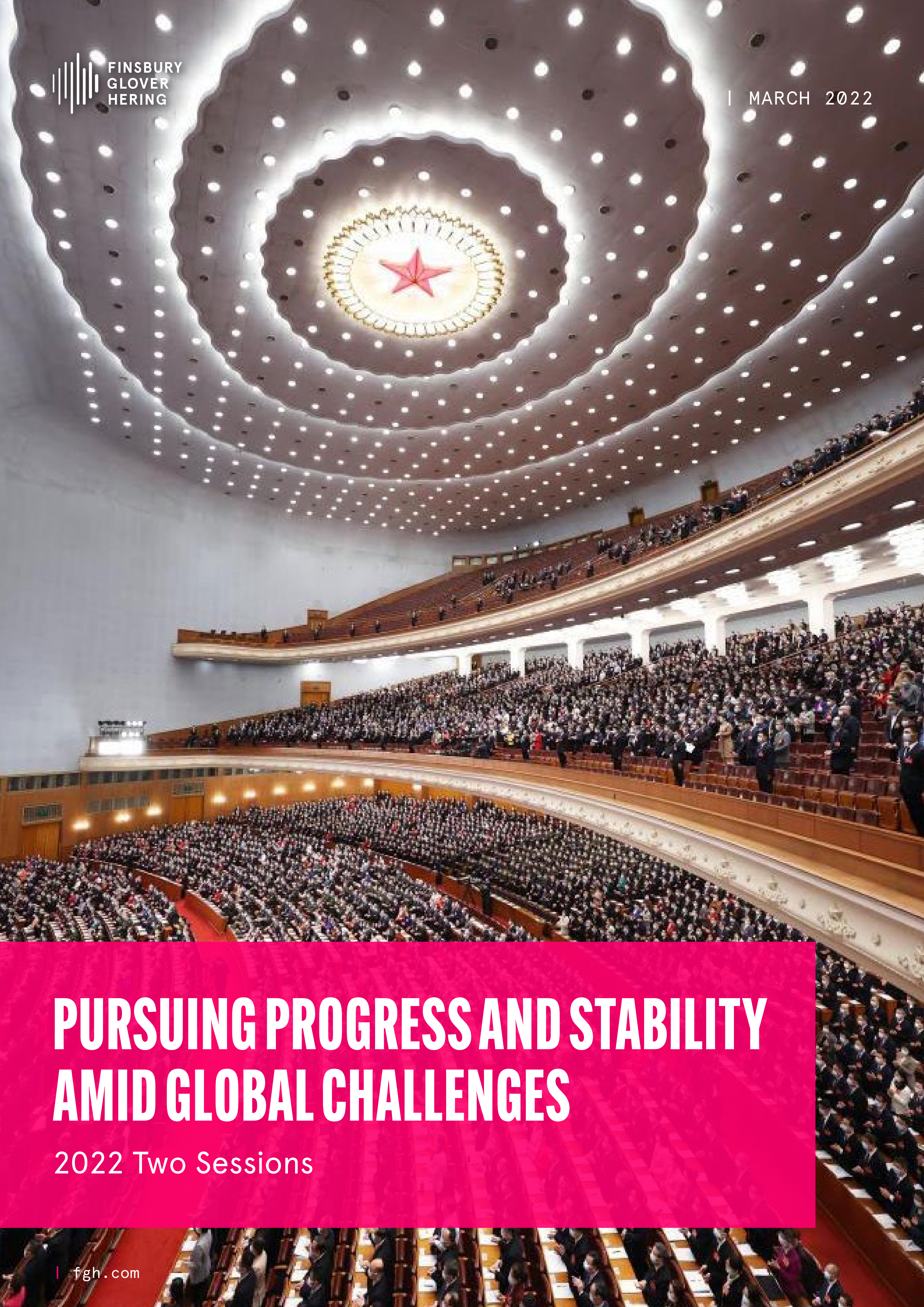


FINSBURY GLOVER HERING

MARCH 2022

PURSUING PROGRESS AND STABILITY AMID GLOBAL CHALLENGES

2022 Two Sessions

2022 TWO SESSIONS

FOREWORD

From March 4 to 11, thousands of Chinese lawmakers and policy advisors assembled in Beijing for one of the country's most important annual political events – the National People's Congress and the Chinese People's Political Consultative Conference.

