BRITISH CHAMBER OF COMMERCE IN CHINA
中国英国商会

BRITISH BUSINESS IN CHINA: POSITION PAPER

2020

ABOUT THE BRITISH CHAMBERS OF COMMERCE IN CHINA

The British chambers of commerce in China are a network of membership organisations with a focus on providing advocacy, business support and networking opportunities for British businesses in China. We operate as an independent, not-for-profit organisation with a strong and diverse membership, representing British companies across the country from our offices in Beijing, Shanghai, Guangdong and Southwest China. With decades' worth of business experience in China, we bring the British business community together and help them thrive in one of the world's fastest growing markets.

CHAIRS' FOREWORD

ST. JOHN MOORE
British Chamber of Commerce in China

ROSIE HAWES
British Chamber of Commerce Shanghai

The British chambers of commerce in China are excited to launch this year's Position Paper. The paper brings together the views and perspectives of members of the chamber network across China and draws upon insight from our industry working groups through roundtables, interviews and surveys.

At its heart, the goal of the Position Paper is to advocate for a fair, open, transparent and well-regulated operating environment in China where members of the chamber network and British businesses more broadly can grow and realise their full potential. It presents perspective on the business operating environment and documents market access concerns facing British businesses on the ground in China. It also provides constructive recommendations for government and opportunities for British investors.

As we finalise this year's Position Paper, we remain in the shadow of COVID-19. The chambers have stood side by side with China since it launched reform and opening-up. A test of that commitment and partnership is being here through good times and through challenges. As China responded to the uncertainties of COVID-19, our members quickly stepped forward with aid and support. To date our members have donated in excess of RMB 160 million (GBP 18 million). As the virus impacted the United Kingdom, China provided its own support that included the supply of personal protective equipment from Chinese businesses and organisations.

Our hearts and minds go out to those who have been impacted by COVID-19 in China, in the UK and around the world. With the transition of spring into summer we are witnessing the green shoots of recovery in China. But these shoots are not yet visible in all markets. What is clear is that the road ahead remains uncertain and challenges exist that are truly global. Navigating this uncertainty requires constructive bilateral and multilateral dialogue and engagement. Only with all countries working together can we address the risk of severe economic recession and other global challenges.

This makes this year's Position Paper even more important. A year ago, we noted the continued steps China has taken on its journey of reform and opening up. Since then, more measures have been announced.

At the start of this year the new *Foreign Investment Law* came into effect and in the Report on the Work of the Government delivered on 22 May 2020, Premier Li Keqiang reiterated that China "must stay committed to opening our door wider to the world, keep our industrial and supply chains stable, and make opening up a catalyst for reform and development". In the Report on the Draft 2020 Plan for National and Social Development released on the same day it stated that China "will enforce to the letter the *Foreign Investment Law* as well as the supporting rules and regulations".

JEREMY SARGENT
British Chamber of Commerce Guangdong

MATT RYAN
British Chamber of Commerce Southwest China

We watched with keen interest the Two Sessions and additional commitments made, including:

- "We will continue to attract foreign investors while creating a comfortable and stable environment for them, expand the catalog of industries for foreign investment and help more major foreign-funded projects come to fruition."
- "We will significantly shorten the 'Negative List for Foreign Investment', and further open up the service, financial, manufacturing and agricultural sectors."
- "We will foster an enabling market environment in which all companies, Chinese and foreign, are treated as equals and engaged in fair competition."

We applaud these continued commitments. In these challenging times, rigorous implementation of reform and opening up will deliver employment, energise the market and support future growth. British business remains ready to play its role.

Yet, obstacles remain that impact the ability of British business to operate to their full potential in China. We provide greater detail on these regulatory challenges through this year's Position Paper. This includes strengthening the implementation of market reforms at all levels across the country, addressing longstanding concerns around cybersecurity and IT restrictions, promoting greater liberalisation of the capital account and ensuring equal access for foreign and private business.

China is the UK's second largest trading partner outside of Europe and in 2019 total bilateral trade grew 17.6% from 2018. The chambers call on the British government to prioritise trade negotiations and work towards a free trade agreement with China. This will bring substantive opportunities to British businesses.

As noted at the outset, this Position Paper represents the views and perspectives of members of the British chamber community in one united independent voice of businesses across China. The chamber network continues to collaborate through our advocacy work, events and networking platforms uniting the British business community in China.

We believe that sustained growth in the Chinese economy will depend on China's ability to foster an environment where the best and brightest come to invest, live and work, where companies compete and succeed on equal terms and where resources flow to support the best talent and ideas to flourish, regardless of origin. This will unleash the full potential of British business and support critical economic growth and job creation.

CONTENTS

CROSS-SECTOR CHALLENGES:

INDUSTRY REPORTS:

APPENDIX:

EXECUTIVE SUMMARY

Faced with the challenges brought about by COVID-19, the continued development of a constructive and thriving trading environment between the UK and China is more important than ever. The British chambers of commerce in China call for an intensification of dialogue between the two governments to help address ongoing regulatory barriers for UK businesses in China, while laying the foundations for a mutually beneficial UK-China free trade agreement.

The past year since our last Position Paper was published has been one of two halves. The first half was one of cautious optimism among British business in China, and the second of considerable uncertainty for businesses both in China and around the world.

Encouragingly, numerous reforms and market openings have come into effect, with the potential to improve the business environment for foreign companies and create new opportunities for British businesses and the Chinese economy. However, 2020 has brought fresh challenges in the form of the COVID-19 outbreak. COVID-19 does not undo the long-term benefits of these reform and opening-up measures, but the road to recovery is far from certain. This makes delivering on these reforms even more critical in order to unleash the full potential of all businesses, regardless of origin, to support economic recovery.

Cooperation, based on mutual trust and respect, will help both countries recover from the impact of COVID-19 and address wider threats to the global economy. The need for constructive dialogue and tangible action is now more critical than ever. The UK and China already have effective mechanisms in place, such as the Economic and Financial Dialogue and the UK-China Joint Economic and Trade Commission, which consistently focus on areas of mutual benefit and opportunity. Now that the UK has exited the European Union, it is vital that businesses and governments further develop this constructive dialogue between China and the UK.

In order to achieve this, both countries must push forward with discussions on a free trade agreement (FTA). As our second largest non-EU trading partner, we call on the UK to include China among the prioritised partners with which the UK is negotiating an FTA. The UK's approach to China must be balanced and informed and must not be swayed by external political pressures. An interconnected world and open markets are crucial for supporting growth and creating new opportunities, but the past few months have demonstrated the ease with which populist and protectionist politics can disrupt international relationships and increase business risk. The UK and China must resist this urge.

SOME PROGRESS MADE ON LAST YEAR'S KEY RECOMMENDATIONS

The Chinese government has enacted notable reforms to the business environment and market openings over the last 12 months. In 2019, the British chambers' Position Paper outlined core recommendations. These were to:

1. Provide more details on the implementation of the *Foreign Investment Law* (FIL)
2. Reduce the number of sectors on the 'Negative Lists'
3. Provide more clarity on the scope of the *Cybersecurity Law*
4. Improve the intellectual property landscape in China
5. Grant British businesses access to a wider range of licences
6. Ensure that regulations are enforced both transparently and consistently

The enactment of the FIL and the *Regulations on the Optimisation of the Business Environment*, both of which came into force at the beginning of this year, and steps to reduce the 'Negative Lists' are welcome commitments to creating a more transparent and level playing field for all businesses regardless of origin. Companies across a range of industries have seen material improvements in their ability to protect intellectual property rights.

There have also been considerable improvements to the regulatory environment of specific industries. British businesses are pleased to see that recommendations provided in the previous Position Paper have been resolved. Foreign banks are now able to gain licences to be lead underwriters for bonds in the interbank market, drug approval times have been accelerated and the Department for International Trade and the Ministry of Housing and Urban-Rural Development agreed to actively address the difficulties built environment services companies face obtaining business licences.

However, serious concerns remain that inhibit the ability of British businesses to operate to their full capability. The recommendations provided in this Position Paper would alleviate these challenges and increase British businesses' capacity and willingness to invest.

OVERARCHING RECOMMENDATIONS FOR THIS YEAR

1 STRENGTHEN THE IMPLEMENTATION OF MARKET REFORMS AT ALL LEVELS

British businesses welcome the Chinese government's efforts to reform the business environment and further open its markets. However, although high-level reforms have been announced by the central government, many businesses report seeing little material change to their operations. A disconnect between the positive intent of new regulations and local implementation remains a critical challenge.

In the year ahead, it is imperative that local governments commit to concrete and consistent implementation of regulations, and that authorities at all levels continue to strengthen implementation mechanisms.

As a flagship piece of legislation, the FIL is a step towards levelling the playing field and improving the business environment, and British companies are closely monitoring its full execution. Thorough enforcement of the FIL will send a strong signal to foreign investors as to the government's genuine commitment to improving their ability to operate and thrive.

2 ADDRESS LONGSTANDING AND CONTINUING CONCERNS AROUND CYBERSECURITY AND IT RESTRICTIONS

Restrictions around cybersecurity and IT have been the most pressing concern for British businesses in China over the past two years, and challenges have become significantly more acute.[1] Data localisation and cross-border data transfer present the most difficulties for companies, isolating them from their global operations and disconnecting the Chinese economy as a whole from global business and innovation.

The *Cybersecurity Law* continues to compel businesses to err on the side of caution, as vaguely defined concepts in the law and its surrounding legislation could raise unforeseen barriers to increasingly digitalised companies operating in China. More clarity is vital if they are to continue innovating.

Implementing legislation must give companies reasonable scope to share information overseas, and there must be a clear and transparent boundary for rights of access to company IT systems. Without this clarity and assurance, these restrictions will continue to limit aspects of British business investment.

3 PROMOTE GREATER LIBERALISATION OF THE CAPITAL ACCOUNT

British businesses in China are unable to efficiently access and share financial resources with global offices due to restrictions on capital outflows. These controls constrain their ability to remit profits to the UK or complete transactions with business partners or contractors in other countries.

Furthermore, the process of making an overseas transaction requires a considerable amount of time and supporting documentation, sapping company resources and undermining their efficiency. As such, it is imperative that cross-border capital transaction processes are streamlined and that more specificity is provided as to what transactions are not permissible.

4 REDUCE THE DIRECT PRESENCE OF STATE-OWNED ENTERPRISES IN THE MARKET

Despite China's increasing adoption of market-oriented reforms, the dominance of state-owned enterprises (SOEs)

1 'British Business in China: Sentiment Survey 2019-2020', British Chamber of Commerce in China, December 2019.

is a considerable obstacle for British enterprises. The overbearing presence of SOEs throughout the Chinese economy stifles competition and discourages foreign investment, thereby limiting the extent to which businesses will bring their technology and capabilities into China.

Although the majority of British businesses are not in direct competition with SOEs, those that are face barriers to either entry or growth which has caused imbalances in the country's economic structure. British businesses are therefore often forced to operate on the margins, providing only a fraction of the goods or services they could otherwise offer.

To address this misallocation of resources and achieve higher quality and impactful growth, structural reforms are needed to lessen the dominance of SOEs and allow open and fair competition.

British businesses call for the authorities to focus on maintaining an effective regulatory system that ensures free competition among all market entities. This will contribute to building a truly level playing field that will allow better allocation of resources, foster innovation and bring sustainable, long-term benefits to business and consumers in China.

5 KEEP CONVERSATIONS ON BILATERAL TRADE FREQUENT AND OPEN

On a bilateral level, the UK and China have fostered a constructive trade relationship, and the two economies remain complementary. This is particularly true in terms of the UK's global leadership in service sector innovation and China's increasing leadership in new technologies. Total bilateral trade in goods and services between the UK and China reached record levels of GBP 81.4 billion (RMB 714 billion) in 2019, up 18% from 2018 levels, and China remains the UK's largest export market after the EU and US.[2]

The UK has been the largest recipient of Chinese investment in Europe cumulatively between 2009 and 2019,[3] highlighting the interconnectivity of our two economies. In order to continue nurturing these productive commercial ties, both governments must actively sustain dialogue in order to find areas of business cooperation and reduce barriers to trade and investment.

2 'BoP: Current Account: Goods & Services: Exports: China', Office for National Statistics, March 2020.

3 'Chinese foreign direct investment in the EU 2019: Lower investment, deeper entanglement and new concerns', Mercator Institute for China Studies, April 2020.

LONG-TERM SOLUTIONS FOR SHORT-TERM CHALLENGES

The findings of this year's Position Paper reflect the views of British businesses throughout the year, but it would be remiss not to acknowledge the impact of the immense economic impact caused by the COVID-19 pandemic over the last four months. The majority of British businesses expect their 2020 China revenues to drop by more than 10%, and going forward companies are concerned about the impact of travel restrictions and reduced consumer demand both in China and globally.[4] The inability of senior management to return to China and for those that have regional or global roles based in China to conduct business travel is having a tangible and detrimental effect on investment and growth strategies. While the risk of a second wave of infection must be taken seriously, governments around the world must not prolong impediments to safe and controlled travel resumption in order to nurture continued investment and interconnectivity.

As the world faces unprecedented challenges, businesses need certainty, clarity and consistency in order to continue sustaining these positive investment trends. Reforms to the business environment in China throughout 2019 are positive steps, and companies await the material impact that full implementation will have on their operations. However, patience has a time limit. Rigorous and consistent implementation of recent reforms and market openings must continue so as to sustain confidence in the business environment and support the further development of China's economy.

KEY RECOMMENDATIONS OF THE *BRITISH BUSINESS IN CHINA: POSITION PAPER 2020*

1. Strengthen the implementation of market reforms at all levels
2. Address longstanding and continuing concerns around cybersecurity and IT restrictions
3. Promote greater liberalisation of the capital account
4. Reduce the direct presence of state-owned enterprises in the market
5. Keep conversations on bilateral trade frequent and open

4 'British Business in China: The Impact of COVID-19', British chambers of commerce in China, February 2020.

AT A GLANCE: INDUSTRY REPORTS

ACCOUNTING

SUB-SECTORS:

Accounting firms | Qualification organisations

KEY CHALLENGES:

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

KEY RECOMMENDATIONS:

- Explore the opportunity of signing Mutual Recognition Agreements between CICPA and British accountancy bodies
- Allow up to 50% British non-CICPA ownership of CICPA firms, in line with the UK model of corporate ownership
- Remove requirements for individual accountants to provide their personal identification to accounts to eliminate the risk of being blacklisted, and entrust the relevant accounting bodies to govern the conduct of accountants

KEY MUTUAL OPPORTUNITIES:

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

AUTOMOTIVE

SUB-SECTORS:

Original equipment manufacturers | Automotive components suppliers | Automotive consulting firms

KEY CHALLENGES:

- Changes to emissions standards with limited consultation
- Burdensome customs requirements
- Stringent and inconsistent NEV development policies

KEY RECOMMENDATIONS:

- Facilitate an ongoing dialogue with domestic and foreign industry participants at all stages of the policy drafting process
- Permit the mutual recognition of certifications by accredited test centres in the UK and China to remove the requirement of retesting at port of entry
- Ensure that the goals of the NEV Industrial Development Plan can be achieved through reasonable means by sustaining policy incentives and accelerating the construction of charging infrastructure, rather than simply by increasing production quotas

KEY MUTUAL OPPORTUNITIES:

- Connectivity
- Premium and luxury vehicles

BUILT ENVIRONMENT

SUB-SECTORS:

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

KEY CHALLENGES:

- Challenges in obtaining licences
- Lack of mutual recognition of qualifications

KEY RECOMMENDATIONS:

- Provide more transparent and equitable approval processes for licences
- Work towards the mutual recognition of engineering, architecture and urban planning qualifications

KEY MUTUAL OPPORTUNITIES:

- UK standards, institutions and education
- Partnerships in new regions
- Higher value service provision

EDUCATION

SUB-SECTORS:

Early years | K-12 | Higher education | EdTech | Education supplies | English language training | Non-profit organisations

KEY CHALLENGES:

- Lack of clarity and openness in the regulatory environment
- Legal controls on the role of educational organisations
- Limitations on human resources and staffing

KEY RECOMMENDATIONS:

- Ensure that authorities at all levels refrain from publishing new regulations without sufficient notice, and that all new regulations or information can be clearly found on government websites and other information channels
- Allow wider scope for cooperation and exchange in non-sensitive areas of education between Chinese academics, professionals, specialists and their foreign counterparts
- Work towards a bilateral agreement between the British and Chinese governments to facilitate opportunities for both young and senior Chinese professionals to work in the UK, and vice versa

KEY MUTUAL OPPORTUNITIES:

- Early years (0-3)
- Partnerships
- EdTech

ENERGY

SUB-SECTORS:

Oil and gas | Nuclear | Renewables

KEY CHALLENGES:

- Inability to fully access market openings
- Procurement barriers to market entry
- Insufficient mechanisms for commercial and industrial sector renewable energy consumption

KEY RECOMMENDATIONS:

- Issue practical implementation guidelines in a timely manner following the release of new laws to remove ambiguities and allow companies to access market and regulatory openings
- Review procurement practices and the requirements for foreign companies under HAF to determine whether this constitutes a barrier preventing access to China's civil nuclear market
- Pilot more large-scale distributed energy projects and grant equal opportunities for foreign companies to utilise their own integrated solutions in managing the distribution of renewable energy along national grids

KEY MUTUAL OPPORTUNITIES:

- Increasing energy security
- New energy vehicles charging infrastructure
- Hydrogen refuelling infrastructure

FINANCIAL SERVICES

SUB-SECTORS:

Asset management | Banking | Foreign exchange | Insurance | Private equity

KEY CHALLENGES:

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

KEY RECOMMENDATIONS:

- Allow foreign institutional investors to use globally-held assets to fulfil capital requirements for licence applications and continue to reduce other barriers to licence acquisition
- Refrain from arbitrarily restricting applications for an increase of a company's QDII quota and allow qualified and reputable private fund managers to access QDII schemes
- Pilot channels that feature reduced fees and swifter processing times for cross-border payments with Hong Kong and other cities in mainland China

KEY MUTUAL OPPORTUNITIES:

- FinTech
- Environmental, Social and Governance
- Internationalisation of the *renminbi*

FOOD AND BEVERAGE

SUB-SECTORS:

Alcoholic beverages | Non-alcoholic beverages | Catering | Seafood

KEY CHALLENGES:

- Difficulties interpreting regulations
- Unfamiliar products held to unreasonably high standard
- Difficulties finding up-to-date customs guidelines

KEY RECOMMENDATIONS:

- Ensure that local authorities refrain from publishing new regulations without reasonable notice, and that all new regulations or information can be clearly found on government websites and other information channels
- Consult F&B producers more often and more closely align GB standards and EU F&B standards
- Make import guidelines more easily accessible and streamline customs processing to reduce the length of time products are held at port

KEY MUTUAL OPPORTUNITIES:

- E-commerce platforms
- Growing interest in premium spirits

HEALTHCARE

SUB-SECTORS:

Healthcare services | Medical devices | Pharmaceuticals

KEY CHALLENGES:

- Restrictions around licences, certification and standards
- Pricing pressures and reimbursement requirements
- Fragmentation and restrictions across supply chains

KEY RECOMMENDATIONS:

- Remove restrictions on foreign ownership of medical services companies and on foreign investment in medical research
- Improve the clarity and transparency of the national reimbursement drug list process
- Increase supply chain flexibility afforded to the 'two-invoice system'

KEY MUTUAL OPPORTUNITIES:

- Free trade zones
- Continued development of the healthcare system
- Healthcare technology

LEGAL SERVICES

KEY CHALLENGES:

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

KEY RECOMMENDATIONS:

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

KEY MUTUAL OPPORTUNITIES:

- Cooperation on international trade and investment
- Knowledge-sharing

RETAIL AND CONSUMER GOODS

SUB-SECTORS:

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

KEY CHALLENGES:

- Concerns over intellectual property rights
- Mandatory animal testing for cosmetics
- Deviation from international product standards

KEY RECOMMENDATIONS:

- Develop and implement administrative measures to enhance the supervision of IP infringements on social media platforms
- Provide explicit guarantees that non-special use cosmetics products which have satisfied the exemption for animal testing will not be subject to toxicological testing from post-filing or post-market supervision
- Exclude recommended standards from market surveillance and supervision, leaving assessments on the performance and function of products to the market

KEY MUTUAL OPPORTUNITIES:

- Rising consumption in lower tier cities
- Demand for high quality and premium products

ECONOMIC AND POLICY OVERVIEW

China entered 2020 grappling with a structural economic slowdown, a trade war with the United States and inflationary pressures owing to the spread of African swine fever that caused pork prices to soar. Nevertheless, the economy was able to grow by 6.1% in 2019, consistent with recent growth trends that would suggest China remains the world's largest contributor to global GDP growth.

Since then, the near-term outlook has dramatically changed, with the outbreak of the COVID-19 virus having brought the Chinese economy to a temporary standstill and progress towards full economic resumption remaining slow. As the government imposed draconian lockdown measures in Hubei from 23rd January to 8th April to contain the virus and as people across the country stayed home, the economy contracted by 6.8% year-on-year in the first quarter of 2020, marking the first drop in more than four decades.[1] The Economist Intelligence Unit (The EIU) now forecasts 2020 annual GDP growth of just 1%.[2] China's aim of doubling its GDP in 2020 from levels in 2010 so as to achieve the political goal of establishing a "moderately prosperous society", for which it would need to reach 5.6% growth this year, now looks unattainable.

Real GDP annual growth forecast

Source: The Economist Intelligence Unit (The EIU)

1 'Narrow decline in economic indicators in March as significant progress made in coordinating the prevention and control of the epidemic and in economic and social development', National Bureau of Statistics, April 2020.

2 'Country Report: China', The Economist Intelligence Unit, April 2020.

ECONOMIC IMPACT FROM COVID-19

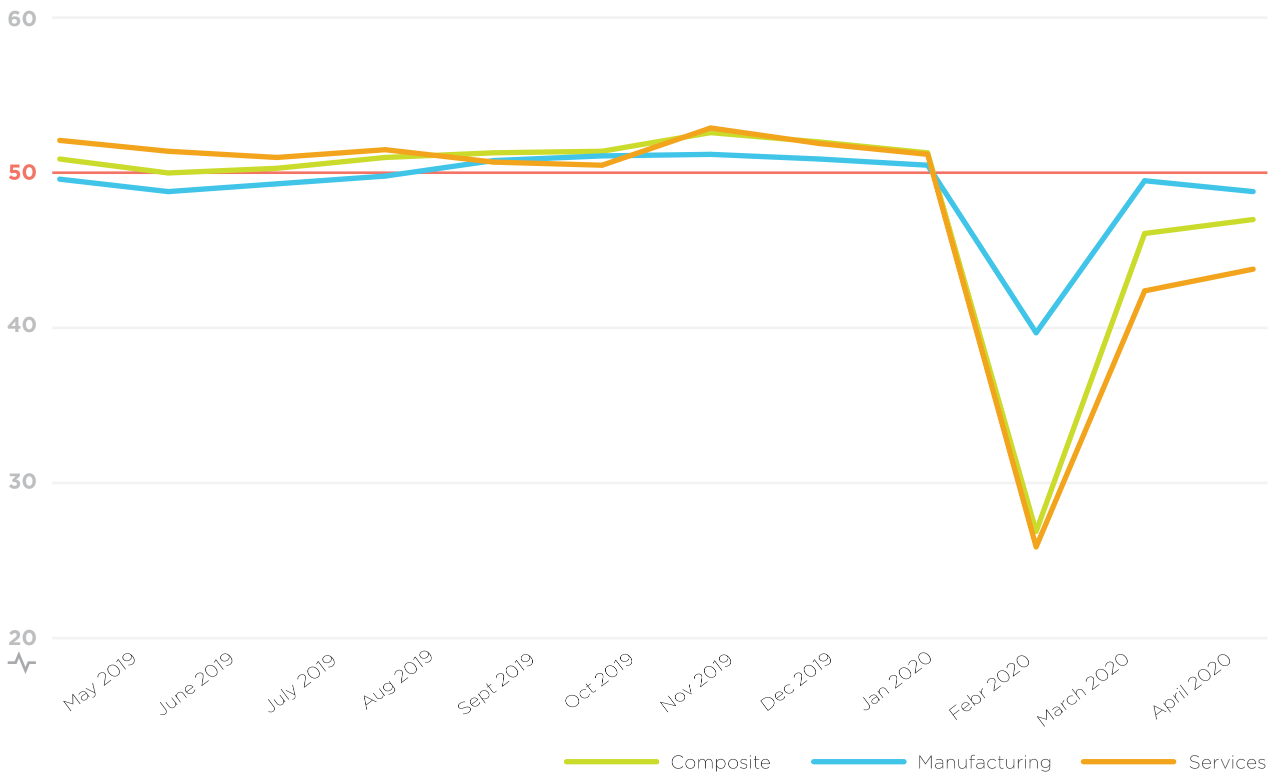
As the outbreak took hold in China, strict containment measures to control the movement of people and goods forced businesses to close and people to work remotely. China's services industry was particularly impacted as shops, restaurants and cinemas closed. The Caixin/Markit Services Purchasing Managers' Index (PMI) plummeted to 26.5 in February, far below the 50 mark threshold distinguishing between an expansion and contraction in activity. Companies in the services sector, which account for approximately 60% of economic growth, have also cut jobs at record rates. Despite signs of improvement in March, the sector was unable to pull out of contraction territory in April, indicating that a difficult path towards full economic recovery lies ahead for services firms.[3]

Manufacturers, on the other hand, have been faced with bottlenecks on the supply side, with widespread factory closures and delays to resuming full capacity. Subsequent disruptions to global supply chains have highlighted a dependence on China for many businesses, and could potentially accelerate the trend towards supply chain diversification that began with the US-China trade war. Suppressed consumer and business sentiment across most sectors from late January through to April also led to steep falls in demand for manufacturers. Automotive sales, for example, dropped by 80% in February compared to the same period a year ago, as dealerships were forced to close and potential buyers stayed home and delayed purchases of big-ticket items.[4]

The economic impact of COVID-19 similarly weighed heavily on British businesses in China. Two surveys released by the British chambers, conducted between 5th and 7th February and 18th and 21st February, found that half of British businesses expected their 2020 China revenue to drop by more than 10% as a direct result of the COVID-19 outbreak, and more than one quarter expected a decrease of more than 20%. Businesses were hit hardest by reduced demand, global travel restrictions, and business uncertainty, leading one third of companies at the time to postpone investment decisions. Small and medium-sized enterprises (SMEs) are particularly vulnerable to the uncertain business environment, with a higher proportion

China purchasing managers' index

Source: Caixin, IHS Markit

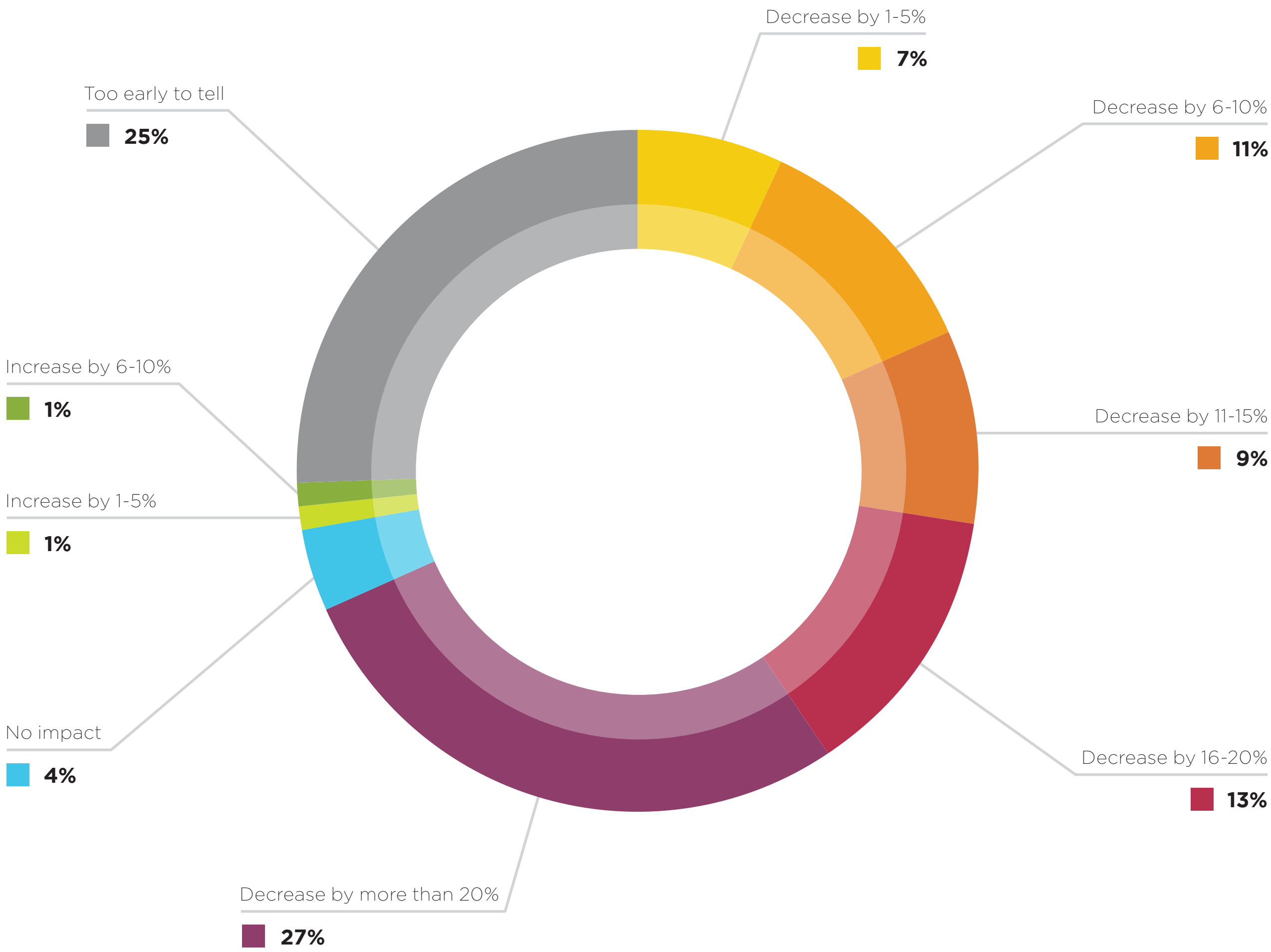


3 'China's services sector contracts for third month as job losses hit record: Caixin PMI', Reuters, May 2020.

4 'Car Sales Smashed by Covid-19 Lockdown, Plummeting 80% in February', Caixin, March 2020.

*Estimated impact of COVID-19 on British businesses' China revenues for 2020**

Source: British chambers of commerce in China



*Survey conducted between 18th and 21st February 2020

of SMEs reporting projected drops in revenue and delays to investment.[5]

While businesses have resumed operations at varying capacity and offices have since reopened as of mid-May, dampened consumer sentiment, both domestically and abroad, has inhibited them from returning to full normality. However, the likelihood that China will emerge economically from the virus sooner than most other countries could help to boost business confidence domestically, especially among global firms looking for sources of growth. The virus has undoubtedly induced severe economic disruption in China, but growth for 2021 is expected to rebound to 8.4% and average rates of around 4% to 5% throughout the first half of the 2020s.[6]

GOVERNMENT RESPONSE TO THE PANDEMIC

To resuscitate economic growth, the Chinese authorities responded with looser monetary policy and fiscal measures targeted at supporting businesses. In April, the People's Bank of China (PBOC) lowered their benchmark lending rates in order to reduce borrowing costs for small companies.[7] The PBOC also cut the reserve requirement ratio (RRR) for small banks by 1 percentage point, releasing RMB 400 billion (GBP 45.6 billion) of liquidity into the economy.[8] Although this is a relatively modest liquidity injection, small banks are the primary lenders to SMEs and cuts to their RRR underline the government's aim of alleviating cash flow challenges for smaller companies.

5 'British Business in China: The Impact of COVID-19', British chambers of commerce in China, February 2020.

6 'Country Report: China', The Economist Intelligence Unit, April 2020.

7 'Coronavirus: China's benchmark loan rate cut another sign authorities are 'serious about monetary easing'', South China Morning Post, April 2020.

8 'Announcement by a Spokesperson of the People's Bank of China: Targeted Cut to the Reserve Requirement Ratio for Small and Medium-sized Banks will Support Economic Development', People's Bank of China, April 2020.

The government has also adopted a more 'proactive' fiscal policy through a range of tax cuts and stimulus policies. In April, the State Council announced a series of measures including value-added tax (VAT) relief for SMEs and the self-employed, an increase to the export tax rebate rate for selected products, a lowering of the employers' social insurance contributions and cuts to electricity and gas rates. These, along with tax and fee cuts carrying over from 2019, are expected to reduce business costs by RMB 1.6 trillion (GBP 182.4 billion).[9] The authorities have also signalled their intent to encourage spending on 'new infrastructure' by private investors as part of a wider effort of promoting industrial upgrading and smart manufacturing. This includes spending on 5G telecommunications, artificial intelligence, data centres and smart transport.[10]

In comparison to the current response in most advanced economies and the Chinese government's stimulus measures during the global financial crisis, the scale of China's fiscal and monetary support has been much lower and more targeted. In recent years, the authorities have engaged in a prolonged campaign to reduce debt and financial imbalances in the economy that arose from the vast stimulus released in 2008 and 2009. The more measured response taken to minimise the impact of the pandemic reflects a concerted effort on the part of policymakers not to fall back on the aggressive stimulus and investment policies characteristic of the government's response after the financial crisis.

A number of stimulus policies have further been released to support businesses, notably extensions to tax breaks and subsides on electric vehicle purchases until 2022.[11] In order to encourage domestic consumption and support the services sector, several local governments have issued vouchers for residents to spend in restaurants, shops and tourism sites. While these vouchers appear to have been a short-term solution in boosting spending beyond the total value of the vouchers released, analysts are sceptical about whether they will be able to compensate for drops in personal income during the outbreak or significantly raise consumer confidence in the face of lingering fears over a possible return of the virus. Furthermore, central officials have raised concerns as to how local governments can afford these stimulus measures.[12]

Going forward, the authorities are increasingly focused on stabilising employment and accelerating the return to 'normal' levels of capacity utilisation. In a State Council executive meeting, Premier Li Keqiang stressed that stable employment should be the government's top priority for the year.[13] According to Trivium China, the Chinese economy is operating at 87.7% capacity as of early June 2020.[14] However, the rapid pace of resumption throughout March has since plateaued, raising concerns that if re-opening stalls at around 80% to 90%, positive GDP growth for 2020 would be highly unlikely. So long as the risk of a second wave of infections remains, consumer confidence will remain depressed and the Chinese economy will be unable to fully recover.

REFORMS TO THE BUSINESS ENVIRONMENT

The past year has seen several key pieces of legislation come into effect, intended to open up sectors to foreign investors and improve the business environment. China's *Foreign Investment Law* (FIL), implemented at the beginning of 2020, pledges to fully enact the principle of competitive neutrality in China's business environment.[15] While the FIL addresses a number of long-standing concerns for foreign businesses in China, such as strengthening intellectual property (IP) rights protections, the law is vague in parts and significant uncertainty remains around provisions related to national security reviews and the accountability of regulatory bodies.

At the same time, the *Regulations on the Optimisation of the Business Environment*, implemented January 2020, seek to create a more unified and modern business environment and streamline administrative procedures, while further pledging to treat all market entities equally.[16] The authorities have also reduced the number of sectors on the *Special Administrative Measures on Access to Foreign Investment,* which prohibit foreign investors from entering certain industries,[17] and have revised the *Catalogue of Encouraged Industries for Foreign Investment*, which

9 'China to intensify fiscal and financial support to tide businesses over difficulties', State Council, April 2020.

10 'New infrastructure to drive growth', State Council, May 2020.

11 'China to roll out mix of fiscal, financial policies to vigorously meet challenges', State Council, April 2020.

12 'Economic Watch: Voucher consumption, a tangible stimulus only to go with steady job gains after coronavirus outbreak', Xinhua, March 2020.

13 'China to deepen reform of government functions and enhance employment stability', State Council, March 2020.

14 'Getting China back to work', Trivium China, May 2020.

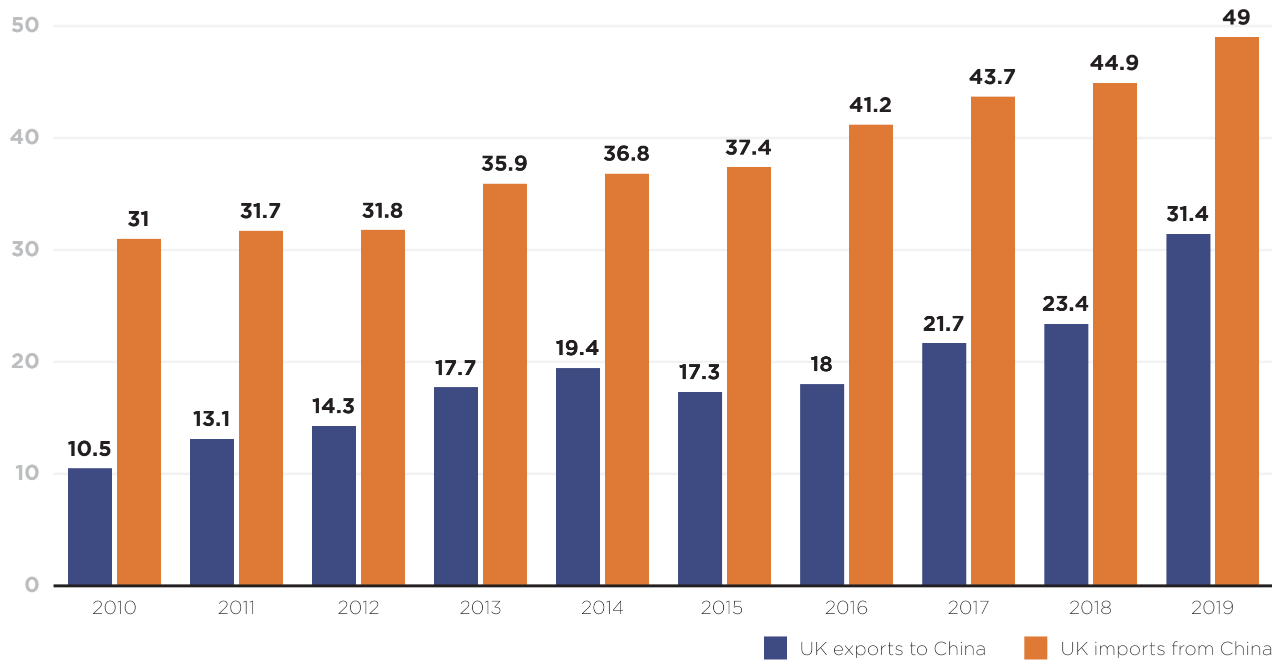
15 'Foreign Investment Law of the People's Republic of China', State Council, March 2019.

