OTC policies on cross-border e-commerce, and expand the positive list of OTC drugs for cross-border e-commerce.

3.2 THE CRITERION FOR DETERMINING JURISDICTION OVER ADVERTISEMENT CENSORSHIP

According to Article 13 of the current *Interim Measures for the Administration of Censorship of Advertisements on Drugs, Medical Devices, Dietary Supplements and Formula Foods for Special Medical Purposes,* 'the application for censorship of advertisements on drugs and formula foods for special medical purposes shall be submitted to the advertisement censorship authorities of the places where the advertisers, such as the manufacturing enterprises or import agents, are located according to law. As for medical devices and dietary supplements, such application shall be submitted to the advertisement censorship authorities of the places where the manufacturing enterprises or import agents are located according to law.' We understand that advertisers are not necessarily manufacturers or importers during actual operation, and advertising is more often carried out by other domestic business entities. As such, following the basic principle that 'the advertiser holds the primary responsibility' in the *Advertising Law*, it is hoped that the jurisdiction over advertisement censorship will be changed from 'the place of manufacturer or importer' to 'the place of advertiser'.

KEY RECOMMENDATIONS

KEY CHALLENGE	RECOMMENDATION
FOOD AND BEVERAGE	
1.1 Challenges in implementation of GACC *Order 248*	■ Extend the grace period for companies to complete the food manufacturer registration process. ■ Create processes for companies to vary legal representative or other information without being required to re-register. ■ Provide an official statement clarifying that Order 248 requirements do not apply to products sold in the Hainan FTP.
1.2 Coordination and unification of regulations and Guobiao standards	■ Harmonise food labelling requirements, coordinate the implementation times of different regulations and GB standards, in order to set up a reasonable transition period for enterprises and reduce the frequency of label change.
1.3 Differential treatment of domestic and imported health foods with identical ingredients	■ Accelerate the revision of the *Food Safety Law*, the *Provisions for the Registration and Recording of Health Foods,* and other relevant regulations, and adopt the same treatment for both health foods being imported for the first time and domestic health foods.
1.4 Continuing tariffs on imported whisky	■ Reduce tariffs on alcoholic beverages in order to encourage consumption and stimulate market development.
1.5 A lack of protection of lot codes where they exist	■ Outlaw and sanction the tampering with/ removal of original brand owners'/manufacturers' lot codes from alcohol products. ■ Make illegal the sale of abovementioned items by distributors/retailers; remove products from shelves. ■ Ban importation of products with damaged lot codes, if such lot codes exist.

KEY CHALLENGE	RECOMMENDATION
1.6 Challenges with customs clearance procedures	■ Standardise and streamline customs procedures to ensure consistent service across different ports.

COSMETICS

KEY CHALLENGE	RECOMMENDATION
2.1 Reporting of safety information of raw materials	■ Strengthen publicity and implementation efforts for Chinese laws and regulations among cosmetic raw material manufacturers, and add a foreign language interface to the raw material information reporting system. ■ The National Institutes for Food and Drug Control, in collaboration with industry experts, should formulate unified guidelines for the reporting of raw material components and impurities, so that raw material manufacturers and cosmetics companies adopt the same principles for information reporting. ■ Provide official clarification that for registered products, where there is no material change in formula ingredients, there is no need to undertake formula alteration or re-registration procedures. ■ For products that have already been registered or recorded, if there are ways to prove that raw material manufacturers and the amount of raw materials in the products remain unchanged, those products should not be asked to re-register or re-record.
2.2 Animal testing requirements for certain cosmetic products	■ Amend the *Safety and Technical Standards for Cosmetics (2015)* and the *Standards of Cosmetics Registration, Filing and Inspection* to allow the replacement of the toxicological test report with a safety assessment report for eligible general products. ■ Conduct a complete safety assessment for cosmetics for children and special cosmetics, followed by a correlation analysis of safety assessments and animal testing. Subject to the results of the correlation analysis, compulsory animal testing should be gradually phased out. ■ Speed up the validation of OECD's in vitro test methods for new cosmetic ingredients, and include them in the *Safety and Technical Standards for Cosmetics.*

KEY CHALLENGE	RECOMMENDATION
2.3 Limited scope of products eligible for equivalence evaluation	■ Enlarge the permitted scope of equivalence evaluation, and permit equivalence evaluation for products with minor adjustments to essences, pigments, preservatives or other trace protective ingredients, as well as to products of multiple shades with efficacy claims of acne treatment, skin nourishment, and skin repair. ■ For products registered before May 2021, allow companies to provide summaries according to the basis for efficacy claims in effect at the time of product development.
2.4 Personalised customisation for cosmetics	■ Formulate regulations on the personalised customisation of cosmetics. ■ Enterprises with high quantitative credit ratings should be selected to carry out pilot programs in personalised customisation, for selected product categories with relatively low safety and quality risks in eligible pilot zones.
RETAIL AND CONSUMER GOODS	
3.1 Cross-border e-commerce policies for OTC drugs	■ Accelerate the reform of the OTC drug registration system. ■ Accelerate the promotion of OTC policies on cross-border e-commerce, and expand the positive list of OTC drugs for cross-border e-commerce.
3.2 Jurisdiction over advertisement censorship	■ Change the jurisdiction over advertisement censorship from 'the place of manufacturer or importer' to 'the place of advertiser'.

KEY MUTUAL OPPORTUNITIES

BRAND BRITAIN – CUSTOMER CONFIDENCE IN BRITISH PRODUCTS

'Made in Britain' continues to enjoy a strong association with quality in the China market. A 2021 report by Barclays found that 63% of Chinese consumers had knowingly paid a premium for a British-made product in the past, compared to a global average of around one in three. 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 – as such, Chinese consumers were willing to pay a substantial average premium of 8.8% for a British-made product across the eight categories surveyed.[12] This appreciation for British culture, product quality, creativity and innovation is a critical selling-point for British goods companies.

CHINESE POLICY FOCUS ON BOOSTING CONSUMER SECTOR

As China looks to continue its transition from an export-focused economy to one in which its domestic economy plays a greater role, domestic consumption will play a greater role in China's economic growth. As domestic disposable income continues its upward trend, increasing 8.1% in real terms in 2021 to GBP 4222 (RMB 35128)[13], the market for high-quality and premium products will continue to grow, presenting an opportunity for British brands to increase brand recognition and sales. This trend looks likely to continue despite setbacks from localised COVID outbreaks.

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

13 'Nationwide per capita disposable income of residents reached 35,128 yuan in 2021', National Bureau of Statistics, January 2022.