Despite the current geopolitical turmoil, those attending the 'Two Sessions', or 'Liang Hui 两会', will no doubt have looked back on the past 12 months with some sense of accomplishment and, dare we say it, ever-growing confidence in China's future prospects.

The 14th Five-Year Plan unveiled this time last year set out a grand vision of a technologically advanced and increasingly self-reliant global power which, having achieved its goal of becoming a 'moderately prosperous society', is now on a quest to become a 'great modern socialist country'.

The government may also have taken pride in achieving bullish growth and largely taming a 'black swan' global pandemic event with a dynamic 'Zero-Covid' policy – an approach that in turn allowed it to successfully stage the Beijing Winter Olympics.

But even if these past achievements brought them a modest amount of satisfaction, China's policy makers are in no doubt that a more challenging year with strong headwinds, both external and internal, lies ahead.

Sluggish consumption and investment, bottlenecks in microchip supplies, shipping containers and labour, rising costs and prices in energy and major commodities, and mounting risks in sectors including real estate, are among a range of issues clearly weighing heavily on their minds. All against a backdrop of increasingly complex U.S.-China relations, a question mark over the effect of regulatory crackdowns in key sectors, and uncertainty about how much the country's rigorous pandemic response may impact the economy.

They have made it clear in response that this year's economic and political priorities are stability, stability and more stability. This will be attained through steady growth, job creation and increased social welfare, while the government is also signalling that China remains an open and secure environment for high-quality foreign investment.

With the all-important 20th Party Congress only eight months away, as President Xi Jinping is expected to take his third term, a singular focus on maintaining stability is an understandable prerequisite for the success of this decisive political event.

But the unexpected emergence of a global geopolitical conflict in Ukraine has made China's external environment harder to navigate. How the country will react to this international crisis alongside other challenges, and whether or not the leadership can maintain the stability they desire, is why 2022 will be the most keenly watched year in recent memory and a crucial one for multi-national companies (MNCs) operating and investing in China.

With that in mind, we hope our analysis and advice will help you navigate the year ahead. We trust you'll find it useful.

Paul Yang
Partner & Head of China

CHINA'S KEY DEVELOPMENTS IN 2021

2021 Economic performance*:

- **GDP of US$17.7 trillion, growth rate 8.1%;**
- **Share of global GDP exceeds 18%;**
- **GDP per capita reaches RMB 80,976, equivalent to US$12,551, approaching the threshold per capita level for high-income economies;**
- **Total foreign trade volume of US$6 trillion, with 20% growth in both Imports and Exports.**

Legislation: In 2021, China has accelerated legislation in multiple sectors and broken records for the number of laws enacted in recent years. The NPC and its Standing Committee approved 17 laws including the 'Anti Foreign Sanctions Law', 'Personal Information Protection Law' and the 'Data Security Law'; amended 26 laws including the 'Population and Family Planning Law' and the 'Work Safety Law'; and announced 11 decisions on legal issues, including changes to the electoral system in Hong Kong SAR.

Business environment: The 'negative lists' for foreign investment access were reduced for the fourth consecutive year, and market access was eased in many areas such as finance and automotive. Shenzhen continues to take the lead nationally: 24 special measures were announced in January 2022 to ease market access for advanced technologies, financial investment, medicine and health, education and culture, and transportation.

Regional cooperation: The world's largest free trade agreement, the Regional Comprehensive Economic Partnership Agreement (RCEP), took effect in China on January 1 2022; while China has also submitted formal applications to join the Comprehensive and Progressive Trans-Pacific Partnership Agreement (CPTPP), and the Digital Economy Partnership Agreement (DEPA).

*From the Government Work Report and National Statistics Bureau, 2022

KEY HIGHLIGHTS AND TARGETS FROM 2022 WORK REPORT

Despite China's economic recovery since 2020, strong headwinds are clearly being felt in Beijing. The country's policy makers are well aware of the mounting domestic and international challenges they face. The fast-evolving geopolitical situation, the continuation of China's strict Covid policies and other factors could have an impact on China's development goals and performance in the coming year and beyond.