16 'Regulations on the Optimisation of the Business Environment', State Council, October 2019.

17 'Special Administrative Measures on Access to Foreign Investment' Ministry of Commerce, June 2019.

UK-China bilateral trade in goods and services (GBP billions)

Source: Office for National Statistics (ONS)



lays out industries in which foreign investment would be incentivised.[18]

Correspondingly, the authorities have introduced a collection of reforms aiming to improve China's IP rights landscape, make procurement processes fairer and more transparent, and restructure various tax systems. However, progress in other areas, such as state-owned enterprise reform, has stalled, while the cybersecurity landscape has worsened significantly for foreign businesses. The impending implementation of the Corporate Social Credit System (CSCS),[19] a mechanism designed to create in effect a self-governing market, has also raised significant uncertainty in the foreign business community, in part due to compliance concerns and the potential for individual employees to be blacklisted.

UK-CHINA ECONOMIC RELATIONS

As the UK's fifth largest trading partner, bilateral trade with China remains robust and continues to grow. According to the UK's Office for National Statistics (ONS), total bilateral trade in goods and services between the UK and China totalled GBP 81.4 billion (RMB 714 billion) in 2019, up 17.6% on 2018 levels. British exports to China grew sharply by 34% to reach GBP 31.4 billion (RMB 276 billion) in 2019, and China remains the UK's largest export market after the EU and US.[20] Total goods and services imports from China amounted to GBP 50 billion (RMB 439 billion) in 2019, an annual increase of 11%.[21] The UK therefore runs a trade deficit with China of GBP -17.6 billion (RMB -154 billion), down somewhat from the deficit of GBP -21.4 billion (RMB -188 billion) in 2018 owing to the significant growth in exports over the past year.[22]

In 2018, the UK's largest goods export to China was non-monetary gold at 21% of all goods exports, followed by road vehicles (19%) petroleum and petroleum products (19%) and medicinal and pharmaceutical products (5%). For services, the largest exports were 'other business services' which includes legal, accounting, architecture and engineering services among others (22%), travel (21%), transportation (20%) and IP (10%).[23]

Recent years have also seen high levels of UK foreign direct investment (FDI) flows into China, reaching GBP 3 billion (RMB 27.4 billion) in 2018, up 159% on 2017 and

18 'Notice on a Call for Comment on the Catalogue of Encouraged Industries for Foreign Investment', National Development and Reform Commission, March 2020.

19 'Plan for Establishing a Social Credit System (2014-2020)', State Council, June 2014.

20 'BoP: Current Account: Goods & Services: Exports: China', Office for National Statistics, March 2020.

21 'BoP: Current Account: Goods & Services: Imports: China', Office for National Statistics, March 2020.

22 'BoP: Current Account: Goods & Services: Balance: China', Office for National Statistics, March 2020.

23 'Statistics on UK trade with China', House of Commons Library, November 2019.

the highest among all non-Asian countries, according to Chinese government data.[24] Slowing economic growth in China and reduced business confidence arising from the US-China trade war and Brexit all weighed on investment plans, and as of October 2019, total FDI amounted to GBP 1.6 billion (RMB 14.4 billion) and is estimated to reach GBP 1.8 billion (RMB 16.8 billion) for the whole of 2019.[25]

Following on from the UK's exit from the European Union in January 2020, British businesses hope to see a renewed focus on improving trade flows between China and the UK. The British government has outlined its priority partners for signing a free trade agreement (FTA), which include the US, Japan, Australia and New Zealand.[26] Questions have been raised among British businesses, however, as to why China is not included among these priority countries for an FTA, given that UK-China bilateral trade flows far exceed the current levels of trade with the prioritised countries, with the exception of the US.

Regular high-level engagement between the UK and China during the COVID-19 pandemic, both by respective heads of government and commerce ministers,[27] is welcomed by British companies in China, and it is hoped that these frequent exchanges will continue even after the virus is contained. For the UK to become a truly global trading nation, engagement with China must be top of the agenda, and sustained dialogue will be essential for strengthening the relationship between the two countries and creating new opportunities for businesses in both markets.

24 'FDI into China, January to December 2018', Ministry of Commerce, January 2019.

25 'FDI into China, January to October 2019', Ministry of Commerce, November 2019.

26 'Free Trade Agreements with the Rest of the World', UK Parliament, February 2020

27 'Minister Zhong Shan Has a Phone Call with UK's Secretary of State for International Trade Elizabeth Truss', Ministry of Commerce, March 2020.

CROSS-SECTOR CHALLENGES

FOREIGN INVESTMENT LAW

The Foreign Investment Law (FIL),[1] effective from January 2020, enshrines into law several reforms that address key challenges British businesses face in China's regulatory landscape. The law was presented by the State Council as a means to grant foreign-invested enterprises (FIEs) greater access to the market and, along with corresponding Implementation Measures and the Company Law, now constitutes the central law governing foreign companies in China.

One in five British businesses believe that the FIL will have a slight positive impact on their overall operations.[2] This is driven by a cautious optimism in the intent of the law to improve the business environment and work towards a level playing field. It touches upon several specific regulatory challenges faced by foreign companies, particularly difficulties protecting intellectual property (IP) rights, which was the second most pressing concern for British businesses in 2018.[3] Article 23 of the *Implementation Measures* centres around IP protections, stipulating that the state is responsible for "increasing the force of punishments" for IP infringement and strengthening legal mechanisms to protect it, which signals a commitment to improve the IP landscape for the benefit of both domestic and foreign innovators.[4] Similarly, Article 24 forbids administrative bodies from forcing foreign companies to transfer their technology to a Chinese partner, with Article 43 confirming that if an administrative body is found to have done so, sanctions will be put in place against it.[5] However, the law states that "no administrative agency [...] may force the transfer of technology by administrative means". Businesses would suggest that forced technology transfer by any means, not just by administrative means, should be prohibited.

Nevertheless, while 22% of businesses expect a slightly positive impact from the law, 40% do not believe it will impact their operations at all, and 25% of British businesses are unsure what impact the law will have on them.[6] This is largely due to the vagueness of the *Implementation Measures*, which do not add much substantial detail to the overarching framework of the FIL and therefore do not allow companies to assess the enforceability of the law at this early stage. This is particularly true of the national security review addressed in Article 35 of the FIL and Article 40 of the *Implementation Measures*, which do not outline the criteria that may trigger a national security review or what the review would entail, leaving businesses concerned that it may inhibit their investment plans. The Ministry of Commerce solicited comments on the establishment of a complaints mechanism for foreign companies, and the British Chamber of Commerce in China submitted a response on behalf of its members.[7] While this addresses the actions to be taken by the government when a complaint is made, there is no specific indication of acceptable disciplinary measures outside of the reference to a settlement between the company and a government body. [8]

Questions remain around the effect of the law on accountability and transparency of regulatory bodies. Article 39 of the FIL requires that regulators who "abuse their authority, neglect their duties, or misuse their power" are sanctioned accordingly, which is elaborated on in Chapter 5 of the

1 'Foreign Investment Law of the People's Republic of China', State Council, March 2019.

2 'British Business in China: Sentiment Survey 2019-2020', British Chamber of Commerce in China, December 2019.

3 'British Business in China: Sentiment Survey 2019-2020', British Chamber of Commerce in China, December 2019.

4 'Implementation Measures of the Foreign Investment Law', State Council, December 2019.

5 'Implementation Measures of the Foreign Investment Law', State Council, December 2019.

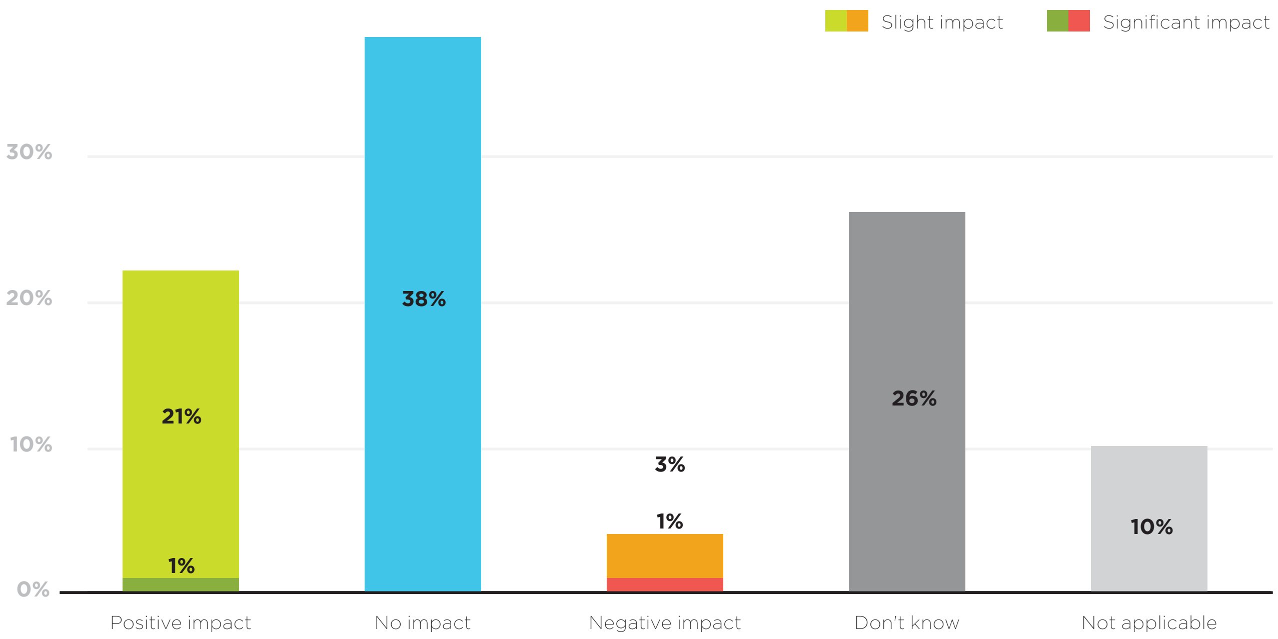
6 'British Business in China: Sentiment Survey 2019-2020', British Chamber of Commerce in China, December 2019.

7 'Call for Comments on the Methods on the Submission of Complaints by Foreign-Invested Enterprises', Ministry of Commerce, March 2020.

8 'Methods on the Submission of Complaints by Foreign-Invested Enterprises (Draft for Comment)', Ministry of Commerce, March 2020.

What impact do you anticipate the Foreign Investment Law will have on your organisation's ability to do business in the Chinese mainland?

Source: British Business in China: Sentiment Survey 2019-2020



Implementation Measures.[9] Specifically, according to Article 41 of the *Implementation Measures*, regulators will be held accountable where they fail to treat FIEs equally to domestic companies, prevent FIEs from participating in developing or revising industrial standards, restrict foreign investors from remitting funds into or out of China or fail to uphold policy commitments made pursuant to the law to foreign investors. Regulators will also be accountable for lost procurement opportunities and cases of forced technology transfer, as per Article 42 and Article 43 of the *Implementation Measures* respectively. Notably, Chapter 5 was only included after the draft was released for comment, and its presence in the final document demonstrates the government's sincerity in responding to feedback, strengthening rule of law and providing a more level playing field for FIEs. Nevertheless, the language of Chapter 5, and in particular Article 41, is vague as to the sanctions that regulators might be exposed to for non-compliance. It is possible that they will be drawn from the *Law on Governmental Sanctions for Public Employees*,[10] which is due to be enacted after it is reviewed at the Two Sessions, but this law is broadly worded and doesn't explicitly confirm its relationship with the FIL. This leaves in question the sharpness of the tools at the disposal of the body holding regulators to account, and their willingness to use them, which will be the ultimate indicator of the government's commitment to equal treatment.

Ultimately, companies are confused by the need for a legal distinction between foreign and domestic companies. In a truly level playing field, the *Company Law* would be the sole legal framework governing companies in China. Through Article 4, the FIL reinforces, rather than addresses, the closing of certain industries to foreign investment through the 'Negative Lists', which outline all industries in which foreign investment is prohibited. This inability to invest is a significant concern for foreign companies. In March of this year, the State Council issued an announcement to expand the number of sectors in which foreign investors are encouraged to invest, which is a positive step.[11] While British businesses are sympathetic to China's need to conduct national security reviews into investments when legitimate concerns arise, they hope that there will be reductions to, and an eventual abolishment of, the 'Negative Lists' system.

The implementation of the FIL is still in its early stages, and the State Council has been a welcome leading voice in the equal treatment of foreign and domestic companies. However, businesses would appreciate more detail, more certainty and sustained opening of the market in order to be secure in their investments and be able to provide a full range of products and services to the Chinese market.

9 'Implementation Measures of the Foreign Investment Law', State Council, December 2019.

10 'The Governmental Sanctions for Public Employees Law is Open to the Public for Comments', Xinhua, October 2019.

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

CYBERSECURITY AND IT RESTRICTIONS

Cyberspace and IT lies at the core of most businesses and, as its role continues to develop, firms all over the world have grown increasingly aware both of new opportunities in and concerns around cybersecurity. In China, British companies applaud government investment in the development of the data industry, such as the implementation of China's New Generation AI Innovation Blueprint[1] in pilot zones established throughout 20 cities, including Beijing and Shanghai. However, the constant evolution of technology and the data industry has forced legislators to move fast to keep up, which often leads to policy and regulatory uncertainty. This is particularly acute for foreign companies in China, with cybersecurity and IT restrictions ranking as the top concern for British companies in the British chambers' Business Sentiment Survey in both 2018 and 2019.[2]

China's *Cybersecurity Law* (CSL) took effect in 2017, with proposed implementation legislation, guidelines and standards still being published regularly.[3] UK companies of all sectors and sizes have experienced common challenges from the CSL and its operational application and are confronted with uncertainty resulting from opaque policymaking. The threat of disconnection from the global economy as a consequence of, at times, an isolationist approach to cyber-legislation adds to this uncertainty and also impedes the Chinese economy's ability to connect with global business and innovation. This creates barriers to both Chinese companies going global and foreign investors entering China.

Among the Cybersecurity and IT restrictions businesses experience, British companies report that the issue of data localisation and cross-border data transfer is of the most concern to them. In 2019, the Cyberspace Administration of China (CAC) and National Information Security Standardisation Technical Committee proposed that all transfers of personal data and important information to be shared internationally will be assessed before being permitted, and stipulated a 15-day turnaround for the assessment of these transfers.[4] In addition, the draft *Guidelines for Data Cross-Border Transfer Security Assessment*[5] and the draft *Measures on Data Security Management*,[6] which are expected to supersede existing legislation on the data security, currently state that all network operators wishing to disclose, share or trade 'important' or personal data across borders must first conduct a security assessment to ascertain the risk level of the information. With data so critical to core business functions today, if the final definition of 'important information' is too restrictive, the resultant prohibitions or hindrances on data-sharing will be a considerable setback to multinational companies' operations. Just a few examples of such functions include human resources, research and development and financial and marketing systems. British businesses are unsure as to the practicality of these

1 'New Generation AI Development Plan', State Council, July 2017.

2 'British Business in China Member Sentiment Survey 2018/2019', British Chamber of Commerce in China, December 2018; 'British Business in China: Sentiment Survey 2019-2020', British Chamber of Commerce in China, December 2019.

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

4 'Regulations on Cross-Border Transfer of Personal Information (Call for Comments) ', Cyberspace Administration of China, June 2019.

5 'Guidelines for Data Cross-Border Transfer Security Assessment (Call for Comments)', National Information Security Standardisation Technical Committee, May 2017.

6 'Measures on Data Security Management (Call for Comments)', Cyberspace Administration of China, May 2019.

proposals, and expect that this arrangement may instead compel them to operate in a grey area, subjecting them to unnecessary regulatory exposure.

Another key challenge lies in the definition of a 'Critical Information Infrastructure Operator' (CIIO) and the important data mentioned above. Even before the 2019 draft proposals were released, this has been key to companies' understanding the applicability of the CSL to them. Qualifying as a CIIO subjects a company to a number of additional obligations including the requirement to undertake security assessments internally or, in some cases, have their security reviewed by the Chinese authorities, before transferring personal information or 'important information' overseas.[7] Firstly, this gives rise to uncertainty about the government's broad rights to access firms' IT systems in the case of an assessment or security breach – in particular, access to private details such as encryption codes and source keys. It is currently unclear whether there is a boundary that the authorities cannot cross, and whether offshore as well as onshore data is covered under these access rights. Secondly, three years after the CSL's promulgation, it remains unclear which organisations qualify as CIIOs and what data is considered important. The authorities have pledged to publish a list of operators that qualify as CIIOs, but this has yet to be made available. Similarly, there have been attempts to define important data, of which the only comprehensive effort is 'Appendix A' of the draft *Guidelines for Data Cross-Border Transfer Security Assessment*.[8] However, the scope extends well beyond traditional definitions of sensitive data, and it remains difficult to discern whether each individual company falls within the scope of supervision or not. A set of guidelines with a level of detail and clarity similar to that provided in the Operating Guidelines for Nationwide Cybersecurity Inspection that came before the CSL would be appreciated, as it is unclear whether they still apply. Finally, there are concerns that these measures will not only apply to the CIIO itself, but will also cascade down to the CIIO's partners. Further clarification of this is necessary for the efficient development of businesses' online operations and offerings.

Transparency around personal data has increased as a result of government guidelines on personal data regulation, such as the *Information Security Technology: Personal Data Protection Specification*, effective from May 2018, which will be replaced by a revised version expected to come into force in October 2020.[9] This national standard sets out detailed guidelines for companies to follow concerning the collection, processing and use of personal data, and is an effective example of the specificity and granularity needed to address the current uncertainty. However, of the two draft legislative measures on data transfer published in 2017 and 2019, one regulates both important and personal data, and the other focuses only on personal data. From the dates of release of these measures, there is a suggestion that the government prioritises important data over personal data, and has created speculation that the authorities plan to legislate for these two areas separately, enforcing important data regulation earlier and more strictly. While this is speculative, it is indicative of a wider problem that a lack of guidance around legislation means companies can only guess as to their implications. Moreover, the proposals across the two sets of measures published in 2019 to require government approval for every single cross-border transfer of personal information and 'important information' is excessive, as well as impractical for both business and government in China.

Finally, questions remain on the enforcement of the CSL and surrounding legislation. Although the CSL has force of law, it remains a framework law which is difficult for companies – domestic and foreign alike – to anticipate how to comply at an operational level, as some companies are unsure whether all requirements are to be taken as already mandatory or whether some provisions should be considered best practice for the time being. There is also a perception that implementation can be somewhat inconsistent across both regions and firms. Greater guidance on the consistent implementation of the CSL, particularly in a way that ensures a level playing field for domestic and foreign companies, is imperative to improving confidence in China's business environment and securing long-term investment.

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

8 'Call for comments on the Guidelines for Data Cross-Border Transfer Security Assessment', National Information Security Standardisation Technical Committee, May 2017.

9 'Information Security Technology: Personal Data Protection Specification', National Information Security Standardisation Technical Committee, December 2017.

ACCESSING OR MOVING COMPANY FINANCES

China's financial system rigorously oversees and controls the flow of foreign exchange in and out of its borders, in an effort to maintain economic stability and curb excess volatility. A third of British businesses in China find that these controls have a significant negative impact on their operations,[1] inhibiting their ability to share resources with their parent company and work efficiently with global partners.

These controls can take various forms: necessitating that companies submit a 'tax filing certificate' and receive approval for remittances after exhausting an allowance of USD 50,000 worth of *renminbi*;[2] forbidding the conversion of capital out of *renminbi* for the purchase of overseas real estate, life insurance and other financial instruments;[3] and restricting the amount of capital that domestic institutional investors can invest offshore, among others. In a similar effort to crack down on money laundering, from July 2017 the *Administrative Measures on the Reporting of Large-Sum Transactions and Suspicious Transactions by Financial Institutions* require banks to report all foreign exchange sales exceeding RMB 50,000 (GBP 5,700) and any cross-border bank account transfers exceeding RMB 200,000 (GBP 22,700).[4]

In recent years, there has been some liberalisation of cross-border transaction mechanisms. The State Administration of Foreign Exchange (SAFE), the primary regulatory body in this area, allowed free conversion of all foreign exchange in a capital account into *renminbi* in 2015.[5] More recently, a circular on promoting cross-border trade and investment issued in October 2019 commits to optimising processes for foreign exchange receipts and payments around trade of goods and services, digitalising the filing of tax documents for foreign exchange payments in trade of services and piloting a reduction in the number of supporting documents needed for payments using foreign exchange, external debt, overseas initial public offerings remittances or other capital account receipts to be approved.[6] SAFE also abolished the investment quotas for qualified foreign institutional investors, demonstrating an interest in greater opening of onshore capital market investment.

Nevertheless, difficulty accessing and moving company finances remains a significant obstacle to operating efficiently and competitively. The most widespread concern is the high administrative costs of cross-border money transfers, caused by complex processes and rigid requirements for supporting documents. When companies wish to make remittances to their parent company or pay foreign contractors, they must provide proof of the validity of the transaction, including proof of their legal status and contracts pertaining to the transaction. The time needed to collate and submit the documents is a considerable drain on resources for large and small enterprises alike. Some companies hire consultancies to assist them with this process so that they can focus on core operations, preferring to absorb these material costs instead of dealing with the inconvenience of personally processing the transaction. This is an overhead that British businesses do not have to account for in many other jurisdictions, making their China operations less efficient.

1 'British Business in China: Sentiment Survey 2019-2020', British Chamber of Commerce in China, December 2019.

2 'Tax clearance procedure for certain outbound remittances overhauled', KPMG, July 2013.

3 'China's new restrictions on outbound investments and remittance', Allen & Overy, December 2016, 'China tightens curbs on mainland purchases of HK insurance - sources', Reuters, March 2016.

4 'Administrative Measures on Reporting of Large-Sum Transactions and Suspicious Transactions by Financial Institutions', People's Bank of China, December 2016.

5 'Relevant Issues Concerning the Reform of the Administrative Method of the Conversion of Foreign Exchange Funds by Foreign-invested Enterprises', State Administration of Foreign Exchange, April 2015.

6 'Circular on Further Promoting Cross-border Trade and Investment Facilitation', State Administration of Foreign Exchange, October 2019.

Some companies have had legitimate transactions rejected by SAFE or banks, constraining cash flow and potentially threatening the survival of smaller enterprises. This may be due to administrative errors made by clients or partners outside of China, who are unfamiliar with the stringent requirements for processing payments. A common difficulty is ensuring that they enter the recipient's name exactly as it appears on their Chinese bank account which, although not a legal requirement, is a common policy of individual banks. This may be because banks in their own country have a character limit on company names and generally allow for slight variations, as long as the name entered leaves no room for doubt that payment has reached the intended recipient. However, if the recipient's bank account name contains the abbreviation 'Ltd.', for example, transactions in which it is styled as 'ltd' will be rejected by the bank. British businesses appreciate that similarities of company names when using the *pinyin* spelling system can lead to confusion if a spelling error occurs, but this significantly inhibits the speed at which business can be conducted. Issuing national guidelines on acceptable variations in the recipient's name in transactions, particularly in terms of punctuation, could be a starting point for resolving this issue without undermining failsafe mechanisms against incorrect payments.

Transactions can also fail if legitimate purchases made by companies are confused with prohibited ones. For example, requests to purchase medical insurance from international suppliers have been denied by regulators, and companies are unsure as to the exact reason behind this. More clearly-defined parameters of what may and may not be purchased, as well as a clear appeals mechanism, would assist companies in understanding what purchases cannot be made, and would also reduce the number of restricted purchases SAFE would need to screen and reject.

More generally, stronger communication channels with SAFE would allow companies to quickly understand the reasons for a transaction's failure and the method in which it can be corrected. Companies report that it can be difficult to reach SAFE on their hotline, limiting their ability to resolve specific or uncommon problems. Furthermore, there is considerable regional variation in the interpretation of regulations, confusing businesses and inhibiting their ability to operate efficiently. Both the central office and the Shanghai branch of SAFE have issued 'Q&A's, one on the national level and one of the regional level,[7] which are helpful for answering common queries and navigating regional variations in foreign exchange regulation. The adaption of this document by other regional SAFE branches would be of use to businesses across the country, and would also reduce the administrative burden on SAFE in the long-term.

Finally, the withholding tax on cross-border payments can result in double taxation for companies. The withholding tax, which applies to payments to non-resident enterprises with no presence in China as a tax on their China-derived income, effectively stands at 10%. However, some services companies have noted that their remittances are often subject to both Corporate Income Tax and the withholding tax, resulting in an effective double tax and creating confusion with their parent or partner company.

These limitations are significant and consistent causes of frustration for companies, and over time may erode confidence in the business environment. Continuing to encourage the interconnectivity of China's business environment and capital system would allay these concerns and maintain robust investment levels into China.

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

COMPETITION WITH STATE-OWNED ENTERPRISES

Although state-owned enterprises (SOEs) have been a fundamental force in China's industrialisation and modernisation, their prevalence in the Chinese economy distorts markets and deters foreign investment. SOEs are largely insulated from competition with more efficient and dynamic private firms, which may offer a higher quality of goods and services. Furthermore, SOEs enjoy a plethora of privileges, ranging from easy access to financing from state banks to favourable prospects in procurement bids. As a consequence, industries in which British businesses usually excel, such as finance, energy and built environment services, are dominated by large SOEs, limiting the ability of British and other private businesses to provide a full range of goods and services to the market. This misallocation of resources is detrimental to the Chinese economy as it constrains growth, innovation and investment.

British businesses find that there are relatively few instances where they are able to compete directly with SOEs, largely owing to both market access restrictions and the size of SOEs which allows them to dominate the sectors they operate in. Instead, British companies mainly work with foreign clients and investors, and alongside SOEs in areas where the quality of SOEs' services is lower. In some cases, this has in effect created two parallel economies within the overall Chinese system: one where SOE monopolies have crowded out private investment, and a separate smaller slice that consists of foreign-invested enterprises (FIEs) engaging with one another and with private domestic firms. While many British businesses have been somewhat content in operating on the margins while the economy was booming, as China faces an economic slowdown compounded by the COVID-19 outbreak, this small slice of the economy looks likely to shrink further as foreign investment declines. For foreign firms, this makes the need for structural economic reform all the more urgent.

China's public procurement processes illustrate the systemic challenges facing British businesses in sectors that have a strong SOE presence. For many government procurement projects, there is a consistent pattern of state-owned banks lending to state-owned firms to work on state projects. Although Article 16 of the *Foreign Investment Law* (FIL) states that FIEs should be treated equally in bidding for government procurement,[1] contracts are often awarded to the company based solely on the lowest-priced bid, rather than such factors as quality or life cycle. Due to the broad array of financial privileges and benefits they receive, SOEs are naturally afforded a strong price advantage when bidding. Under pressure to maintain a low budget, it is therefore common for local governments to issue tenders with price specifications catered towards SOEs, and which are not commercially feasible for foreign and private companies. Price is certainly an important element in bidding, but basing procurement decisions solely on price considerations severely limits the tendering opportunities for British businesses which are often able to offer higher quality service provisions.

1 'Foreign Investment Law of the People's Republic of China', State Council, March 2019.

On paper, many sectors permit foreign and private investors to compete on an equal footing with SOEs, but rules are often designed to favour SOEs and create invisible barriers protecting them from competition. In many cases, the particular requirements necessary for businesses to gain operating licences are such that only large SOEs and domestic firms can gain approvals, while in practice foreign businesses cannot qualify. Foreign banks, for example, must satisfy extremely high capital requirement thresholds for many licences, such as custodian licences, despite their expertise and proven track record in other markets, while 'Big Four' state-owned banks with large assets are naturally qualified. Given the sheer size of state-owned banks in China's financial sector, it is impossible for British banks to compete directly with them and so they must instead cooperate on areas such as interbank lending and cross-border investment. Similarly, in the built environment services sector, engineering and architecture firms are only able to obtain a Grade A licence if they have past experience providing these services in China, which they are unable to acquire without the licence. Despite many having operated in China for more than 30 years, they have so far been unable to secure this licence to work on such areas as infrastructure or urban planning, whereas SOEs are easily able to obtain such licences. Instead, British firms must partner with local design institutes or negotiate directly with foreign clients in order to bypass these licence restrictions.

These systemic barriers have allowed SOEs to grow to such a size where it is difficult for foreign and private businesses to challenge their dominance. In the Government Work Report issued in March 2019, it was stated that China will abide by the principle of competitive neutrality. In theory, this would mean that all enterprises, regardless of ownership, are treated equality in terms of market access, licences, business operations and government procurement.[2] This is a welcome step, but businesses would urge greater consideration of the invisible barriers and gaps in implementation that inhibit foreign businesses from fully accessing the market and competing with China's SOEs on an equal footing. The authorities should also move away from their ambitions to make SOEs "stronger, better and bigger",[3] especially in non-strategic sectors that are not essential to national security, which currently does little to assure businesses that the spirit behind competitive neutrality will be fully adhered to.

The presence of the state throughout the economy is a deterrent to greater foreign and private investment, and is ultimately counterproductive to China's economic objectives. A business environment that limits the extent to which foreign companies can invest and transfer capabilities, and markets distorted by a disproportionate amount of resources and subsidies flowing to inefficient SOEs, are not conducive to growth and innovation. As the Chinese economy faces significant challenges from the outbreak of COVID-19, global trade disputes and a cyclical downturn, the need for meaningful structural reform is now more critical that ever. Reducing the direct presence of SOEs and instead focussing on maintaining an effective regulatory system governing the private sector will give foreign businesses more confidence to invest.

2 'Full text: Report on the Work of the Government', State Council, April 2019.

3 'Xi calls for furthering SOE reform', China Daily, October 2017.

OBTAINING BUSINESS LICENCES AND CERTIFICATES

The central government has issued several laws and programmes in the past year to streamline the application process for business licences and certificates. After a pilot period in Shanghai's Pilot Free Trade Zone,[1] the *Regulations on Optimising the Business Environment* encouraged regulators to simplify and the licence system and separate permits and licences.[2] British businesses in Shanghai have typically found it easier to apply for licences than in other parts of the country, indicating that a nationwide rollout would be successful if it is consistently implemented across jurisdictions. Similarly, the upcoming revision of the *Catalogue of Encouraged Industries for Foreign Investment*,[3] which lays out industries in which foreign investment would be incentivised, is expected to be accompanied by a reduction of the number of sectors on the 'Negative Lists',[4] which preclude foreign investors from entering sensitive industries. Enterprises in certain sectors, particularly financial services,[5] have seen significant increases in the number of business licences they can apply for.

Nevertheless, over half of British businesses have not seen a material impact to their ability to obtain licences and it remains the fourth highest issue for companies.[6] Many types of licences can take months to be approved, slowing a company's ability to fulfil new market demands before competitors. Grade A licences for built environment services companies require an in-market track record, which itself can only be obtained with a Grade A licence, making it impossible to obtain. Certain licences in financial services require large upfront capital commitments, but foreign companies are precluded from using globally-held assets to fulfil these requirements, artificially raising barriers to entry. Domestic companies also seem to be able to receive licences more quickly, granting them a competitive advantage despite the commitments made in the *Foreign Investment Law* (FIL).

If licence applications are rejected, a thorough explanation of the reason for rejection should be provided so that companies can amend or re-evaluate their application. Finally, outside of national security concerns, the UK is open to and welcomes Chinese investment in almost all its sectors. In the spirit of greater interconnectivity and cooperation, British businesses would welcome a review of the necessity of the 'Negative Lists' system and a significant reduction to the number of sectors on the list, if not the complete abolishment of the system itself.

1 'Red tape gives way to better business environment', State Council, December 2019.

2 'Regulations on Optimising the Business Environment', State Council, October 2019.

3 'Notice on a Call for Comment on the Catalogue of Encouraged Industries for Foreign Investment', National Development and Reform Commission, March 2020.

4 'Market Access Negative List', Ministry of Commerce, November 2019, and 'Special Administrative Measures on Access to Foreign Investment', Ministry of Commerce, June 2019.

5 'Relevant Measures for Further Opening Up the Financial Sector', State Council, July 2019.

6 'British Business in China: Sentiment Survey 2019-2020', British Chamber of Commerce in China, December 2019.

EMPLOYING FOREIGN STAFF

Attracting and retaining talent is a perennial issue for foreign companies in China. The difficulty of securing work permits for foreign talent is the largest barrier stopping firms from being certain in their ability to hire the right candidate for all positions, irrespective of whether they are local or foreign hires. Being unable to hire young, driven foreign graduates unless they have a master's degree or two years' work experience, or retain seasoned professionals once they reach the retirement age of 60, can significantly constrict the talent pool for many British firms looking for international experience particularly in sectors that require specialist knowledge. Furthermore, the length of time taken to process a work permit and the amount of supporting documentation needed for applications makes the process of hiring foreign staff a considerable drain on business resources while also dissuading skilled employees from coming to China for work.

Changes to the *Individual Income Tax Law* (IIT Law),[7] which as of January 2019 has applied to all foreign residents in China for more than 183 days in a calendar year. This is generally welcomed as a positive step, as it reduced the tax burden on individuals and set out six clear tax deductions. However, a large proportion of British companies have not seen any particular impact from these IIT Law reforms on their ability to attract foreign talent into China.[8] Sustained consultation with businesses on how to optimise China's income tax regime, as well as monitoring of its implications for encouraging talent into China, would be of particular interest to foreign companies in China.

7 'Individual Income Tax Law', State Taxation Administration, August 2018.

8 'British Business in China: Sentiment Survey 2019-2020', British Chamber of Commerce in China, December 2019.

TRANSPARENCY AND CONSULTATION AHEAD OF REGULATORY CHANGES

Over the past year, British businesses in China have seen a slight improvement in the transparency and inclusivity of China's regulatory environment.[9] This is largely driven by commitments from the government to increase regulatory transparency and engage businesses in policymaking, as seen in the FIL and its *Implementation Measures*.[10] Although this is a welcome first step, companies still harbour significant concerns, and broader application of these principles would be of material benefit to investor confidence.

As an example, the *National Security Law*[11] is notably broad in its scope, assessing threats to economic security as well as traditional defensive capabilities, and foreign companies would appreciate more information on approval and prohibition decisions to inform their own strategies. Similarly, the lack of definitions of key terms in the *Cybersecurity Law*,[12] such as 'critical information infrastructure operator', is also a source of concern for companies, as they find it difficult to understand whether or not such designations would apply to their operations.

Depending on its implementation, the Corporate Social Credit System (CSCS) could effectively hold both government and business to account transparently and objectively. However, the lack of a comprehensive list of metrics governing CSCS scores limits businesses' ability to ensure employees fully understand the system. There have also been instances of unknown third parties falsely affiliating themselves with the company and accruing bad credit scores, undermining the purpose of the CSCS. Granting foreign companies greater insight and input into the formulation of new initiatives would improve confidence in the business environment and provide more information to policymakers.

9 'British Business in China: Sentiment Survey 2019-2020', British Chamber of Commerce in China, December 2019.

10 'Implementation Measures of the Foreign Investment Law', State Council, December 2019.

11 'National Security Law', Ministry of National Defence, July 2015.

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

ENFORCEMENT OF LAWS AND REGULATIONS

Foreign companies are encouraged by recent commitments from the central government to strengthen the rule of law in China and ensure that laws are consistently and fairly enforced. For example, the *Implementation Measures of the Foreign Investment Law* state that "local governments at all levels ... shall perform on policy commitments lawfully made to foreign investors and foreign-invested enterprises (FIEs)",[13] addressing a key concern of FIEs in China. Nevertheless, there are still concerns that FIEs compliant with existing laws may encounter operational difficulties when interacting with local governments.

Businesses in certain sectors report that some regional jurisdictions interpret the various 'Negative Lists' governing foreign investment differently to others or can fail to enforce a law published at the central level. In the energy sector, for example, enforcement of recent market openings can be highly inconsistent across regions. Although recent revisions to the *Special Administrative Measures on Access to Foreign Investment* permit wholly and majority foreign ownership in oil and gas exploration and development, some energy companies report that local governments continue to insist that they must form a joint venture with a local company in order to enter the market.[14] This heavily restricts foreign firms' ability to establish themselves in the market and contribute to the development of the region in question.

13 'Implementation Measures of the Foreign Investment Law', State Council, December 2019.

14 'Special Administrative Measures on Access to Foreign Investment', Ministry of Commerce, June 2019.