HEALTHCARE

AT A GLANCE

SUB-SECTORS

Healthcare services

Medical technology

Pharmaceuticals

KEY CHALLENGES

- The need to continue to improve the Volume-Based Procurement (VBP) system
- Treatment of Foreign-Invested Enterprises (FIEs) in public procurement
- Lack of clarity around cross-border data transfers

KEY RECOMMENDATIONS

- Greater focus on value-based procurement in order to build a sustainable healthcare ecosystem
- Reinforce fair treatment in public procurement
- Provide further clarification around cross-border data transfer rules

KEY MUTUAL OPPORTUNITIES

- Demographic trends and healthy ageing
- Innovation as a priority

STATE OF THE SECTOR

China's healthcare industry has continued to grow in recent years with its healthcare spending expected to increase from an estimated 5.4% of GDP in 2021 to 5.7% of GDP by 2026.[1] This rise, along with an expected growth of the pharmaceutical market by 8.5% over the same period, an expected compound annual growth rate of 6.2% in the medical technology industry between 2020-2025, and increasing demand for quality healthcare, continues to offer significant opportunities for foreign companies in the market.

From a regulatory perspective, the past year has seen China continue to deepen its healthcare reform with the aim of reducing medical expenses for patients, relieving the financial stress on the national healthcare system, and accelerating innovation in pharmaceuticals and medical technology. A range of policy updates have had mixed impacts on foreign companies.

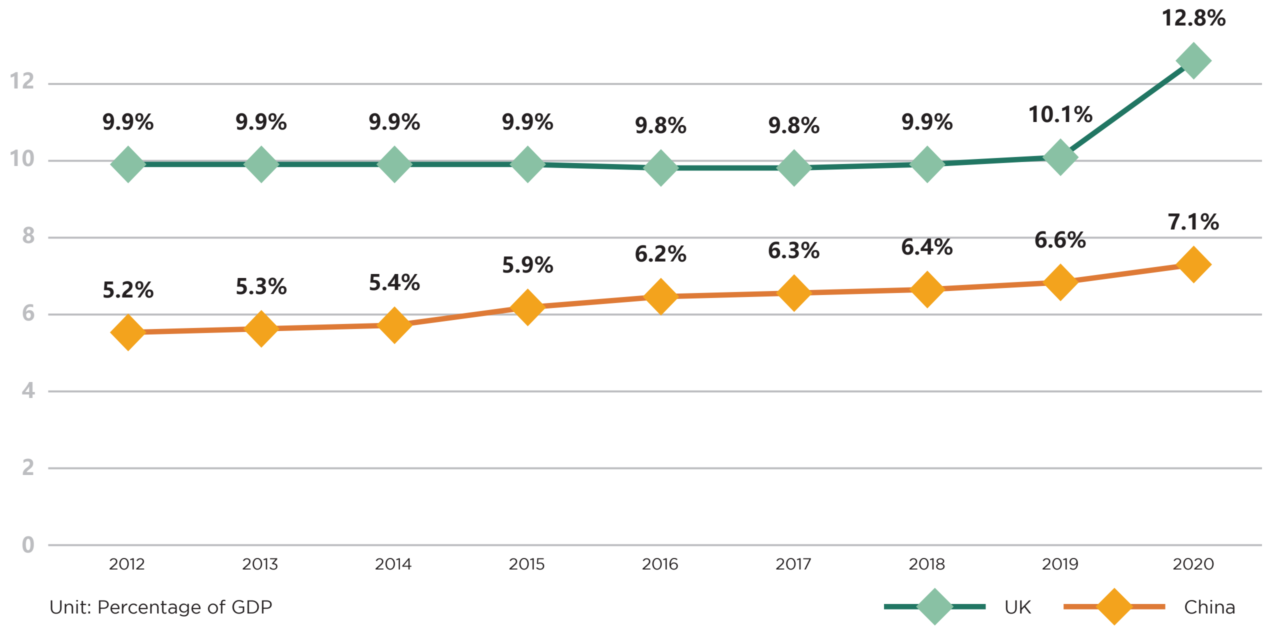
Introduced in 2018, volume-based procurement (VBP) has expanded to cover more regions, as well as a wider variety of drugs and medical consumables in the past few years. A number of policy documents, including the *Opinions on Normalising and Institutionalising VBP* in *Pharmaceuticals*[2] and *Guiding Opinions on National VBP of High-Value Medical Consumables*,[3] were released in 2021, with the goal to normalise the implementation of VBP and drive down medical costs.

Given the strong policy push, three rounds of national pharmaceutical VBP were held in 2021, leading to price cuts of 52%, 56% and 48%, respectively on 112 products, representing GBP 19.2 billion (RMB 160 billion) of spend at patient prices. The VBP for artificial hip and knee joints became the second nation-wide tender for medical consumables and delivered an average patient-price reduction of 82%.

The dramatic price cuts have so far caused significant pricing pressure on pharmaceutical and medical consumable multinationals, although the impact has not been even across the board. The system, however, has also prompted many companies to shift their focus towards more innovative products as price-based competition in the generic drugs

China and UK Healthcare Expenditure as a Percentage of GDP

Source: Statista, Office for National Statistics



1 'Industry Report: Healthcare, China', Economist Intelligence Unit, Q1 2022

2 'Opinions on Normalising and Institutionalising VBP in Pharmaceuticals', General Office of the State Council, January 2021.

3 'Guiding Opinions on National VBP of High-Value Medical Consumables', National Healthcare Security Administration, June 2021.

and less innovative categories of medical consumables markets becomes increasingly fierce and profitability drops.

Meanwhile, China's government has also instituted a range of other measures aimed at containing rising medical spending over recent years. Since 2017, the Chinese government has been conducting negotiations on the entry into the National Reimbursement Drugs List (NRDL), which enables innovative drugs with high clinical value to be reimbursed by the national health insurance scheme. In 2021, 74 new drugs were admitted into the NDRL through negotiation, with an average cut to listed prices of 62%. Rare disease and cancer drugs were notably favoured in the process as part of the efforts to address the growing challenges of treating these diseases in China.[4] Meanwhile, the government released a second draft on administration measures on the payment system of medical consumables covered by national basic insurance, aiming to soon adopt a national reimbursement list for medical consumables as well.[5]

Another policy priority of the ongoing healthcare reform concerns the DRG/DIP payment method. In 2021, a three-year action plan on DRG/DIP was kicked off in order to reduce incentives for over-prescription in public hospitals.[6] While the goal was to contain medical costs for both patients and the national health insurance fund, and to improve efficiency, some worry it might incentivise hospitals to choose cheaper medical solutions for patients at the expense of quality. Like the VBP system, the reform is expected to have profound impacts on domestic and foreign suppliers alike.

Innovation is another key word in China's government's healthcare policy-making vocabulary in recent years. The priority review mechanism, introduced in 2015 to shorten timelines for innovative drugs to be marketed, resulted in over 30 fast-track market authorisations for new drugs in 2021. Foreign companies have also benefited from the process, as the 2021 list included a large proportion of Western-developed rare disease drugs.[7] Furthermore, measures have also been introduced to accelerate the development of the healthcare industry in certain pilot zones, such as Bo'ao Lecheng International Medical Tourism Pilot Zone in Hainan province, where clinical real-world data is allowed to be used when registering imported medical products that can then be sold nationally.