In our view, Premier Li Keqiang's work report – the Chinese government's most important annual policy document - is very pragmatic and has deliberately kept some room for manoeuvre for further policy adjustments and fine tuning. The work report focuses heavily on addressing fundamental domestic needs and challenges within China's economic and social system, including tax and fee cuts, infrastructure spending, incentives for R&D, and support for small and medium-sized companies. There is only a small section on China's vision and plans in the international arena and on Hong Kong, Macao and Taiwan affairs.

- **GDP growth target at around 5.5%, singling the Party's confidence on China's economy despite the headwinds**
- **Proactive fiscal policy plus prudent monetary policy with an estimated RMB 2.5 trillion of total tax and fee cuts**
- **More than 11 million new jobs to be created**
- **CPI to remain at around 3% percent**
- **Current COVID-19 containment strategy will become routine, with increased effort and investment in R&D of vaccines and effective medicines against COVID-19 variants**
- **Activation of a 10-year action plan on basic research in Science & Technology**
- **More government spending on technology and innovation, rural development, big infrastructure, transportation and energy projects, and social welfare projects**
- **Robust action against monopolies and unfair competition will continue**
- **Defence budget raised by 7.1% to US$230 billion, following 6.8% growth in 2021**
- **An emphasis on "keeping balanced development and well-ordered steps" on peak carbon emissions and carbon neutrality plans**

CHINA AIMS FOR HIGH-QUALITY GROWTH, ARE YOU READY?

China saw a record RMB 1.15 trillion (US$182 billion) in foreign investment in 2021, a 14.8% increase on the previous year. In his work report, Premier Li promised to continue cultivating a sound business environment in China in the years ahead by expanding international economic and trade cooperation, introducing further market reforms and opening-up measures, expanding investment opportunities by reducing the 'negative lists' of industries restricted or prohibited to foreign investors, and providing a level playing field for foreign-funded enterprises.

MNCs are encouraged to invest in strategic industries such as advanced manufacturing, digital economy and renewable energy. The Ministry of Commerce is very likely to revise and expand the 'Industry Guidelines on Encouraging Foreign Investment' in 2022 to give full play to the effect of preferential policies on land and taxation, and to encourage investment in advanced manufacturing, modern services, high-tech, green and low-carbon, digital economy and other fields, especially in central and western regions.

China has downsized the 'negative lists' for foreign investment for five consecutive years, sending a strong signal regarding China's efforts to open more widely. Foreign investors now can hold a majority stake and even wholly own enterprises in auto, television and broadcasting equipment manufacturing industries. A new section on listing regulation has also been introduced to provide a pathway to IPOs for businesses in restricted sectors.

Yet, even as China has been adjusting its foreign investment policies over the years to facilitate its economic development needs and present a more welcoming environment, it has also felt the need to respond to the evolving external environment and geopolitical challenges. This includes taking a stronger national security stance against perceived punitive economic action by the U.S..

In 2021, Chinese regulators expanded the scope of the national security review by adding new rules for foreign investment with the intention of "strengthening China's legal framework for greater opening-up". These 'Foreign Investment Security Review Measures' caused concern among the foreign business community.

Six months later, China's legislators passed an 'Anti Foreign Sanctions Law'. The law gives the Chinese government another legal tool to respond to foreign sanctions, especially from the U.S., with its own counter-sanctions, which could affect individuals and companies doing business in China.

These developments pose significant challenges for companies that need to be compliant with both China and US laws. It is important for MNCs and investors who are operating in China to develop a better understanding about the evolving regulatory landscape they are facing and evaluate their risk exposure accordingly.

Green Ambition

As the world's largest emitter of greenhouse gases, China aims to achieve peak CO2 emissions before 2030 and carbon neutrality before 2060. The country is calling for green development, green transition, and low carbon investment, providing potential new business and growth opportunities for market participants. But developing a strong and resilient business means a lot more than just opening new factories, generating job opportunities and making charitable donations. It also creates a new group of government and local community stakeholders for companies to get to know and engage with. MNCs may want to ask themselves a few questions before they start:

- **What role do we want to play in China's green economy?**
- **What is the expertise we could bring to China to support the green economy?**
- **Who are these new stakeholders and what's their agenda?**
- **What ESG story do we want to tell our stakeholders and investors?**

SECTOR HIGHLIGHTS - FINANCIAL SERVICES

As the sector most closely linked to the government's macroeconomic policy, the approach to financial services epitomizes the overarching economic focus laid down by the central government in 2022 – "pursuing progress while ensuring stability". This will be a two-pronged approach but maintaining a stable sector will be the top priority.