CUSTOMS REQUIREMENTS

China's complex and opaque customs system can create significant challenges for British businesses importing products, components or ingredients into China. Heavily bureaucratic and relatively unclear processes mean that items may take weeks, if not months, to clear customs, impacting supply chains and sales timetables and, in the case of perishable goods, causing the products to spoil. Products, components or ingredients imported into China must comply with *guobiao st*andards, in accordance with the *Standardisation Law of the People's Republic of China*.[15] However, these standards change frequently, and importers receive little notice or consultation beforehand, which may mean that standards suddenly change to prohibit their product despite them not posing a risk to public health and safety, which is particularly true of foodstuffs unfamiliar to regulators. Furthermore, while companies fully understand the need to penalise significant and misleading labelling errors, inconsequential errors can lead to entire batches either being rejected at port or subject to fines, despite the fact it poses no risk to the consumer. Finally, inconsistencies between ports in terms of customs processes and rules can disrupt production and sales for certain companies, such as those in the automotive sector where procedures to import vehicles in certain ports are much quicker than others. Greater transparency in the formulation of standards and consistency in the enforcement of customs regulations would be welcomed by British firms.

15 'Standardisation Law of the People's Republic of China', Standardisation Administration of China, November 2017.


HIGH

TAXATION LANDSCAPE FOR FOREIGN FIRMS

There has been significant movement in China's tax system in 2019, with a focus on streamlining and digitalising the submission of tax payment systems and strengthening feedback channels. [16] A key shift was the reform of the value-added tax (VAT) system, announced by Premier Li Keqiang at the Two Sessions in March 2019. VAT rates were reduced for companies in manufacturing, transportation, construction and other related industries. There was also a commitment to simplifying the VAT system, cutting the number of VAT brackets from three to two and promoting policies that provided small and micro businesses with preferential tax cuts, in order to bolster domestic innovation and growth. [17] The revised *Individual Income Tax Law* (IIT Law) also came into force at the beginning of 2019,[18] raising the minimum payment threshold and creating six deductions categories. This is a strong incentive for businesses and talent to enter and stay in China.

Despite this, concerns remain around other taxation categories. Multinational companies are particularly exposed to taxes on cross-border transactions, such as the withholding tax on payments to non-residents, which currently stands at a concessionary rate of 10%. When taken in addition to Corporate Income Tax, this acts as a double tax on a company's payments to its parent company, putting it at a competitive disadvantage to domestic companies. More broadly, throughout the ongoing tax system reform process, changes to the regime should be accompanied by detailed guidelines, which must be aligned at the local level. Different taxation authorities, including the State Administration of Taxation, the General Administration of Customs China and the State Administration of Foreign Exchange, should also share information to align tax collection and mitigate the need for companies to repeatedly submit the same supporting documents.

16 'Plan for the Reform of the National Tax and Local Tax Collection and Management System', State Council, July 2018.

17 'Report on the Work of the Government', State Council, March 2019.

18 'Individual Income Tax Law', State Taxation Administration, August 2018.

PUBLIC PROCUREMENT POLICY AND PRACTICES

Procurement activity in China is governed by two major pieces of legislation: the *Government Procurement Law* (GPL) and the *Tender and Bidding Law* (TBL). The GPL covers the purchase of goods and services, using fiscal funds from central and local government authorities,[19] whereas the TBL more broadly applies to the procurement of projects and related goods and services regardless of the type of entity that conducts the procurement. A recent draft revision to the TBL aims to make the tendering process more inclusive for foreign companies by discouraging preferential practices, while also enhancing the transparency and efficiency of bidding processes.[20] The *Foreign Investment Law* (FIL), implemented January 2020, similarly grants national treatment to foreign-invested

19 'Government Procurement Law of the People's Republic of China', Ministry of Finance, June 2002.

20 'Bidding and Tendering Law of the People's Republic of China', National People's Congress, December 2019.

enterprises (FIEs) participating in public procurement.[21] However, exceptions around the right to deviate from the principle of national treatment when a specific procurement involves national policy objectives, and provisions in Article 10 of the GPL which give explicit preference to domestic entities in procurement appear to contradict the principle of competitive neutrality behind the FIL.

When China joined the World Trade Organisation (WTO), it declared its intent to adhere to the Agreement on Government Procurement (GPA). Previous offers to join were rejected over the transparency and fairness of China's procurement processes, and the scope and coverage of their terms. In October 2019, China submitted its sixth offer to join the GPA, with pledges to open up additional services sectors and all construction services to foreign competition.[22] British businesses welcome China's recent offer to join the WTO GPA and the principle of national treatment, but hope that efforts are made to treat FIEs fairly in bidding, as well as to improve the transparency of bidding processes and the effectiveness of appeals procedures.

21 'Foreign Investment Law of the People's Republic of China', State Council, March 2019.

22 'China submits revised offer for joining government procurement pact', World Trade Organisation, October 2019.

INTELLECTUAL PROPERTY RIGHTS PROTECTION

In a concerned effort to improve the intellectual property (IP) rights landscape in China, the authorities have issued a number of positive reforms and amendments to existing IP legislation. In January 2019, the new IP Court of Appeal was established within the Supreme People's Court (SPC),[23] and it is hoped that this will lead to greater consistency and efficiency in the adjudication of complex cases in China. To curb the prevalence of bad faith trade marks, amendments to the *Trade Mark Law* allow for rejections for bad faith at the application stage, while also increasing the punishment for trade mark infringement.[24] Revisions to the *Anti-Unfair Competition Law* aim to improve the protection of trade secrets by widening the definition of protected trade secrets, increasing civil awards and reversing the burden of proof on to the defendant.[25] The implementation of the *Foreign Investment Law* (FIL) further provides explicit assurances that foreign companies' IP and technology will be protected. However, while the law forbids forced technology transfers "by administrative means", [26] it does not explicitly prohibit non-administrative bodies from forcing technology transfers by other means. Similarly, repealing the *Technology Import and Export Regulations* (TIER), which disadvantaged foreign parties regarding contractual provisions in technology import contracts, is a positive step towards levelling the playing field for foreign technology owners.[27]

British businesses welcome these measures, and as a result, the ability to protect IP rights has fallen from British businesses' second most concerning issue in 2018 to eleventh in 2019.[28] However, companies still anticipate long-awaited amendments to China's *Copyright Law*, which currently lags behind on areas around online copyright infringement, enforcement, evidential requirements, digital copyright and punitive damages.[29] Similarly, the *Patent Law*, which was published in 2008, is widely considered out-dated, and businesses would like to see the implementation of the latest draft which proposes increased compensation for infringement, the introduction of the "principle of good faith", and patent term extensions for design patents and pharmaceutical patents.[30]

23 'Supreme People's Court to set up IPR court', Xinhua, December 2018.

24 'Trade Mark Law of the People's Republic of China', Ministry of Justice, April 2019.

25 'Anti-Unfair Competition Law of the People's Republic of China', National People's Congress, April 2019.

26 'Foreign Investment Law of the People's Republic of China', State Council, March 2019.

27 'Technology Import and Export Regulations', State Council, March 2019.

28 'British Business in China: Sentiment Survey 2019-2020', British Chamber of Commerce in China, December 2019.

29 'Copyright Law of the People's Republic of China', National Copyright Administration of the People's Republic of China, December 2012.

30 'Patent Law', National People's Congress, January 2019.

RECOGNITION OF PROFESSIONAL QUALIFICATIONS

The majority of foreign companies hire extensively from the local job market, bringing job opportunities to their sector and encouraging the transfer of knowledge and experience between the UK and China. However, in certain sectors, their status as foreign enterprises can restrict the functions that their employees can fulfil, limiting the development opportunities available to local employees and, consequently, the attractiveness and hiring power of the company. The legal sector is particularly affected by this, as Chinese lawyers have their legal right to practise PRC law suspended upon joining a foreign legal firm. The lack of mutual recognition of British and Chinese qualifications is also of concern to accounting firms. British accounting firms governed by a foreign accounting qualification body are unable to provide auditing standards in China. Professional services firms are also more likely to report that local candidates do not always have the full skill-set required by the position, identifying a key area in which UK training associations can work with Chinese accreditation bodies to diversify local professionals' skill sets.

EMPLOYING LOCAL STAFF

Over the course of 2018 and 2019, several changes to employment laws have streamlined human resources operations. The abolishment of requirements for citizens from Hong Kong, Macau and Taiwan working in the Chinese mainland to apply for work permits[31] meant talent from these areas were more accessible to employers, enhancing companies' ability to hire the best talent for the role regardless of place of origin. China's revised *Individual Income Tax Law* also came into force at the beginning of 2019,[32] raising the minimum tax threshold and confirming six additional itemised deductions to taxable income, increasing incentives for talent in senior and middle management to remain in or move to a company's China offices.

However, challenges remain in this space, particularly around difficulties in processing payments to contracted labour. In some cases, contractors have requested payment before work has been completed, despite the deliverables being clearly stipulated in the labour contract, due to the fact that the Lunar New Year holiday was approaching. The ability for individual arbitrators to override contractual agreements after judging them to not be fully aligned with statutory employment requirements without proper recourse for businesses, particularly at the township-level, undermines the attractiveness of China as an investment destination. Furthermore, a ruling in favour of the contractual workers may require businesses to settle the dispute in cash within a short period of time — in some cases on the day of the ruling — which can be extremely difficult for small- and medium-sized enterprises.

31 'Decision on Repealing the Provisions on the Administration of the Employment of Taiwan, Hong Kong and Macao Residents in the Mainland', Ministry of Human Resources and Social Security, August 2018.

32 'Individual Income Tax Law', State Taxation Administration, August 2018.

RECOMMENDATIONS

REGULATORY CHALLENGE	RECOMMENDATION
Foreign Investment Law	▪ Promote regional consistency in the interpretation and enforcement of the Foreign Investment Law. ▪ Provide greater detail on the ways in which officials may be held legally accountable if the Foreign Investment Law is disregarded. ▪ Revisit the possibility of incorporating the Foreign Investment Law into the Company Law.
Cybersecurity and IT Restrictions	▪ Safeguard the mutual benefits of international information-sharing by ensuring that the final iteration of the implementing rules under the CSL gives firms reasonable scope to share information overseas that is crucial to business operations, as long as it does not have a tangible impact on national security. ▪ Provide more detailed guidance and greater clarity on the terms and implementation of the CSL and its surrounding legislation. ▪ Establish a clear and transparent boundary for rights of access to company IT systems for both the authorities and third parties in the case of a security assessment or security breach. ▪ Transparently align cyber laws closer with international standards, such as the General Data Protection Regulation, International Organisation for Standardisation and the APEC Cross-Border Privacy Rules, to improve commercial clarity and create a space for information-sharing and collaboration on standards. ▪ Strengthen bilateral and multilateral mechanisms for dialogue and exchange between regulators and businesses. ▪ Ensure equal and consistent enforcement of the CSL and related regulations across entities and regions.

REGULATORY CHALLENGE	RECOMMENDATION
Accessing and Moving Company Finances	▪ Encourage provincial and municipal branches of SAFE to issue their own Q&As to address common enquiries from businesses. ▪ Reduce the complexity of cross-border remittance processes, particularly regarding the number of supporting documents required for smaller transactions. ▪ Work with banks to create national guidelines on acceptable variations of a recipient's name when processing bank transactions. ▪ Provide clearer parameters for the types of products businesses cannot purchase from overseas. ▪ Reduce the withholding tax rate.
Competition with state-owned enterprises	▪ Develop a transparent roadmap for SOEs to actively withdraw from non-strategic sectors, and instead focus on maintaining an effective regulatory system that ensures free competition among all market entities. ▪ Ensure that the principle of competitive neutrality is rigorously enforced by identifying and removing explicit and invisible barriers that grant SOEs a competitive advantage over foreign companies.
Obtaining business licences and certificates	▪ Ensure that applications for business licences made by foreign and domestic companies are treated equally. ▪ Provide detailed feedback if a business's application for a licence is rejected. ▪ Continue to reduce the number of sectors on the 'Negative Lists', with the aim to remove all sectors from it in the long-term.

REGULATORY CHALLENGE	RECOMMENDATION
Employing foreign staff	■ Allow companies to receive work permits for staff on the basis of sufficient possession of soft skills and qualifications, instead of setting hard limits on age and minimum post-graduation experience. ■ Continue to monitor and adapt China's income tax regime to increase its attractiveness to foreign talent.
Transparency and consultation ahead of regulatory changes	■ Work to provide clear definitions of terms in new laws, implementation measures and other legal documents. ■ Engage businesses at all stages of formulating or updating policies in order to optimise business environment.
Enforcement of laws and regulations	■ Encourage consistent implementation of legislation that affects foreign businesses across regional jurisdictions.
Customs requirements	■ Consult with British businesses more frequently when formulating *guobiao* standards and provide more notice to businesses when standards change. ■ Allow more leeway for products with inconsequential errors on labels to enter the market, as long as those errors are unlikely to cause harm. ■ Ensure that customs processes and rules are applied consistently across ports in China.

REGULATORY CHALLENGE	RECOMMENDATION
Taxation landscape for foreign firms	■ Reform the withholding tax on cross-border payments in order to ensure it does not act as duplicate of corporate income tax. ■ Provide detailed guidelines to help companies comply with new tax requirements. ■ Increase coordination between different tax authorities in order to reduce administrative costs for businesses.
Public procurement policy and practices	■ Ensure that pledges made in the *Foreign Investment Law* to grant equal treatment to foreign and domestic enterprises in government procurement are rigorously enforced. ■ Open all procurement activity in goods, services and construction services to foreign competition, in line with China's most recent GPA offer.
Intellectual property rights protection	■ Accelerate the implementation of the revised *Copyright Law* and *Patent Law*. ■ Build upon the *Foreign Investment Law* to explicitly prohibit forced technology transfer by any means.
Recognition of professional qualifications	■ Allow lawyers qualified in PRC law to practice PRC law within a foreign law firm. ■ Work towards signing mutual recognition agreements between British and Chinese qualification bodies across the services industries.
Employing local staff	■ Provide companies with effective recourse mechanisms when an individual arbitrator overrules the terms of agreements between companies and contractors. ■ Allow companies a longer grace period to pay settlements.

INDUSTRY REPORTS

ACCOUNTING

AT A GLANCE:

SUB-SECTORS:

Accounting firms

Qualification organisations

KEY CHALLENGES:

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

KEY RECOMMENDATIONS:

- Explore the opportunity of signing Mutual Recognition Agreements between CICPA and British accountancy bodies
- Allow up to 50% British non-CICPA ownership of CICPA firms, in line with the UK model of corporate ownership
- Remove requirements for individual accountants to provide their personal identification to accounts to eliminate the risk of being blacklisted, and entrust the relevant accounting bodies to govern the conduct of accountants

KEY MUTUAL OPPORTUNITIES:

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

STATE OF THE SECTOR

A well-governed and robust accounting sector is vital to ensuring a healthy and transparent economy conducive to domestic and international investment and financial stability. China's accounting sector has played an essential role in the country's economic development and in fostering a more reliable business environment. According to the Ministry of Finance (MOF), there are currently 7,862 accounting firms and 109,352 certified public accountants operating in China, providing services to more than four million businesses and organisations, including over 3,000 listed companies.[1]

The UK has a strong history of excellence in accounting, and is home to a number of widely recognised qualification bodies and global accounting firms, with 17 of the top 20 global accounting firms headquartered in the UK. However, British and other foreign accounting organisations are prohibited from operating as a wholly foreign-owned enterprise (WFOE) in China, leading many firms to instead join international accounting networks, granting them greater brand recognition while cutting down on operating costs and vulnerabilities to shifts in the market. Big Four firms, by contrast, were granted the right to audit in 1992 and began providing accounting services in China through joint ventures (JVs), while also managing representative offices and WFOEs in other cities, through which they provided business consulting services. Big Four firms have since been required to restructure into Special General Partnerships (SGPs) after their initial JV licences expired.

China's accounting sector has proved to be somewhat more resilient to the effects of COVID-19, relative to other industries. Global accounting firms have already been moving towards greater digitalisation, such as cloud accounting or remote access solutions. The need to work remotely during the outbreak is likely to have accelerated the adoption of such technologies by firms. This has presented a challenge in that many of the global technology solutions are restricted or blocked in China, significantly hindering international business interaction and collaboration. Beyond remote working, the virus outbreak has further encouraged accounting firms to reassess the rigid working hours in place during normal times and to shift towards a more flexible mode of operations between staff and firms.

Several pieces of cross-industry legislation have a particular impact on accounting firms. The draft *Regulations on the Optimisation of the Business Environment* issued by the National Development and Reform Commission (NDRC) aims to create a more transparent and predictable business environment in China.[2] Given the costs associated with regional inconsistencies in interpreting regulations, the draft has been welcomed by British accounting firms, although they await to see whether it will have a tangible impact on standardising policy interpretation and implementation across regions. The implementation of the *Foreign Investment Law* (FIL) should also level the playing field in terms of auditing Chinese firms at the same consistency and rigour as foreign companies.[3] China's Corporate Social Credit System (CSCS), due to be implemented by the end of 2020, will create severe ramifications for individual accountants who must report their own identification on accounts and are liable to being put on a blacklist for misconduct instead of the company itself.

China's national professional accounting organisation is the Chinese Institute for Certified Public Accountants (CICPA). CICPA is China's principal certification body for accountancy qualifications and membership organisation for accountants. Certified auditors must hold a CICPA qualification in order to provide auditing services in market. Under the supervision of MOF, CICPA also formulates professional standards for the industry and monitors their implementation. CICPA consults widely with both Chinese and foreign accounting firms and associations, granting British businesses the opportunity to influence the regulatory environment in which they operate. In addition, the Chinese Securities Regulatory Commission (CSRC) and MOF set additional requirements for auditors and audit firms of listed companies, and administer the regulations surrounding security-related services.

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

2 'Regulations on the Optimisation of the Business Environment', State Council, October 2019.

3 'Foreign Investment Law of the People's Republic of China', State Council, March 2019.

REGULATORY CHALLENGES

1 LACK OF MUTUAL RECOGNITION OF BRITISH AND CHINESE QUALIFICATIONS

A key concern of accounting firms and bodies is the lack of recognition of accounting qualifications between the UK and China. Only firms governed by a Chinese qualification body are permitted to sign audits, and few full exemptions have been granted by CICPA. Chinese qualifications such as CICPA are similarly not recognised in the UK, and so the introduction of a Mutual Recognition Agreement (MRA) between British accounting bodies and CICPA would be beneficial for firms from both countries. This would allow both British and Chinese accountants and firms to become members of the equivalent body and operate more efficiently in the other country, without spending even more time to pass additional certified public accountant (CPA) qualification exams. With no nationality-based restrictions, a reciprocal agreement to translate the CICPA exam into English and vice versa could alternatively further ease the ability of accountants to become CPAs in the other jurisdiction. Many British firms nevertheless hold the view that assurance services are generally of a higher risk and offer lower profit margins, and so the provision of advisory services such as tax advisory, corporate finance or risk consulting is becoming increasingly more attractive for British accounting firms.

2 LIMITATIONS ON NON-CICPA FIRM OWNERSHIP

British accounting firms governed by a British accounting qualification are prohibited from operating as a WFOE for the provision of auditing services, and British chartered accountants are prohibited from being equity partners of China registered firms. It is common for firms instead to join international accounting associations in order to provide assurance services, which has significant advantages in terms of quality, risk mitigation and client service. Assurance services are regulated by a separate government bureau from that of CICPA and MOF, which oversees accounting and business advisory services, and so British firms must register separate companies in order to provide these services, adding to the administrative costs of establishing additional offices. Further complications and added costs can therefore arise for firms when maintaining consistent branding across multiple legal entities.

Furthermore, only accountants with a CICPA qualification are permitted to hold the position of equity partner in Chinese accounting firms governed by CICPA. In the UK, up to 50% of a CPA firm's shareholders can be non-CPAs,[4] which permits Chinese nationals who are not chartered accountants to serve as partners in a British CPA firm and own shares. British nationals, however, are blocked from holding a partner position without a CICPA qualification, highlighting the significant lack of reciprocity in this regard. Big Four firms are similarly required by MOF to cap the percentage of non-CICPA partners at 20%, in effect capping the number of foreign equity partners in possession of British accounting qualifications.

3 BLACKLISTING OF ACCOUNTANTS THROUGH THE CORPORATE SOCIAL CREDIT SYSTEM

British accounting firms express concern about the potential for accountants to be blacklisted under the CSCS. The CSCS monitors the behaviour of companies and provides an assessment through regulatory ratings and compliance records. For violations such as tax evasion, not honouring legal obligations and financial fraud for example, companies can be blacklisted by a single government agency and face penalties by a range of other state agencies. This could involve restrictions around public procurement, exclusion from preferential policies, and greater difficultly in securing business licences and approvals. Conversely, companies can be placed on a 'redlist' for exemplary behaviour, making them eligible for various rewards. Under the CSCS, both companies and individuals can be penalised and even blacklisted by relevant government agencies for violating regulations. A company's social credit score is directly tied to the personal credit score of its senior leaders, often its legal representative. If a company is found to be in violation of a particular regulation, then the credit score its directors will be affected and vice versa.[5]

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

5 'Understanding China's Social Credit System', Trivium China, August 2019.

Individual accountants are not exempt from being blacklisted. Whereas lawyers can be protected under client privilege, accountants themselves do not enjoy such protections under the CSCS. While accountants should be registered under the company's name, according to the draft *Measures for the Blacklisting of Accounting Personnel in Serious Violation of Laws and Breach of Trust*, accounting personnel are now required to list their own name and identification. The draft measures state that accountants found to have engaged in criminal acts such as providing false financial and accounting reports, forging or altering accounting books, or embezzling public funds will be subject to administrative punishment and blacklisted for five years.[6] Accounting is not black and white, and relies heavily upon the judgement of qualified accountants. Having government officers with little, or even no, experience of the profession determine whether an accountant has carried out misconduct is worrying for British accounting firms, and in the regulations there is no clarity on what recourse accountants have to defend their name and reputation. The conduct of accountants should therefore remain under the governance of their respective governing body, which are better versed in the complexities and nuances of the profession. Additionally, while company law covers the responsibilities of directors, expanded legislation to cover fiduciary duties of directors and their role in the running of a company versus that of accountant would be welcome.

4 INCONSISTENT INTERPRETATION OF REGULATIONS

Loosely defined regulations that cause inconsistent interpretation by government officials and accountants from region to region can incur significant costs on British accounting firms in China. This is an issue in many industries and is particularly prevalent in accounting, where misinterpretation of a particular law could be viewed as non-compliant behaviour and can incur severe financial penalties. Travelling back and forth to various tax offices in order to clarify regulations is highly time consuming, and some firms have estimated that the time spent doing so roughly accounts for 10-20% of the costs that they charge clients. These additional costs similarly impact Chinese accounting firms, as well as other businesses in the wider economy as fees are passed onto client firms.

Businesses hope that the draft *Regulations on the Optimisation of the Business Environment* will remove inconsistencies in the implementation of laws. Article 7 of the regulations pledges to formulate an optimised business environment across regions and departments, removing policy discrepancies between local governments. Article 64 similarly prohibits local authorities from engaging in local protectionism by restricting the entry of foreign players into local markets.[7] British accounting companies welcome the central government's intent to standardise policy implementation across the country, and hope that this will be rigorously enforced to remove any inconsistencies in the implementation of regulations across China and foster a more stable, predictable and transparent business environment.

5 CYBERSECURITY AND IT RESTRICTIONS

British accounting firms are further inhibited by restrictions on access to corporate technology platforms in China. Cloud and remote access solutions are becoming widely used among accounting firms globally. The inability of British accounting companies to access restricted technology solutions, such as cloud-based services, to share resources and collaborate across offices hinders international business interactions and isolates companies' China operations. As firms have turned towards remote working during the COVID-19 outbreak, the need to access cloud technology services has become all the more vital as colleagues must work together efficiently across time zones.

6 'Measures for the Blacklisting of Accounting Personnel in Serious Violation of Laws and Breach of Trust (Draft Calls for Comments)' Ministry of Finance, September 2019.

7 'Regulations on the Optimisation of the Business Environment', State Council, October 2019.

RECOMMENDATIONS

REGULATORY CHALLENGE	RECOMMENDATION
1 Lack of mutual recognition of British and Chinese qualifications	▪ Explore the opportunity of signing Mutual Recognition Agreements between CICPA and British accounting qualification bodies. ▪ Allow British non-CICPA auditors to provide other assurance services to clients such as IFRS audits.
2 Limitations on non-CICPA firm ownership	▪ Allow British non-CICPA up to 50% ownership of CICPA firms, in line with the UK model of corporate ownership.
3 Blacklisting of accountants through the Corporate Social Credit System	▪ Remove requirements for individual accountants to provide their personal identification to accounts to eliminate the risk of being blacklisted, and entrust the relevant accounting bodies to govern the conduct of accountants. ▪ Expand legislation to cover fiduciary duties of directors and their role in the running of a company as opposed to that of the accountant.
4 Inconsistent Interpretation of Regulations	▪ Ensure that the *Regulations on the Optimisation of the Business Environment* are fully implemented to remove discrepancies in the interpretation of accounting standards and regulations.
5 Cybersecurity and IT Restrictions	▪ Consider lifting restrictions on non-sensitive business software, applications and tools used international by businesses, and allow more use of paperless accounting and reporting.

MUTUAL OPPORTUNITIES

BUSINESS ADVISORY SERVICES

In the global accounting industry there has been a marked shift towards the provision of business advisory services, rather than simply auditing. In China, where British accounting firms not governed by Chinese qualifications are prohibited from performing auditing services, this trend has been accelerated. Advisory services are widely viewed as offering higher margins and lower risk, which British accountancy firms naturally find more attractive. This also mitigates against increasing competition from Chinese firms and the rise of automated accounting services. Chinese firms are all able to offer tax services, but not all can offer the more complex business advisory services British firms excel at. The presence of British accounting firms in China amid an industry-wide shift towards business advisory services brings expertise to the sector and improved services for Chinese clients.

TRAINING AND THE PROVISION OF TALENT

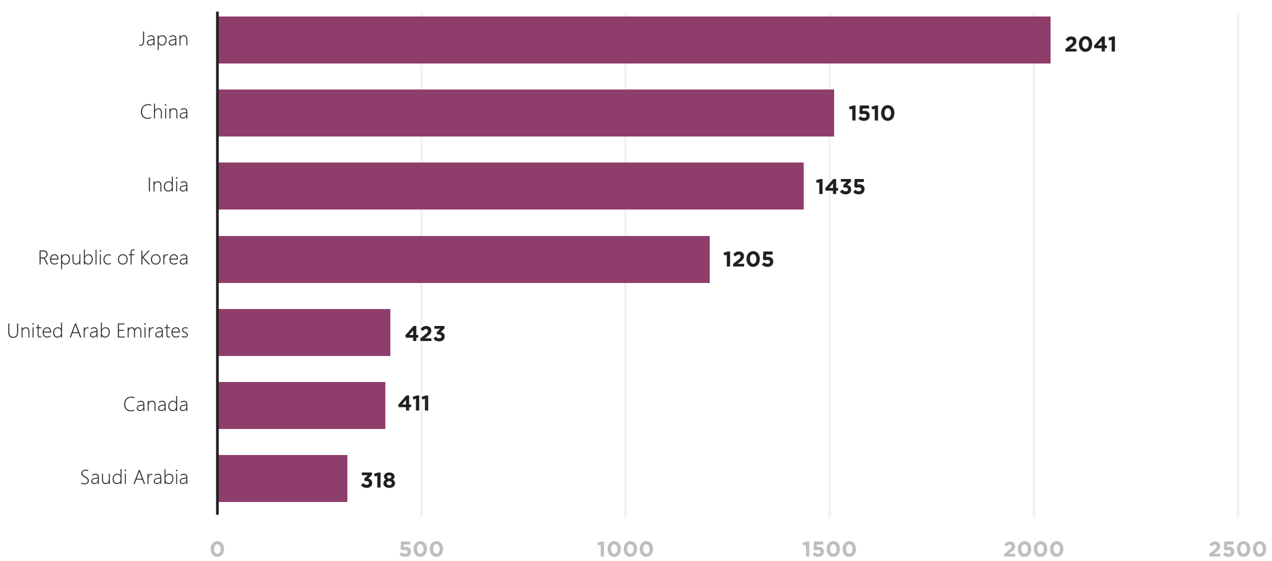
A sharp increase in the number of qualified and experienced accountants is needed to satisfy the growing demand for business advisory services in China. The opportunity to provide business advisory is dependent on the availability of talented accountants with practical business experience – something China's accounting industry is relatively short of. To better prepare accountants for the need to understand business challenges in order to provide consulting services, many qualification bodies are already working with universities to embed their courses into their curriculums. The presence of globally-recognised British accounting qualification bodies in China to train accountants and meet the needs of businesses for quality advisory services will strongly complement China's shift to a more service-based economy.

TECHNOLOGY IN ACCOUNTING SERVICES

The adoption of cloud accounting software in China remains quite low, despite its potential to improve the handling of clients' business. Cloud accounting technology can assist with a range of client services, including bookkeeping business transactions, statutory reporting and tax findings; communication with clients; and the posting and filing of *fapiaos*. It can also help companies improve the quality of their value-added advisory services and navigate new and uncertain challenges. Artificial intelligence (AI) will soon replace standard accounting services such as tax preparation, payroll and audits. The demand for value-added business advisory services that is reliant on human intelligence and judgement helps alleviate the threat to jobs from automated accounting, as business advisory is an area that is difficult to replicate with AI.

Number of CPA exam candidates by international jurisdiction (2017)

Source: NASBA



AUTOMOTIVE

AT A GLANCE:

SUB-SECTORS:

Original equipment manufacturers

Automotive components suppliers

Automotive consulting firms

KEY CHALLENGES:

- Changes to emissions standards with limited consultation
- Burdensome customs requirements
- Stringent and inconsistent NEV development policies

KEY RECOMMENDATIONS:

- Facilitate an ongoing dialogue with domestic and foreign industry participants at all stages of the policy drafting process
- Permit the mutual recognition of certifications by accredited test centres in the UK and China to remove the requirement of retesting at port of entry
- Ensure that the goals of the NEV Industrial Development Plan can be achieved through reasonable means by sustaining policy incentives and accelerating the construction of charging infrastructure, rather than simply by increasing production quotas

KEY MUTUAL OPPORTUNITIES:

- Connectivity
- Premium and luxury vehicles

STATE OF THE SECTOR

The automotive industry remains a vital pillar in UK-China bilateral trade, and has been a significant contributor to China's economic miracle. At 6%, China is the third largest destination for UK-manufactured passenger vehicles, down from 8% the previous year, putting it behind only the European Union and the United States.[1] After non-monetary gold, motor vehicles were the second largest export to China, representing 19% of total goods exports.[2]

China remains the world's largest consumer market for passenger vehicles, yet in 2018 automotive sales declined for the first time since 1990 and sales figures have fallen even more sharply in 2019. The Economist Intelligence Unit (The EIU) forecasts a compound annual growth rate of 0.7% for vehicles between 2019 and 2023, although tight restrictions on vehicle registrations in major coastal cities, dampened consumer confidence and market saturation make it unlikely that sales will reach their 2017 peak in the near future. Growth is likely to be driven by smaller cities in the interior which have less stringent air pollution restrictions and a rapidly growing middle class population.[3] Whereas sales of new energy vehicles (NEVs) had seen continuous strong growth, sales declined for the first time in July 2019 as the government began to rein in financial support for manufacturers. The premium and luxury segment, the market in which British automotive manufacturers in China excel, however, has proved more resistant and sales generally remain high among wealthy consumers.

The automotive sector has been among those worst hit by COVID-19. As the sector looked to recover from two years of declining sales, manufacturers have seen a dramatic impact on their demand and production as a result of the virus. According to the China Passenger Car Association, car sales fell by 80% in February compared to the same period a year ago as dealerships have been forced to shut.[4] Manufacturers have also been hit on the production side as factory output across China dropped owing to stringent restrictions on the movement of people and goods. Wuhan, where the virus first emerged, is a significant manufacturing and supply chain hub for China's automotive sector. The closure of factories producing automotive components has caused severe disruption to global supply chains, impacting British automotive companies manufacturing both domestically in China, and in the UK and across the world. As factories face shortages of key parts, and while demand for new vehicles remains low, manufacturers have had little choice but to operate below full capacity. Importers are also finding that customs inspections have lengthened substantially during the COVID-19 outbreak, with customs officials uncertain as to when vehicles and components can be imported, leading to significant delays.

Like many other industries in China, the automotive sector is governed by a number of different government agencies. The country's emissions standards are determined by the Ministry of Ecology and Environment (MEE), which companies must comply with before selling their vehicles in China. For original equipment manufacturers (OEMs) manufacturing domestically, they must obtain investment approvals and manufacturing licences from the National Development and Reform Commission (NDRC) and the Ministry of Industry and Information Technology (MIIT). The Certification and Accreditation Administration of China (CNCA) manages the China Compulsory Certification (CCC) scheme, which grants approval to manufacturers to market and import their vehicles and components. OEMs must also ensure that their vehicles comply with the Corporate Average Fuel Consumption (CAFC) regulations and NEV credits rules, administered by MIIT.

Over the past year, the Chinese government has promulgated many new regulatory reforms designed to open the market, alleviate the slump in sales and ensure the

1 'The motor industry: statistics and policy', House of Commons Library, December 2019.

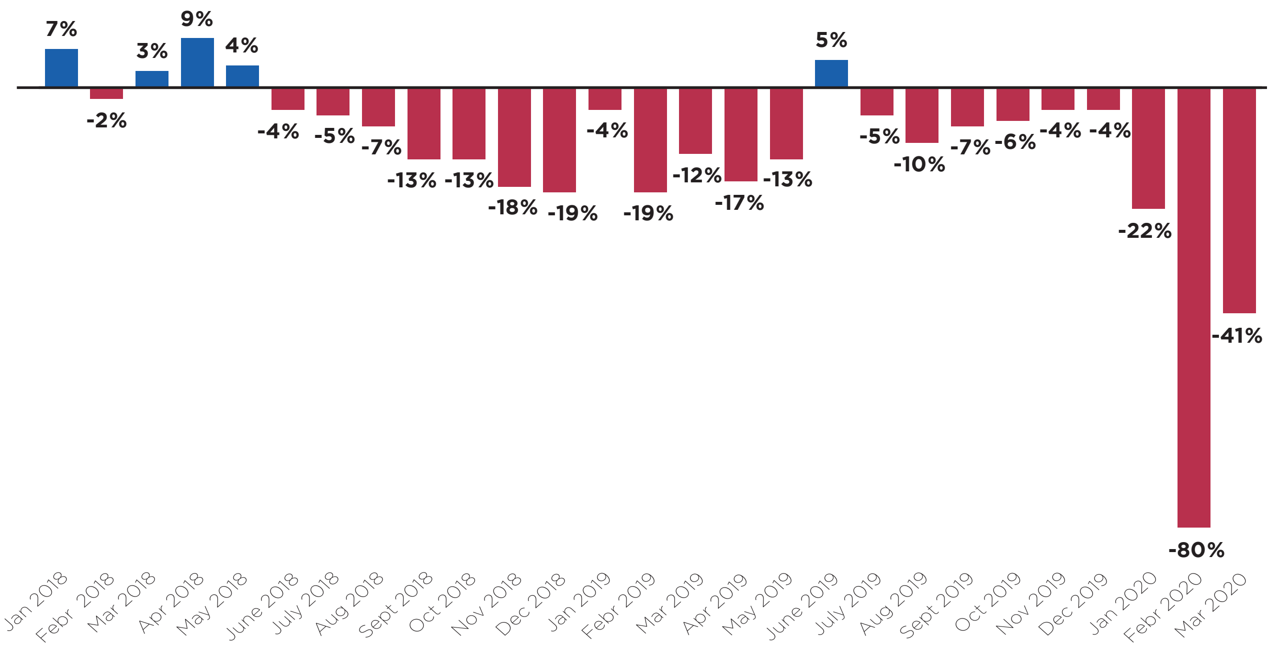
2 'Statistics on UK trade with China', House of Commons Library, November 2019.

3 'China Automotive Industry Report', The Economist Intelligence Unit, October 2019.

4 'Car Sales Smashed by Covid-19 Lockdown, Plummeting 80% in February', Caixin, March 2020.

China passenger vehicle sales (year-on-year growth)

Source: China Passenger Car Association



sector is more environmentally sustainable in the long-term. The latest China VI emissions standards, some of the most stringent standards in the world, were implemented in July 2019 in 18 cities and provinces, one year ahead of the previously announced deadline.[5] The enforcement of the new standards ahead of schedule and the banning of China V cars after that date exacerbated the fall in sales. Measures announced in June 2019 by the NDRC to revitalise national consumption notably did not include plans to ease restrictions on the issuance of new vehicle registration plates,[6] although the State Council later encouraged local governments to gradually relax controls over new vehicle sales.[7] Intelligent connected vehicle (ICV) technology and components were added onto the *Catalogue of Industries Encouraging Foreign Investment*, which lists sectors where foreign investment is encouraged and businesses can benefit from preferential policies.[8]

As China looks to promote a greener and more sustainable economy, NEVs have become a priority industry for development. The British Chamber of Commerce in China submitted comments on the draft NEV Development Plan 2021-2035 released by MIIT in December 2019, which states that NEVs should account for one quarter of all new vehicle sales by 2025.[9] While British businesses welcome measures such as those to remove local protectionism by city and provincial governments, there is concern that the window to respond with meaningful comments on the draft was too short. In August 2019, MIIT announced plans to launch pilot programmes that will gradually phase out internal combustion engine (ICE) vehicles and promote the widespread use of electric vehicles.[10] Following years of generous incentive policies to increase both supply and demand on NEVs, in July 2019 the government drastically cut subsidies for manufacturers as part of a move to reduce reliance on state financial support. Despite previous announcements that subsidies would be completely phased out by the end of 2020, British OEMs welcome the recent decision by the authorities to extend subsidies and tax exemptions for purchases of NEVs by another two years in response the impact of the COVID-19 outbreak on declining sales.[11] On the supply side, credit quotas for the production of NEVs under the Mandate Policy will rise from 10% to 12% in 2020, and are expected to increase to 14% in 2021 and 16% in 2022.