The *Patent Law* that came into effect in May 2021 also improves the innovation landscape as it introduces patent term extension, adjustment, and patent linkage systems which strengthen and extend the term of protections for pharmaceutical patent proprietors.

A few other developments in the industry are equally worth watching. With an ageing population and growing affluence in the country, China's private hospital market has experienced rapid growth in the past decade. More than 65% of the hospitals in China are now private (though it should be noted that 85% of inpatient care is still provided for by public hospitals). This has created opportunities for foreign medical service providers that have been providing high-quality services to Chinese patients, although there are still impediments on their ability to realise their full potential due to certain market access barriers, such as a 70% limit on foreign shareholding.[8]

With the tightening of China's data privacy regulations and the proliferation of digital hospitals and health technologies in recent years, market participants have been strengthening the protection of consumers' data, including healthcare data. The lack of clarity around cross-border data transfers, however, is increasing operational burdens on companies. The *Biosecurity Law*, which took effect in 2021, and a number of regulations related to Human Materials Administration, released by the State Council and the Ministry of Science and Technology (MOST) in recent times, establish stringent requirements for foreign entities who seek to be included in research involving human genetic materials in China. This has prompted some foreign firms to delay or cancel research projects in light of the lengthy application and approval process for such projects, with negative consequences for the pace of and investment in innovation.

Overall, regulatory reforms have continued unabated in China's healthcare industry over the past year, with mixed effects on foreign pharmaceutical and medical technology companies. While certain policies, such as VBP, still raise concerns among market participants as to the value and quality of products and sustainability of business, other trends, such as China's innovation drive, a growing ageing population and increasing demand for quality healthcare, still offer reasons for optimism for foreign investors.

4 'China's 2021 NDRL Listing Sees Price Cuts of up to 95%', The Pharma Letter, June 2021.

5 'Draft Interim Measures for the Administration of Payment System of Medical Consumables Covered by National Basic Insurance,' National Healthcare Security Administration, November 2021.

6 'Official Launch of the Three-Year Action Plan on the Reform of the DRG/DIP Payment Method by the National Healthcare Security Administration', Xinhua News Agency, December 2021.

7 'Over 30 New Drugs Enter into the Market Through the Priority Review Mechanism, and Antineoplastic Drugs Remain the Main Line of Domestic Innovation in 2021', www.jksb.com.cn, December 2021.

8 'What lies ahead for healthcare in China: Perspectives from a hospital CEO', Hospital Management Asia, July 2021.

KEY CHALLENGES

1 THE NEED TO CONTINUE TO IMPROVE THE VBP SYSTEM

Although the VBP system has significantly driven down medical costs for both patients and the government, the drastic price cuts experienced so far – in particular prior to 2021 – have led to concerns about the potential impact on the quality of drugs and medical devices going forward. With the implementation of the latest round of VBP for insulin and orthopaedic devices, the government has improved certain rules; price is no longer the only metric (although still a key deciding factor) in determining a winning bid. British businesses appreciate these improvements, but encourage the government to continue to refine the system and adopt a more value-based approach. UK medical devices companies, in particular, note that the system presents a major challenge: once selected as suppliers, foreign medical devices companies are also required to provide on-site support in clinical operations, including for surgical instruments to facilitate operations, the costs of which are not currently reflected in VBP.

Notably, both Europe and the UK have been putting more focus on value-based procurement, where consideration during procurement is not solely dependent on price, but also covers overall costs over the product life cycle, product quality, and effectiveness.[9] IIn fact, low-value healthcare, regardless of its costs, lead to a waste of resources and reduction in efficiency over the long run. A 2017 OECD report, for example, found that patients who visited worst performing hospitals in Germany are 18 times more likely to go through re-operation following hip replacement surgery than those who visited the best ones.[10] A UK National Health Service (NHS) research project also studied ways of achieving value-based procurement and found that clinical engagement is essential, where clinicians are consulted during the procurement process to better understand patient outcomes and areas for improvement. While British businesses understand that China's VBP was driven by concerns around the country's surging medical costs, in order to ensure that the industry grows sustainably and patients benefit from quality services, it is vital to factor in the quality of the product and consult key stakeholders in the procurement process as well.

2 TREATMENT OF FOREIGN-INVESTED ENTERPRISES (FIES) IN PUBLIC PROCUREMENT

2.1 DOCUMENT 551 AND PROCUREMENT OF MEDICAL EQUIPMENT

The *Administrative Measures for the Government Procurement of Import Products* (hereinafter *Document 551*), issued by the Ministry of Finance (MOF) and Ministry of Industry and Information Technology) in May 2021, raised serious concerns among FIEs, as the document sets mandatory quotas for the government to procure domestic products, including 178 types of medical equipment. This has led to significant barriers for foreign companies in government procurement, which represents approximately 80% of total demand via the publicly owned and operated hospitals. While the MOF released another notice in October 2021 requiring localities to grant equal treatment to 'domestically produced' products regardless of whether they are manufactured by foreign-owned or local companies, companies were unsure of how 'domestically produced' should be defined. The reality of global value chains means that many products assembled in China can have their parts imported from elsewhere. Some companies also reported that the interpretation of this requirement can vary across different localities. British business therefore hope that the government will offer more clarity on the definition of 'domestically produced products' or 'domestic goods' in order to ensure transparency and standardised enforcement in public procurement. This definition should also give recognition to the efficiency, quality and innovation that can be delivered via global supply chains.

9 'How Procurement Unlocks Value-Based Health Care', Boston Consulting Group (BCG), January 2020.

10 'How Procurement Unlocks Value-Based Health Care', Boston Consulting Group (BCG), January 2020.

2.2 PROCUREMENT OF MEDICAL SERVICES IN PUBLIC HOSPITALS

British companies providing healthcare services in China's market note difficulty in having their services procured by public hospitals. For example, some companies mentioned that although public hospitals were interested in procuring their services, the MOF's procurement rules required foreign companies to enter joint ventures with Chinese partners before procurement agreements could be entered into. The difficulty in convincing these companies' headquarters to set up JVs in order to provide their services has led them to give up such opportunities. British businesses hope that the government's pledge to grant domestic and foreign firms equal treatment is rigorously implemented. British healthcare service providers have strength and expertise in providing a wide range of medical care that would be complementary to China's own experiences. Allowing them to realise their full potential in the market would not only elevate the quality of China's healthcare services, but also benefit Chinese customers, providing them with a wider selection of quality health services.

3 LACK OF CLARITY AROUND CROSS-BORDER DATA TRANSFERS

As China tightens rules around cross-border data transfers with the enactment of the *Data Security Law* and *Personal Information Protection Law* in 2021, foreign companies in China are increasingly investing in their IT infrastructure to ensure data processing activities comply with the latest regulations. However, many in the healthcare services and medtech sectors find that a major challenge lies in understanding the practicalities of conducting these cross-border data transfers, including what data can be sent overseas and the assessment procedures for such transfers.