Tightening financial regulations to ensure economic stability has been a key economic theme since 2017. The ultimate goal has been to guide the financial services sector towards serving the 'real economy' and prevent systemic risks.

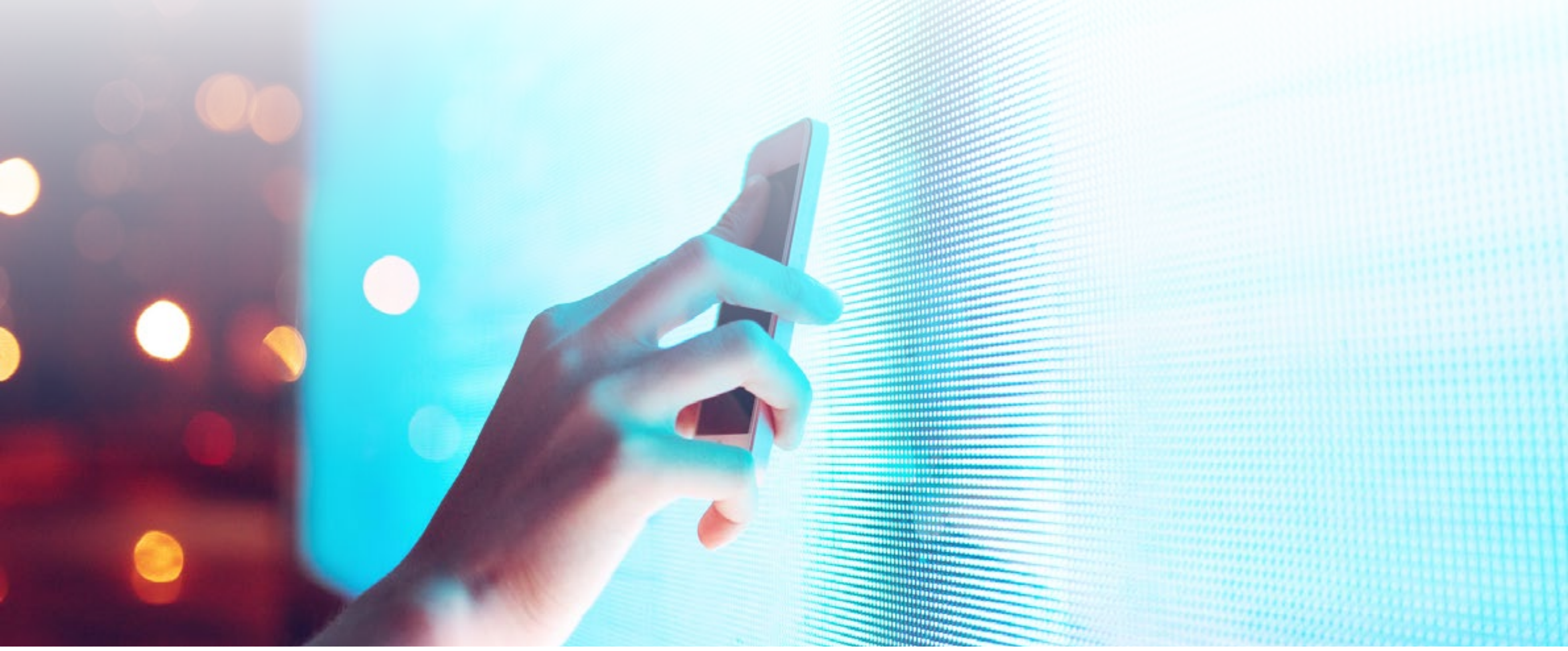
In 2021, we witnessed some significant events, such as the regulation of fintech players as financial institutions or financial holding companies rather than tech companies, incorporating a data security review into the overseas listing process which led to Didi's de-listing from the US, and the deleveraging of the property development sector from contagion debt default risks. In 2022, we expect to see continuous upgrading of the macro-prudential regulation framework, with newly implemented regulatory programs for systemically important banks/insurers and financial holding corporations. The establishment of a fund for financial stability was also announced to provide support for financial institutions in liquidity crisis, and it is worth observing how it will function.