5 'China Focus: China starts implementing tougher vehicle emissions standards', Xinhua, July 2019.

6 'Implementation Plan (2019-2020) for Promoting the Upgrading of Key Consumer Goods and Boosting the Circular Use of Resources', National Development and Reform Commission, June 2019.

7 'Opinions of the General Office of the State Council on Accelerating the Development of Circulation and Promoting Commercial Consumption', State Council, August 2019.

8 'Catalogue of Industries Encouraging Foreign Investment (2019)', Ministry of Commerce, June 2019.

9 'NEV Development Plan (2021-2035)', Ministry of Industry and Information Technology, December 2019.

10 'Response to Recommendation No. 7936 of the Second Session of the 13th National People's Congress', Ministry of Industry and Information Technology, August 2019.

11 'China to roll out mix of fiscal, financial policies to vigorously meet challenges', State Council, April 2020.

REGULATORY CHALLENGES

1 CHANGES TO EMISSIONS STANDARDS WITH LIMITED CONSULTATION

In order to directly address the significant issue of air pollution in many of China's major cities, in 2020 the government will introduce much more stringent emissions standards for all vehicles on China's roads. Although the implementation date of July 2020 for China VI was scheduled December 2016, a number of local governments brought the implementation date forward. This did not give manufacturers enough time to complete necessary product verification, undergo the required testing and acquire certification. British automotive manufacturers that focus on high-performance vehicles need several years for product development and production. Sudden changes to regulatory standards generate disruption and additional costs for all those in the industry. Furthermore, the introduction of the new standards after the national implementation date in provinces such as Inner Mongolia has added to the confusion for manufacturers trying to sell vehicles.

The MEE conducted consultation meetings with automotive manufacturers and issued a call comments on the emissions standards. However, with no information or feedback publically released by the government regarding companies' suggestions, businesses do not fully understand the reasoning behind some regulations or requirements. The views of businesses are often only solicited regarding the final draft law, rather than at an earlier drafting stage. The absence of a clear timeline to outline which local governments would accelerate the implementation of China VI standards and when generated significant uncertainty and confusion among British OEMs and components manufacturers. A more predictable regulatory environment in which companies can have an ongoing dialogue with the authorities and receive feedback on their comments will improve the business landscape for automotive manufacturers, allowing them to focus on designing and producing high-quality road vehicles for consumers to enjoy.

2 BURDENSOME CUSTOMS REQUIREMENTS

British manufacturers importing automotive components and finished vehicles into China must undergo onerous customs procedures that can be highly unpredictable. Certification tests by CCC and MEE needed to import vehicles into the country can currently only be conducted in China's regional testing facilities, even though the testing procedures largely model the New European Driving Cycle test for Euro V emissions standards carried out by the Vehicle Certification Agency in the UK. This in effect means that British automotive manufacturers must conduct the tests first in Europe and then again in China, creating significant additional costs and delays for importers. The China Automotive Technology and Research Centre has recently established a testing facility in Munich, Germany, where manufacturers can arrange certain tests, although the rest must be conducted in China. As China's passenger vehicle market has largely saturated following decades of high growth, domestic car brands are increasingly looking to sell their models globally. The signing of a mutual recognition agreement (MRA) between the UK and China whereby each side accepts the other's vehicle test reports would be hugely beneficial for manufacturers in both countries. As businesses find that gaining customs clearance can be unpredictable with parts or vehicles rushed through or delayed for extended periods of time owing to minor errors, an MRA would further reduce delays and uncertainty.

The General Administration of Customs China (GACC) has since introduced a number of additional inspections that manufacturers must further undertake. This includes checks on environmental protection components, on-board diagnostics systems inspections and emissions tests for at least 1% of each model a manufacturer imports.[12]

12 'Notice of the General Administration of Customs no. 168 of 2019 (Notice Regulating the Environmental Protection Inspection of Imported Motor Vehicles)', General Administration of Customs, October 2019.

These exact tests are already conducted in advance by MEE and the China Quality Certification Centre (CQC), and so they add a procedure that is costly and repetitive for importers. Businesses welcome the steps taken by the authorities to enhance environmental protection and reduce air pollution. However, they express frustration with repetitive testing requirements that contradict the State Council's efforts to streamline the operating environment for businesses.

3 STRINGENT AND INCONSISTENT NEV DEVELOPMENT POLICIES

In order to advance the development of NEV technologies, the Chinese governments has provided numerous policy incentives, as well as NEV credit quotas to encourage OEMs to manufacture more NEVs. However, these policies are often overly stringent and can be inconsistent for manufacturers. According the NEV Industry Development Plan (2021-2035), sales of NEVs should account for 25% of all total car sales by 2025. This is coming at a time when the authorities have signalled their intent to gradually ease out preferential policies designed to encourage NEV consumption, so as to make the market more sustainable. At the same time, however, the quota of NEV credits carmakers must earn is expected to continue to rise in the coming years, according to the plan. Meeting rising NEV credit quotas is particularly challenging for OEMs in the aftermath of the COVID-19 outbreak when industry sales plunged and demand for NEVs and ICVs remains uncertain. Furthermore, businesses were given just one week to provide comments and feedback on the industry development plan. This is simply not enough time to companies to conduct a thorough internal assessment of the draft plan and its full impact in order to provide meaningful feedback. British OEMs, however, welcome measures to extend subsidies and purchase tax exemptions for NEVs, and recommend that the authorities extend this same leniency to NEV credit quotas.

The implementation of national policies to develop its NEV industry can often be inconsistent and conflicting. Manufacturers are required to provide real-time data on a car's battery performance to a national government server in order to monitor its safety. However, if an OEM wants to obtain a green number plates in Shanghai, which are easier to obtain for consumers than regular plates and exempt the cars from being banned on polluted days, then they must link their batteries to the local Shanghai system as well as the national system. This added requirement causes additional and unnecessary time pressures for OEMs to provide this information and manage potential issues arising from consumer data privacy. OEMs that manufacture vehicles locally similarly experience challenges in accessing government preferential policies, which on paper, should be fully accessible to domestic and foreign companies. The inconsistent implementation of China's NEV policies undermines China's environmental objectives of reducing fuel emissions by making it more difficult for them to access financial incentives that would encourage greater investment in developing NEV technology.

4 RESTRICTIONS ON INTELLIGENT CONNECTED VEHICLES

In addition to the electrification of vehicles, the global automotive industry is currently undergoing another transformation as information technology plays an increasingly important role in urban mobility. China's current regulatory framework for developing ICVs, however, restrict foreign automotive companies from fully participating in the sector's technological development. Many of the internet and telematics services provided by ICV companies are legally classified as value-added telecommunications services (VATS). Foreign businesses are prohibited from providing VATS as a wholly foreign-owned enterprise (WFOE) under China's telecommunications regulations, and can only do so by forming joint ventures (JVs) with an equity cap of 50%. Furthermore, the ability of businesses to conduct R&D into autonomous vehicles and exchange necessary data on traffic information and algorithms with other operational bases abroad is severely restricted by China's *Cybersecurity Law*.[13] The requirement that foreign businesses must store their data locally in the Chinese mainland prevents companies from pooling information in cloud data centres overseas.

Foreign businesses also face stringent regulations around obtaining detailed geographic information and high-precision mapping for automated vehicles. The development of self-driving algorithms and technologies is dependent on the ability to gather high volumes of data on road conditions. Companies can apply for special licences to collect data on road conditions and height or weight limits on bridges from the National Administration of Surveying, Mapping and Geo-Information (NASG). However, according to the *Survey and Mapping Law*,[14] and the Special *Administrative Measures on Access to Foreign Investment* ('Negative List for Foreign Investment'),[15] foreign businesses are prohibited from obtaining a higher-level licence that would allow them to collect and process data for survey and mapping purposes. British businesses can only

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

14 'Survey and Mapping Law of the People's Republic of China', National People's Congress, April 2017.

15 'Special Administrative Measures on Access to Foreign Investment' Ministry of Commerce, June 2019.

gain access to high-precision maps by partnering with an indigenous supplier, preventing them from launching autonomous driving capabilities in China independently.

British OEMs in China also face roadblocks on their ability to conduct autonomous driving tests. According to the *Administrative Rules on Intelligent Connected Vehicle Road Testing* jointly released by MIIT, the Ministry of Transport (MOT) and the Ministry of Public Security (MPS) in 2018, autonomous vehicles can only be trialled on designated national test roads with a test driver present to supervise the vehicle (Level 4 according to the Society of Automotive Engineers classification system), and the testing of fully automated vehicles (Level 5) is prohibited.[16] Testing permits are granted by municipal governments for a fee of RMB 5 million (GBP 572,000), which are valid only within that particular city. The absence of a unified national testing licence makes it incredibly time-consuming and expensive for OEMs to test autonomous vehicles in different cities and on varying road conditions. This discourages businesses from thoroughly testing across the country to ensure passenger safety in the future and ultimately hinders the development of China's ICV industry.

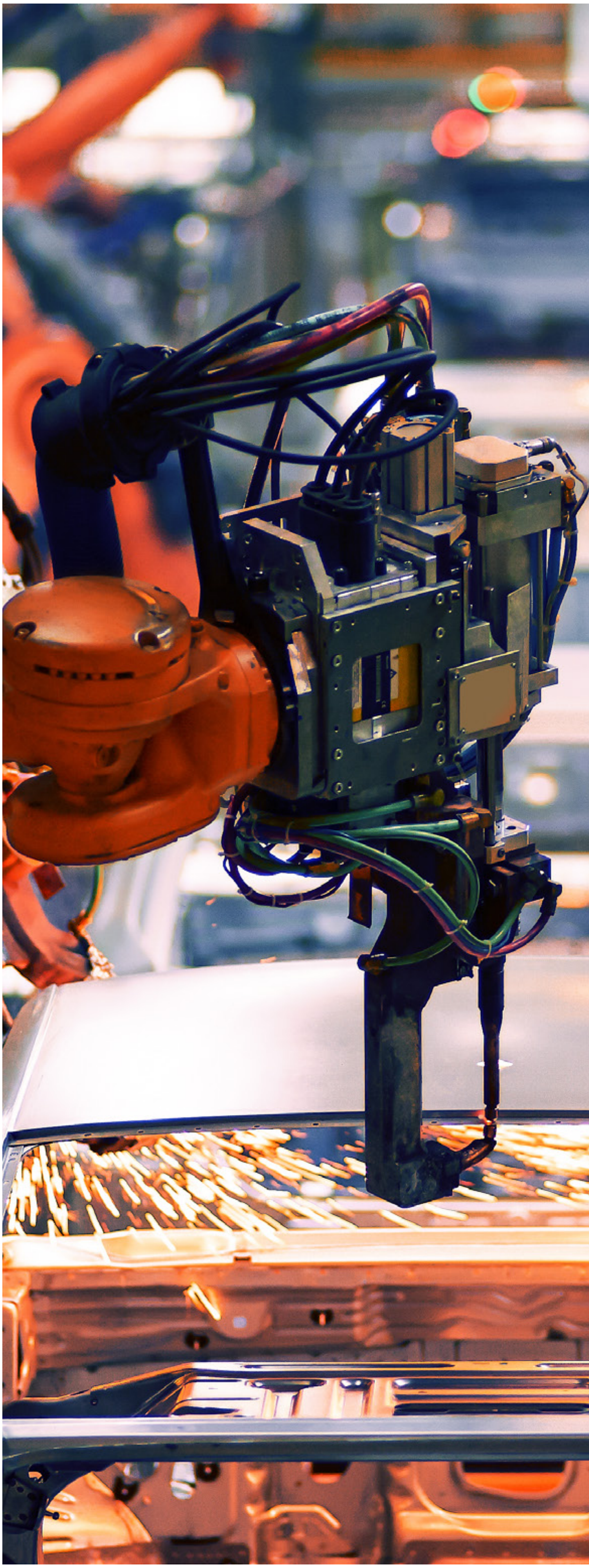
5 BAN ON USED COMPONENTS AND VEHICLES

The importation of second-hand vehicles and automotive components is banned in China, according to the *Administrative Measures for the Import of Mechanical and Electronic Products* issued by the Ministry of Commerce (MOFCOM).[17] The implementation of the *Administrative Measures for the Recycling of Scrapped Vehicles* in June 2019 permits five types of components (engines, steering wheels, transmissions, front and rear axels, and frames) suitable for remanufacturing to be sold to remanufacturing companies.[18] British automotive manufacturers welcome this as a positive step towards further developing China's remanufacturing sector. However, the quality and quantity of used parts sold in China does not meet the production needs of remanufacturing companies, and permitting imports of used components would contribute significantly to China's pool of available parts. Fully lifting the ban would benefit the country's R&D industry through increased access to used vehicles and parts, while aiding China in its efforts to build a more environmental sustainable and circular economy.

16 'Administrative Rules on Intelligent Connected Vehicle Road Testing', Ministry of Industry and Information Technology, April 2018.

17 'Administrative Measures for the Import of Mechanical and Electronic Products', Ministry of Commerce, May 2008.

18 'State Council regulates recycling scrap vehicles', State Council, May 2019.



RECOMMENDATIONS

REGULATORY CHALLENGE	RECOMMENDATION
1 Changes to emissions standards with limited consultation	■ Facilitate an ongoing dialogue with domestic and foreign industry participants at all stages of the policy drafting process.
2 Burdensome customs requirements	■ Permit the mutual recognition of certifications by accredited test centres in the UK and China to remove the requirement of retesting at port of entry. ■ Remove repetitive customs requirements that require importers to conduct repeated vehicle tests.
3 Stringent and inconsistent NEV development policies	■ Ensure that the goals of the NEV Industrial Development Plan can be achieved through reasonable means by sustaining policy incentives and accelerating the construction of charging infrastructure, rather than simply by increasing production quotas. ■ Issue a clear timeline for NEV financial subsidies that extends beyond the next two years. ■ Delay the increase in NEV credit quotas until industry sales recover after COVID-19.
4 Restrictions on intelligent connected vehicles	■ Remove the equity cap on investment into ICVs and permit foreign businesses to offer VATS as a WFOE. ■ Ensure that the final implementation measures of the Cybersecurity Law gives automotive firms reasonable scope to share information overseas that is crucial to the development of ICVs, as long as it does not have a tangible impact on national security. ■ Consider lifting restrictions, where possible, on access to non-sensitive HD maps to allow businesses to collect their own data on roads. ■ Establish a single national permit for autonomous driving testing that allows companies to test automated vehicles on designated roads.
5 Ban on second hand components	■ Lift restrictions on importing second-hand automotive parts and components.

MUTUAL OPPORTUNITIES

CONNECTIVITY

In order to improve road safety and ease traffic congestion, while also looking to establish the country as a global leader in mobility services, the Chinese authorities have made ICVs a strategic focus for the development of the automotive sector. Despite the current restrictions placed on foreign investment into ICV technology, in addition to challenges around standards and the legal framework for ICVs, British businesses note the immense market potential for connectivity-based technologies in the automotive sector. With certain licence restrictions for foreign enterprises having been lifted in China's telecommunications sector, companies hope that this same policy direction will be applied to the automotive sector around the provision of VATS. For autonomous vehicle testing, China is not a signatory to the 1968 Vienna Convention on Road Traffic, which permits only highly automated driving (Level 4), and so the government does not face restrictions on traffic legislation around autonomous driving. The authorities are therefore in a position to enact legislation that could permit the testing of fully automated driving without a driver present (Level 5).

PREMIUM AND LUXURY VEHICLES

The UK is home to a number of globally recognised premium automotive manufacturers who have a strong presence in China. Although there are few bright spots in the industry, with OEMs suffering from very narrow profit margins as car sales decline, the premium and luxury market has proved slightly more resilient relative to mass-market brands, in terms of both ICE vehicles and NEVs. The decline in automotive sales among premium brands in China has been more limited, especially for premium sports utility vehicles (SUVs). SUVs now comprise approximately 40% of all passenger vehicle sales in China,[19] and British manufacturers have been releasing new SUV models specifically with the Chinese consumer in mind. Wealthier consumers are less price-sensitive during economic downturns, and are more willing to pay for a premium and luxury high-performance cars. British automotive brands are well placed to tap into this demand, despite the wider slowdown in vehicle sales, and offer consumers the experience of driving high-performance models.

19 'Why China's auto market can bounce back', Financial Times, April 2019.

BUILT ENVIRONMENT SERVICES

AT A GLANCE

SUB-SECTORS:

Architecture

Construction

Engineering

Project management

Real estate

Spatial planning

KEY CHALLENGES:

- Challenges in obtaining licences
- Lack of mutual recognition of qualifications

KEY RECOMMENDATIONS:

- Provide more transparent and equitable approval processes for licences
- Work towards the mutual recognition of engineering, architecture and urban planning qualifications

KEY MUTUAL OPPORTUNITIES:

- UK standards, institutions and education
- Partnerships in new regions
- Higher value service provision

STATE OF THE SECTOR

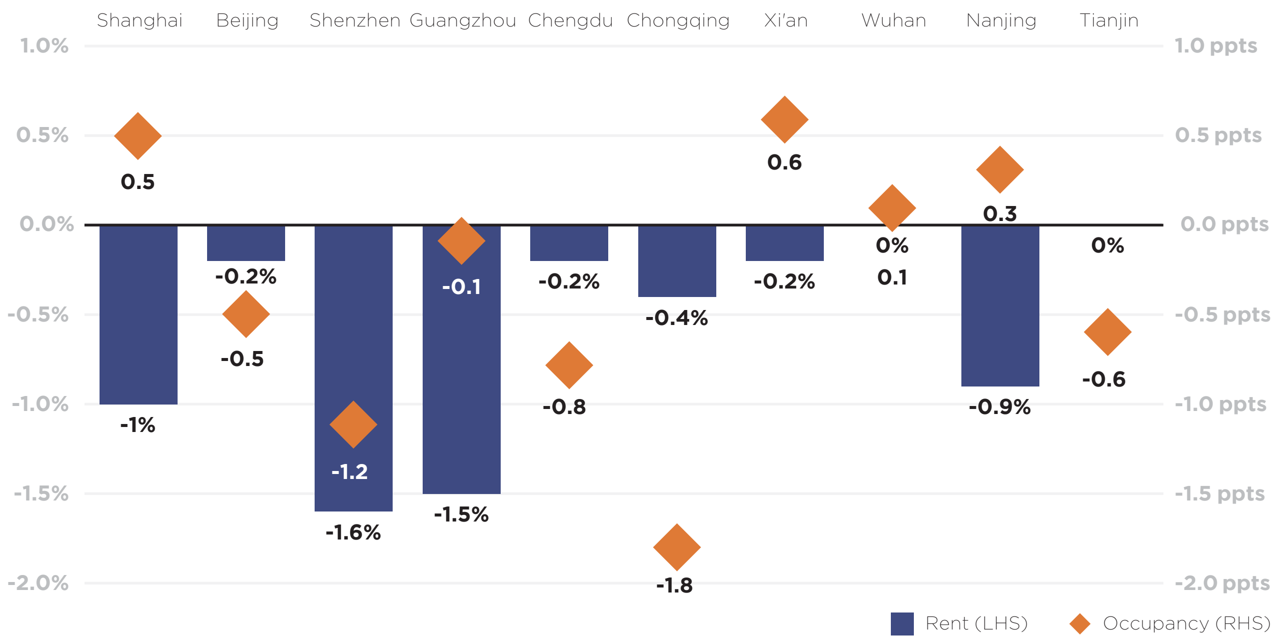
British companies in the built environment sector have the potential to play a decisive role in China's ongoing shift towards high-quality development. A number of the world's most renowned and innovative engineering, architecture, construction and design companies originate from the UK, many of which established operations in China more than 25 years ago. In 2018, UK construction services exports to China totalled GBP 44 million (RMB 389 million), constituting 1% of UK services exports to China.[1] The built environment sector in China is highly competitive and is dominated by domestic firms, largely owing to licence restrictions that inhibit the operations of foreign companies. 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.

2019 was a relatively challenging year for Chinese real estate markets, partly due to higher levels of business uncertainty and weakened demand across a number of sectors brought about by the US-China trade war. While residential markets remained relatively stable, commercial markets faced significant amounts of new supply, which pushed up vacancy rates as rents either stayed flat or fell.[2]

The impact of the COVID-19 outbreak on Chinese real estate and infrastructure markets is still being understood. February 2020 saw a virtual freeze of all markets and, while March and April saw some recovery, demand is still significantly below pre-COVID-19 levels. In terms of residential markets, a relatively strong rebound in April bodes well for the market, although challenges for smaller developers based in lower tier cities could mean some industry consolidation in 2020.[3] Demand for office space is closely correlated with economic growth, and as such, commercial markets have been slow to recover. This has led to further demand shortfalls and higher vacancy rates, in addition to delays in fitting out new

Rental and occupancy rate (quarter-on-quarter change, Q1 2020)

Source: Savills Research



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

2 'China's office market sees highest vacancy rate in a decade', Financial Times, October 2019.

3 'The impact of Covid-19 on Asia's residential markets', Knight Frank, March 2020.

offices as companies have been unable to conduct on site inspections.[4]

Over the past year, British businesses in the built environment services sector have seen positive movements to improve the business environment, both in terms of bilateral agreements and reforms introduced by the authorities intended to level the playing field for foreign and domestic companies. In April 2019, the UK's Department for International Trade (DIT) signed a Memorandum of Understanding (MOU) with China's Ministry of Housing and Urban-Rural Development (MOHURD) to reduce barriers to each country's construction markets and to create a more open, sustainable and transparent market place.[5] While businesses welcome this bilateral effort to further open up the sector, they have yet to see a material impact on their ability to access China's construction markets as a result of the MOU. Since its signing, the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM) issued revisions to the Negative List for Market Access in October 2019. The construction industry remains on the list and therefore the participation of both foreign and private built environment services companies in China continues to be constricted.[6] Businesses hope that this dialogue between both governments can extend towards substantially removing the critical barriers that prevent British companies from accessing the market.

On paper, the Chinese authorities have introduced a number of measures regarding the ability of foreign companies in the built environment industry to participate in government procurement. China's *Foreign Investment Law* (FIL), implemented in January 2020, pledges to grant international companies in China equal treatment in government procurement.[7] This commitment has been reaffirmed by a recent draft revision to the *Tendering and Bidding Law* (TBL), which aims to make the tendering process more inclusive for foreign-invested enterprises (FIEs) by discouraging preferential practices and enhancing the transparency and efficiency of bidding processes.[8] As part of wider reforms to open China's services sector, in June 2018 the State Council approved a series of pilot projects in cities which featured engineering consulting among the sectors included.[9] The notice revoked the 'track record' requirement which has prevented foreign firms from gaining approval for design qualifications. The Shanghai authorities have since issued guidelines that allow FIEs to apply for Grade B licences, and once obtained, businesses would theoretically be eligible to apply for a Grade A licence after six months.[10] While these reforms should, on paper, present foreign built environment firms with more opportunities to expand their service offerings in China, British businesses would like to see these measures fully implemented nationwide in order for them to make use of these openings.

4 'Coping with COVID-19 – China Office', Savills, April 2020.

5 'Policy Outcomes of the 10th UK-China Economic and Financial Dialogue', UK Government, June 2019.

6 'Negative List for Market Access', State Council, June 2019.

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

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

9 'Approval of the State Council on Deepening Pilot Projects for Services Trade for Innovative Development', State Council, June 2018.

10 'Guidelines on Qualification Approval for Foreign-invested Construction and Engineering Design Enterprises', Shanghai Government, May 2020.

REGULATORY CHALLENGES

1 CHALLENGES IN OBTAINING LICENCES

The most pressing challenge for British companies across the built environment services sector relates to the challenges in obtaining industry Grade A design licences and the discrepancy between reforms on paper and implementation at the local level. While it is technically possible in most cases to obtain this kind of licence, in practice a number of administrative and regulatory hurdles prevent companies from obtaining one at a local level. To circumnavigate this issue, companies can merge or buy out local firms with the licence, but it is not possible to continue using their licence unless they retain the requisite number of registered professionals. Since the State Council approved a series of pilot policies that revoked the requirement of a track record, as of May 2020, no British companies have yet obtained a Grade B design licence.

The ability of British businesses to obtain other licences across the built environment remains equally difficult. In urban planning and related functions, responsibility for the granting of licences passed to the Ministry of Natural Resources (MNR) in April 2018, and has been reformulated as 'spatial planning'. No new licences have since been issued and businesses anticipate that it will likely take some time for the issuance of design licences to resume under MNR. Valuation and appraisal licences (graded A to C) can only be obtained by companies that are wholly domestically-owned and domestically-registered valuers who hold individual licences and work for the majority shareholder in a partnership. Companies have so far only been able to acquire a valuation and appraisal licence through acquiring a Chinese firm with an existing licence.

2 LACK OF MUTUAL RECOGNITION OF QUALIFICATIONS

In a number of built environment disciplines, most notably engineering, architecture and urban (spatial) planning, there is a lack of mutual recognition of qualifications. For example, currently, the Institute of Structural Engineers recognises Chinese educational qualifications with a conversion exam. However, UK qualifications are not recognised in China at all, therefore constituting a lack of equal opportunity. While some individuals have managed to receive an individual licence after translating and presenting overseas qualifications, for the most part it has not been successful, and permitting the mutual recognition of qualifications would forgo the resources lost by the added time and effort needed to submit an application.

RECOMMENDATIONS

REGULATORY CHALLENGE	SUB-SECTOR	RECOMMENDATION
1 Challenges in obtaining licences	**ENGINEERING** **ARCHITECTURE** **CONSTRUCTION** **AGENCY**	■ Provide more transparent and equitable approval processes for licences.
	ARCHITECTURE **URBAN DESIGN** **ENGINEERING**	■ Allow China-registered architects, urban planners and engineers to park their registrations with potential non-licensed British companies to ensure they can practice in their relevant sector.
	ARCHITECTURE **URBAN DESIGN** **ENGINEERING**	■ Work towards an agreement between the UK and China to have reciprocal licence recognition between the two countries.
	ENGINEERING **ARCHITECTURE** **CONSTRUCTION** **AGENCY**	■ Ensure that high-level bilateral agreements are locally implemented by both governments.
	ENGINEERING **ARCHITECTURE** **CONSTRUCTION** **AGENCY**	■ Explore the opportunity of implementing a pilot licence, focusing on either a specific sector or specific geography in line with the MOU signed between the UK and China.
	SPATIAL PLANNING	■ Seek reassurance that the needs of British firms providing world-class spatial planning services in China are not ignored under the new system and are able to apply for and realistically secure the relevant design licences under the Ministry of Natural Resources.
2 Lack of mutual recognition of qualifications	**ARCHITECTURE** **ENGINEERING** **URBAN PLANNING**	■ Work towards the mutual recognition of engineering, architecture and urban planning qualifications.

MUTUAL OPPORTUNITIES

UK STANDARDS, INSTITUTIONS AND EDUCATION

The UK is recognised for its role in setting and promoting international standards throughout the built environment industry. Greater collaboration between British built environment professional institutions and China can significantly support the sustainable development of the sector in China. This can be done through aligning training staff to contribute technical knowledge, enhance risk management and promote health and safety. UK educational establishments could not only produce high calibre apprentices and graduates, but also leverage their capabilities and reputation to increase engagement with China. For example, there are no degree level courses in China on project or cost management, and graduates with engineering degrees must then re-train to gain further local qualifications while working as project managers or quantity surveyors.

PARTNERSHIPS IN NEW REGIONS

British engineering consultancies are well-placed to work with Chinese partners on a range of geographic projects both in China and around the world. UK expertise is highly compatible with that of China's capabilities, particularly in the areas of feasibility and management of risk. There are significant opportunities for cooperation on Belt and Road Initiative (BRI) projects, given their complementary skillsets, international track record and the widespread adoption of British standards in these markets where many have a strong historic UK presence. Similarly, the continued opening of Free Trade Zones (FTZs) and the development of the Greater Bay Area (GBA) and Xiong'an New City provide opportunities for partnership in the built environment. Furthermore, as the Chinese economy moves away a reliance on heavy industry, UK built environment services have opportunities to advise and participate in development of brown field sites and regeneration, contributing their global experience and expertise.

HIGHER VALUE SERVICE PROVISION

The growing use of high quality asset management, including cutting edge management technology such as building information modelling (BIM) by UK developers is widely seen as an opportunity going forward for retail, mixed-use and specialist properties. Partnering with and advising Chinese government authorities and clients on smart infrastructure and city development could provide considerable downstream opportunities to other property developers and built environment professionals.

EDUCATION

AT A GLANCE:

SUB-SECTORS:

Early years

EdTech

Education supplies

English language training

Higher education

K-12

Non-profit organisations

KEY CHALLENGES:

- Lack of clarity and openness in the regulatory environment
- Legal controls on the role of educational organisations
- Limitations on human resources and staffing

KEY RECOMMENDATIONS:

- Ensure that authorities at all levels refrain from publishing new regulations without sufficient notice, and that all new regulations or information can be clearly found on government websites and other information channels
- Allow wider scope for cooperation and exchange in non-sensitive areas of education between Chinese academics, professionals, specialists and their foreign counterparts
- Work towards a bilateral agreement between the British and Chinese governments to facilitate opportunities for both young and senior Chinese professionals to work in the UK, and vice versa

KEY MUTUAL OPPORTUNITIES:

- Early years (0-3)
- Partnerships
- EdTech

STATE OF THE SECTOR

The education sector is traditionally one of the strongest and most vibrant areas of UK-China cooperation. The Chinese education sector is expected to grow at roughly 11.3% a year to reach a market value of RMB 4.1 trillion (GBP 462.4 billion) in 2023.[1] Growth continues to be primarily driven by rapid urbanisation, accelerating household wealth, rising government spending, ever-greater internet penetration and increasing pre-school enrolments.

In the first four months of 2019, the State Council and the Ministry of Education (MOE) jointly announced plans to modernise education by 2035 and promote 'education informatisation' (EdTech and innovation).[2] These policies chart a course for education for the coming 15 years, and are intended to reform the national education system and regulate the market. Aligning with objectives in the 13th Five-Year Plan, this year saw the education sector in China continue on its long-term path to shift focus from quantity to quality.

Since the introduction of the 'Two-Child Policy' in January 2016, the number of children aged 0-6 in China has grown substantially. With both policy and capital support from the government, the early years sector has expanded significantly in line with this. In the first five months of 2019 alone, China's early education industry agreed 28 financing deals worth RMB 2.8 billion (GBP 322.8 million).[3] However, to standardise the market, the Chinese government also tightened rules on private ownership and oversight in the early years sector in 2018, officially designating the role of preschool education as a social public good.[4] The most significant consequence for private providers is that, from 2019, for-profit kindergartens are no longer permitted to go public or be acquired by listed companies.[5] Further to this, diversification into kindergartens is now off-limits for existing listed companies. Regulations further limit the size of the for-profit preschool market to 20% in some localities around China, indicating that, if trends continue, this is likely to become a predominantly government-supported segment.[6]

The international schools market in China, while remaining relatively buoyant, also encountered some noticeable new headwinds in 2019, with 65 new international schools opening across the country, a growth of 4.9% as compared with 11.9% in 2018.[7] Tighter regulations and economic uncertainty have contributed to the slowdown, particularly the implementation of regulations distinguishing between for-profit and not-for-profit school models.[8]Reticence from local administrative governments to approve licenses, more stringent checks on foreign curriculums, and suggestions of admission lotteries and fee caps have also complicated the regulatory environment of the sector, making compliance a marked challenge for many. A series of restrictions on the type of education materials that can be used in public schools is also of significant concern for the future regulatory environment of the sector.[9]

Internationalisation continues to be presented as a core aspect of the MOE's development strategies in Chinese education, and 2019 saw new Sino-foreign collaborations in transnational education (TNE) programmes established with a range of foreign partners. The overall number of TNEs in China has, however, seen a steady decline in recent years as the MOE's tolerance of poorly-conceived programmes diminishes, especially for those established as *de facto* recruitment and pathway channels. Between 2006 and 2018, 234 closures of existing Sino-foreign

1 'China Education Market Report: Insights, Trends and Forecast', Research and Markets, December 2019.

2 'China's 2035 Education Modernisation Plan', Ministry of Education, February 2019, '2019 Educational Informatisation and Cybersecurity', Ministry of Education, March 2019.

3 '2019 China Infants Early Education Market Status and Investment Trend Value Analysis Report', iiMedia Research, June 2019.

4 'China Investment Outlook 2019, Spotlight on Edtech', LEK Consulting, February 2019.

5 'Curbs on preschool IPOs', State Council, November 2018.

6 'China Investment Outlook 2019', LEK Consulting, February 2019.

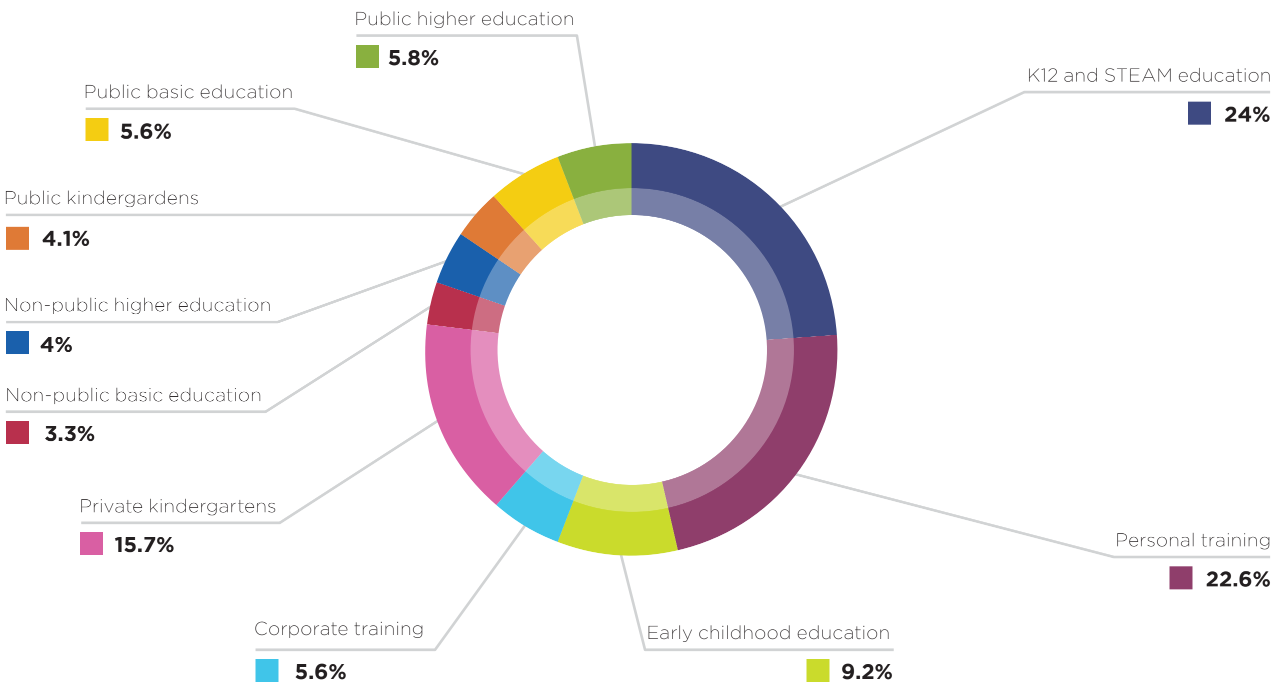
7 '2019 International Schools in China', Newschool Insight Media, November 2018.

8 'British Independent Schools in China, Annual Report 2020', Venture Education, January 2020.

9 'Notice from the Ministry of Education on the Measures on Management of Primary and Secondary School Teaching Materials, Measures on Management of Vocational School Teaching Materials and Measures on Management of Ordinary Higher Education Institute Teaching Materials', Ministry of Education, December 2019.

Proportion of services in the education market (2020 estimate)

Source: Deloitte



partnership programmes and jointly managed institutions were announced, including 62 TNE programmes initiated by British providers (a mean reduction of five per year).[10] Nevertheless, four new partnerships involving UK institutions at undergraduate level were approved in 2019 and the British Council reports that the UK remains a leading TNE partner for China.

2019 also saw a significant strengthened focus on technical and vocational education. In the face of ongoing demographic changes and slow rates of economic growth, the government has prioritised reforms of vocational education in China. The State Council has recently announced a series of plans and policies to improve the national vocational education system,[11] and has earmarked over RMB 70 billion (GBP 8 billion) to expand the vocational training system network of around 11,700 vocational institutions.[12]

In the past decade, English tutoring and training has attracted substantial investment, with the English language training (ELT) market in China expected to be worth RMB 530 billion (GBP 60.2 billion) by 2022.[13] However, with the success of online brands entering the market, some more traditional offline ELT brands have struggled to maintain market share. The sudden closure in October of one of the first English training companies to operate in China raised fears of a deteriorating market, especially for post-18 learners. In light of increasing saturation in many Tier 1 cities, further growth may now be more extensive in smaller cities, and in new models combining online and offline learning experiences.

With the growth of online companies, one notable new trend has been the greater crossover between the world of ELT and the world of EdTech. With over 400 million students, China is the world's largest market for educational technology and Chinese cities are home to the world's best funded and most valuable EdTech companies. Beijing is currently reported as having the highest concentration of EdTech companies per capita in the world,[14] and as of July 2018, seven of the world's ten largest EdTech unicorns were based in China. This growth can only be expected to continue, particularly now that uptake has surged as a result of the COVID-19 outbreak. However, this crowded and intensely competitive landscape for online education market poses challenges to EdTech start-ups in China, who can find it hard to differentiate their products and gain market footholds.

10 'Announcement on the closure of some TNE programmes in China', Ministry of Education, July 2018.

11 'Implementation Plan on National Vocational Education Reform', The State Council, January 2019.

12 'China Has 11,700 Vocational Institutions', Xinhua News Agency, February 2019.

13 'English language training (ELT) market size in China in 2017 and 2022', Statista, September 2018.