While there is currently a mechanism for sending human genetic data overseas, albeit involving burdensome requirements, such clarity does not extend to most other types of data. This is worrisome as healthcare services and medtech multinationals are often in a position of having to access patients' data from outside China in order to deliver patient care and conduct treatment, with some of their healthcare professionals based overseas. The lack of clarity around accessing, or in some cases the outright inability to access, patients' data in China significantly impacts firms' ability to respond to emergencies and poses risks to patients' health. It also prevents overseas-based R&D centres of these healthcare product developers from gaining critical insights into data in China, which is essential to improving their products to meet Chinese patients' needs.

4 IMMATURE PRIVATE MEDICAL INSURANCE MARKET

Although the National Health Security Administration (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. Meanwhile, despite the success of measures such as VBP and DRG/DIP in cutting medical expenses, the current cost containment strategy still faces limits in increasing patients' access to quality drugs and other medical technologies.

In order to overcome this challenge, China would need to further develop its private medical insurance (PMI) market to supplement the support that public healthcare insurance provides to patients. Although growing rapidly, China's PMI market is still at an early stage of development compared to developed countries. The country's PMI density only reached around GBP 60 (RMB 500) per capita in 2019, while the figures for countries such as Japan and Germany were GBP 360-480 (RMB 3,000-4,000).[11] The percentage of PMI payout as a percentage of the country's healthcare spending was 4% in 2020, compared to over 10% for Germany and France. Increasing the coverage and density of PMI would expand channels of payments for China's patients, increase their ability to access high-quality drugs and medical devices, and improve the overall quality of medical care. We understand this is included in the Chinese government's goals as well, with aims to improve the multi-layered medical insurance system. In 2020, 13 government ministries published opinions on developing China's commercial insurance in the area of social services with a goal of increasing the size of China's commercial medical insurance market to over GBP 24 million (RMB 200 million). We hope that the government accelerates efforts to achieve this goal and allows payers, medical services providers, as well as pharmaceutical and medtech companies to all play a role in contributing to improved innovation in China's healthcare industry.

5 IP PROTECTION IN THE PHARMACEUTICAL INDUSTRY

China's fourth amendment of the *Patent Law* strengthens IP protection and has positive implications for originator drugs companies in the country. Article 42 introduces a patent extension system where the term of a patent can be extended for up to five years to compensate for the time taken for drugs to obtain market authorisation. While this is a welcome development, the article only

11 'China's Healthcare Insurance Innovation Report (2021)', Yiou Think Tank, February 2021.

applies to drugs that enter the market after 1 June 2021. British pharmaceutical companies thus hope this rule can be retrospective to include new drugs marketed before 31 May 2021 as well. We believe that due to the costly and time-consuming nature of drug development, it is important that the government give full recognition to the resources and investment that have gone into the R&D process of creating innovative drugs – this stands true for new drugs marketed both before and after 31 May 2021. Allowing the former to benefit from the latest policy change will further demonstrate China's commitment to encouraging innovation in the pharmaceutical market and is also consistent with the principle of 'retrospective operation of beneficial provisions' in Chinese law.

6 MARKET ACCESS BARRIERS AND PROFESSIONAL QUALIFICATIONS

With the growth of China's economy, the country's middle class is increasingly seeking a broader range of quality health services. Relaxing market entry rules for foreign market participants, such as expanding the provision of healthcare services to outside clinics and hospitals, and allowing more UK healthcare service providers to enter and thrive in the market, will provide a more complete and competitive range of care options for China's consumers.

Meanwhile, as the Chinese population becomes increasingly health-conscious, both in terms of physical and mental health, exploring ways to facilitate the registration of overseas professionals in providing mental health therapy and nutrition counselling to the country will bring more international expertise and capacity into the industry and help meet the increasing demand in China. Currently, a lack of a regulatory framework to support the licensing of overseas therapists, counsellors and nutritionists in China has made it difficult for China's patients and healthcare institutions to tap into the deep global pools of experience that exist in these areas.

7 REGISTRATION AND ADMINISTRATION OF FOREIGN HEALTH PROFESSIONALS

BritCham members also note that the registration and administration requirements of foreign health professionals in China have been rather troublesome to manage, and hope that the government streamline the processes to facilitate their practice in China. For example, the current registration of foreign doctors at different medical sites requires considerably more documentation and administrative steps compared to that of their Chinese counterparts. Foreign hospitals hope to see more standardised processes for allowing foreign doctors to practise at multiple medical sites going forward. This will benefit patients greatly as it increases the sharing of medical resources between hospitals which gives patients a wider range of options. Other requirements such as the short-term licence of foreign doctors being valid for only one year, foreign health professionals' inability to register on China's social security site with their passport numbers, as well as the lack of a foreign-language interface for tax administration services, also creates challenges for foreign health professionals' work and life in China, and reduces China's attractiveness for them to work in for the long term.

8 EVALUATION AND APPROVAL OF PAEDIATRIC MEDICATION

China has successively introduced a number of effective policies and measures in recent years to encourage the R&D and innovation of paediatric drugs, accelerate their registration, evaluation and approval, as well as support the development of new varieties of paediatric drugs, with the goal of ensuring the accessibility of these drugs for paediatric patients.

For drugs already approved overseas, with a definite curative effect for the treatment of rare diseases (including internationally recognised rare diseases that have not been included in the first batch of the rare diseases catalogue) and tumours in children, especially those which are the first and only therapeutic drugs for those diseases, we suggest that the National Medical Products Administration (NMPA) give priority to their evaluation and approval process, make full use of overseas clinical data, and accelerate the approval process for their marketing by either exempting them from full clinical trials, or by conducting clinical trials on a smaller number of samples. This would enable more Chinese paediatric patients to receive treatment during the most critical treatment period.

For drugs already approved for marketing overseas, with a definite curative effect for the treatment of extremely rare diseases in children (especially those which are the first and only available therapeutic drugs for those diseases), and which do not have racial differences in efficacy, we suggest that the NMPA exempt them from clinical trials in order to reduce the time needed for marketing. In addition, keeping post-market requirements as low as possible would reduce the concerns of enterprises over drug R&D, and greatly benefit paediatric patients with extremely rare diseases in China.