14 '8 Chinese Edtech startups leading the glocal educational technology industry', Daxue Consulting, May 2019

The increasingly systematic regulatory environment remains another challenge. In July 2019, the MOE launched a campaign to scrutinise online after-school training businesses, specifically checking operation information, payment structures, course content and teacher qualifications.[15] It has also introduced new action plans – such as the New Generation AI Development Plan[16] and the AI Innovation Action Plan in Institutions of Higher Learning[17] – which can be expected to pose further challenge and competition for market players. These plans lay the groundwork for the development of AI technologies into mainstream education, teaching practices, teacher training, and academic research.[18] The draft *Implementation Rules of the Promotion of Privately-run Schools Law* issued in August 2018 further sets approval, filing, and cybersecurity requirements for online schools and online training institutions.[19] This revision is expected to be finalised very soon.

The progress of COVID-19, and corresponding global measures to slow the virus, have had a seismic effect on the Chinese education market as a whole. All early years providers, K-12 organisations and learning centres have endured government-imposed closures, most of which remain ongoing across the country at time of writing. Kindergartens have been legally required to refund fees while continuing to pay operating costs, with many afterschool and extracurricular organisations facing similar or identical challenges. The private K-12 market has been somewhat more insulated, with most schools having transitioned classes and work online in order to maintain operations. Schools face significant challenges, however, including coordinating geographically dispersed teacher and student populations, navigating IT skills gaps among staff and students, maintaining student focus in the new online environment and managing parent frustration.

These have made quality of provision and stakeholder perceptions hugely variable from school to school. This may well have an impact on schools' relationships with parents and student grades in the longer term. The outbound market is currently buoyant, but much will depend on the success of popular destinations such as the UK, US and Australia to control the spread of the virus, their willingness to protect and support Chinese students, and Chinese people's perceptions of the relative safety and tolerance of each destination. It is likely that this year's summer course market in the UK will be severely affected by the crisis. At the same time, the ongoing online experiment, with hundreds of millions of students studying fully online, could lead to significant growth in long-term innovation and greater market dominance of EdTech in the education sector.

15 'China to launch inspection on after-school training institutions', Ministry of Education, July 2019.

16 'New Generation AI Development Plan', State Council, July 2017.

17 'AI Innovation Action Plan in Institutions of Higher Learning', Ministry of Education, April 2018.

18 'Education Minister delivers keynote speech at International Conference on Artificial Intelligence and Education', Ministry of Education, May 2019.

19 'Call for comments on the Implementation Rules of the Promotion of Privately-run Schools Law', Ministry of Justice, August 2018.

REGULATORY CHALLENGES

1 LACK OF CLARITY AND OPENNESS IN THE REGULATORY ENVIRONMENT

Overall regulatory supervision of education in China has been stepped up significantly in recent years, with sometimes severe effects. Many policies and regulations have been announced or enforced without adjustment or implementation periods, limiting the viability of some projects. The unilateral and unpredictable nature of some of the regulatory changes and enforcements to date have also raised fears of further tightening of the sector to come, contributing to a slow leak of optimism in the sector and lowered investment incentives. A major contributing factor is uncertainty; despite ongoing systematisation, the regulatory environment in China consists of a web of ambiguous interrelated national, provincial and local regulations, many of which are interpreted and applied inconsistently. This continues to make full regulatory compliance challenging.

2 LEGAL CONTROLS ON THE ROLE OF EDUCATIONAL ORGANISATIONS

In the UK education sector, lines are blurred among public, private and civil society when it comes to education and empowering young people. Non-governmental organisations (NGOs), membership organisations and commercial entities all play a role in facilitating and promoting education objectives. In China, however, membership organisations and professional bodies have to register as either wholly foreign-owned enterprises (WFOEs) or NGOs. In either form, organisational operations or activities in education are significantly legally constrained from being able to share their expertise with Chinese institutions through education outreach or to support the community through grants or donations.[20]

3 LIMITATIONS ON HUMAN RESOURCES AND STAFFING

For many UK education organisations, a perennial challenge of operating in China continues to be negotiating visa policies, the complexity and opacity of which can severely limit options to recruit and retain top talent. Other than the opacity and time-consuming nature of the general work permit and visa application processes, the lack of clarity on the validity of different degree certifications in China (including online qualifications such as the iPGCE, and other qualifications below degree level such as vocational diplomas) has increasingly been cited as a serious challenge. Other criteria, such as the two year minimum for relevant work experience, combined with the requirement for a bachelor's or master's degree, and restrictions on foreign professionals over the age of 60 to work in China, have limited the scope of UK companies to hire both young educators and experienced professionals with significant expertise in the sector.

4 CONSTRAINTS OBTAINING ONLINE EDUCATION PERMITS AND LICENCES

The outbreak of COVID-19 in China has triggered unprecedented growth in the online education market. However, foreign investment in online education has been much more limited than might have been reasonably expected. Besides prohibitions for any investment in online activities providing compulsory education, foreign enterprises are also prevented from obtaining the relevant licenses or permits needed to operate in this field, including the Internet Content Provider (ICP) licence. Even for companies operating under a variable interest entity model, obtaining an ICP licence often takes longer and is more challenging when compared to the experiences of government-backed schools and institutions.

20 'Law of the People's Republic of China on Administration of Activities of Overseas Nongovernmental Organisations in the Mainland of China', National People's Congress, November 2017.

5 CYBERSECURITY AND IT RESTRICTIONS

Restrictions on internet access is another persistent issue for UK education companies. Their websites are often hosted on servers outside of China, which can slow down loading times and therefore impact customer perceptions of their brand. At the same time, internet access to the virtual learning environments used by many can often be sporadic, limiting their uptake despite the advantages they present to parents. A number of companies have reported that it has also become increasingly difficult to access the Eduroam platform for academic research used by global universities in China, limiting the resources available to their students and impairing cross-border exchange of knowledge. Furthermore, UK education companies and Sino-UK cooperative education institutions are also having to fulfil a wider range of obligations under the *Cybersecurity Law* and its implementing rules, including obligations for maintaining network operational security and network information security, increased cooperation with authorities and managing their obligations as data controllers.[21] Furthermore, general uncertainty remains around definitions of certain terms in the *Cybersecurity Law*, such as 'Critical Information Infrastructure Operator' and 'important data', that can make it difficult for foreign education companies to ascertain which areas they are able to operate in.

6 RESTRICTIONS ON COMPETITION WITH LOCAL SUPPLIERS

The ability of UK school supply companies to grow in China is severely hampered by duties, customs delays and inconsistent compliance. Taxes, value-added tax and import duties, as well as compelling evidence of forced dependency on local distributors, agents and suppliers have made these importers extremely uncompetitive. These duties are currently far higher than for imports of the same types of goods into the UK for Chinese suppliers. At the same time, procurement departments in China are encouraged to favour local suppliers over UK school suppliers, despite the latter producing globally-recognised, high quality products. This runs counter to the underlying principles of the *Foreign Investment Law*,[22] which requires foreign and local suppliers to be considered equally in the procurement process. Restrictive practices over foreign curriculums[23] and tacit encouragement to only use Chinese suppliers have made it difficult for UK suppliers to sell to bilingual schools or UK schools in China, despite the obvious alignment of these markets with their products. Lifting these restrictions and granting students greater access to learning materials would enrich their learning experience and help them become more competitive when entering the workforce.

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

22 'Foreign Investment Law of the People's Republic of China', State Council, March 2019.

23 'Notice from the Ministry of Education on the Measures on Management of Primary and Secondary School Teaching Materials, Measures on Management of Vocational School Teaching Materials and Measures on Management of Ordinary Higher Education Institute Teaching Materials', Ministry of Education, December 2019.

RECOMMENDATIONS

REGULATORY CHALLENGE	RECOMMENDATION
1 Lack of clarity and openness in the regulatory environment	■ Ensure that authorities at all levels refrain from publishing new regulations without sufficient notice, and that all new regulations or information can be clearly found on government websites and other information channels. ■ Create stronger mechanisms to communicate information about regulations down to all relevant departments. ■ Provide reasonable timelines for companies to comply with changes in regulations.
2 Legal controls on the role of educational organisations	■ Allow wider scope for cooperation and exchange in non-sensitive areas of education between Chinese academics, professionals, specialists and their foreign counterparts.
3 Limitations on HR and staffing	■ Work towards a bilateral agreement between the British and Chinese governments to facilitate opportunities for both young and senior Chinese professionals to work in the UK, and vice versa. ■ Allow companies to receive work permits for staff on the basis of sufficient possession of soft skills and qualifications, instead of setting hard limits on age and minimum post-graduation experience. ■ Increase the transparency of the work permit process.

REGULATORY CHALLENGE	RECOMMENDATION
4 Constraints obtaining online education permits and licences	▪ Expedite foreign-invested companies' ability to obtain the necessary licences to operate in the online education sector. ▪ Ensure that all applications for the internet content provider licence are treated equally.
5 Cybersecurity and IT restrictions	▪ Create specialised on-campus internet access permissions that allow reputable academic institutions to access global knowledge centres and navigate other cybersecurity issues. ▪ Clarify the definitions of the terms such as "critical information infrastructure" and "important data" in education industry sector; and clarify the legal requirements for cross-border transfer of personal data.
6 Restrictions on competition with local suppliers	▪ Equalise duties on UK education supplies entering the China market to mirror the duties on Chinese education supplies entering the UK market. ▪ Open public procurement for government schools and universities so that foreign companies can compete on a level playing field. ▪ Allow for greater freedom to import goods without having to use a local reseller.

MUTUAL OPPORTUNITIES

EARLY YEARS (0-3)

Demographic changes and the high regard for the quality of UK early years education continue to drive demand and consequently create substantial opportunities, despite the increasingly dominant role played by the state in this sector. Parents want good quality education for their children and are willing and ready to pay for it. English as a language of instruction is not universally sought-after, but many parents favour a bilingual approach. The relative lack of expertise among practitioners and school leaders also provides opportunities for training, supplies and management systems.

EDTECH

While China has a number of very large EdTech companies, the UK leads in the use of ethical AI, safeguarding, data protection and research-driven EdTech that is proven to improve learning and achieve positive impact. There is considerable opportunity for UK companies to export, and UK institutions to partner, to support Chinese students' growth, protect their data and develop their creativity and critical thinking.

In addition, online-merge-offline (OMO) looks to be the new buzzword in Chinese education. Driven forward by the recent virus outbreak, OMO looks to utilise and integrate data and learning from both the online and offline realms. As students begin to live in an 'always online' world, education will need to seamlessly move from classroom to online platforms. UK EdTech companies that can integrate tools, teaching and best practice with Chinese platforms will be in considerable demand.

PARTNERSHIPS

While franchises and licences have been a popular, even dominant, model for UK and China partnerships to date, organisations that can truly partner and produce 50/50 organisations that leverage the best of UK and Chinese expertise are likely lead to longer-term success. As online, blended and OMO models of work and education continue to develop, particularly now that the COVID-19 outbreak has further normalised online education, the physical distance between countries is likely to become less and less significant. Highly functional joint organisations may also find opportunities to expand into third countries along the Belt and Road Initiative. As English language

expertise continues to deepen in student populations, further opportunities may exist for UK tutoring companies to partner with schools in China. British universities can use their expertise to support setup, curriculum design; operation management; faculty recruitment and training; and actual education delivery in new institutions based in cities across China. Besides introducing students to study opportunities in China, British universities and their hosts can pool resources to establish research institutes with the aim to build capacity and become leaders in their field.

TEACHER TRAINING AND CERTIFICATION

There is considerable and growing demand for qualified teachers in international and bilingual schools, demand that is unlikely to be met long-term by foreign teachers alone. Internationally-qualified Chinese teachers, in-nation teacher training programmes and recognised qualifications that can bridge the gap between expertise in Chinese and international education are likely to become a rapidly developing trend. Joint institutes and training facilities in China will continue to open and grow. Areas such as safeguarding, special education needs and mental health training where the UK leads global best practice, are also significant areas of opportunity. The extremely rapid proliferation of new international schools in recent years and an expected growth of compliance costs, mean that there is also, and will continue to be, considerable demand for consultancies able to deliver long-term, hands-on training for teachers and provide knowledgeable local intelligence for school leaders.

EMPLOYABILITY AND ENTREPRENEURSHIP

In 2020, over 8.5 million students will graduate from Chinese universities into one of the most challenging job markets in a generation.[24] The urban unemployment rate jumped to 6.2% in February 2020,[25] and with the shape of China's economic recovery still uncertain, companies may be reluctant to hire. There is also a growing need for the soft skills in the new economy that the UK education system has proven strength in providing. Start-ups and small businesses will lead the next wave of innovation and employment in China, and graduates who can develop an enterprising mindset, creative thinking and self-efficacy will be much more competitive in both the domestic and the global job market. Long-standing UK expertise in entrepreneurial, vocational and employment education provides fertile ground for potential partnerships.

24 'China expected to have 8.74 mln college graduates in 2020: ministry', Xinhua, October 2019.

25 'The Urban Surveyed Unemployment Rate(%)', National Bureau of Statistics, March 2020.

DOUBLE FIRST-CLASS PROGRAMS

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

ENERGY

AT A GLANCE

SUB-SECTORS:

Oil and gas

Nuclear

Renewables

KEY CHALLENGES:

- Inability to fully access market openings
- Procurement barriers to market entry
- Insufficient mechanisms for commercial and industrial sector renewable energy consumption

KEY RECOMMENDATIONS:

- Issue practical implementation guidelines in a timely manner following the release of new laws to remove ambiguities and allow companies to access market and regulatory openings
- Review procurement practices and the requirements for foreign companies under HAF to determine whether this constitutes a barrier preventing access to China's civil nuclear market
- Pilot more large-scale distributed energy projects and grant equal opportunities for foreign companies to utilise their own integrated solutions in managing the distribution of renewable energy along national grids

KEY MUTUAL OPPORTUNITIES:

- Increasing energy security
- New energy vehicles charging infrastructure
- Hydrogen refuelling infrastructure

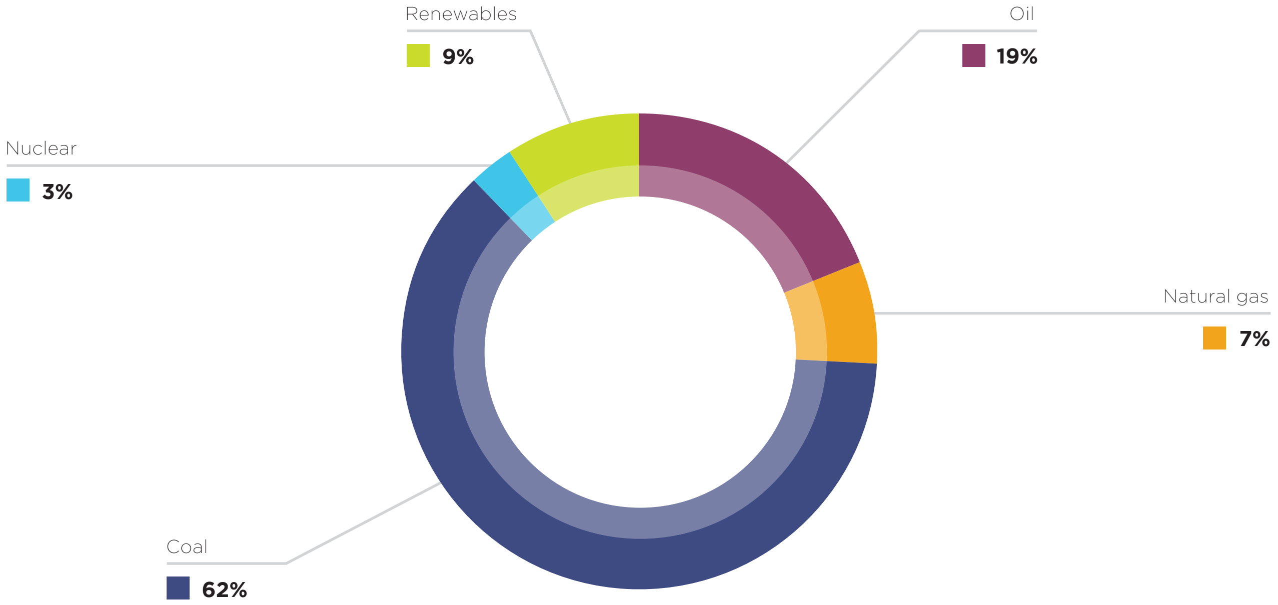
STATE OF THE SECTOR

Since the beginning of China's reform and opening, British businesses have played an important role in the supply of affordable, reliable and clean energy products and services to the Chinese market. UK companies have a strong presence in China's energy sector, including a number of globally recognised multinational corporations (MNCs) and many small and medium-sized enterprises (SMEs) operating across the oil and gas, nuclear and renewables sectors. In addition to trading, local exploration and the provision of energy from domestic sources, British companies also engage in exporting energy products produced in the UK into China, and petroleum and petroleum products currently stand as the UK's third largest goods export to China, valued at GBP 4 billion (RMB 36 billion).[1] However, exports from the UK represent just one of the subsets of overall trading activity, and the total profits from trading production sources and importing into China are far greater.

China is the world's largest consumer of energy, accounting for one quarter of global energy consumption. Although energy consumption per capita remains approximately one third that of the United States, rising levels of prosperity and continued growth of the Chinese middle class have resulted in continued growth in per capita consumption. Coal has fallen to 59% of China's primary energy consumption, with demand led by the country's industrial sectors. Although coal production in China grew by 4.5% in 2019 and will continue to rise in absolute terms in the near future,[2] as energy demand increases China's coal share is expected to decline to 35% by 2040. As China rebalances the economy away from energy-intensive industrial activities and shifts towards a cleaner, lower-carbon energy mix, natural gas, along with nuclear power and renewables, are expected to offset the decline in coal while matching the corresponding rise in energy demand.[3] This transition is likely to accelerate as renewables continue to exhibit rapid cost declines, with the phase-out of renewable power subsidies beginning in 2018 and fully unsubsidised, cost-competitive demand is expected en masse by 2022. Natural gas, as a generally 'cleaner' fossil fuel compared with coal and

China's energy mix (2019)

Source: The Economist Intelligence Unit (The EIU)



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

2 'Industry Report: Energy', The Economist Intelligence Unit, September 2019.

3 'BP Energy Outlook 2019', BP, February 2019.

crude, is expected to continue to play an important role in ensuring a more diverse energy mix and an affordable transition towards a lower-carbon future.

As overall economic activity slowed during the COVID-19 outbreak in China, primary and second energy demand similarly dropped which, compounded with a simultaneous global excess supply of crude oil, led to a sharp decline in oil prices. Accounting for roughly 70% of the country's electricity consumption, the shuttering of the industrial sector across China had a significant impact on power sector demand for coal. However, as of March 2020, retail fuel sales in China have recovered to approximately 80% of their pre-outbreak level, and demand is expected to return to growth in the second half of the year.[4]

The National Energy Administration (NEA), operating under the National Development and Reform Commission (NDRC), is responsible for setting China's national energy strategy, drafting and implementing energy policies, and

4 'What is the outlook for the Chinese oil sector with COVID-19 on the wane domestically?', IHS Markit, March 2020.

regulating various energy sectors. The NDRC administers the access of foreign companies to energy markets and formulates emissions reductions plans and sets energy prices, which are approved by the State Council. In December 2019, the NEA convened its 2020 National Energy Work Conference, reiterating President Xi Jinping's strategic thought of "Four Revolutions, One Cooperation" in the country's energy development, emphasising the need to develop a low-carbon energy system while also ensuring sufficient supply as China undergoes its energy transition.[5] Improving national production capabilities and promoting renewable energy sources reaffirms the government's general objectives of improving energy security, encouraging affordable prices for consumers and industries and transitioning to a low-carbon energy system. The government's commitment to clean energy and renewable technologies has further been demonstrated by the notice on the compilation of the draft 14th Five-Year Plan for the Development of Renewable Energy.[6] In April 2020, the NEA released a draft *Energy Law* for public consultation, which is the second draft for public consultation since the first draft in 2007. If promulgated, it will be the first fundamental law to govern China's energy industry. Three overarching features are apparent in the draft law: marketisation, prioritisation of renewable energy and the separation of administrative principles between sectors of natural monopoly and those of competitive nature.[7]

The energy sector has seen positive reforms over the past year that are intended to further open the market up to foreign players, particularly in upstream oil and gas. Revisions to the *Special Administrative Measures on Access to Foreign Investment* ('Negative List for Foreign Investment') permit majority foreign ownership and wholly foreign-owned enterprises to conduct oil and gas exploration and development, while also removing restrictions that only allowed Chinese entities to control gas and heat pipelines in cities with more than 500,000 people.[8] In January 2020, the Ministry of Natural Resources (MNR) announced that it will grant private and foreign companies with net assets of RMB 300 million (GBP 33.1 million) the right to conduct upstream oil and gas exploration. These measures further unify the exploration and production rights for companies and remove the need to apply for separate licences.[9]

In line with high-level efforts to break up the administrative vertical monopoly in China's oil and gas industry, a series of opening measures in oil and gas pipeline reform have accelerated. Notably, the *Measures for Fair and Open Supervision of Oil and Gas Pipeline Facilities* aim to strengthen supervision and administration procedures for pipeline networks, while eliminating information asymmetries and improving the information disclosure system.[10] A national pipeline company (NPC) was also established in December 2019 as a vehicle to open the market and grant non-discriminatory access to pipelines for third parties.[11] Correspondingly, the Catalogue of Central Pricing, effective from May 2020, clearly distinguishes between sectors of natural monopoly and those of competitive nature.[12] British companies appreciate this overall drive toward the marketisation of the energy sector.

The downstream oil market has additionally seen moves towards greater deregulation. Revisions to the 'Negative Lists' in 2018 allow foreign-invested enterprises to operate retail fuel stations without any equity limitation. Following high-level steer from State Council in 2019, the Ministry of Commerce (MOFCOM) recently released the *Opinions on Promoting High-quality Development of Petroleum and Refined Oil Circulation* for public consultation.[13] Once implemented, it will replace the existing industry regulations, namely, the *Administrative Measures on the Refined Oil Market*[14] and the *Administrative Measures on the Crude Market*,[15] transferring the management of retail fuel stations to municipalities, removing wholesale fuel license approvals, further promoting the marketisation of the sector and creating a level playing field for all enterprises, which will ultimately benefit Chinese consumers.

5 '2020 National Energy Work Conference Convened in Beijing', National Energy Administration, December 2019.

6 'Notice by the National Energy Administration on the Compilation of the 14th Five-Year Plan for the Development of Renewable Energy', National Energy Administration, April 2020.

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

8 'Special Administrative Measures on Access to Foreign Investment' Ministry of Commerce, June 2019.

9 'Opinions of the Ministry of Natural Resources on Promoting of Administrative Reform of Mineral Resources', Ministry of Natural Resources, December 2019.

10 'Measures for Fair and Open Supervision of Oil and Gas Pipeline Facilities', State Council, June 2019.

11 'China sets up new central SOE to manage oil, gas pipelines', Xinhua, December 2019.

12 'Catalogue of Central Pricing', National Development and Reform Commission, March 2020.

13 'Opinions on Promoting High-quality Development of Petroleum and Refined Oil Circulation', Ministry of Commerce, April 2020.

14 'Administrative Measures on the Refined Oil Market', Ministry of Commerce, December 2006.

15 'Administrative Measures on the Crude Market', Ministry of Commerce, December 2006.

REGULATORY CHALLENGES

OIL AND GAS

1 INABILITY TO FULLY ACCESS MARKET OPENINGS

Despite seeing a number of broad market openings in the energy sector from the central government over the past year, British businesses report an inability to fully capitalise on these opportunities. Encouraging policies on paper, such as revisions to the Catalogue of Encouraged Industries for Foreign Investment,[16] which included oil and gas exploration, electric vehicle charging infrastructure and hydrogen refuelling stations, are welcomed by British businesses. However, there is a lack of clarity at a local level as to the implementation of these national policies. Local officials receive little guidance from Beijing as to how foreign investment is to be encouraged in these new markets in practice, and so industrial barriers at a local level remain in place, even if the investment item in question is explicitly stated in the Catalogue, such as new energies including renewable power and hydrogen refuelling stations. Revisions to the 'Negative List for Foreign Investment' and 'Encouraged List for Foreign Investment' omit concrete implementation details to accompany these openings, and so local authorities grant approvals based on their own interpretation. This limits the ability of foreign companies to operate fully independently at the upstream, midstream and downstream levels. Similarly, many relevant industry policies have not been updated. For example, although foreign equity caps for aviation fuels were removed in the 2018 revisions to the 'Negative Lists', the *Regulations on Domestic Investment in Civil Aviation* still contain strict limitations on the participation of foreign-invested enterprises (FIEs).[17]

For some British companies looking to access new markets, local authorities continue to assert that they must partner with a local company through a joint venture (JV), despite revisions made to the 'Negative List for Foreign Investment'. Furthermore, a lack of coordination between ministries presents an additional obstacle to businesses, whereby access to preferential tax credits for example may be announced by the NDRC, but officials from the State Taxation Administration or the Ministry of Ecology and Environment (MEE) are uninformed about these policies. Until clear and comprehensive guidance and performance metrics are issued to businesses and local authorities alike, invisible barriers to entry will remain in place and British energy companies will continue to be competing on an uneven playing field in core areas of the market.

Foreign oil and gas companies express additional reservations over the dominance of national oil companies (NOCs) in China's upstream segments, which prevents them from gaining a strong foothold in the market and make exploration activities less commercially viable. Remaining oil fields open to exploration are generally of a lower quality, and onshore blocks in China's western provinces are incredibly challenging to extract from owing to the local geology. The more attractive blocks with greater exploration prospects are largely controlled by NOCs, which have often been reluctant to actually engage in exploration. Regulations stipulate that companies must conduct exploration work within five years, otherwise the block will be reopened for bidding. However, returned blocks are usually of poor quality and potential, while the more attractive ones remain under the control of NOCs. If corresponding implementation guidelines are provided for foreign companies to conduct exploration and if more attractive acreage were made available, British companies would be more inclined to increase investments in China's oil sector and bring their advanced technologies into the market. For China to reduce its dependence on foreign oil imports and increase its domestic production, there is an urgent need to fully implement the 'Negative Lists' and update industrial regulations and procedures as part of a practical and cohesive policy package so as to allow MNCs to fully access the market and increase their production in China.

With regards to oil and gas pipeline reform, while British businesses appreciate the significant steps taken towards the marketisation of the sector and the complexity of assets transition, a series of implementation policies, regulations and standards still need to be released and updated. In order to ensure truly open and fair access for third parties, the authorities must guarantee that information disclosure is up to date, transmission prices are open and transparent, a new monopoly is not created and

16 'The Catalogue of Encouraged Industries for Foreign Investment', National Development and Reform Commission, March 2020.

17 'Regulations on Domestic Investment in Civil Aviation', Ministry of Transport, December 2017.

that NPC shareholders are not provided with favourable treatment in its implementation. Legacy contracts also need to be honoured and counterparties' interests should be protected during the asset transition. Furthermore, the progress of provincial gas pipeline integration and national oil pipeline integration should be made public periodically.

NUCLEAR

2 PROCUREMENT BARRIERS TO MARKET ENTRY

On paper, China's *Foreign Investment Law* (FIL), enacted in January 2020, guarantees equal participation for international companies in government procurement.[18] Procurement as a barrier to new market entrants in China is covered separately in this paper, but the issues discussed apply to nuclear power construction in China. Nuclear vendors invariably seek local solutions and only open bidding to international providers in the event that there is no established local supplier. This presents a significant obstacle for any foreign companies seeking to enter the market.

Changing technical requirements also serves as a *de facto* barrier to new market entrants in China's civil nuclear power sector. In order to supply equipment and machinery to nuclear power stations, companies must have a Civil Nuclear Safety Regulations (HAF) licence. Companies can only gain HAF certification with established product references outside of China, in order to prove they have international experience in the provision of this technology. While this has not been a barrier to entry for international companies with localised operations when certification in China was based on existing international technical requirements, the development of China's indigenous third generation nuclear power plants establishes new technical requirements for certification that present an added barrier to entry for foreign companies, especially where product specifications are unique to China and there is no existing international reference.

International civil nuclear companies without localised operation are further restricted from entering this market owing to opposing principles that determine how companies can qualify for HAF certification. As China develops its own indigenous nuclear technology, corresponding regulations stipulate specific requirements for technologies. By contrast, in the UK, as in many other countries, regulation is based on probabilistic safety assessment. This depends on a continuous dialogue whereby the vendor for the reactor is able to demonstrate the reliability and safety of its design to the regulator. This approach to probabilistic safety, if applied in China, would permit more companies to develop and supply solutions for China's nuclear market and support the export of China's civil nuclear technology overseas.

RENEWABLES

3.1 INSUFFICIENT MECHANISMS FOR COMMERCIAL AND INDUSTRIAL SECTOR RENEWABLE ENERGY CONSUMPTION

China's power market has seen significant growth in the past few years, with considerable advancements made in solar and wind power capacity expansion, renewable power curtailment mitigation and non-fossil energy growth in the primary energy mix. The impressive growth of distributed generation (DG) solar has been a particular bright spot in China's renewables market. While there remains strong interest from electricity consumers and solution providers in DG solar, the sparse coverage of DG solar in the draft *Energy Law* has generated uncertainty around its growth as the market transitions away from financial incentives. For instance, in October 2017 the NEA issued the *Notice on Pilot Schemes for the Market Trading of Distributed Generation*, which laid out a plan to create platforms that facilitate electricity trading directly between distributed power plants and end users in major cities, while permitting power grid enterprises to charge transmission fees with a price approved by local authorities.[19] However, few pilot projects have been announced and the market awaits concrete progress. Escalated government support targeted at stimulating the marketplace for DG local electricity production and consumption would be well received by the commercial and industrial sectors. With the draft *Energy Law* focusing on locally-sited clean power for local consumption, additional non-financial policy support for self-consumption industrial zone renewable power would benefit policymakers and electricity consumers alike.

An additional significant advancement in the development of the renewable power market and electricity sector overall is the proposed formalisation of the Renewable Portfolio Standard (RPS) mechanism outlined in the draft *Energy Law*. This sophisticated policy instrument

18 'Foreign Investment Law of the People's Republic of China', State Council, March 2019.

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

concurrently deepens renewable power demand across the power value chain – increasing ownership and responsibility sharing of market participants to contribute to a more sustainable power system – while also alleviating the financial subsidy burden on the Ministry of Finance (MOF). Under the RPS framework, provincial power grid operators, electricity retail companies and certain industrial and commercial electricity consumers will each have a compulsory target for renewable electricity consumption – Beijing, for example, has a target of 15% for 2020. While this policy is well received conceptually within the market, the necessary enabling mechanisms, marketplaces, and governing rules are currently unclear and immature. For instance, the absence of a transparent accounting ledger for the Green Energy Certificate (GEC) – the tradable certificate representing the environmental attributes associated with one megawatt hour (MWh) of renewable power electricity – raises concerns regarding potential for double counting, miscounting, and unintentional non-compliance. A transparent and auditable GEC marketplace (primary and secondary) covering issuance, flows through the electricity value chain, trading and retirement will provide greater clarity and confidence to market participants. Meanwhile, while utility-scale solar and wind power generators qualify to issue GECs, which also carry a market-based monetary value and replace the previous regime of MOF subsidy payments, DG clean power does not qualify to issue GECs. British businesses question why this is, and believe a more equitable policy treatment would be for DG clean power generation to also qualify for GEC participation.

Lastly, while the recent RPS and GEC integrated policy mechanism, as well as the DG clean power solution, all provide assistance for businesses to purchase renewable energy attributes or even physical renewable electricity, gaps remain in the power market which potentially hinder RPS fulfilment and the renewable power procurement objectives of British MNCs. Many businesses, MNCs and Chinese alike, attach great importance to purchasing large-scale renewable power while also enjoying the cost savings that are associated with the disruptive technology. MNCs increasingly consider market accessibility to low-cost renewable power when evaluating locations for their next manufacturing facility or data centre. With solar and wind power generation now reaching price parity with the wholesale power market, it is time for renewable power to have unfettered access to power trading markets. This advancement in power market rules would greatly support commercial and industrial consumer capability to fulfil their RPS mandated quota, and would allow for a flourishing of market-driven unsubsidised demand for renewable power new installations.

3.2 INADEQUATE COMMERCIAL PROSPECTS IN OFFSHORE WIND

Under the Paris Agreement, China pledged to rely on renewable energy sources for 20% of its energy needs by 2030, and in 2018, China added 1.6 gigawatts (GW) of offshore wind capacity, more than any other country. In the 13th Five-Year Plan for Wind Power Development, the NEA set a goal of generating 5 GW of offshore wind power by 2020,[20] and by the end of 2019, China had reached a total capacity of 4.9 GW with a further 3.7 GW under construction.[21] With the world's largest offshore wind fleet, the UK should, in theory, be a natural partner to support China in its sustainability ambitions. Substantial technological advances and government policy have allowed the UK to drive down the cost of offshore wind deployment from GBP 150/MWh (RMB 1,300/MWh) in 2014 to around GBP 44/MWh (RMB 380/MWh) by the end of 2019.[22] However, British companies report that the commercial opportunities from China's offshore wind sector are limited. This is largely due to both geographical factors, such as irregular wind patterns and soft ocean beds that make it challenging to install turbines and which require a different set of expertise, and operational challenges in working with local partners to convert potential projects into real opportunities.

Alongside the 10th UK-China Economic and Financial Dialogue (EFD) in June 2019, both governments separately convened the UK-China Energy Dialogue and Offshore Wind Industry Advisory Group Meeting. Agreements were made to deepen clean energy partnerships, including quickening the deployment and integration of renewable energies such as offshore wind.[23] Businesses are concerned however that this has not translated into viable commercial opportunities, and would encourage both sides to sustain this dialogue and explore practical opportunities where British businesses are able to invest in China's offshore wind market. Despite the phasing out of national subsidies, the provision of local incentives would encourage British businesses to bring their expertise in areas such as installation, project finance and risk management to China, if returns on investment were more assured.

20 '13th Five-Year Plan for Wind Power Development', State Council, November 2016.

21 'Global Offshore Wind Report 2019', World Forum Offshore Wind, February 2020.

22 'Analysis: Record-low price for UK offshore wind cheaper than existing gas plants by 2023', Carbon Brief, September 2019.

23 'Policy Outcomes of the 10th UK-China Economic and Financial Dialogue', UK Government, June 2019.

MULTI-SECTOR

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

The ability of FIEs to participate equally in China's standards setting processes for fuel and hydrogen standards and industrial safety standards is critical for the internationalisation of China's standards and the ability of Chinese firms to go global. However, foreign companies experience hurdles when attempting to participate in China's standards committees and do not enjoy equal rights in competing for organisational positions. For instance, FIEs can only act as 'observing members', which limits their ability to fully participate in and contribute to standards commissions. Foreign enterprises should enjoy the same treatment as domestic companies in the process of drafting of national standards and providing opinions on the implementation of standards in China, according to the *Notice of the State Council on Several Measures on Promoting Further Openness and Active Utilisation of Foreign Investment.*[24] This was reaffirmed in the FIL, which stipulates that foreign companies have equal right to participate in China's standards setting,[25] and British businesses therefore view the full implementation of the FIL as a matter of urgency. The involvement of all players in China's energy sector, including foreign businesses, to provide comments and suggestions on the formulation of policies is critical for long-term environmental sustainability and energy stability, particularly as the central government begins drafting its 14th Five-Year Plan. Involving foreign businesses will also contribute to the harmonisation of China's own energy standards with existing international standards. This will benefit Chinese companies going global and their ability to comply with the Paris Agreement's sustainability requirements when participating on Belt and Road Initiative (BRI) projects. Furthermore, given the excellent safety records of many MNCs, their involvement in developing and applying industrial safety standards can contribute to the further development of industrial safety conditions in China.

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

25 'Foreign Investment Law of the People's Republic of China', State Council, March 2019.

RECOMMENDATIONS

REGULATORY CHALLENGE	SUB-SECTOR	RECOMMENDATION
1 **Inability to fully access market openings**	**OIL AND GAS**	▪ Issue practical implementation guidelines in a timely manner following the release of new laws to remove ambiguities and allow companies to access market and regulatory openings. ▪ Ensure that ministries and local authorities are fully aligned on all relevant laws and regulations. ▪ Ensure that foreign companies in China are treated equally in bidding and tendering processes for onshore blocks, and encourage NOCs to release attractive acreage if they have no intention of conducting exploration.
2 **Procurement barriers to market entry**	**NUCLEAR**	▪ Review procurement practices and the requirements for foreign companies under HAF to determine whether this constitutes a barrier preventing access to China's civil nuclear market.

REGULATORY CHALLENGE	SUB-SECTOR	RECOMMENDATION
3.1 Insufficient mechanisms for commercial and industrial sector renewable energy consumption	**RENEWABLES**	■ Pilot more large-scale distributed energy projects and grant equal opportunities for foreign companies to utilise their own integrated solutions in managing the distribution of renewable energy along national grids. ■ Further refine the Renewable Portfolio Standard mechanism with the inclusion of a transparent and auditable Green Energy Certificate marketplace.
3.2 Inadequate commercial prospects in offshore wind	**RENEWABLES**	■ Engage in regular exchanges between the British and Chinese governments to explore viable commercial opportunities for UK companies to invest in offshore wind. ■ Encourage local governments to provide reasonable policy incentives to encourage British businesses to invest their expertise and resources in developing and managing offshore wind farms.
4 Lack of involvement of foreign businesses on formulating new policies and standards setting	**ALL**	■ Grant equal access for all enterprises to participate in China's standards committees and in competing for organisational positions.

MUTUAL OPPORTUNITIES

INCREASING ENERGY SECURITY

While China's energy consumption continues to grow year-on-year, domestic production has failed to keep pace. As such, China is now the world's largest importer of crude oil and gas, with its foreign oil dependency accounting for 70% of total use.[26] Energy security and reducing dependency on foreign imports is therefore high on the government's agenda, presenting opportunities for British energy providers in China to increase domestic production. Issuing practical implementation guidelines following new market openings and more closely aligning with local governments on policy announcements will allow British businesses to increase domestic production to meet growing domestic energy demand, while also reducing exposure to volatile international oil markets. Furthermore, a greater role for British companies in nuclear and renewable energies can help offset the need to increase coal production, further contributing to China's energy transition and the diversification of the country's overall energy mix.

NEW ENERGY VEHICLES CHARGING INFRASTRUCTURE

China is a world leader in the production and sales of new energy vehicles (NEVs), accounting for approximately half of all global NEV sales.[27] The government has pursued a top-down policy driven approach to developing the sector and incentivising companies to invest in battery technology. Although financial support will gradually be phased out as the sector becomes more market oriented, in April 2020 the authorities announced that NEV subsidies will be extended until 2022, indicating that NEVs will remain a significant focus for the government over the coming years.[28] Investment from British energy companies to develop charging infrastructure at existing retail sites across China for electric vehicles can help alleviate range anxiety for potential NEV buyers. This is critical at a time when the average range for NEV batteries continues to lag behind internal combustion engine (ICE) vehicles, and a greater availability of charging facilities will allow NEV drivers to travel across the country rather than only within cities while relying on home charging. However, more certainty around future policies regarding investment into charging infrastructure and financial support from the state is needed for British energy companies to support this shift within the automotive sector towards NEVs.

HYDROGEN REFUELLING INFRASTRUCTURE

Fuel cell electric vehicles (FCEV) powered by hydrogen, which offer both high performance and greater convenience from fast refuelling times, can complement battery electric vehicles (BEVs) to further decarbonise China's transportation sector. China has set a target of having one million FCEVs on the road and 1000 hydrogen refuelling stations (HRS) in operation by 2030, with a near-term target of 5000 FCEVs and 100 HRS by 2020. The government has recently signalled its desire to fully support the development of hydrogen as an energy source. In the Government Work Report delivered during the Two Sessions in 2019, an emphasis was given to promoting the construction of HRS infrastructure,[29] and the construction and operation of HRS has also been included in the 'Encouraged List for Foreign Investment'.[30] Hydrogen was also formally defined as a form of energy in the recently released draft *Energy Law*. However, while the 2020 FCEV target has been achieved, the number of HRS currently in operation remains below target.

In cities which have announced aggressive HRS plans, MNCs often encounter implementation issues such as a lack of transparency in land approvals and HRS operating

26 'Nation's reliance on crude oil imports set to continue', China Daily, June 2019.

27 'China Set to Dominate Electric Vehicle Battleground For Decades', Bloomberg, May 2019.

28 'Notice on Improving the Promotion and Application of Financial Subsidy Policies for New Energy Vehicles', Ministry of Finance, April 2020.

29 'Hydrogen to reshape clean energy drive', China Daily, April 2019.

30 'The Catalogue of Encouraged Industries for Foreign Investment', National Development and Reform Commission, March 2020.

certification, preferences to Chinese companies from local governments and insufficient evidence that MNCs have equal access to local subsidies. If this mismatch between central guidelines and local implementation were to be addressed, MNCs would be better able to bring in their advanced technology, safety and operational best practices to an industry that is still in its incubation phase. This would ultimately be beneficial for China's low carbon ambitions and the domestic advancement of hydrogen fuel cell technology.

FINANCIAL SERVICES

AT A GLANCE:

SUB-SECTORS:

Asset management

Banking

Foreign exchange

Insurance

Private equity

KEY CHALLENGES:

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

KEY RECOMMENDATIONS:

- Allow foreign institutional investors to use globally-held assets to fulfil capital requirements for licence applications and continue to reduce other barriers to licence acquisition
- Refrain from arbitrarily restricting applications for an increase of a company's QDII quota and allow qualified and reputable private fund managers to access QDII schemes
- Pilot channels that feature reduced fees and swifter processing times for cross-border payments with Hong Kong and other cities in mainland China

KEY MUTUAL OPPORTUNITIES:

- FinTech
- Environmental, Social and Governance
- Internationalisation of the *renminbi*

STATE OF THE SECTOR

2019 has been a year of relative opening and optimism for British financial services companies in the China market. China's financial system is estimated to be worth over RMB 300 trillion (GBP 34.9 trillion),[1] and total social financing for 2019 grew by 14% to RMB 25.6 trillion (GBP 2.9 trillion).[2] Profits for British financial companies have also grown year-on-year, and two-thirds of them are optimistic about their prospects in 2020.[3]

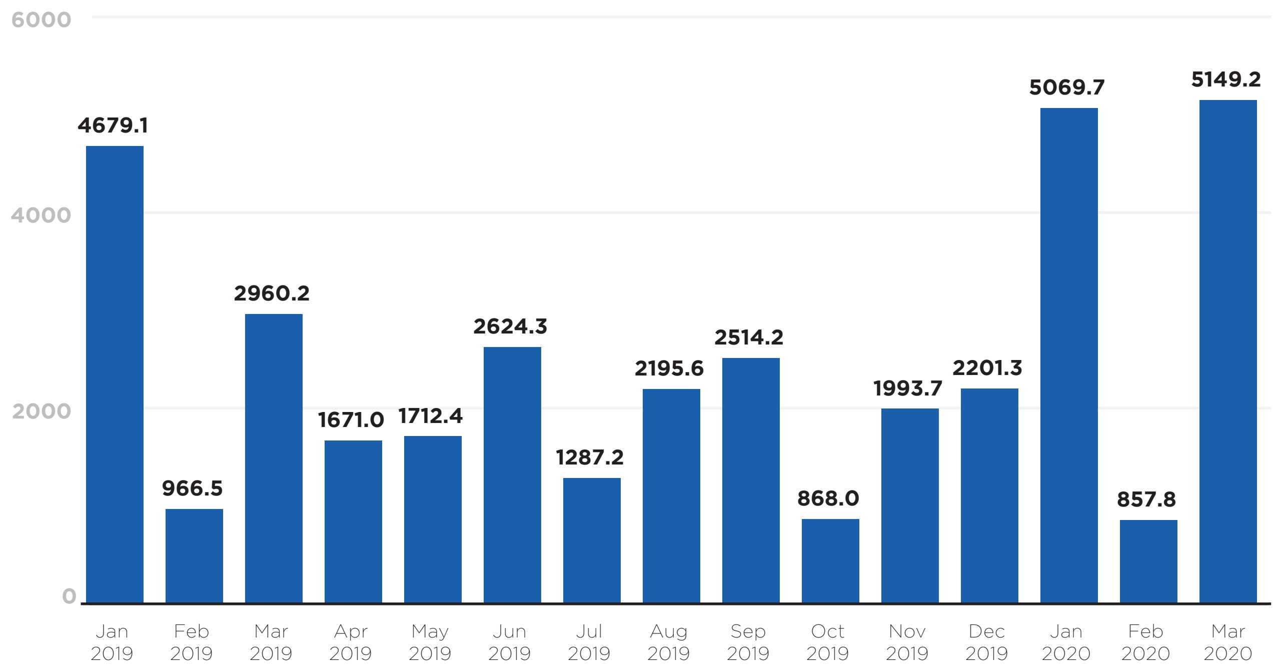
The financial system continues to be dominated by banks, particularly the state-owned 'Big Four'. The total *renminbi* and foreign currency assets of China's banking institutions at the end of 2019 grew by 8.1% from the previous year to RMB 290 trillion (GBP 31.4 trillion), and 40.3% of these were held by large commercial banks.[4]

Foreign banks, however, hold a relatively small market share. As of October 2019, foreign banks have established 41 locally-incorporated foreign banks, holding RMB 3.37 trillion (GBP 370 billion) assets in total.[5]

By the end of 2019, the total assets held by insurance companies amounted to RMB 20.6 trillion (GBP 2.2 trillion), up by 12.2% from the beginning of the year. Life insurers remain the largest insurance sub-sector by total assets, holding RMB 17 trillion (GBP 1.8 trillion). The reinsurance sector was the fastest-growing, expanding by 16.8% in 2019 to RMB 426.1 billion (GBP 46.1 billion).[6] Market penetration for foreign-invested enterprises (FIEs) remains low: there are 59 foreign-funded insurance institutions and 131 representative offices in China. Together, they

Total Social Financing (Flow, RMB billions)

Source: People's Bank of China



1 'Trade War Hasn't Stopped Wall Street's $9 Billion China Rush', Bloomberg, September 2019.

2 'China's Social Financing Jumped 14% to USD3.7 Trillion in 2019', YiCai Global, January 2020.

3 'British Business in China: Sentiment Survey 2019-2020', British Chamber of Commerce in China, December 2019.

4 'CBIRC Releases Supervisory Statistics of the Banking and Insurance Sectors – 2019 Q4', China Banking and Insurance Regulatory Commission, February 2020.

5 'CBIRC Actively Implements Opening-up Measures', China Banking and Insurance Regulatory Commission, December 2019.

6 'CBIRC Releases Supervisory Statistics of the Banking and Insurance Sectors – 2019 Q4', China Banking and Insurance Regulatory Commission, February 2020.

hold around 7% of market share, which equates to RMB 251.4 billion (GBP 27.2 billion) in primary premium income and RMB 1.3 trillion (GBP 140.7 billion) in total assets.[7]

China's asset management market remains relatively small, but its share of global assets under management (AUM) grew from 2% in 2008 to 6% in 2018, while that of the US shrank from 52% to 47%.[8] The sector was worth RMB 13.1 trillion (GBP 1.4 trillion) in 2018 and is forecasted to grow to RMB 29.4 trillion (GBP 3.2 trillion) by 2025.[9] As of September 2019, 22 wholly foreign-owned enterprises (WFOEs) had received private fund management (PFM) qualifications from the Asset Management Association of China (AMAC). The growth of the mutual funds market and the removal of foreign ownership restrictions in fund management companies (FMCs), however, could be a catalyst for further market penetration by foreign firms. There are 45 Sino-foreign joint venture (JV) FMCs, 20 of which have a 49% foreign share and thus are potentially in a strong position to soon become either wholly or majority foreign-owned.[10]

In 2019, several new regulations issued by key industry bodies – the Financial Stability and Development Committee (FDSC), the People's Bank of China (PBOC), the China Banking and Insurance Regulatory Commission (CBIRC), the China Securities Regulatory Commission (CSRC), the State Administration of Foreign Exchange (SAFE) and several quasi-regulatory industry associations – offer new opportunities for foreign financial services companies to enter or strengthen their presence in the market. The most significant of these, particularly for asset management companies (AMCs), has been the *Relevant Measures for Further Opening of the Financial Sector* ('11 Measures') announced in July 2019,[11] which was particularly notable for allowing foreign institutional investors (FIIs) to take whole or majority ownership of most types of financial institution and granting them greater access to the China Interbank Bond Market (CIBM). Three foreign AMCs, none of them British, have received a securities business licence that allows them to expand into brokerage, investment consulting, proprietary trading and asset management, and several British AMCs are in the process of applying for FMC licences.

Aside from the 11 Measures, in December 2019 CBIRC permitted foreign banks to establish subsidiaries and branches simultaneously throughout the country, removed the required level of capital to set up locally incorporated banks and branches and shortened processing times for the approval of high-level personnel joining the institution.[12] SAFE has scrapped the upper limits on quotas for offshore investment into China,[13] and announced a programme that lifts some restrictions on foreign exchange controls in Shenzhen in an effort to liberalise the capital account and generate further investment and growth.[14] This liberalisation makes it easier for companies to convert foreign exchange into *renminbi* without banks' prior removal, although restrictions remain on converting *renminbi* to other currencies and capital repatriation. The new *Securities Law*, implemented in March 2020, has also been welcomed for its potential to improve asset quality and reform the capital market, although more detail will be needed in its corresponding Implementation Measures before firms can make a full assessment of its impact.[15]

This wave of opening can be attributed to policymakers' desire to diversify and stabilise its financial system against a backdrop of slowing domestic and global growth. US-China trade tensions have influenced some degree of liberalisation, formalising a commitment to further open the sector to foreign players. This developed in tandem with a wider push by regulators to mitigate systemic risks, however, driven by continued concern over shadow banking and a series of defaults by smaller banks. As a result, the PBOC has prioritised encouraging prudent monetary policy, increased competitiveness and increased lending to the private sector, particularly to small and medium-sized enterprises.[16] Levelling some areas of the playing field for FIEs has been recognised as one option in policymakers' toolkit, because they increase competition in the sector and offer expertise in underdeveloped aspects of the financial system, such as the third pensions pillar.

7 'CBIRC Actively Implements Opening-up Measures', China Banking and Insurance Regulatory Commission, December 2019.

8 'China's asset management market', Roland Berger, October 2019.

9 'China's asset management market', Roland Berger, October 2019.

10 'China's asset management market', Roland Berger, October 2019.

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

12 'Revised Implementation Rules on Administrative Licensing of Foreign-funded Banks', China Banking and Insurance Regulatory Commission, December 2019.

13 'Administrative Measures for QFII and RQFII Investments in Domestic Securities and Futures', China Securities Regulatory Committee, January 2019.

14 'Notice of the Shenzhen Branch of the State Administration of Foreign Exchange on Pilot Projects to Facilitate the Payment of Foreign Exchange Income to Capital Accounts Under its Jurisdiction', State Administration of Foreign Affairs, August 2019.

15 'Securities Law of the People's Republic of China', Asset Management Association of China, December 2019.

16 'PBOC to streamline lending interest rate system', China Daily, May 2019.

Nevertheless, 60% of British FIIs in China continue to be restricted by regulatory challenges. Although firms acknowledge the notable level of market opening, these openings generally offer limited potential revenue returns,[17] and significant barriers to operation continue to hamper FIEs relative to their domestic counterparts. Private equity has seen no movement from last year and geopolitical tensions have inhibited initiatives that, if successful, could have created more synergy between the British and Chinese financial systems. These challenges, combined with relatively small market share, necessitate continued regulatory support for British financial companies in 2020. Previous outcomes of the Economic and Financial Dialogue (EFD), such as a commitment to promote further opening up of sectors to foreign investment in the next revision of the current 'Negative Lists',[18] the approval of British institutions to join Chinese financial marketplaces and continued work on the creation of the UK-China Bond Connect, have visibly demonstrated this support.[19] In this regard, the value of high-level bilateral dialogues in finding working solutions that benefit both British and Chinese companies cannot be understated.

Despite its impact on domestic and global growth, the COVID-19 outbreak has caused less immediate distress for financial services companies than other sectors. Almost one-fifth believe that the outbreak will have no impact on their revenue for 2020 and, compared to the average business, fewer financial services companies anticipate a drop in annual revenue of more than 20%. A drop in demand and an uncertain business environment were impacting their operations at the height of the outbreak, but nonetheless, fewer financial services companies are concerned about this than in other sectors. However, there is still the possibility that an increase in risk in the lending system and weak global demand will damage investor confidence until the economy recovers.[20]

17 'British Business in China: Sentiment Survey 2019-2020', British Chamber of Commerce in China, December 2019.

18 'Market Access Negative List', Ministry of Commerce, November 2019, and 'Special Administrative Measures on Access to Foreign Investment', Ministry of Commerce, June 2019.

19 'Policy Outcomes of the 10th UK-China Economic and Financial Dialogue', UK Government, June 2019.

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

REGULATORY CHALLENGES

MULTI-SECTOR

1.1 INABILITY TO USE GLOBALLY-HELD ASSETS TO FULFIL LICENCE REQUIREMENTS

While the 11 Measures removed some of the obstructive barriers facing FIIs, the high level of AUM required to enter the market or expand their offering remains a challenge for many. For example, principal shareholders are required to hold RMB 200 million (GBP 22.7 million) in minimum required capital in order to establish a fund management company,[21] and must have managed an average of RMB 2 billion in AUM globally in the three years before the application is made.[22] In addition to holding minimum required capital, foreign insurance companies must possess total global assets of at least RMB 34.8 billion (GBP 3.8 billion) in order to form a WFOE, JV or subsidiary.[23] The China offices of foreign firms are largely unable to use globally-held assets to satisfy the minimum capital requirements for new licences. While the importance of remaining solvent and acting as a responsible player in financial markets is recognised, the current system requires multinational players to commit a relatively large amount of capital to their China operations irrespective of their ability to efficiently access capital from their global network.

Some companies have obtained exceptions to this for other licences, allowing them to include globally-held assets gained from Chinese onshore bonds to support their application to enter the CIBM. Therefore, it should be possible for all FIIs to be able to use global assets to support a wider range of licence applications, at least up to a certain amount. In applications for a domestic funds custodian licence, the China Securities Depository and Clearing Corporation may be willing to accept a 'Letter of Commitment' in lieu of a capital requirement of RMB 40 billion (GBP 4.5 billion) for mainland European banks with strong global balance sheets. This avenue remains closed for British banks, but these precedents demonstrate that, for companies with an impressive reputation and demonstrable track record, some level of flexibility should be possible going forward.

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

No significant quotas were released in 2019 and, of those that were, none were issued to foreign financial institutions.[24] Current quotas are severely limited compared to the scope of services British FIIs are able to provide; have not kept pace with economic growth, rising household wealth and divestment needs in China; and do not match levels of FIIs' interest in investing in the securities market. Unpredictable restrictions on Qualified Domestic Institutional Investor (QDII) quotas disrupt FIIs' ability to create long-term business strategies, discouraging them from fully committing themselves to the China market.

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

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

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

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

24 'QDII Investment Quota Approval Table', State Administration of Foreign Exchange, February 2020.

1.3 DIFFICULTIES WITH CROSS-BORDER TRANSACTIONS

Due to their expertise in international markets and their global network, a large portion of British financial companies' work includes cross-border transaction. China's capital controls system creates substantial operational barriers that make it difficult for FIEs to provide services effectively to the China market and limits the full potential of fundraising channels available for Chinese companies. Although these barriers affect all FIEs in China to a degree, financial services' companies are more affected than most due to their proximity to the financial system.

For example, the restrictions placed by SAFE to limit capital outflows slows the pace at which companies can transfer assets between global branches or remunerate partners and investors. The screening process for transactions is highly bureaucratic, generating substantial costs to both the administrator and the FII. In an industry in which high-volume and fast-paced transactions are a feature, this can lead to bottlenecks and inefficiencies in the China operations of a multinational company. SAFE has signalled an interest in easing restrictions on remitting profits. However, more clarity on this is needed in order to give companies more confidence in the business environment and their ability to operate efficiently in China.

1.4 DIFFICULTIES ESTABLISHING BUSINESS AND INVESTMENT ADVISORY SERVICES

British FIIs have considerable expertise in international investment markets, and are in a strong position to advise clients on optimising their own investment strategies. However, the requirements for an investment advisory licence provides barriers to them offering a full range of services to. Firstly, to obtain an investment advisory licence, three eligible members of staff are required to have a consecutive three-year track record in investment management. However, there may be knowledgeable and experienced staff who have three years non-consecutive investment management experience or have obtained the bulk of their experience in more varied or junior roles, complicating qualified companies' ability to provide these services despite the strong experience of its staff.[25] Secondly, PFMs are currently only able to provide advisory services to domestic clients, as no guidelines for providing advisory services to overseas clients are available. British FIIs have a strong network with global clients and, should these barriers be removed, can continue to guide them into the China market.

BANKING

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

The CIBM remains a key investment platform of interest for British FIIs, with the number of FIIs using it doubling year-on-year to 2,610 in 2019.[26] The ability of foreign banks to underwrite the vast majority of bonds, however, remains limited. It is encouraging that in September 2019 two foreign lenders obtained Type-A licenses to lead underwrite corporate debt issued by non-financial institutions in the CIBM,[27] but more widespread and expedited approval is necessary to ensure a level playing field. The Ministry of Finance also allowed foreign banks to join underwriting syndicates for local government bonds in January 2020.[28] These are welcome steps in the liberalisation of the sector, but there is strong continued interest in the ability to underwrite a greater variety of debt instruments, such as

25 'Launch of the Online Submission of Materials for Private Fund Managers' Provision of Investment Advisory Services', Asset Management Association of China, March 2018.

26 'Foreign Institutional Investors on China's Interbank Bond Market More than Double in 2019', China Banking News, January 2020.

27 'BNP Paribas, Deutsche Bank First Foreign Banks Licensed to Underwrite Corporate Bonds in China', China Banking News, September 2019.

28 'China encourages foreign-invested banks to underwrite local government bonds', Xinhua, January 2020.

Medium-Term Notes and Commercial Papers. Granting foreign banks the ability to become lead underwriters for a wider range of 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.

2.2 INABILITY TO PARTICIPATE IN THE TREASURY FUTURES MARKET

In February 2020, CBIRC announced that qualified commercial banks and insurance institutions will be able to participate in treasury bond futures trading.[29] Currently, the five largest state-owned banks have been granted the opportunity to access the market on a pilot programme.[30] It is imperative, particularly in a financial system dominated by a small number of large financial institutions, that a diverse range of state-owned and private banks, both domestic and foreign, are granted equal and open access to this new opportunity. This has significant advantages for the further maturation and stabilisation of the economy. Firstly, it would provide another important avenue for qualified commercial banks to hedge against interest rate risks without adding other risks to the market, given their existing participation in the derivatives market and proven risk management capability. More importantly, it will diversify and deepen China's treasury futures market, support interest rate liberalisation and enhance commercial banks' capability to support the real economy.

INSURANCE

3.1 LACK OF MOVEMENT ON OPENING INSURANCE BROKERAGES TO INDIVIDUAL CLIENTS

Despite the removal of insurance brokerages from the *Catalogue of Industries for Guiding Foreign Investment* in 2015,[31] the scope of foreign insurance brokers' ability to operate in China remains limited. British insurance brokerages have a particular interest in smaller-scale markets, particularly individual life insurance. Despite assurances from CBIRC that these markets would open up to foreign brokers in 2018, there has been little communication or visible movement on this matter since, limiting Chinese consumers' choice of brokerages and ability to access a full range of professional analysis of the insurance market.

3.2 REQUIREMENT FOR INSURERS TO ESTABLISH A BRANCH IN EVERY LOCALITY IN WHICH THEY HAVE A CLIENT

Digital solutions are increasingly allowing businesses to comprehensively serve customers regardless of location, granting a broader swathe of China's population with more security for the future. The requirement for insurance companies, both domestic and foreign, with a national licence to establish a branch in every locality in which they have clients, however, is becoming increasingly outdated as this trend continues. Instead, it creates steep operational costs for companies entering the market, inhibiting their ability to grow and reinvest their revenue in improving their products. Clients need reliable and accessible communication channels with insurance companies, but a mutually beneficial online mechanism can be found to replace this requirement.

3.3 PENALISATION OF FOREIGN REINSURANCE COMPANIES UNDER C-ROSS

British reinsurers understand and support the need for prudent regulation of the sector. However, some aspects of China Risk Oriented Solvency System (C-ROSS) lead to structural penalisation of foreign reinsurance companies, particularly in terms of credit risk charges. Under C-ROSS, domestic cedants' assets incur a credit risk charge of 58.8% on foreign reinsurance companies if unsecured, reducing to 8.7% if secured assuming they meet the additional solvency requirement. For comparison, the credit risk loading for domestic reinsurance companies operating at between 50% and 100% solvency is 26.1% and at more than 100% solvency this drops to 4.7%, creating far less pressure on domestic reinsurance firms. Furthermore, should a foreign company choose to set up a branch office in China, 5% loading will be added to the calculation, whereas if they choose to set up a subsidiary there will be no additional loading, restricting

29 'Enriching Treasury Bond Futures Investors to Promote Healthy and Orderly Market Development', China Banking and Insurance Regulatory Commission, February 2020.

30 These five banks are the 'Big Four' (the Bank of China, the Industrial and Commercial Bank of China, the Agricultural Bank of China, the China Construction Bank) and the Bank of Communications.

31 'Catalogue of Industries for Guiding Foreign Investment', Invest in China, June 2017.

foreign reinsurers' flexibility when establishing entities in China. For offshore reinsurance, capital controls also create another charge when the risk is brought back into China, which transactions between domestic cedants and counterparties are not subject to.[32]

ASSET MANAGEMENT

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

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

4.2 RESTRICTIONS ON THE INVESTMENT SCOPE ALLOWED FOR QFII AND RQFII

The removal of the quota restrictions on the Qualified Foreign Institutional Investor (QFII) and *Renminbi* Qualified Foreign Institutional Investor (RQFII) programmes and simplification of outbound remittance processes,[33] along with an earlier removal of requirements of minimum AUM and years of experience needed to be eligible for involvement, has some potential to encourage more offshore investment into China. The relaxation of these requirements could shorten the application process from nine months to three.[34]

However, FIIs using these programmes are currently only allowed to invest in stocks, bonds and warrants, fixed-income products in the interbank bond market, securities investment funds and stock index futures. A provision allowing QFIIs and RQFIIs a wider range of investment opportunities, particularly PFM products, would be of great benefit both to FMCs and to companies in China looking to connect with a new group of investors.

4.3 INCONSISTENCIES BETWEEN REGIONAL QFLP PROGRAMMES

The opportunities provided by Qualified Foreign Limited Partnership (QFLP) programmes are of interest to FMCs. However, different cities have different regulatory requirements and standards for their QFLP system, leading to inconsistencies between the actions an FII can take between one branch and another, particularly regarding capital repatriation and taxation laws. Such inconsistencies add to FIIs' operational burdens and ability to coordinate strategies across their offices.

PRIVATE EQUITY

5.1 RESTRICTIONS ON INVESTING IN RMB-DENOMINATED FUNDS

There has been minimal movement in the private equity regulatory environment from last year. Private equity WFOEs are unable to fully invest in the market, due to their inability to invest in RMB-denominated funds. Only having access to USD-denominated funds restricts the sectors they can invest in to those not on the 'Negative Lists', limiting the options available to Chinese investors and to small businesses seeking investment. Furthermore, capital controls on USD-denominated funds hinder the efficiency with which private equity firms can operate and reinvest. While the sector should be monitored for malpractice, foreign and domestic firms should be treated equally by regulators and granted equal access to the market.

5.2 INABILITY TO FORM JOINT VENTURES WITH ACQUIRED COMPANIES

When investing as a majority shareholder in a listed company in China, foreign private equity firms are relatively restricted in terms of the investment structures they can create in the companies they acquires. They are unable to form Sino-foreign JVs, and instead must utilise variable interest entities or contractual structures. However, these provide less legal certainty for the parties involved, reducing the attractiveness of investing in Chinese businesses.

---

32 'China Risk-Oriented Solvency System', China Banking and Insurance Regulatory Commission, February 2015.

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

34 'RQFII and QFII: A New Chapter Begins', BNY Mellon, November 2019.

RECOMMENDATIONS

REGULATORY CHALLENGE	SUB-SECTOR	RECOMMENDATION
1.1 Inability to use globally-held assets to fulfil licence requirements	**BANKING** **INSURANCE** **ASSET MANAGEMENT** **PRIVATE EQUITY**	▪ Reduce capital requirements to more sustainable levels. ▪ Allow FIIs to use globally-held assets to fulfil capital requirements for licence applications. ▪ Continue to reduce other barriers to licence acquisition.
1.2 Limitations of QDII quotas in terms of maximum allocated capital, allocation process and accessibility	**BANKING** **ASSET MANAGEMENT**	▪ Refrain from arbitrarily restricting applications for an increase of a company's QDII quota. ▪ Allow qualified and reputable PFMs to access QDII schemes.
1.3 Difficulties with cross-border payments	**ALL**	▪ Pilot channels that feature reduced fees and swifter processing times for cross-border payments with Hong Kong and other cities.
1.4 Difficulties establishing business and investment advisory services	**ASSET MANAGEMENT** **PRIVATE EQUITY**	▪ Allow for greater flexibility regarding business advisory employees, within reason. ▪ Provide guidelines for PFMs wishing to provide overseas advisory services.
2.1 Continuing limited access to lead underwriting licences for the bond market	**BANKING**	▪ Grant more foreign banks lead underwriting licences for debt instruments.
2.2 Inability to participate in the Treasury Futures market	**BANKING**	▪ Allow the participation of foreign banks in the Treasury Futures market.

REGULATORY CHALLENGE	SUB-SECTOR	RECOMMENDATION
3.3 Lack of movement on opening insurance brokerages to individual clients	**INSURANCE**	■ Provide more clarity on allowing insurance brokerages to open to individual clients.
3.4 Requirement for insurers to establish a branch wherever they have a client	**INSURANCE**	■ Allow insurers to cover clients regardless of location.
3.5 Penalisation of foreign reinsurance companies under C-ROSS	**INSURANCE**	■ Rebalance C-ROSS credit risk loading to ensure that foreign reinsurers are not charges higher rates than domestic reinsurers for the same asset.
4.1 Lack of guidance on how to apply for pension management company licences	**ASSET MANAGEMENT**	■ Publish detailed guidance on the steps required to receive a pension management licence.
4.2 Restrictions on the investment scope allowed for QFII and RQFII	**ASSET MANAGEMENT**	■ Release the revisions to the *Regulations on Foreign Exchange Administration of Domestic Securities Investment by Qualified Foreign Institutional Investors.*
4.3 Inconsistencies between regional QFLP programmes	**ASSET MANAGEMENT**	■ Increase alignment between QFLP programmes in different jurisdictions.
5.1 Restrictions on investing in RMB-denominated funds	**PRIVATE EQUITY**	■ Align regulation of USD-denominated funds and RMB-denominated funds.
5.2 Inability to form joint ventures with acquired companies	**PRIVATE EQUITY**	■ Allow private equity firms to use a greater variety of ownership structures when acquiring companies.

MUTUAL OPPORTUNITIES

FINTECH

China is a world leader in embracing digital solutions and its population has a FinTech adoption rate of 87%, compared to a global average of 64%.[35] The sector is swiftly evolving, presenting opportunities for new ideas to emerge and for innovative enterprises to thrive. The government is actively encouraging development of FinTech capabilities, particularly through the *FinTech Development Plan 2019-2021*,[36] which aims to see FinTech become a "new engine" for development of a healthy, sustainable real economy and a diversified FinTech ecosystem for consumers. The Chinese government is also encouraging growth and innovation in the sector through some access for domestic firms to partnerships with SOEs[37] and favourable policies for technology companies in certain cities.[38] Access to the market for foreign companies is still relatively limited, but the strength of the UK's FinTech industry, particularly in mass-customisation makes it a natural partner for China's further development of its digital capabilities.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE

Investors in China are growing more interested in including products with a strong Environmental, Social and Governance (ESG) element in their portfolios, and several companies have reported a strong interest in ESG both as a commitment for their own organisation and from their customers. As awareness of climate change increases and as the government continues its fight against pollution, green loans are becoming more popular, although more incentives are needed to improve uptake. The Chinese government has also signalled that its interest in improving corporate governance through such measures as the targeting of poor corporate governance in the Corporate Social Credit System. Discussion amongst the financial community on this topic is already robust, creating strong advocates for new and bold ESG initiatives.

INTERNATIONALISATION OF THE RENMINBI

There are significant opportunities to be found for FIIs as the *renminbi* becomes a more widely-used currency abroad. Development projects across Africa, Asia and Europe as part of the Belt and Road Initiative could create rewarding opportunities for British financial firms, which can offer expertise in underwriting or insuring projects in third markets. The UK's position as the largest clearer of *renminbi* outside of China also highlights the strength of the UK-China financial relationship, and commitments within the EFD to strengthen this role are a promising indicator of its continued support. It should be noted, however, that as long as the capital account is restricted, the potential of *renminbi* internationalisation will remain limited.

GREATER BAY AREA

The continued development of the Greater Bay Area (GBA) continues to be of great interest to British FIIs. Greater interconnectivity between the dynamic cities in the area could create an economic powerhouse that generates over RMB 10 trillion (GBP 1.1 trillion.[39] The flow of ideas, capital and people between key cities would

35 'Global FinTech Adoption Index 2019', Ernst & Young, June 2019.

36 'PBC Releases FinTech Development Plan (2019—2021)', People's Bank of China, August 2019.

37 'China Wants State-Owned Firms to Work More Closely With Tencent', Caixin Global, August 2019.

38 'Shanghai Sets Out New Rules For Financial Services to Help Local Tech Firms', Caixin Global, November 2019.

39 'China unveils plans to develop Greater Bay Area', Reuters, February 2019.

provide ample opportunities for growth and innovation, which could be well-supported by Hong Kong's investment expertise and cutting-edge research. British businesses often span both the Chinese mainland and Hong Kong, and more opportunities to align operations would benefit both them and the GBA project. It is vital that all investment firms can access the capital they need to develop and that the financial system that helped create Hong Kong's economic success continues to thrive. If this is assured, the GBA would have the potential to become a powerful financial and commercial hub.

FOOD AND BEVERAGE

AT A GLANCE:

SUB-SECTORS:

Alcoholic beverages

Non-alcoholic beverages

Catering

Seafood

KEY CHALLENGES:

- Difficulties interpreting regulations
- Unfamiliar products held to unreasonably high standard
- Difficulties finding up-to-date customs guidelines

KEY RECOMMENDATIONS:

- Ensure that local authorities refrain from publishing new regulations without reasonable notice, and that all new regulations or information can be clearly found on government websites and other information channels.
- Consult F&B producers more often and more closely align GB standards and EU F&B standards.
- Make import guidelines more easily accessible and streamline customs processing to reduce the length of time products are held at port.

KEY MUTUAL OPPORTUNITIES:

- E-commerce platforms
- Growing interest in premium spirits

STATE OF THE SECTOR

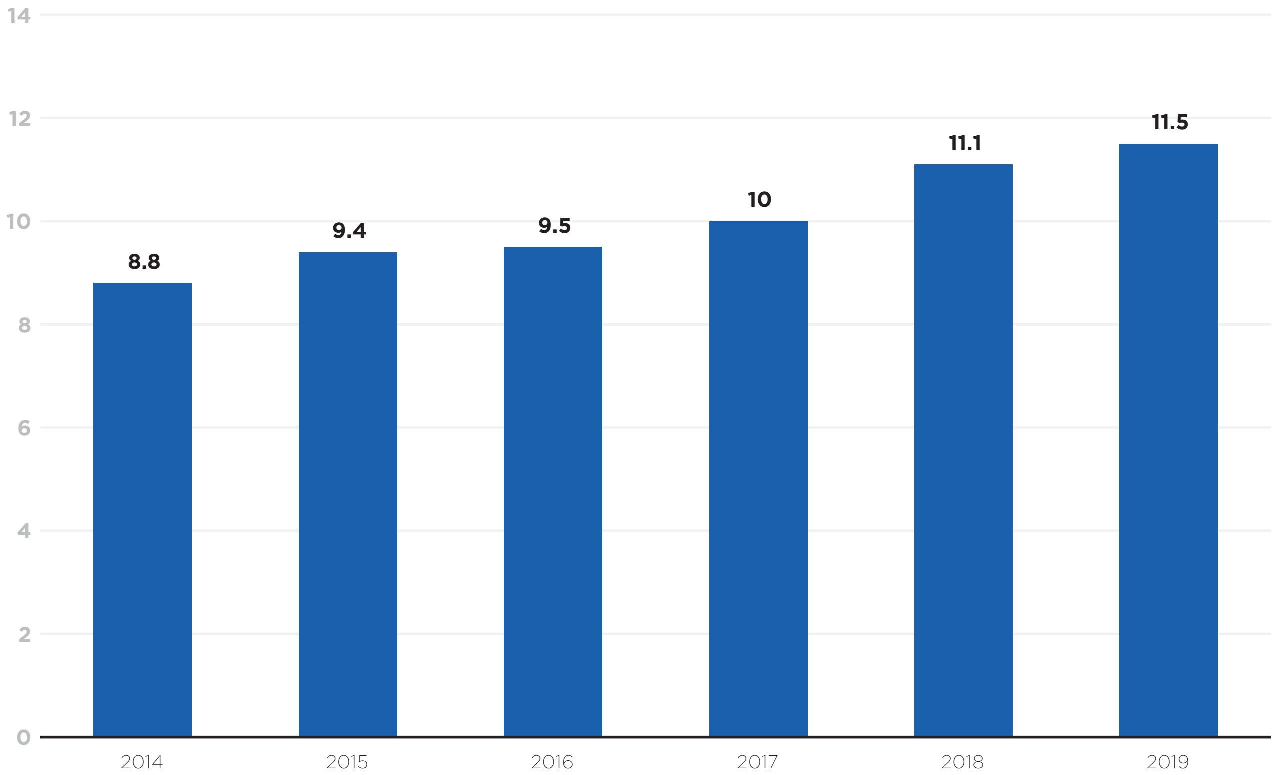
The quality and creativity behind many British food and beverage (F&B) brands form the basis of a strong offering to a market in China worth over RMB 11.2 trillion (GBP 1.2 trillion).[1] Growth in the sector over the past year continues to be boosted by rising incomes and increased household expenditure. However, this has also intertwined with significant levels of inflation. The cost of food in China surged 20.6% year-on-year in January 2020, the largest increase since April 2008. This has been primarily driven by African Swine Flu, which has driven up pork prices by 116% year-on-year as of January 2020.[2] Other factors include long-term rising purchasing power, the COVID-19 outbreak, and to a lesser extent a poor harvest due to fall armyworm and unsuitable weather.