KEY RECOMMENDATIONS

KEY RECOMMENDATION	
1 A greater focus on value-based procurement in order to build a sustainable healthcare ecosystem	■ Consult key stakeholders both domestic and foreign during hospital procurement processes. ■ Factor in the quality and life cycle of a product, not just the price in hospital procurement.
2 Improve fair treatment of foreign and domestic companies in public procurement of medical equipment and services	■ Clarify the definition of 'domestic goods', giving due consideration to the efficiency, quality and innovation of global supply chains. ■ Drop the requirement for foreign healthcare services providers to enter joint ventures with Chinese partners in order to deliver services in public hospitals.
3 Address the lack of clarity around cross-border data transfers	■ Provide implementation details around cross-border data transfers, including more clarity over important data. ■ Support foreign firms in accessing data across borders and in China for R&D purposes.
4 Expand the private medical insurance market (PMI) to increase patients' access to quality healthcare	■ Increase the coverage and density of PMI in order to increase patients' access to high-quality drugs and medical devices and improve their quality of medical care.

KEY RECOMMENDATION

5	**Further strengthen IP protection in the pharmaceutical industry**	- Expand the patent extension system to drugs that received approval before 31 May 2021 in order to better protect IP.
6	**Address market access barriers and licensing of professional qualifications**	- Relax market entry rules for foreign market participants, such as expanding the provision of healthcare services to outside clinics and hospitals. - Build a regulatory framework to support the licensing of overseas therapists, counsellors and nutritionists in China.
7	**Streamline registration and administration of foreign health professionals**	- Produce more standardised processes for allowing foreign doctors to practice at multiple medical sites, and streamline registration and administration of foreign health professionals more generally.
8	**Accelerate the evaluation and approval of paediatric drugs for rare diseases and tumours**	- Give priority to the evaluation and approval process of drugs already approved overseas with a definite curative effect for the treatment of rare diseases and tumours in children. - Accelerate the approval process for the marketing of such drugs by either exempting them from the requirement for full clinical trials, or by conducting clinical trials on a small number of samples.

KEY MUTUAL OPPORTUNITIES

SCI-TECH COOPERATION ON VACCINES AND THERAPEUTIC DRUGS

The emergence of new highly-infectious and complex variants has brought new challenges to pandemic prevention and control. Practical and effective sci-tech cooperation, on both vaccines and therapeutic drugs, is key to addressing the COVID-19 pandemic. In addition to the expansion of vaccination coverage, more protective measures are needed for the elderly population, as well as those with underlying diseases and weakened immune systems (such as leukaemia patients, organ transplant patients and patients undergoing dialysis).

Therefore, we hope that international sci-tech cooperation will continued to be strengthened in this context and new solutions explored, including COVID-19 vaccines, neutralising antibodies, small molecule drugs and other multi-pronged approaches, in order to effectively control the spread of COVID-19, improve the cure rate, and reduce death rates. All sectors of society and industry should work together to jointly implement the consensus on vaccines as global public goods, help improve the accessibility and affordability of vaccines in developing countries, and promote the production, supply and equitable distribution of COVID-19 vaccines, neutralising antibodies and COVID-19 therapeutic drugs across the globe, thereby contributing to global pandemic prevention and control.

DEMOGRAPHIC TRENDS AND HEALTHY AGEING

China's population has been ageing rapidly. According to the country's national census released in 2021, the number of people aged 60 or older has reached 260 million, representing 18.7% of China's total population and an increase of 5.4% from 2010.[12] This has created growing demand for higher quality healthcare for the elderly population. A national strategy to proactively respond to this demographic challenge, as mentioned in China's 14th Five-Year Plan,[13] will lead to enormous opportunities for companies to facilitate healthy ageing. For example, there has been growing interest in adult vaccination programmes due to the increasing awareness of disease prevention and healthy ageing. 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. British businesses also hope there will be continued improvement of vaccination infrastructure for adults which will form the basis for further rollout of adult vaccinations.

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 capability of UK firms in genomics research is particularly noteworthy, and UK firms have used genomics in clinical care for rare diseases and some cancers.[14] There is considerable scope for the two countries to deepen exchanges and cooperation in innovative drugs and therapeutics in treating rare diseases that will be mutually beneficial for both countries.

12 'The Population Aging Process Speeds up Obviously, Bringing Both Challenges and Opportunities', the State Council Information Office, May 2021.

13 'Outline of the People's Republic of China for the 14th Five-Year Plan for National Economic and Social Development and Long-Range Objectives through the Year 2035', National Development and Reform Commission, March 2021.

14 'The Future of life science in the UK: How to Reshape the life science Industry in the 2020s', Economist Intelligence Unit, January 2020.


VACCINE
2019-nCoV
2019-nCoV
vaccine

LEGAL SERVICES

AT A GLANCE

KEY CHALLENGES

- Inability of PRC-qualified lawyers to practice Chinese law in a foreign firm
- The need to continue to improve the joint legal operations structure
- Restrictions on appearance before government agencies

KEY RECOMMENDATIONS

- Pilot allowing Chinese lawyers joining foreign firms to keep practicing licences in certain areas that are non-sensitive and most relevant to foreign firms
- Establish uniform, nationwide rules for JLO offices that reflect the processes in place in Shanghai and expand the pilot to other cities
- Allow lawyers from foreign firms to represent their clients in meetings with government agencies, when clients require it

KEY MUTUAL OPPORTUNITIES

- Chinese outbound investment
- Environmental, Social, and Governance (ESG)
- China's shifting regulatory landscape