In 2019, British F&B companies performed strongly in the China market. UK exports to China in this sector have almost tripled in value over the past six years, growing from less than GBP 260 million (RMB 2.6 billion) in 2013 to GBP 781.1 million (RMB 6.9 billion) in 2019.[3] In the past year alone, F&B exports have risen in value by 25%, comprising 3% of all British exports to China.[4]

The largest global export categories are whisky, salmon, chocolate, cheese and gin. It should be noted, however, that while whisky is the UK's highest value export, in China the spirits market is almost completely dominated by the traditional spirit *baijiu*. Prepared food for infants is the fastest growing branded export from the UK to China.[5]

Expenditure on food, beverages and tobacco in China (RMB trillion)

Source: The Economist Intelligence Unit (The EIU)



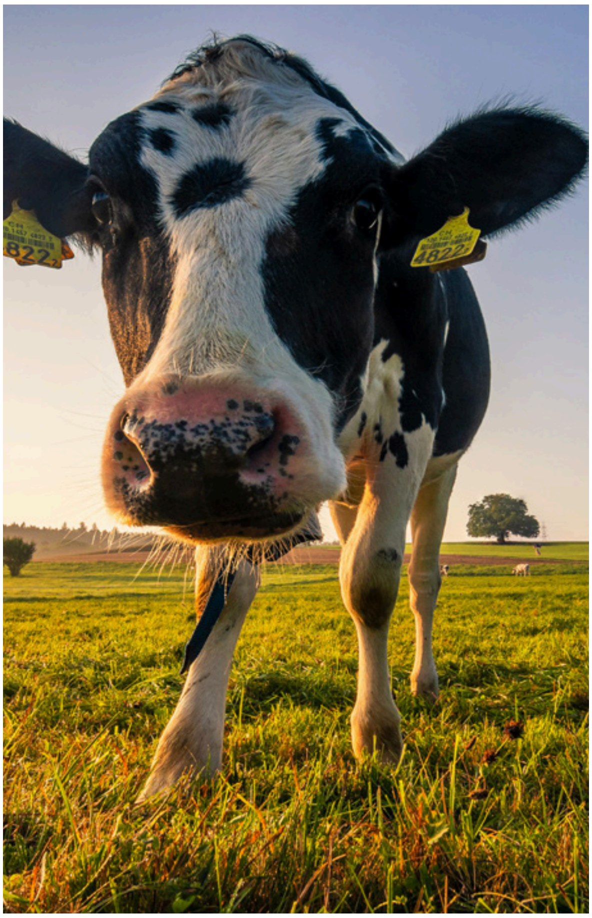
1 'Industry Report: Consumer Goods and Retail', The Economist Intelligence Unit, September 2019. This figure includes food, beverages and tobacco.

2 'Consumer Prices for January 2020', National Bureau of Statistics, February 2020.

3 'Exports snapshot Q4 2019', Food & Drink Federation, March 2020.

4 'Exports snapshot Q3 2019', Food & Drink Federation, March 2020.

5 'Exports snapshot Q3 2019', Food & Drink Federation, March 2020.



The milk formula market, dominated by foreign players at 56% of market share, is also thriving — there are predictions that it will be worth RMB 221.8 billion (GBP 24.6 billion) by 2023.[6] Beef and pork also performed relatively well in 2019. Three months after the ratification of the UK-China Beef Protocol in June 2019, which brought an end to a ban on imports, GBP 7.6 million (RMB 66.8 million) of British beef had entered China.[7] As of October 2019, fresh pork exports from the UK to China have doubled year-on-year, largely due to the need to replace herds decimated by African Swine Flu.[8]

The most significant development from a regulatory standpoint was the update to the *Implementation Measures of the Food Safety Law*, which came into force in December 2019.[9] The new measures clarified the definition for "recovered food", strengthened sanctions for food safety violations and rewards for whistleblowers, consolidated the 'food operations licence' with administrative measures published by SAMR in 2015[10] and made requirements for the labelling of genetically modified foods more stringent. There were also considerable improvements to protection of intellectual property, of which more details can be found in the relevant chapter in cross-sector challenges. The State Administration for Market Regulation (SAMR), is the principal regulator for the industry and is responsible for drafting and implementing food safety regulations. Supervision of imports is performed by the General Administration of Customs China.

However, new challenges have appeared for British companies in the sector in the first quarter of 2020. The US-China Phase One Trade Agreement, signed in January this year, requires China to increase the value of its agricultural imports from the US, possibly to the detriment of the UK's share of imports to China. However, clauses focused on relaxing China's stringent requirements for imported food could also address compliance issues faced by British importers for certain foodstuffs and beverages.

The outbreak of COVID-19 has also had an unforeseen and devastating impact on China's F&B industry. A third of British businesses in the sector believe their revenue for 2020 will drop by more than 20% as a direct result of the virus, largely due to delayed openings and drops in demand since early February as customers stay indoors and limit their use of takeaway delivery services.[11] Access to supplies has remained stable, but restaurant operators must comply with strict limits on opening and restaurant capacity. In addition, businesses have also faced staffing shortages due to domestic travel restrictions. This is of particular concern when businesses or staff are located outside Tier 1 and Tier 2 cities. A restaurant operator reported that these measures have caused their income for February to drop by 40% year-on-year. This has a knock-on effect on the F&B importers supplying hotels, restaurants and other such establishments, which make up their largest customer base. One has projected a loss of up to GBP 200 million (RMB 1.8 billion) in annual profits due to the effect of COVID-19 on the Asia market alone, while another is making losses of GBP 10,000 (RMB 90,953) per week now that all their sales to China have stopped. The sector is also pessimistic about resumption of normal business operations,[12] with restrictions on maximum capacity and public events possibly continuing over the coming months.

6 'Foreign brands still dominate as parents do not trust China's home-grown baby milk formula makers 12 years on from melamine milk scandal', South China Morning Post, February 2020.

7 'Exports snapshot Q3 2019', Food & Drink Federation, March 2020.

8 '2020 outlook – what lies ahead as the new decade dawns?', Pig World, January 2020.

9 'Implementation Measures of the Food Safety Law', State Council, October 2019.

10 'Administrative Measures for the Food Operations Licence', China Food and Drug Association (now overseen by the State Administration of Market Regulation), November 2017.

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

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

REGULATORY CHALLENGES

1 DIFFICULTIES INTERPRETING REGULATIONS

A lack of regulatory transparency is one of the key areas of concern for F&B businesses, and has become significantly more challenging in the past year. Companies have reported that sudden changes to regulations in the past have forced them to close down businesses or move production out of certain districts at unreasonably short notice, and at great cost. Businesses also can find it difficult to navigate the advice and updates provided by regulators, particularly at the local level. Local regulatory authorities often fail to respond to queries about importing and selling products.

It should be noted that there is some level of regional nuance to this, with local authorities in Shanghai seeming to be more responsive than those in Beijing, for example. In some cases, businesses have perceived that the local department itself may be unsure as to how to interpret and implement certain regulations. As well as adding to business uncertainty on how to proceed, this can also lead to different companies being held to different standards depending on how any particular official interprets the regulation, which could bring about unfair competition.

2 UNREASONABLE FOOD SAFETY STANDARDS FOR CERTAIN PRODUCTS

Guobiao (GB) standards generally align with the UN's *Codex Alimentarius* and other international standards at a basic level, reducing the need for British businesses to adjust their products specifically to satisfy Chinese regulatory requirements in many cases.[13] However, there are still some areas in which GB standards restrict British businesses from efficiently offering a full range of products to market. As a particularly illustrative example, since the lifting of a ban in 2015, the UK accounted for 90% of live brown crab imports to China. However, as of December 2019, it has become increasingly harder for British seafood companies to export to the market.

China currently forbids the import of live crab that is judged to contain more than 0.5 milligrams per kilogram of cadmium, according to the *National Food Safety Standards on Limits of Contaminants in Food* (GB2762).[14] Whereas testing was previously conducted through random selection from any given batch, now the entire batch must be tested for cadmium on import. However, due to the three-to-four day testing process, almost all of the crabs are likely to expire before testing is concluded, making them unfit for market. Companies report that some ports do take extra measures to attempt to keep the batch alive during testing, but these measures are largely unsuccessful. It should be noted that UK and EU standards also stipulate that a crab's white meat must contain no more than 0.5 milligrams of cadmium per kilogram, but the difference lies in the fact that they disregard cadmium levels in brown meat. Chinese standards include both white and brown meat, despite the fact that brown meat contains digestive glands and therefore naturally contain a higher concentration of such substances. Further development of these standards to grant Chinese consumers greater choice in the market, while also ensuring that protection of public health is guaranteed, would be beneficial for both producers and consumers.

3 DIFFICULTIES FINDING UP-TO-DATE CUSTOMS GUIDELINES

Difficulties navigating government information portals to find the most recent guidelines on importing products remains a challenge for British importers. If an importer is operating under outdated information and consequently fills out a form erroneously, it can lead to strict penalties, increasing the final cost of a product and undermining their competitiveness. In addition, products can often be held in customs for an extended period of time, sometimes up to three months, affecting companies' sales projections. Established government hotlines can be a useful resource when companies have specific queries, but companies have reported that their calls are frequently unanswered, causing significant frustration.

13 'Building Food Safety Governance in China', European Commission, June 2018.

14 '*National Food Safety Standards on Limits of Contaminants in Food* (GB2762-2017)', National Health Commission, April 2017.

4 INCONVENIENCE CAUSED BY OPPORTUNISTIC PROFESSIONAL CONSUMERS

Professional consumers, or people who purposefully bulk-buy items and hunt for minor errors on product labels in order to sue the producer for up to ten times the value of the sale, continue to be an issue for British businesses. Companies find that dealing with complaints raised on trivial typos or errors can be time consuming and raise significant administrative costs. They may also face further fines and the need to conduct a total recall of their products, damaging both their revenue and reputation.

The Supreme People's Court signalled that it would approve limiting the power of professional consumers in the *Response Opinion on Recommendation No. 5990* in 2017.[15] Subsequently, local authorities in Shanghai and Zhejiang have issued guiding opinions on managing complaints,[16] and the *Interim Measures for the Handling of Complaints and Whistleblowing Reports during Market Regulation* came into effect from January 2020.[17] Article 15 within the law states that the market regulatory authorities will not accept complaints if it is apparent that the product or service was purchased for any other reason than to genuinely use it or if the case for complaint isn't clear, with the aim to prevent the submission of malicious complaints. British businesses welcome these measures as a positive signal that the government recognises the difficulties they face in this area. However, more time is needed to see if these measures will effectively limit the number of trivial cases brought to court.

5 TARIFFS ON ALCOHOLIC BEVERAGES

Tariffs on whisky currently stand at 5%, having been reduced from 10% at the end of 2017. However, businesses would encourage the complete removal of these tariffs. Similarly, a 40% tariff on imported cider makes the China a less attractive market. This tariff stands despite the fact that the domestic varieties of apples available to brewers are not suitable for making cider, discouraging many from expanding into brewing cider and thus limiting the access of the typical Chinese consumer to the product as a whole. A reduction in these tariffs would again help diversify the choice present in the current alcohol market.

15 'The Supreme People's Court's Reply Opinion on Recommendation No. 5990 at the 5th Session of the 12th NPC', Capital Intellectual Property Services Association, June 2017.

16 'Shanghai to Establish a Blacklist System for Professional Consumers', Shanghai Municipal People's Congress, November 2018, and 'Call for Comments for the Guiding Opinions on Effectively Handling Professional Consumers in order to Create a Good Business Environment', The People's Government of Zhejiang Province, April 2019.

17 'Interim Measures for the Handling of Complaints and Whistleblowing Reports during Market Regulation', State Administration for Market Regulation, November 2019.

RECOMMENDATIONS

REGULATORY CHALLENGE	RECOMMENDATION
1 Difficulties interpreting regulations	▪ Ensure that local authorities refrain from publishing new regulations without reasonable notice, and that all new regulations or information can be clearly found on government websites and other information channels. ▪ Establish efficient information hotlines that businesses can use to ensure they are fully compliant.
2 Unreasonable food safety standards for certain products	▪ Provide more opportunities for consultation with F&B producers at an individual company level. ▪ More closely align GB standards and EU F&B standards.
3 Difficulties finding up-to-date customs guidelines	▪ Make import guidelines more easily accessible. ▪ Streamline customs processing to reduce the length of time products are held at port.
4 Inconvenience caused by opportunistic professional consumers	▪ Limit the number of trivial cases brought to court by professional consumers.
5 Tariffs on alcoholic beverages	▪ Gradually reduce tariffs on imported cider and whisky with the aim to completely remove them in the future.

MUTUAL OPPORTUNITIES

E-COMMERCE PLATFORMS

British companies are continuing to make full use of China's strong e-commerce infrastructure, particularly Jingdong, Taobao and Tmall. The online shopping market is now worth over RMB 1 trillion (GBP 110 billion) and accounts for a considerable share of F&B sales. Using e-commerce channels also significantly reduces the administrative costs and overheads that brick-and-mortar companies in this space encounter, although in exchange retailers face a relatively high tax on e-commerce sales.

GROWING INTEREST IN PREMIUM SPIRITS

In China, domestically-made spirits — mostly *baijiu* —dominate the market, comprising 90 to 95% of sales of spirits.[18] However, there has been an uptick in demand for Western spirits, particularly single malt whisky, as the urban middle class grows and consumer tastes begins to change. British businesses are well-placed to provide quality products, but there is still a need for strong marketing efforts by business and government to give non-Chinese spirits a more widespread appeal.

18 'Competition in the Chinese Alcohol Market', Mersol & Luo, May 2019.

HEALTHCARE

AT A GLANCE:

SUB-SECTORS:

Healthcare services

Medical devices

Pharmaceuticals

KEY CHALLENGES:

- Restrictions around licences, certification and standards
- Pricing pressures and reimbursement requirements
- Fragmentation and restrictions across supply chains

KEY RECOMMENDATIONS:

- Remove restrictions on foreign ownership of medical services companies and on foreign investment in medical research
- Improve the clarity and transparency of the national reimbursement drug list process
- Increase supply chain flexibility afforded to the 'two-invoice system'

KEY MUTUAL OPPORTUNITIES:

- Free trade zones
- Continued development of the healthcare system
- Healthcare technology

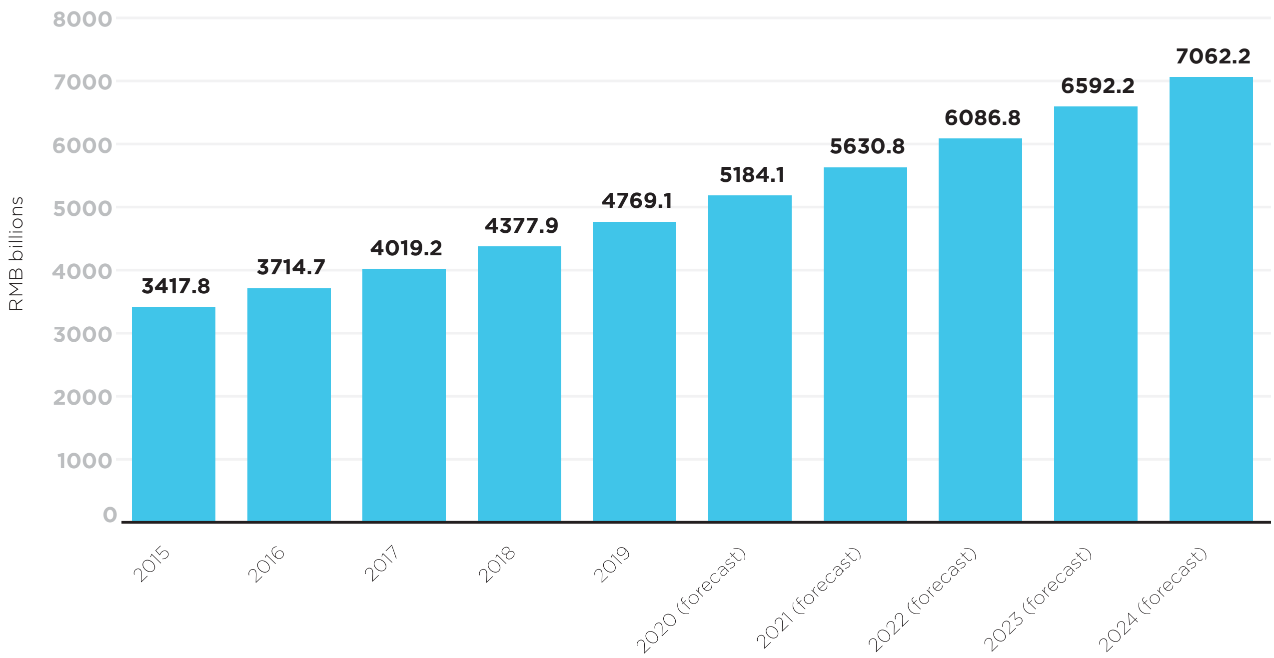
STATE OF THE SECTOR

The global COVID-19 outbreak has reinforced the necessity for countries to develop strong healthcare sectors. In China, healthcare infrastructure has been improving both in terms of sustainability and in terms of quality of provision over recent years. Public healthcare spending in China is estimated to have reached RMB 4.8 trillion (GBP 546.9 billion) in 2019, or roughly 5% of GDP, while consumer expenditure on healthcare totalled around RMB 3 trillion (GBP 339.6 billion).[1] Although the rate of population growth has slowed in recent years, the sector continues to be driven by pressures from an ageing population, increasing urbanisation and a growing disease burden.[2] Non-communicable diseases — particularly stroke, heart disease, lung disease and Alzheimer's — are becoming more serious health challenges facing policymakers, accounting for 85% of deaths in China last year.[3]

In order to address these challenges, the central government formulated the Healthy China 2030 plan, which aims to improve health and wellbeing among its citizens. The plan involves promoting healthy lifestyles, tackling serious diseases, improving healthcare services capacity, scaling up the industry and modernising healthcare governance.[4] The initial blueprint was enshrined into the *Basic Healthcare and Health Promotion Law*[5] and is supplemented by the Healthy China Programme (2019-2030)',[6] an implementation outline released in July 2019. The programme focuses on 15 concrete goals, including decreasing the health effects of second-hand smoking, reducing obesity, increasing overall levels of physical

Total annual healthcare spending in China

Source: The Economist Intelligence Unit (The EIU)



1 'Industry Report: Healthcare', The Economist Intelligence Unit, December 2019.

2 'Health care in China: Entering 'uncharted waters', McKinsey, November 2012.

3 'Industry Report: Healthcare', The Economist Intelligence Unit, December 2019.

4 'Healthy China 2030 (from Vision to Action)', World Health Organisation, November 2016.

5 'Basic Healthcare and Health Promotion Law', State Council, December 2019.

6 'State Council measures to enhance people's fitness, health', State Council, July 2019.

activity, preventing chronic and non-communicable diseases and addressing mental health, underpinned by a re-orientation of China's healthcare to emphasise preventive measures. Policies that action these goals have already begun to be implemented, such as the establishment of a cancer registry system in February 2019 that initially covers 438 million people.[7] This has only been reinforced by the COVID-19 outbreak, with President Xi Jinping calling for the improvement of disease prevention systems, the strengthening of primary-level capacity and further digitalisation of the sector in February 2020.[8] As such, a continued drive to fulfil the 'Healthy China 2030' goals at all levels of government is to be expected.

The *Foreign Investment Law*, which took effect in January 2020, also has significant ramifications for the sector. It pledges the application of 'national treatment' for foreign businesses, which has the potential to remove several restrictions for healthcare systems if fully implemented.[9] The addition of this sub-sector to the *Catalogue of Industries for Encouraging Foreign Investment*,[10] permitting local governments to create incentives for foreign entities to invest in this category, is a welcome signal of greater openness to foreign investors. However, 'medical institutions' remains on the *Special Administrative Measures on Access to Market Entry of Foreign Investment* (Negative List for Foreign Investment),[11] limiting foreign ownership to 70% and their ability to fully control operations of their facilities.

China is also liberalising the market for cheaper generics, amid increasing pricing pressures. In August 2019, the government approved a revision to the *Drug Administration Law* (DAL), which aims to improve safety standards by encouraging information-sharing and drug-tracking.[12] Although the initial impetus for the regulations was the danger posed by substandard vaccines, it also reduces penalties for importing small quantities of foreign drugs, potentially increasing foreign companies' customer base. In addition to benefitting foreign imports, the DAL also promulgated the Market Authorisation Holder (MAH) system, which allows drug innovators to receive regulatory approval for a new product without also being required to manufacture it, granting them more leeway in R&D. The system prioritises innovation that relates to life-threatening or rare diseases, drugs of clinical urgency, paediatric drugs and new drugs, helping companies find solutions for urgent areas of public health more efficiently. More generally, the clinical trial approvals process has been streamlined, allowing pharmaceutical companies to deliver new products to market more quickly. Online prescription-drug sales have also been legalised through the DAL, giving patients in more remote areas or patients who are unable to get to pharmacies and hospitals easily greater access to high-quality drugs. Allowing medical institutions to provide this service was particularly useful during the COVID-19 outbreak, as it improved their ability to supply patients under lockdown with necessary drugs.

Reforms to pharmaceutical licences throughout the past year demonstrate the government's recognition of the contributions of international pharmaceutical companies towards achieving China's policy goals. British businesses commend the authorities' effective work in continuing to implement the opening-up of the pharmaceutical sector and its move to alignment with international standards. Approval rates for drugs and vaccines continue to accelerate, especially for urgently-needed drugs in areas such as rare and chronic diseases. As a result, 45 products passed drug approval in 2019, up from six in 2016,[13] and China's drug lag continues to close in on the EU's drug lag. The '4+7' centralised drug procurement system was also expanded from its initial pilot in 11 cities to cover the whole Chinese mainland, excluding Hebei and Fujian, allowing more pharmaceutical firms to participate in the procurement process.[14] At the same time, the government has announced the establishment of professional inspection teams to monitor drugs and medical equipment sold in China, with the aim of restoring trust in health products in China.[15] Continuing such reforms will allow China to deepen innovation, expand the range of medications available to patients and improve the quality of healthcare provision.

7 'China's cancer registry system covers 438 million people', National Health Commission, February 2019.

8 'Xi Focus: Xi stresses improving mechanism for major epidemic prevention, control', Xinhua, February 2020.

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

10 'The Catalogue of Encouraged Industries for Foreign Investment', National Development and Reform Commission, March 2020.

11 'Special Administrative Measures for the Market Entry of Foreign Investment' Ministry of Commerce, June 2019.

12 'China Focus: China revises law to ensure drug safety', Xinhua, August 2018.

13 'How Is China's Drug Approval Agency Outpacing International Counterparts? It's Complicated', Mercatus Center, March 2019; 'With 45 new drug approvals in 2019, friendly FDA is here to stay', Fierce Biotech, January 2020.

14 'Centralised Drug Procurement Document', Joint Procurement Office?, September 2019.

15 'Opinions on Deepening the Reform of Review and Approval System for Drugs and Medical Devices and Encouraging Innovation', State Council, October 2017. 'Professional drug-inspection teams to be established', State Council, July 2019.

Among various healthcare service provisions, China has specifically devoted resources to elderly care, pre- and postnatal care and growing the number of healthcare personnel in China. Elderly care in particular has seen a number of openings. In April 2019, the central government explicitly communicated that foreign enterprises will be treated equally to domestic companies as part of the government's development of elderly care provision, further to being eligible to support from the government in the forms of finance, land and human resources.[16] This was supplemented by the release of a medium- to long-term plan on tackling the problems associated with an ageing population, which reiterates a focus on building "a high quality healthcare system for the elderly".[17]

The COVID-19 outbreak has been a stress-test for Chinese health policy, and several changes have been announced by the government to relieve pressures on the system. They have shouldered the financial burden on the general public by reimbursing the cost of all drugs and medical services used to fight the virus,[18] and the Central Leading Small Group for the Work to Counter the Novel Coronavirus Pneumonia Epidemic has called for the acceleration of clinical trials of treatment drugs.[19] The digitalisation of services has also been accelerated, with online consultations and prescriptions becoming more common in order to minimise contact.

However, British healthcare companies have seen a considerable decrease in demand for their products or services. For example, hospitals were regulated to close down some non-essential clinics, such as dental clinics, and postpone elective surgeries. This shrink in their scope of services was compounded by reluctance of regular patients to visit healthcare facilities at the height of the pandemic, resulting in lower patient volume. As such, in late February two fifths of British healthcare companies expected their revenues in the Chinese mainland to decrease by more than 20% in 2020 and reduced demand was a key concern for them in the first half of the year, along with public health concerns and disruptions to supply chains and travel.[20]

16 'Opinions on the Promotion of the Development of Elderly Care Services', State Council, April 2019.

17 'Mid- to Long-Term Plan on the National Active Response to the Ageing Population', State Council, November 2019.

18 'The National Health Insurance Bureau's Two Guarantees Launched in a Full Effort to Respond to the Virus and Guarantee Treatment', National Healthcare Security Administration, January 2020.

19 'Li Keqiang Presides Over a Meeting of the Central Leading Small Group on the COVID-19 Epidemic Response, Effective Prevention and Control will be Deployed Further at All Levels, Diagnosis and Treatment will be Optimised and Drug Research and Scientific Prevention and Cure will be Accelerated', State Council, February 2020.

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

REGULATORY CHALLENGES

1 RESTRICTIONS AROUND LICENCES, CERTIFICATION AND STANDARDS

The past year has seen minimal reform in healthcare services licences, limiting UK healthcare services providers from being able to offer a full range of services to the market. Personnel qualifications is one key area of difficulty, as the *Interim Measures for the Administration of Short-term Medical Practice of Foreign Physicians in China* permit senior employees to work at one or more healthcare facilities, but in practice foreign doctors' work permits only allow them to practise on one medical site.[21] This prevents organisations from deploying doctors effectively, especially in emergencies, and blocks them from undertaking the rotational experience that many regard as integral to developing the experience they need. Beijing's municipal government has recently permitted doctors to practise in several districts within the city, which businesses welcome as an encouraging step they hope will also be implemented in other jurisdictions. Furthermore, the qualifications of Chinese nationals who have trained as doctors in the UK are not recognised in China, requiring them to spend time retraining in China in order to practise. The strength of medical training in the UK makes UK-trained doctors valuable additions to medical teams around the world, and recognising British training qualifications would allow them to more easily contribute these skills to China's healthcare sector.

To practise in China, nurses must take China's Registered Nurse examination, which is not available in English. This makes working in China almost impossible for those who do not speak native-level Chinese. However, foreign doctors are currently able to practise in China irrespective of their level of Mandarin ability, although this may be restricted by the draft *Administrative Measures for the Practice of Foreign Doctors in China,*[22] released in January 2020 by the National Health Commission (NHC), which may require foreign doctors to pass the NHC exam in Chinese. Facilitating foreign nurses' ability to gain the Registered Nurse licence and maintaining foreign doctors' ability to practise in China would allow them to share their knowledge and experience with colleagues and improve access to Western training opportunities, while also alleviating pressure in overstretched hospitals.

Although 'medical institutions' was added to the *Catalogue of Industries for Encouraging Foreign Investment*, inbound investment is also subject to considerable restrictions. Medical institutions remain on the 'Negative List for Foreign Investment', despite assurances from the central government to reduce the number of sectors on the list.[23] Due to this listing, medical institutions in China are restricted to Sino-foreign joint ventures (JVs) or cooperative joint ventures, with a 70% shareholding limitation for foreign parties.[24] Wholly foreign-owned enterprises (WFOEs) are also barred from investing in sensitive areas, such as biotech, human stem cells and gene diagnosis and treatment, and so must form a domestically-incorporated company or partner in a JV to do so. This created operational complications that discourage foreign investors from entering the market and relieving some of the overwhelming demand for R&D in this area. Similarly, services firms report that the absence of licences for using certain drugs impedes their ability to care for their patients. For example, anti-D, a medication routinely given to pregnant women to prevent Rhesus disease, is not licensed in China. As a result, doctors cannot use trusted and familiar drugs to treat their patients, which could lead to unnecessary health risks.

Medical devices and pharmaceutical firms note that foreign manufacturers have been able to use data from overseas multi-centre clinical trials for applications in China since 2017, as long as data meets Chinese standards and data on differences among ethnic groups is provided if the drug or device has not been launched in China.[25] As a result, costs theoretically should be lowered and

21 'Interim Measures for the Administration of Foreign Doctors Practicing Medicine in China for Short Terms', Ministry of Health, July 1992.

22 'Administrative Measures for the Practice of Foreign Doctors in China (Call for Comments)', National Health Commission, January 2020.

23 'Special Administrative Measures for the Market Entry of Foreign Investment' Ministry of Commerce, June 2019.

24 'Special Administrative Measures for the Market Entry of Foreign Investment' Ministry of Commerce, June 2019.

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

timelines shortened for clinical trials. However, some companies report that these benefits have yet to tangibly impact their operations.

Finally, for pharmaceutical retailers there is currently regulatory uncertainty over whether retail pharmacy dispensaries will need to be classified according to the drug types they sell. The measures may cut out malpractice, or the variety of licences needed could overcomplicate and impede business. Greater clarity is needed in order to open this space to foreign businesses and allow greater competition and efficiency, which is ultimately to the benefit of the consumer, while ensuring that all healthcare products are sold in appropriately licenced outlets.

2 PRICING PRESSURES AND REIMBURSEMENT REQUIREMENTS

The 'two invoice' system was created by a series of regulations intended to simplify supply chains and reduce malpractice by cutting down the number of transactions to two invoices. However, the device logistics network is more complex than this in practice, and so the system has created administrative difficulties across the supply chain. In addition to providing a connecting link between manufacturers and customers, distributors also provide essential functions, such as training hospital staff to use the product and providing product maintenance services. Given China's scale and the level of market and regulatory fragmentation, it is often impossible for one distributor to perform these tasks across one province, let alone the country. As such, having multiple distributors is necessary to ensure that medical devices are properly used and maintained. Often, companies have been forced to split themselves into two halves, with each branch individually compliant with the 'two invoice' system, which intensifies complexity and increases costs for medical institutions and patients.

A recent update to the National Green Book has also increased the cost of distribution and the complexity of the overall system. Although medical devices companies have yet to be materially impacted by the aim of the centralised drug procurement system to drive down costs of medical products, there are concerns that it may compromise quality in the future, as seen in the pharmaceutical sector. The sector also faces many of the same challenges as other industries in which state-owned enterprises (SOEs) dominate, as they undercut private competitors by bidding at prices that are simply unfeasible for private companies.

At first glance, the inclusion of foreign pharmaceuticals in the '4+7' system would seem to be a positive step towards wider opening of the sector. In 2018, only two foreign pharmaceuticals companies won tenders for the reimbursement list, but in 2019 this rose to seven.[26] However, foreign pharmaceutical companies could only achieve this by setting prices that weren't commercially viable, making a considerable loss. This further compounded the pressure of competing with SOEs, which are naturally afforded a strong price advantage when bidding.

Pharmaceutical companies have been forced to drive down prices of innovative drugs dramatically over the course of their negotiations with the Chinese government to enter the National Reimbursement Drug List (NRDL). While last year's negotiation saw 70 new drugs successfully enter the list, the average decrease in price was 61%,[27] calling the sustainability of long-term operations in the market into question. Furthermore, businesses have not yet had the opportunity to communicate with regulators in order to explain the complexities behind their supply

26 'Sanofi, AZ, Lilly and more win business in China's expanded cut-price purchase program', FiercePharma, September 2019.

27 'Drug makers including Roche and Novaris slash medicine prices in China to get on reimbursement list', South China Morning Post, November 2019.

chains and clarify government expectations. The two-year contract length is relatively short, meaning that drugs in the NRDL are likely to be exposed to a regular cycle of renegotiation and price cuts. Procurement strategies must be adjusted to ensure that the long-term benefits of investing in high-quality, sustainable and often more economical products for both patients and administrators are actively considered in government decision-making.

Although recent policy documents, such as the *Notification of the Publication of Key Tasks in Deepening Reform in 2019 of the Medical and Health System*,[28] and confirmation by the National Healthcare Security Administration (NHSA) that it will use a dynamic adjustment process for the NRDL are positive developments, concerns remain around the related processes and specifications. In particular, the desired specifications for drugs and the profile of commercial competitors are no longer clearly provided by regulators, and companies have been permitted to only make two allotted bids. This compromises their ability to make well-informed and effective decisions and hinders them from accessing all of the opportunities available in the procurement system. This is exacerbated by the short period between the date on which companies are notified that they are required to submit product information and the submission deadline. In addition to the tight timeframe, the NHSA demands a large quantity of information with no communication given to businesses on where the information goes or how it is used. Greater clarity of the process would help companies provide useful information in a succinct and efficient way, in turn reducing the amount of information that authorities would need to evaluate when reviewing bid submissions.

3 FRAGMENTATION AND RESTRICTIONS ACROSS SUPPLY CHAINS

Logistical capabilities in the medical devices and pharmaceutical sectors in China have improved accessibility and transparency through such initiatives as the 'two invoice' and 'track and trace' systems. Infrastructure development has made it easier for medical products to reach remote areas, related programmes have improved health education and an increase in the number of hospitals have made healthcare services more accessible for patients. Improvements to and the implementation of the MAH has given businesses more flexibility to adopt an efficient market strategy and leapfrog some of the logistical challenges usually experienced in the Chinese market, such as developing online sales platforms. Some firms have reported that approval to distribute their products and sell directly to clients through the 'two-invoice' system has considerably reduced friction and made it easier to do business.

However, these reforms have also created new difficulties, and regulations regarding the organisation of logistics generally remain fragmented, opaque and inconsistent. The 'two invoice' system fundamentally oversimplifies the whole supply chain to two links, impacting complex and sophisticated process in which products and devices are built by sourcing components from multiple highly-specialised manufacturers. In addition, a purchaser of medical devices must either source products that have been built in China or otherwise provide an acceptable explanation for why a foreign-built medical device is required. This undermines the principle of free and open trade and constructs barriers to trade for British medical device manufacturers which Chinese manufacturers are not subject to in the UK.

Furthermore, tensions in a system that features both highly centralised management of resources and regionally inconsistent implementation of policy can cause bottlenecks and inefficiencies. Certain drugs are distributed by central government bodies, such as the Centre for Disease Control, and can only be made available to healthcare services companies if there is proven to be significant need for them. This can make it difficult to provide medication at the point of need, as it is very difficult to gather and monitor constantly updated data on patient needs at the national level. This discrepancy can result in a lack of supply, as seen in the unnecessary shortage of ketamine, which is a commonly-used sedative for children. Increasing the agency of local authorities to procure such drugs from reputable sources at need, while maintaining stringent oversight of the process, would help improve the availability of drugs for those in need. Furthermore, a number of important and internationally-approved drugs have not been approved by regulators, and doctors may therefore be forced to use less effective alternatives, ultimately to the detriment of patients.

Moreover, the hospital 'restricted list' means that public hospitals have limited slots for drugs, and in order to bring in an in-demand drug to the list, another must be removed. This limits the ability of hospitals to provide patients with the most recent therapies and cutting-edge care, undermining the reputation of China's healthcare system and encouraging patients to seek treatment in other countries. Addressing these issues would both help hospitals across China to optimise the level of care they can provide and help improve the reputation of China's healthcare system domestically and internationally.

28 'Notification of the Publication of Key Tasks in Deepening Reform in 2019 of the Medical and Health System', State Council, June 2019.

RECOMMENDATIONS

REGULATORY CHALLENGE	RECOMMENDATION
1 Restrictions around licences, certification and standards	■ Remove restrictions on foreign ownership of medical services companies and on foreign investment in medical research. ■ Explore the opportunity of signing Mutual Recognition Agreements to allow registered nurses and doctors to operate in both countries, or provide an English-language version of requisite examination. ■ Amend work permits for foreign doctors to allow them to work on all medical sites owned by their employer. ■ Establish a mechanism to fast-track approvals in China through the recognition of approvals granted by other countries. ■ Provide more clarity on the classification and regulation of dispensaries.
2 Pricing pressures and reimbursement requirements	■ Improve the clarity and transparency of the National Reimbursement Drug List decision-making process in order to grant companies greater insight as to the reasoning for accepting products onto the list. ■ Grant companies more time between notification of the need to submit an application for reimbursement and the submission deadline. ■ Adopt a more nuanced procurement mechanism that recognises the merits of investing in high-quality products for both patient welfare and administrative sustainability.
3 Fragmentation and restrictions across supply chains	■ Amend the ‘two-invoice system’ in order to account for the complex manufacturing process behind many medical devices and allow for greater supply chain flexibility. ■ Improve regulatory uniformity across China, whilst also granting local governments the authority to ensure that drugs can be delivered to areas in need.

MUTUAL OPPORTUNITIES

FREE TRADE ZONES

Free trade zones (FTZs) have provided policymakers with avenues to expedite the approval of pharmaceutical products and medical devices in the past. In 2018, the State Council issued a decision on adjusting the *Implementation Measures of the Drug Administration Law* in the Bo'ao Lecheng International Medical Tourism Pilot Zone in Hainan.[29] This allows companies to introduce drugs and devices that have not yet been approved on the Chinese mainland to be piloted in Hainan, establishing a small foothold in the market. In September 2019, the government then announced that data collected on the clinical use of medical products in Hainan can be used for their registration applications,[30] speeding up the process to the benefit of both manufacturers and consumers. Piloting further reforms in the healthcare sector in FTZs, if accompanied by a concrete plan for nationwide rollout, would be an effective means of fine-tuning regulations to ensure they benefit all parties.

CONTINUED DEVELOPMENT OF THE HEALTHCARE SYSTEM

As implementation of 'Healthy China 2030' continues to gain momentum, it will spur broader reforms to China's healthcare system. It is apparent that the government fully intends to lessen the burden on public hospitals, by moving towards a more community health-based system which will focus more on preventative measures, cover a broader swathe of the population and allow hospitals to focus on more complicated or serious cases. Should this occur, there will be areas of considerable similarity between the British and Chinese healthcare systems. As such, China can benefit from cooperation with the UK National Health Service, the National Institute for Health and Care Excellence and hospital trusts. The UK is well placed to share its experience in adapting its healthcare system to meet new challenges and demographic trends, particularly in terms of specialist clinical care and management systems. The training of medical professionals (especially general practitioners), hospital managers, specialist engineers for medical devices, nurses and elderly care staff, will also need continued development in China as 'Healthy China 2030' is implemented. Partnering with each other in these areas would create greater exchange of knowledge and experience that would benefit both countries.

HEALTHCARE TECHNOLOGY

Digitalisation can work to alleviate some of the pressures caused by difficulties providing medical care to more remote areas. Previously, building infrastructure and training doctors in these regions would require a significant amount of time, with few incentives for investors and healthcare professionals. However, telemedicine and teleconsultation can allow one doctor to contact patients regardless of location and in a time-efficient manner, while the harnessing of artificial intelligence and big data can decongest, streamline and personalise services. Uptake and familiarity with healthtech in China is also likely to have increased in the wake of the COVID-19 outbreak. UK healthtech developers have been recognised for their innovation and the quality of their work, and the industry is currently worth GBP 24 billion (RMB 210.3 billion).[31] With full access to the market, it will be able to provide China with agile solutions, providing useful support in the development of its healthcare system.

DEMOGRAPHIC TRENDS

By 2035, China is expected to have 409 million senior citizens, representing 28.5% of the total population.[32] This will exert considerable pressure on China's ability to provide palliative care, treat chronic diseases and develop elderly care services, including day care, rehabilitation care and assisted meals and mobility services. The UK has already learnt to manage some of the problems that China will soon be facing, and can support China with its strong specialist knowledge and resources in these areas.

29 'Decision to Provisionally Adjust the Implementation of the Relevant Provisions of the Regulations for the Implementation of the Drug Administration Law in Hainan's Bo'ao Lecheng International Medical Tourism Pilot Zone', State Council, December 2018.

30 'New policy hastens approval of overseas drugs, equipment', State Council, September 2019.

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

32 'Emerging opportunities in China's healthcare sector', Eastspring Investments, July 2019.

LEGAL SERVICES

AT A GLANCE:

KEY CHALLENGES:

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

KEY RECOMMENDATIONS:

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

KEY MUTUAL OPPORTUNITIES:

- Cooperation on international trade and investment
- Knowledge-sharing

STATE OF THE SECTOR

In China's legal services market, supply is being steadily outstripped by rising demand despite slowing economic growth. Although legal spend by organisations in China currently stands at a third less than the global average, it has been growing at a fast pace. 46% of legal departments plan to increase their overall legal spend in the next year.[1] This comes as Chinese companies increasingly turn their ambitions outbound, and 93% of Chinese organisations now have a need for international legal advice.[2]

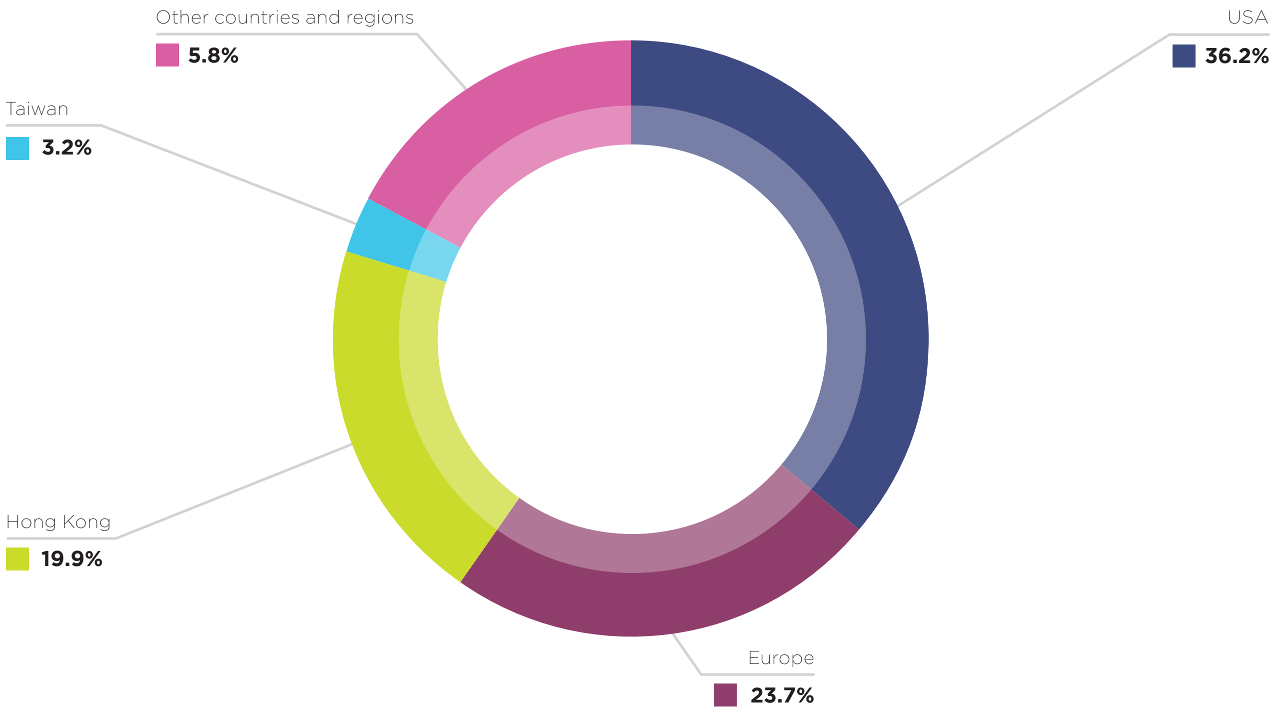
The pace of development is impressive, especially given that the private legal sector evolved out of the state apparatus less than 40 years ago. The relative youth of China's legal market can be seen as an advantage, as it is less burdened by long-established practices and potentially more amenable to innovation, such as alternative fee arrangements, workflow automation and increasingly digitalised case management.

As China's growth ambitions turn outbound, the sector must also expand to follow it. The industry enjoys Chinese government support for its internationalisation and Chinese legal services have the potential to be an important global player. However, Chinese law (PRC law) is still not among the preferred laws for use in international business. English law remains one of the most trusted and widely-used systems of law for international trade, and the UK's legal sector is highly developed and competitive, with many of the world's most respected and established law firms originating in the UK.

As such, opportunities for partnership are evident. However, comparatively restrictive access to China's legal sector currently limits the country's ability to internationalise its market, and inhibits the contributions that UK and other foreign law firms can make to the Chinese legal market. Despite the valuable network and experience that

International representative offices on the Chinese mainland by region (2018)

Source: Ministry of Justice



1 '2019 State of the Legal Market in China', Thomson Reuters Legal Executive Institute, April 2019.

2 '2019 State of the Legal Market in China', Thomson Reuters Legal Executive Institute, April 2019.

foreign firms have to offer, domestic firms dominate, benefitting from regulatory advantages in the industry and continuing to expand, while foreign firms are restricted to operating in outbound work and in joint operations. On average, international firms only generate 5% of global revenue from their China operations[3] and most firms report that they struggle to operate profitably in China. Moreover, while the ability to establish joint operations in Shanghai and, more recently, Hainan have allowed foreign firms to access more of the market, such joint operations are a long way from the full integration that firms require in order to satisfy the needs of their clients and operate on a level playing field with their domestic counterparts.

The strength and success of domestic firms suggests that they are robust enough to be able to withstand competition from international firms; this competition may even raise the overall performance of the industry by necessitating continuous innovation and efficiency. For Sino-international relationships to achieve their full potential in all areas, British and other foreign firms need to be able to operate in the China market and partner with Chinese firms domestically, just as Chinese firms are free to operate in the UK and many other jurisdictions around the world.

Along with most of the economy, China's legal services sector has been heavily impacted by the economic slowdown in the wake of COVID-19. While law firms with the necessary digital infrastructure are able to work remotely to a degree, the industry has suffered from dampened demand as investment and business operations pause and travel bans impede the intrinsically international nature of their work. The frequency of late client payments has risen, and business development plans have had to be cancelled due to an uncertain environment and difficulties meeting clients and partners.[4]

One example of an area of work that has slowed is cross-border mergers and acquisitions (M&A), which was already declining in 2019 as a result of the US-China trade war and dropped even further over the course of the initial outbreak in China. However, a small number of firms are seeing an increased need for advice from clients who require guidance navigating these uncertain times. In particular, there has been an uptick in interest around *force majeure* and its implications, particularly in China where it is imposed on all commercial contracts.

3 'Foreign Firms in China: Looking beyond the hype', The Practice, October 2016.

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

REGULATORY CHALLENGES

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

In China, the legal right of PRC-qualified lawyers to practise Chinese law is suspended while they are employed by foreign law firms. Therefore, UK and foreign firms cannot issue opinions on PRC law without entering into arrangements with local firms, in which the Chinese firm services clients' domestic needs. Such arrangements include joint law ventures (JLVs), which are inefficient as their establishment consumes time and resources, increasing costs and reducing firms' competitiveness. To compound this, representatives of foreign law firms are also not permitted to appear before Chinese courts and tribunals. Regardless of expertise, foreign passport-holders are barred from obtaining PRC legal practicing certificates.

All this makes it increasingly difficult to attract talent to bring and share their experience and knowledge with the sector, as it places clear limitations on the career path of a prospective employee. Allowing PRC-qualified layers to work in foreign firms would assist in augmenting international exposure to PRC law, through such schemes as Belt and Road Initiative (BRI) projects, which British law firms are often enlisted to advise on. The state of play also demonstrates a distinct lack of reciprocity. In the UK, a English-qualified lawyer can practise English law, and there are no restrictions on PRC law firms opening offices and employing English-qualified lawyers of any nationality to advise on English law in the UK. Furthermore, a pilot scheme was established in 2017 that allowed PRC firms in Beijing, Shanghai and Guangdong to employ foreign lawyers to practise PRC law.[5] This is an encouraging first step, and allowing PRC lawyers to practise PRC law in foreign firms would expand the ability for professionals to share knowledge and continue to develop the field.

5 'Notice on the Pilot Work of Hiring Foreign Lawyers as Foreign Legal Counsels in Domestic Law Firms', Ministry of Justice, March 2017.

2 RESTRICTIONS ON OWNERSHIP AND CORPORATE STRUCTURE

Foreign firms are currently limited to two representative offices in China. As a result, some firms have looked to partner with local firms, and the authorities have made some routes to doing so available. However, while the offer of this option is appreciated and some British businesses have utilised it, several restrictions limit the practicality and popularity of these methods. In particular, the inability to operate as a single firm and the significant barriers to entry make the decision to establish joint operations a considerable investment in terms of both time and capital. These costs dissuade some large firms from entering the market, and make it virtually impossible for smaller firms to do so.

Some municipalities have created alternative solutions to JV partnerships. The Shanghai Free Trade Zone allows foreign-local joint operations, permitting co-marketing and shared referrals. However, it is subject to requirements reducing its attractiveness, including that the firm must have 20 lawyers employed by the PRC partner, be located in the premium Pudong area, have three years' operating experience, partner with a Chinese firm which also has an operating history of at least three years and be subject to restrictions in management and profit-sharing rights. Although the Shanghai Municipal Bureau of Justice indicated in 2018 that it would consider expanding the scheme to the rest of the city, there has been no further progress on this since.[6]

Similarly, in Hainan, foreign-local joint operations may be established if the PRC partner employs at least 20 lawyers, both partners have a minimum of three years' operating history and neither partner has been subject to administrative punishment in the past three years. Tianjin may

6 'Freehills to offer legal services in Shanghai Pilot Free Trade Zone', State Council, August 2019.

soon allow the same joint operations, subject to further specified regulations.[7] The Closer Economic Partnership Agreement (CEPA) between the Chinese mainland and Hong Kong is subject to some similar stipulations, but it is limited to representative offices of Hong Kong firms or offices and it seems that this will not be offered to the Hong Kong offices of firms incorporated outside of Hong Kong.

Other domestic and foreign firms have combined through a Swiss Verein structure, in which the two entities keep their finances independent, but share other resources in other core functions, such as strategy, branding and IT systems. Importantly, blocking financial sharing forces the local entity to fund all operations independently and removes the shared interest in client referrals. Shared IT systems are further threatened by measures in the *Cybersecurity Law* that could affect local and foreign partners' ability to share data with each other.[8] Most firms operating this model report that, if regulation made it possible, they would choose to become fully integrated instead. Any firms that successfully completed such strategies reported that the process is long and unnecessarily bureaucratic.

3 RESTRICTIONS ON APPEARANCE BEFORE GOVERNMENT AGENCIES

Foreign firms are generally prohibited from appearing or participating in meetings between their clients and Chinese mainland government authorities. Moreover, there is sometimes a lack of transparency or consistency as to whether they are permitted or not, resulting in firms generally taking the conservative option not do so. Clients would benefit from their China-based foreign lawyers being able to appear before certain government agencies, particularly in such areas as product licensing, regulatory compliance, approvals and registrations and intellectual property protections, and would subsequently provide clients with confidence in their ability to do business.

These restrictions also put clients in a position in which they may not be free to select the lawyer or firm of their choice. This could be especially problematic in cross-border transactions. If, for example, a client has a preference for a foreign firm with experience in the non-China market but needs to bring in an additional counsel who is not familiar with the case, this may result in inefficiencies and additional costs for them.

4 UNEQUAL TAX TREATMENT

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

5 OFFICE LICENCE AND HR RESTRICTIONS

To set up a representative office, a foreign law firm must both demonstrate a 'need' to do so and wait three years before opening an additional one. This limits firms' opportunities for growth and contrasts with requirements in the UK, where Chinese firms may establish offices with relative ease. In addition, the processes of changing representatives, particularly chief representatives, of a firm, transferring foreign lawyers between overseas and PRC offices and hiring foreign lawyers are bureaucratic and time-consuming, and have deteriorated over time. Firms report that this can now easily take a year, compared to a few months previously. Therefore, resourcing decisions must be made long in advance of need and the ability of foreign firms to react quickly to market opportunities has become significantly restricted.

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

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

RECOMMENDATIONS

REGULATORY CHALLENGE	RECOMMENDATION
1 Inability of PRC-qualified lawyers to practice chinese law in a foreign firm	▪ Pilot allowing licences in certain areas that are most relevant to foreign firms, such as commercial and corporate work, particularly in M&A and anti-trust areas. It is not suggested that foreign law firms start to engage in areas that would be sensitive.
2 Restrictions on ownership and corporate structure	▪ Increase flexibility of the joint operations models, in particular reducing barriers to entry, such as minimum numbers of lawyers, length of operating history of the local partner and location of the joint operations ▪ Improve the ability of foreign partners to control and share the profits they earn.
3 Restrictions on appearance before government agencies	▪ Allow lawyers from foreign firms to represent their clients in meetings with government agencies, when clients require it.
4 Unequal tax treatment	▪ Bring taxation of foreign representative offices and partners in line with that of their domestic law firm counterparts.
5 Office licence and HR restrictions	▪ Align the ease of setting up a representative office and employing representatives for foreign firms in China that Chinese firms enjoy in the UK.

MUTUAL OPPORTUNITIES

COOPERATION ON INTERNATIONAL TRADE AND INVESTMENT

As international trade and investment continues to strengthen, the prevalence of English law as the legal system of choice between business partners from different countries reinforces the demand for the services of UK law firms in other countries. In particular, many UK firms have been present in China for a considerable time and have gained significant experience in and understanding of China's commercial and legal systems, as well as the difficulties Chinese companies may encounter when operating overseas. When working directly with companies, they can advise throughout the full life of investment or project development, but they can also offer insights into broader initiatives, such as the work of the UK-China Infrastructure Alliance along the BRI. While such projects are likely to continue being driven financially by state-owned enterprises, increasingly the sponsors and financiers of these projects are looking to include a greater proportion of international investment. British legal firms will be well-placed to offer guidance on integrating these investments into existing structures.

KNOWLEDGE-SHARING

The UK is home to several well-established firms with significant expertise in a variety of areas and committed investment to internal training and education. This can directly help Chinese businesses, and indirectly help Chinese law firms, to innovate and expand internationally through the migration of UK law firm-trained lawyers to domestic firms. In particular, British firms can share management experience and skills in handling international operations and cases with Chinese firms looking to expand globally. UK firms that have a long-established presence in China have played an important role in training PRC-background lawyers who have gone on to rise to senior management in domestic PRC companies and PRC law firms alike.

RETAIL AND CONSUMER GOODS

AT A GLANCE:

SUB-SECTORS:

Cosmetics

High street retailers

Luxury goods

Product developers

Shopping outlets

KEY CHALLENGES:

- Concerns over intellectual property rights
- Mandatory animal testing for cosmetics
- Deviation from international product standards

KEY RECOMMENDATIONS:

- Develop and implement administrative measures to enhance the supervision of IP infringements on social media platforms
- Provide explicit guarantees that non-special use cosmetics products which have satisfied the exemption for animal testing will not be subject to toxicological testing from post-filing or post-market supervision
- Exclude recommended standards from market surveillance and supervision, leaving assessments on the performance and function of products to the market

KEY MUTUAL OPPORTUNITIES:

- Rising consumption in lower tier cities
- Demand for high quality and premium products

STATE OF THE SECTOR

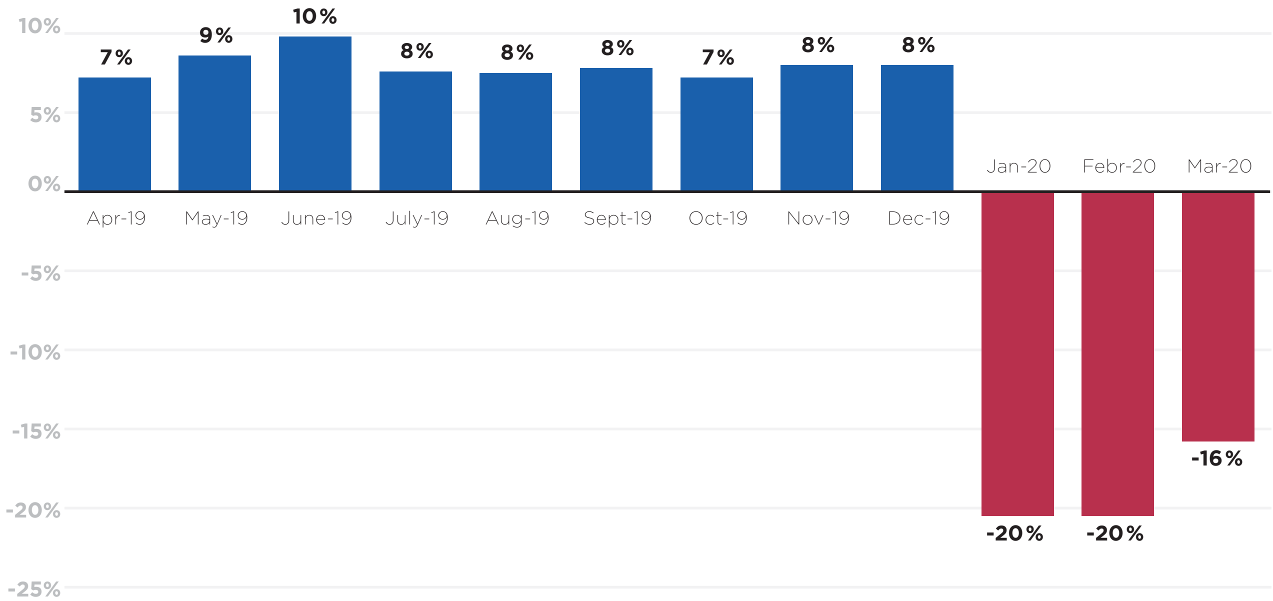
As the world's largest retail market, China is a key source of revenue for many British retailers and consumer goods companies. In 2019, China's GDP per capita topped USD 10,000 (GBP 7,900/RMB 71,000) for the first time, signalling a rising middle class with a greater propensity to spend and a growing demand for high quality and premium products. While the sector has seen growth dip as the Chinese economy continues to slow, retail sales still grew by 8% in 2019, down from 9% in 2018.[1] The market continues to offer huge potential for long-term growth, with retail sales in China expected to exceed RMB 37.2 billion (GBP 4.2 billion) by 2023, driven increasingly by online channels.

The impact of COVID-19 on China's retail sector, however, has put a significant dampener on growth. Retail sales dropped by 20.5% year-on-year, the largest drop on record for the sector, as many retails stores across China were forced to close during the peak of the outbreak in January and February.[2] The short-term impact on businesses has been substantial, especially for small and medium-sized enterprises (SMEs), who have struggled with cash flow and falling demand. A number of larger companies have continued to pay staff full wages despite them not being eligible to work, which has been costly when combined with depressed sales. As domestic virus cases subside and normal business operations begin to resume however, retailers hope pent-up demand will unleash a wave of revenge spending on the part of consumers. In order to stimulate such consumption, local governments in Nanjing, Shandong and Ningbo have issued citizens with vouchers worth more than RMB 400 million (GBP 46 million) to be spent in the retail, tourism and leisure industries.[3] However, the retail sector is unlikely to fully recover until employment stabilises and businesses across the country resume normal operations either at or near full capacity.

As China undergoes a long-term economic slowdown while structurally transitioning to a more consumer-driven

Retail sales growth in China (year-on-year)

Source: National Bureau of Statistics



1 'China GDP growth last year was 6.1 per cent, slowest rate for 29 years', South China Morning Post, January 2020.

2 'Total retail sales of consumer goods decreased by 20.5% from January to February 2020', National Bureau of Statistics, March 2020.

3 'Vouchers to Boost Post-Virus Spending Trigger Affordability Warning', Caixin, 19 March.

economy, bolstering consumption and improving the business environment have been a key focus of the government over the past year. A two-year stimulus plan jointly released by the National Development and Reform Commission (NDRC), the Ministry of Ecology and Environment (MEE) and the Ministry of Commerce (MOFCOM) aims to promote the purchase of high-tech and green products, such as home appliances and consumer electronic goods. The plan pledges financial incentives and a more supportive regulatory environment for manufacturers and suppliers,[4] while seeking to eliminate traditional products and replace them with upgraded green consumer products. To satisfy growing consumer demand for higher-quality products, the plan includes such measures as merging new technologies and business platforms, revamping old shopping centres and pedestrian shopping streets, encouraging trade-ins for old household appliances and promoting night markets and activities during public holidays.[5]

Over the past year, the authorities have also been proactive in improving China's Intellectual Property (IP) landscape, introducing the *E-Commerce Law* and making significant amendments to the *Trade Mark Law*. In addressing the phenomenon of trade mark squatters maliciously registering the trade marks of well-known brands, the new *Trade Mark Law* empowers the China Trademark Office (CTMO) to deny bad-faith filings at the initial examination stage, while also increasing both legal obligations for trade mark agencies and the punishments for trade mark infringement.[6] China's *E-Commerce Law* placed a greater responsibility on e-commerce platforms to combat IP infringements by introducing more stringent penalties for failing to prevent the sale of counterfeit goods on their platforms.[7]

The presence of British companies spans across all areas of retail such as fast moving consumer goods (FMCG), cosmetics, luxury fashion and real estate. The premium and luxury segment in particular is one area in which British companies thrive. Chinese consumers spent RMB 770 billion (GBP 87 billion) on luxury goods domestically and abroad in 2018, accounting for a third of global spending on luxury goods. This figure is forecast to almost double to RMB 1.2 trillion (GBP 136 billion) by 2025, or 40% of global luxury sales.[8] British companies are well positioned to cater to the growing demand among China's savvy middle class for high quality and premium products, while being able to quickly adapt to and engage with rapidly changing consumer tastes.

4 'Implementation Plan for Promoting Update and Upgrade of Key Consumer Goods and Facilitating Resource Recycling (2019-2020)', NDRC, June 2019'

5 'Opinions of the General Office of the State Council on Accelerating the Development of Circulation and Promoting Commercial Consumption', State Council, August 2019.

6 'Trade Mark Law of the People's Republic of China', Ministry of Justice, April 2019.

7 'E-Commerce Law of the People's Republic of China', National People's Congress, August 2018.

8 'China Luxury Report 2019: How young Chinese consumers are reshaping global luxury', McKinsey & Company, April 2019.

REGULATORY CHALLENGES

1 CHALLENGES AROUND INTELLECTUAL PROPERTY RIGHTS

To address the concerns of businesses over IP rights across all sectors of China's economy, the Chinese authorities have taken proactive steps to strengthen protections of IP and increase penalties for infringements. China's Public Security Bureau (PSB) has worked closely with several British retailers, alerting them to cases of IP infringements on their products and working to remove counterfeit goods on the market. Businesses recognise the material improvements made to China's IP landscape, highlighted by IP dropping out of the top three challenges faced by British companies in the *British Business in China: Sentiment Survey 2019-2020*.[9] However, retailers continue to see IP infringements on their brands, designs and patents, and express concern about the sale of copycat and counterfeit goods online and offline, as well as challenges in receiving the appropriate compensation in damages.

Although significant government focus has been paid towards countering IP infringements on traditional e-commerce platforms, this same focus has not been paid towards other social media channels, leading to widespread sales of counterfeit goods on social media channels. China's *E-Commerce Law*, implemented in January 2019, placed a greater responsibility on e-commerce platforms to combat the sale of counterfeit goods on their platforms. While these measures, along with the desire of the platforms themselves to improve their public reputation, have significantly reduced cases of IP theft, this same legislation does not cover social media platforms. Under the *E-Commerce Law*, the definitions for an e-commerce business operator and an e-commerce platform operator do not apply to social media platforms. As a result, private group chats and personal accounts that facilitate the sales of fake products have not received the same government attention around IP protection, and IP infringements of recognised British brands continue to proliferate.

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

2 MANDATORY ANIMAL TESTING REQUIREMENTS FOR COSMETICS

China is the only country in the world where animal testing for cosmetics products is mandatory. Despite being the world's largest cosmetics market, this mandatory requirement effectively shuts out British cruelty-free brands from physically selling their products in the market. Brands unwilling to sacrifice this ethical policy have two alternative routes into market. The first is to manufacture cosmetics domestically in the Chinese mainland. However, this only applies to non-special use cosmetics such as perfume and makeup, and does not cover special use cosmetics with specific claims, such as whitening or anti-wrinkling benefits. This requires them to label these products as 'made in China', which could diminish the brand's premium appeal in the eyes of Chinese consumers. The second route is to sell via cross border e-commerce platforms, although these sites tend to incur substantial import levies, which are generally born by the retailer as opposed to the consumer.

9 'British Business in China: Sentiment Survey 2019-2020', British Chamber of Commerce in China, December 2019.

The Chinese authorities have signalled their intent to remove the animal testing requirement for foreign cosmetics companies exporting to China, although the complexity of national implementation has led to delays in the process. In May 2019, the National Medical Products Administration released the *Draft Measures for the Administration of Filing for Non-Special Use Cosmetics*, which exempt non-special use cosmetics from animal testing if relevant safety requirements can be met.[10] However, the measures remain in draft form, with no indication as to when they are likely to be implemented. Furthermore, the measures do not apply to special use cosmetics, and they do not explicitly rule out toxicological testing on animals from post-filing or post-market supervision.

These measures are certainly a positive step towards a cruelty-free cosmetics market. The potential risk that products which have satisfied the exemption for animal testing may undergo post-market toxicological testing, however, is likely to deter cruelty-free brands from physically selling non-special use cosmetics products in China. Providing this guarantee while also repealing the mandatory animal testing requirement for special use cosmetics and replacing it with internationally-used alternative scientific practices to guarantee safety, would offer Chinese consumers a far greater selection of cosmetics products at more competitive prices. This would be equally beneficial for Chinese cosmetics brands looking to export to countries such as the UK, where animal testing is prohibited, as they will need to validate the safety of their products via other modern scientific methods.

3 DEVIATION FROM INTERNATIONAL PRODUCT STANDARDS

British consumer goods companies that manufacture and sell everything from footwear to everyday household appliances find their operations in China hindered by deviations from international standards. When a country's standards do not fully comply with World Trade Organisation Agreement on Technical Barriers to Trade (WTO/TBT) principles, foreign companies are faced with additional obstacles to doing business, incurring unnecessary cost and time. The Standards Administration of China (SAC), operating under the State Administration for Market Regulation (SAMR), is the central body responsible for developing and disseminating the country's national standards.

According to the revised *Standardisation Law* issued by SAC in 2018, products must comply with mandatory standards, and progress has been made in recent years in streamlining and consolidating mandatory national standards.[11] Standards have been grouped into five categories: national standards, industry standards, local standards, social organisation standards and enterprise standards. However, voluntary requirements around these categories have been included in China's market surveillance processes in order to support China's mandatory standards. This means that voluntary standards are in effect *de facto* mandatory standards, thereby making companies liable to penalties if they fail to meet them. These voluntary standards are generally domestic oriented however, and diverge from international standards. Foreign companies similarly have to comply with sector-specific standards, despite already being in compliance with national mandatory standards. For household electrical appliances for example, hundreds of standards have been integrated into three sets of overarching standards for electrical safety, hygiene and environmental protection. These three standards cover the whole life cycle of the product including materials, production, storage and transportation, instillation, use, maintenance and repair and recycling. The addition of voluntary performance requirements and standards covering the entire life cycle of products diverges from global practice, creating additional technical barriers to trade which increases the complexity, time and cost for businesses to gain certification and approvals.

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

10 'Measures for the Administration of Filing for Non-Special Use Cosmetics (Draft Call for Comments)', National Medical Products Administration, May 2019.

11 'Standardisation Law of the People's Republic of China', Standards Administration of China, November 2017.

RECOMMENDATIONS

REGULATORY CHALLENGE	RECOMMENDATION
1 Concerns over intellectual property rights	■ Develop and implement administrative measures to enhance the supervision of IP infringements on social media platforms. ■ Consider the size of inventories of counterfeit goods and counterfeit accessories and parts when calculating the amount of damages for infringement cases.
2 Mandatory animal testing requirements for cosmetics	■ Provide explicit guarantees that non-special use cosmetics products, which have satisfied the exemption for animal testing, will not be subject to toxicological testing from post-filing or post-market supervision. ■ Release a timeline for the implementation of the draft *Measures for the Administration of Filing for Non-Special Use Cosmetics*. ■ Evaluate the viability of adopting alternative international practices to guarantee product safety for cosmetics through scientific methods.
3 Deviation from international product standards	■ Exclude recommended standards from market surveillance and supervision, leaving assessments on the performance and function of products to the market. ■ Limit the scope of the SDOC mechanism to mandatory national standards adopted by enterprises. ■ Ensure full transparency and impartiality between foreign and domestic companies in the process of ranking enterprise standards.

MUTUAL OPPORTUNITIES

RISING CONSUMPTION IN LOWER TIER CITIES

As the authorities continue to reorient the main drivers of economic growth towards consumption, the continuing expansion of China's middle class presents vast opportunities for British retailers operating in China's enormous consumer market. This is especially prevalent in China's Tier 3 and Tier 4, where urbanisation and the emergence of new middle class consumers with greater spending power is generating further demand for British goods outside of China's most developed cities. The Economist Intelligence Unit (The EIU) forecasts that the share of households with incomes above USD 25,000 (GBP 20,100/RMB 176,700) will surpass 16% by 2023, up significantly from just 5% in 2013.[12] Widely used e-commerce platforms allow British retailers based in Tier 1 and Tier 2 cities to more easily sell their products to consumers in all corners of the country without having to establish bricks-and-mortar stores. This also prevents the need for Chinese consumers to travel to coastal cities or even abroad to purchase premium and luxury goods.

DEMAND FOR HIGH QUALITY AND PREMIUM PRODUCTS

British businesses are well placed to cater to the new generation of quality-conscious Chinese consumers who are increasingly looking for premium products and willing to spend more to enjoy a higher quality of living. Consumption upgrades in the retail sector are expected to become a dominant trend in the industry and a significant source of demand for retailers, as Chinese consumers look to purchase superior goods in line with wage increases. In particular, premium segments in consumer electronics, cosmetics and fashion apparel will continue to see strong demand in China. According to a survey by Nielsen, 61% of Chinese consumers are motivated to purchase premium products because of their superior quality, which is much higher than the global average rate of 49%.[13] As consumers seek out products that will enhance their quality of life and deliver value for money, British retail and consumer goods companies with a history and reputation for offering premium, high quality and healthy products are in a strong position to succeed in the Chinese market.

12 'Industry Report: Consumer Goods and Retail', The Economist Intelligence Unit, September 2019.

13 '61% of Chinese Consumers Choose Premium Products Because of Superior Quality', Nielson, April 2019.

ACRONYMS

AI	Artificial Intelligence
AMAC	Asset Management Association of China
AMC	Asset Management Company
AUM	Assets Under Management
BEV	Battery Electric Vehicle
BIM	Building Information Modelling
BRI	Belt and Road Initiative
CAC	Cyberspace Administration of China
CAFC	Corporate Average Fuel Consumption
CBIRC	China Banking and Insurance Regulatory Commission
CCC	China Compulsory Certification
CEPA	Closer Economic Partnership Agreement
CIBM	China Interbank Bond Market
CICPA	Chinese Institute for Certified Public Accountants
CIIO	Critical Information Infrastructure Operator
CNCA	Certification and Accreditation Administration of China
CPA	Certified Public Accountant
CQC	Quality Certification Centre China
C-ROSS	China Risk Oriented Solvency System
CSCS	Corporate Social Credit System
CSL	Cybersecurity Law
CSRC	China Securities Regulatory Commission
CTMO	China Trademark Office
DAL	Drug Administration Law
DG	Distributed Energy
DIT	Department for International Trade
EFD	Economic and Financial Dialogue
ELT	English Language Training
ESG	Environmental, Social and Governance
F&B	Food and Beverage
FCEV	Fuel Cell Electric Vehicle
FDI	Foreign Direct Investment
FDSC	Financial Stability and Development Committee
FMCG	Fast Moving Consumer Good
FIE	Foreign-invested Enterprise
FII	Foreign Institutional Investor
FIL	Foreign Investment Law
FMC	Fund Management Company
FTA	Free Trade Agreement
FTZ	Free Trade Zone
GACC	General Administration of Customs China
GB	Guobiao
GBA	Greater Bay Area
GBP	Great British Pound
GEC	Green Energy Certificate
GDP	Gross Domestic Product
GPA	Agreement on Government Procurement
GPL	Government Procurement Law
GW	Gigawatt
HAF	Civil Nuclear Safety Regulations
HRS	Hydrogen Refuelling Station
ICE	Internal Combustion Engine
ICP	Internet Content Provider
ICV	Intelligent Connected Vehicle
IIT	Individual Income Tax
IP	Intellectual Property
JLV	Joint Law Venture
JV	Joint Venture
M&A	Mergers and Acquisitions

MAH	Market Authorisation Holder
MEE	Ministry of Ecology and Environment
MIIT	Ministry of Industry and Information Technology
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
MOT	Ministry of Transport
MOU	Memorandum of Understanding
MPS	Ministry of Public Security
MRA	Mutual Recognition Agreement
MWH	Megawatt Hour
NASG	National Administration of Surveying, Mapping and Geo-information
NEA	National Energy Administration
NEV	New Energy Vehicle
NDRC	National Development and Reform Commission
NGO	Non-Governmental Organisation
NHC	National Health Commission
NHSA	National Healthcare Security Administration
NOC	National Oil Company
NPC	National Pipeline Company
NRDL	National Reimbursement Drug List
OEM	Original Equipment Manufacturer
OMO	Online-Merge-Offline
ONS	Office for National Statistics
PBOC	People's Bank of China
PFM	Private Fund Management
PMI	Purchasing Managers' Index
PRC	People's Republic of China
PSB	Public Security Bureau
QDII	Qualified Domestic Institutional Investor
QFII	Qualified Foreign Institutional Investor
QFLP	Qualified Foreign Limited Partnership
RMB	Renminbi
RPS	Renewable Portfolio Standard
RQFII	Renminbi Qualified Foreign Institutional Investor
RRR	Reserve Ratio Requirement
SAC	Standards Administration of China
SAFE	State Administration of Foreign Exchange
SAMR	State Administration for Market Regulation
SDOC	Self-declaration of Conformity
SGP	Special General Partnership
SME	Small and Medium-sized Enterprise
SOE	State-owned Enterprise
SPC	Supreme People's Court
SUV	Sports Utility Vehicle
TBL	Tendering and Procurement Law
TBT	Technical Barriers to Trade
TIER	Technology Import and Export Regulations
TNE	Transnational Education
USD	United States Dollar
VAT	Value-added Tax
VATS	Value-added Telecommunications Services
WFOE	Wholly Foreign-Owned Enterprise
WTO	World Trade Organisation

ACKNOWLEDGEMENTS

AUTHORS:
Will Miller
Anika Patel
Christopher Sargent

DESIGN:
Boglárka Miriszlai
Rachel Tsang

TRANSLATION:
Practical Translations Ltd.

The British chambers of commerce in China would like to thank all of the paper's contributors for their time and insights. Particular thanks go to the steering committee and to industry advisors, who provided expert guidance throughout the research and drafting process.

ABOUT THE POSITION PAPER 2020

The British chambers of commerce in China's Position Paper 2020 represents the views of its members on the regulatory challenges for companies operating in China's business environment. It offers recommendations to both the Chinese and British governments on how to level the playing field for British companies across 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 drawn from the *British Business in China: Sentiment Survey 2019-2020*. The thirteen entries are ranked in order of severity, with cybersecurity and IT restrictions presenting the greatest challenge for British businesses, followed by accessing and moving company finance and competition with state-owned enterprises. Analysis within the paper is drawn from the data provided in the *Sentiment Survey* and industry roundtables and interviews. Roundtables and interviews were held with British companies and industry associations from Beijing, Shanghai, Guangdong, Chengdu and other regions between October 2019 and March 2020, providing input from companies across revenue profiles and years of experience in market.

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

advocacy@britishchamber.cn

BRITISH CHAMBER OF COMMERCE IN CHINA
中国英国商会

ADVOCACY | BUSINESS SUPPORT | NETWORKING