STATE OF THE SECTOR

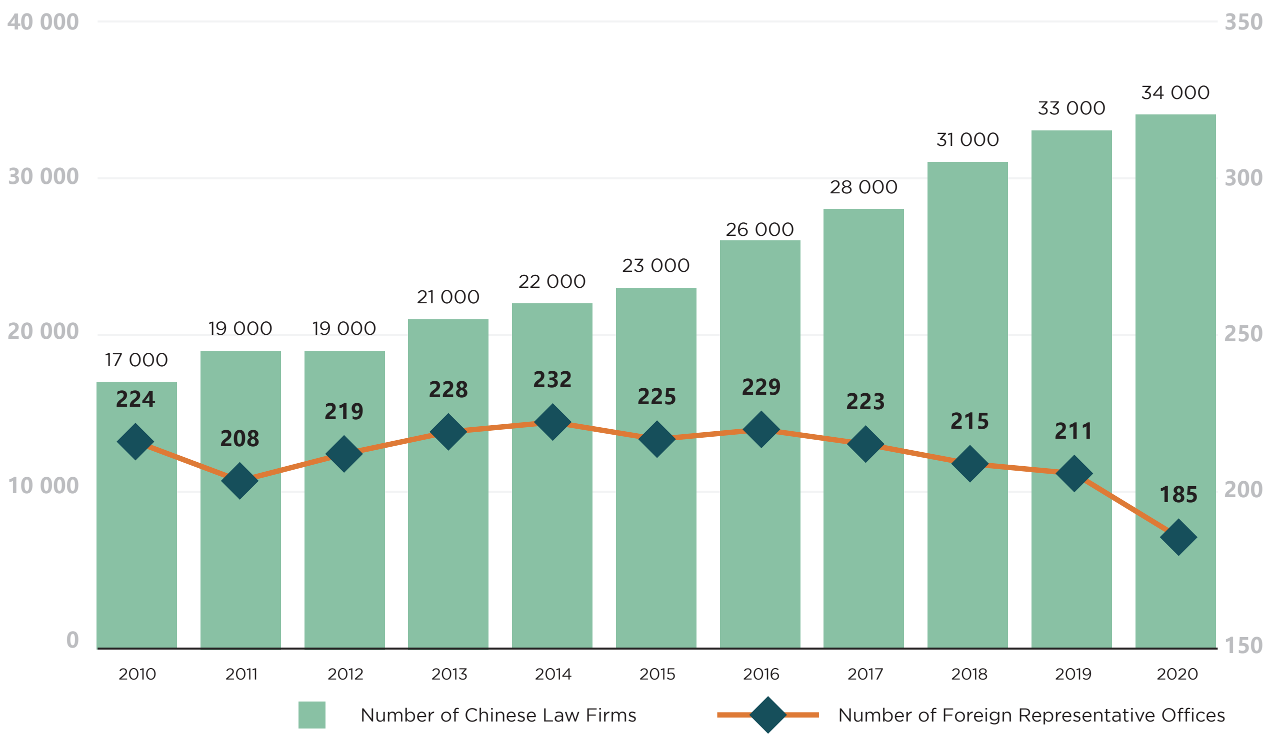
COVID-19 still looms large over foreign law firms in China, however cross-border activity is continuing to recover this year. The pandemic gave rise to a greater focus on domestic transactions – divestment, restructuring, repositioning within the market and so on – but overall a slow start to 2020 was followed by a recovery in the later part of 2020 and in 2021. In the *British Business in China: Sentiment Survey 2021-2022*, almost all law firms reported that their projected earnings for 2021 were likely to either equal (40%) or exceed (47%) 2020 levels. Many are looking to grow their headcount in China. However, a number of firms have yet to recover to pre-pandemic levels of earnings.[1]

In China, a dynamic marketplace has created significant opportunities in the legal sector, from fin-tech to health-care to new energy in particular.[2] Complicated and unexpected developments in China's regulatory space have also created demand, especially among foreign investors, for law firms that can advise them about their China business in the wider context of international business. There are many UK law firms that have this expertise, but significant restrictions inhibit foreign law firms from operating at their full potential in the Chinese mainland, limiting their ability to fully access these opportunities and provide a choice of legal advisor for foreign investors wanting a full-service, one-stop shop for legal services.

As a result, of the 34,000 law firms operating in China, only roughly 230 (or 0.7%) are firms headquartered outside of the Chinese mainland.[3] The vast majority of these operate as representative offices, but seven foreign firms have established joint legal operations (JLOs) with Chinese law firms in the Shanghai Free Trade Zone, six

Number of Foreign Representative Offices and Domestic Law Firms

Sources: MOJ, Statista, China-briefing, Qianzhan



1 'British Business in China: Sentiment Survey 2021-2022', British Chamber of Commerce in China, December 2021.

2 'China: Legal Market Overview', The Legal 500, February 2022.

3 'Statistical Analysis of Lawyers and Grassroots Legal Services in 2020', Ministry of Justice, June 2021.

of which are headquartered in the UK – Allen & Overy, Ashurst, Herbert Smith Freehills, Hogan Lovells, Holman Fenwick Willan and Linklaters.[4] There is general consensus amongst members that JLOs are currently the most viable of the operating structures available to UK firms in China who wish to engage in areas otherwise off limits to foreign firms. However, the JLO structure, whilst recognised as a step forward in terms of market access, presents significant challenges to foreign firms entering into a JLO and therefore limits the potential of UK-China trade in legal services.

By contrast, the UK has a very open regulatory environment which allows foreign lawyers, including those qualified in China, to practise any law including the laws of England and Wales (subject to relevant qualifications) in the UK through a number of permutations including partnership with other foreign lawyers or with local lawyers. In addition, foreign lawyers have a clear and transparent route to re-qualification as a solicitor of England & Wales through the Solicitors Qualifying Examination (SQE), which is open to lawyers from any foreign jurisdiction holding a degree in any subject or an equivalent qualification or work experience. We hope that Chinese legal services industry continues to open up as fostering a diversified, rich business environment brings benefits not only by keeping the industry competitive and dynamic, but also by providing Chinese businesses with a wider range of solutions and expertise.

4 'China: Legal Market Overview', The Legal 500, February 2022.

KEY CHALLENGES

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

PRC-qualified lawyers continue to be unable to practise Chinese law due to the suspension of their practicing licences while they remain employed by a foreign law firm. This prevents them, and their firms, from providing key domestic legal services to their clients and results in foreign-registered firms being unable to offer a one-stop shop in legal services in which their legal staff are qualified to practise but limited by PRC regulations to providing 'information on the impact of the Chinese legal environment'. This restriction on locally qualified staff in turn leads to inefficiencies as clients have to engage more than one firm for different advice covering different jurisdictions. Alternatively and in contrast, local law firms have had a competitive advantage by being able to offer such one-stop shop services, for example in providing English and PRC law advice, by availing of the open and inclusive regulatory environment in the UK since these restrictions on PRC legal staff in foreign firms do not exist for lawyers qualified in English law, for example, practising in Chinese law firms.

This long standing restriction on foreign representative offices and their PRC legal staff results in numerous impediments to the development and successful provision of legal services for foreign-registered companies, including UK-based law firms in China. Foreign firms need to offer other incentives to attract local legal talent to mitigate the inherent constraints placed on the ability of local lawyers to develop their domestic legal practice in the foreign firm. Moreover, retention of such talent is very challenging due to the handicaps on such local staff's ability to build a local client base focusing on domestic legal services. Consequently, foreign firms are materially impeded in developing organically in China which is detrimental to the healthy development of the PRC legal market.

China has developed at an astounding pace since the reforms of the early 1980s and since its accession to the WTO and its domestic legal market has thrived correspondingly. In 1979, prior to the reforms, there were reportedly 212 lawyers in China.[5] A mere two years later, in 1981, there were approximately 5,500 lawyers (many of whom were working part time).[6] Almost 20 years later, the Ministry of Justice (MOJ) of the PRC reported that there were 522,000 qualified lawyers in China in 2020.[7] China's domestic legal services market has enjoyed the regulatory protection to thrive over the last several decades and is now without doubt significantly robust to compete with foreign firms on a level playing field. Furthermore, Chinese law firms' overseas presence have continued to grow, with Chinese law firms reporting 150 overseas office in 2020[8] compared with 126 in 2019[9]

If China is to continue developing as an international hub, it must cultivate an internationalised legal services sector. This includes reciprocity in the freedom afforded to foreign law firms to practise and develop in China that is afforded to China-based law firms practising in many overseas jurisdictions, including those in the UK. This includes allowing PRC-qualified lawyers to practise the law in which they are trained, regardless of whether they work for a domestic or foreign firm.

2 THE NEED TO CONTINUE TO IMPROVE THE JOINT LEGAL OPERATIONS STRUCTURE

Foreign law firms have increasingly looked to the JLO model as a way of engagement in the provision of PRC legal services. This has become more prominent than the 'merger' which is in effect collaboration through a Swiss Verein structure that does not allow for shared profits from different parts of the verein. Whilst the JLO does not address the longstanding issues regarding market

5 '40 Years of Chinese Law Firms: Emergence, Rise, Wave and Transformation', Chinese Lawyer, August 2019.

6 'Forty Years of Change in the Bar', Fang Yuan, November 2018.

7 'Statistical Analysis of Lawyers and Grassroots Legal Service Work in 2020', Ministry of Justice of the PRC, June 2019.

8 '126 Branches of Chinese Law Firms Established Overseas', China News Service, December 2019.

9 'Statistical Analysis of Lawyers and Grassroots Legal Service Work in 2020', Ministry of Justice of the PRC, June 2019.

access for foreign firms, such as outlined elsewhere in this chapter, it has at least provided an avenue for greater engagement by foreign firms in domestic practice.

However, the process of establishing and operating a JLO poses challenges and places heavy burdens on firms, and particularly on foreign firms. For example, the foreign firm seeking to establish a JLO must already have operated in China for three years through a representative office, operating with the limitations and challenges highlighted elsewhere in this chapter. It must then identify a potential Chinese law firm to partner with. If the potential partner is not established in Shanghai's Free Trade Zone, then the foreign firm must be, requiring significant capital to be put aside for rent and other operational considerations.

The local law firm that might partner with a foreign firm in the JLO must also have a minimum three-year operating history and have at least 20 full-time lawyers in its employ.[10] However, according to the MOJ, only 13% of China's law firms employ more than 20 lawyers. This significantly limits the collaborative options available to foreign firms. We would advocate a relaxation of the minimum number of lawyers for a local firm's eligibility to enter a JLO in favour of a more flexible assessment based upon a range of considerations including the proposed activities of the JLO and the relative sizes of the existing operations of the local law firm and the foreign law firm's PRC representative office. This would allow a broader and more diverse range of firms, both UK and PRC, to cooperate and share knowledge and resources through the JLO structure.

Notwithstanding these fundamental barriers to entry, UK law firms compliment the Shanghai Free Trade Zone for developing a mature regulatory environment for JLOs. In the eight years since the promulgation of the *Implementation Measures for Joint Ventures Between Chinese and Foreign Law Firms in the Shanghai Free Trade Zone*, the Shanghai government has developed a strong administrative process that has increasingly seamlessly allowed for the establishment and operation of JLOs.

10 'Statistical Analysis of Lawyers and Grassroots Legal Services in 2020', Ministry of Justice, June 2021.

It is strongly encouraged that the processes developed in Shanghai are replicated when JLOs establish branch offices outside of the city. Minor operational processes or features that have made the model successful in Shanghai, from the allowance of shared bookkeeping and email domains to even connecting doors between offices, are not always allowed in other cities. This has significantly hampered the ability of JLOs to establish bases in cities outside of Shanghai, with some firms reporting that minor differences in requirements between cities have reset their application process to open an office in a new city. Establishing uniform, nationwide rules for JLO offices, based on the relative success of the Shanghai Free Trade Zone model, would limit friction when JLOs expand across the country and create more opportunity for Sino-foreign cooperation in this space.

3 UNEQUAL TAX TREATMENT BETWEEN DOMESTIC AND FOREIGN LAW FIRMS

As foreign law firms are established as representative offices of a partnership, they 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. This is significant as a PRC partnership itself is only taxed on the individual level. 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.

4 RESTRICTIONS ON APPEARANCE BEFORE GOVERNMENT AGENCIES

China does not allow lawyers in foreign firms to participate in meetings between their clients and Chinese mainland government authorities. Where the rules are not clear, firms will err on the side of caution and decline the opportunity. In areas that fall within the scope of providing information on the impact of the Chinese legal environment such as transactional work, product licencing, intellectual property protection, data protection requirements and other compliance matters, it is unclear where sensitivities lie that should exclude them from meetings with relevant government entities in order to advise their clients.

This limitation on their ability to operate can constrain companies' ability to select the most knowledgeable or otherwise appropriate lawyer or law firm to advise them. It can be especially problematic in cross-border transactions. If, for example, a client has an established relationship with a firm, but cannot use that firm's China-based lawyers and must instead bring in a new, additional counsel, this creates significant inefficiencies. Allowing lawyers in foreign firms to represent their clients in such circumstances would significantly address these issues.

5 CHALLENGE AROUND HIRING INTERNATIONAL TALENT AND SETTING NEW BRANCHES

Travel restrictions in and out of China are exacerbating challenges foreign law firms face both in recruiting new international talent to their China offices and to developing new clients. While online solutions help with the latter to some degree, there is no quick fix for the former challenge.

Foreign law firms, like peers in many other industries, are struggling to hire new, and increasingly to retain existing, foreign talent. As increasing numbers of foreign lawyers leave their jobs in China in order to return to families based overseas, law firms cannot bring qualified foreign lawyers into the country to replace them, limiting the choice of talent they can offer to their clients in China.

Foreign law firms in China face an additional challenge, however. Foreign lawyers are required to have a minimum of two years' relevant practice experience outside of the Chinese mainland before being permitted to join the Chinese mainland representative office as a representative of that law firm. As travel restrictions continue into their third year, young foreign lawyers based in-country are less likely to fulfil this requirement, shrinking the talent pool even further. This is a critical issue for foreign firms, which can provide attractive development opportunities to young talent and which need to be able to access the same pool of talents as their local counterparts in order to develop and compete.

Meanwhile, to set up a representative office in the first place, a foreign law firm must demonstrate a 'need' to do so and wait three years before it can apply to expand to other locations. This artificially limits its ability to grow, and stands in stark contrast to the UK, where foreign firms face no regulatory restrictions on the number of branches they can open at any given time. Furthermore, the process of changing representatives – particularly chief representatives – as well as transferring foreign lawyers between overseas and Chinese mainland offices and hiring foreign lawyers are generally bureaucratic. These add significant administrative burdens and associated costs onto firms, who report that such processes can easily take in excess of a year even before the added impact of COVID-19. This makes foreign firms much less agile in hiring.

KEY RECOMMENDATIONS

KEY CHALLENGE	RECOMMENDATION
1 Inability of PRC-qualified lawyers to practice Chinese law in a foreign firm	■ Pilot allowing PRC-qualified lawyers to keep practicing licences when joining a foreign firm in certain areas that are non-sensitive and most relevant to foreign firms, such as commercial and corporate work – particularly M&A, investment, funds formation, financial regulatory and anti-trust areas.
2 The need to continue to improve the joint legal operations structure	■ Reduce the requirement for the Chinese partner firm in a JLO to employ a minimum of 20 lawyers or replace with a system that scales the minimum lawyer requirement relative to the size of the foreign partner's representative office. ■ Develop a unified national set of rules on establishing new JLO offices, based on the successful model in Shanghai's Free Trade Zone.
3 Unequal tax treatment	■ Bring taxation of foreign representative offices and partners in line with domestic law firms.
4 Restrictions on appearance before government agencies	■ Allow lawyers from foreign firms to represent their clients in meeting with government agencies, when clients require it.
5 Challenge around hiring international talent and setting new branches	■ 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. ■ Align the ease of setting up a representative office and employing representatives for foreign firms in China with that which Chinese firms enjoy in the UK.

KEY MUTUAL OPPORTUNITIES

CHINESE OUTBOUND INVESTMENT

With sustained high levels of outbound investment activity from China, foreign firms are seeing significant demand for services related to cross-border activities. The PRC MOFCOM records China's foreign direct investment in 2021 at GBP 113 billion (RMB 937 billion), a rise of just over 2% on the prior year.[11] Baker McKenzie estimates that Chinese overseas mergers and acquisitions may have fallen in 2021, but that Chinese foreign direct investment into Europe in particular rose by 25%.[12] British law firms are well placed to play an important role in advising on these deals.

ESG STANDARDS

China's regulatory framework around Environmental, Social, Governance (ESG) factors has become more developed over the past year. Notably, disclosure requirements are becoming more robust, with the Ministry of Ecology and Environment[13] and the China Securities Regulatory Commission[14] publishing regulations necessitating disclosure of activities that pollute the environment. There are significant opportunities for foreign law firms to contribute in advising on compliance in this area, especially around continued alignment of China's ESG reporting system with other countries' systems. Progress has already been seen around China-EU alignment on the burning of sulphur in shipping fuel and carbon emissions trading systems. Engaging with foreign law firms, around vehicles emissions, ferry emissions and more broadly on disclosure requirements and governance best practice, could grant access to a wealth of expertise on international precedents and successful systems from which China can further develop its ESG framework.

CHINA'S SHIFTING REGULATORY LANDSCAPE

China's business environment continues to develop rapidly from a regulatory perspective as well as economically. Regulatory developments can have a significant impact on the ability to do business in China, particularly business with a cross-border element. From the *Data Security Law* to the *Anti-Unfair Competition* Law, many foreign firms find these laws challenging by virtue of their broad construct and lack of detail. As such, understanding both the implications of these new laws towards existing compliance mechanisms and the long-term policy trends can be a significant burden for foreign companies, particularly those too small to have an in-house policy, compliance or legal team. Growing demand for counsel in these areas will likely continue as these shifts continue and foreign firms with deep expertise in regulatory compliance overseas are well placed to assist and in doing so, help foreign clients navigate inbound investment and the local business landscape as well as advising PRC clients on cross-border data protection and cyber security issues.

11 'Basic Statistics on China's Sector-wide Outbound Direct Investment in 2021', Ministry of Commerce, January 2022.

12 'Chinese Outbound FDI Held Steady In 2021, As Global FDI Rebounded', Baker McKenzie, January 2022.

13 'Administrative Measures on the Statutory Disclosure of Company's Environmental Information', Ministry of Ecology and the Environment, December 2021.

14 'CSRC Publishes the Amended Guidelines for Publicly-Listed Companies on the Format of Annual and Biannual Reports', China Securities Regulatory Commission, June 2021.

ACRONYMS

BIM	Building Information Management
CBAM	Carbon Border Adjustment Mechanism
CBIRC	China Banking and Insurance Regulatory Commission
CERF	Carbon Emission Reduction Facility
CLIL	Content and Language Integrated Learning
CEA	Carbon Emission Allowances
CCUS	Carbon Capture, Utilisation and Storage
CCER	Certified Emissions Reduction
CDR	Chinese Depositary Receipts
CIBM	China Interbank Bond Market
CIIO	Critical Information Infrastructure Operator
CIT	Corporate Income Tax
CSL	Cybersecurity Law
CSRC	China Securities Regulatory Commission
DCCS	Data Categorisation and Classification System
DSL	Data Security Law
ESG	Environmental, Social, Governance
ETS	Emission Trading Scheme
F&B	Food and Beverage
FIDIC	International Federation of Consulting Engineers
FIE	Treatment of Foreign-Invested Enterprise
FII	Foreign Institutional Investor

FIL	Foreign Investment Law
FTP	Free Trade Port
FTZ	Free Trade Zone
FYP	Five Year Plan
GACC	General Administration of Customs of the People's Republic of China
GB	Guobiao
GBA	Greater Bay Area
GBP	British pound sterling
GDP	Gross Domestic Product
GDPR	General Data Protection Regulation
GEC	Green Electricity Certificate
GMP	Good Manufacturing Practice
GW	Gigawatt
HE	Higher Education
HFCV	Hydrogen Fuel Cell Vehicles
HRS	Hydrogen Refuelling Station
ICP	Internet Content Provider
ICV	Intelligent Connected Vehicle
IIT	Individual Income Tax
IP	Intellectual property
iQTS	International Qualified Teacher Status
JLO	Joint Legal Operation
JV	Joint Venture

kWh	kilowatt-hours
K9	Compulsory Education
LNG	Liquefied Natural Gas
LPR	Loan Prime Rate
MFN	Most Favoured Nation
MNC	Multinational Corporation
MNR	Ministry of Natural Resources
MOE	Ministry of Education
MOF	Ministry of Finance
MOFCOM	Ministry of Commerce
MOHURD	Ministry of Housing and Urban-Rural Development
MOJ	Ministry of Justice
MOST	Ministry of Science and Technology
MRV	Monitoring, Reporting and Verification
NDRC	National Development and Reform Commission
NEA	National Energy Administration
NEV	New Energy Vehicle
NHS	National Health Service (UK)
NHSA	National Health Security Administration
NMPA	National Medical Production Administration
NOC	National Oil Companies
MIIT	Ministry of Industry and Information Technology
NRDL	National Reimbursement Drugs List
PBOC	People's Bank of China
PEC	Power Exchange Centres
PIPL	Personal Information Protection Law
PMI	Private Medical Insurance
PPA	Power Purchase Agreement
PV	Photovoltaic
RMB	Renminbi
QDII	Qualified Domestic Institutional Investor
QFII	Qualified Foreign Institutional Investor
SAMR	State Administration for Market Regulation
SAFE	State Administration of Foreign Exchange
SOE	State-Owned Enterprises
SQE	Solicitors Qualifying Examination
TVET	Technical, Vocational, Educational and Training
VBP	Volume-Based Procurement
VPP	Virtual Power Plants
WFOE	Wholly Foreign-Owned Enterprises
WMC	Wealth Management Connect

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