The other side of the coin however is reform and opening up. China's capital market was a highlight in this respect in 2021. New actions were launched for cross-border bond, stock and wealth management connect programs. The Beijing Stock Exchange was born with a strategic mission to foster easier financing of SMEs and help support innovations. A registration-based IPO mechanism had already been implemented in the STAR and ChiNext markets, in 2019 and 2020 respectively. China's capital market opened its doors even wider to foreign investors and we can expect this positive momentum to be sustained in 2022, with the full implementation of the registration-based IPO system and a smoother regulatory mechanism to connect Chinese and global financial markets as key areas to watch.

This is a golden opportunity for global financial institutions to gain wider access and a stronger footing in China's financial market. Chinese regulators and industry peers are also eager to learn from international best practices. On the other hand, Chinese companies seeking financing overseas are facing a more restrictive regulatory, political and reputational environment, which requires a more sophisticated understanding and mature experience to navigate changing and complex processes. Either way, a robust corporate reputation and stakeholder engagement plan to respond to new policy and regulatory priorities will be a critical success factor in 2022.

Kevin Ma, Director in our Beijing office, contributed to this section. If you would like to discuss how we can help financial services sector clients manage critical issues and reputational challenges, please get in touch via Kevin.Ma@finsbury.com

SECTOR HIGHLIGHTS - TECHNOLOGY



We expect to see a continuation of the tech and science policy signals that have been clearly transmitted over the last two years. These include investment in basic technologies, support for standards development and ensuring China has a voice globally. There will also be stronger regulation of the digital economy (especially anti-trust, employee welfare and data security), and leveraging of tech policy to boost consumption, support economic growth, and help China reach its carbon neutrality goals. Tech companies will want to show alignment with China's "Common Prosperity" aims.

Following the slew of tech regulatory measures in the past few years, including the 'Cybersecurity Law' and the 'Personal Data Protection Law', we will also see a strong emphasis on anti-monopoly and fair business practices, and stronger guardrails around the abuse of personal data and algorithms. This suggests that big tech companies will continue to be under scrutiny over the coming year, and companies will be impacted by new data security regulations. China has and will continue to invest more in cybersecurity for next-generation critical infrastructure, like smart cities, connected cars, and the industrial internet. There is also clearly an intention to introduce additional policies for online content control.

We are also seeing further growth in the digital economy. COVID-19 has brought long-term economic pressure on China and smaller businesses have been finding it increasingly difficult to stay afloat. Therefore, the country has laid out very specific employment goals, and there is a big focus on boosting online consumption in the digital economy and boosting job creation in order to fully leverage the growth in e-commerce and livestreaming.

In particular, there was a strong emphasis during the Two Sessions on tech research and development, especially in cutting-edge technology grounded in substantial scientific or engineering basic research (such as hard tech). The primary driver for this push is China's desire to become a global leader in high tech and innovation to overcome strategic technological bottlenecks, such as the export control sanctions imposed on Chinese companies by the U.S.

Measures introduced at the Two Sessions continue China's policy incentives in this area, including its existing 10-year plan for basic research. This macro-level plan consists of more than 70 key R&D plans (including AI, quantum physics and brain sciences), acceleration of plans to build a national laboratory system, a push for green technologies that promote a more efficient use of coal and reduce air pollution, and much more besides. China also introduced incentives for R&D talent growth and has granted preferential tax policies to enterprises that invest in these areas. There are also plans to better build up China's science and technologies management and intellectual property systems.

In addition, there is stronger policy language around high-tech manufacturing, which includes chips, new EVs and, interestingly, smart home appliances in rural areas. As China strives for further technological independence, we will continue to see a build out of network infrastructure and data digital information infrastructure, including 5G, data centers, and cloud services. Foreign companies are encouraged to invest in high tech R&D and manufacturing, especially in the central, western, and northeastern regions of China.

Ginny Wilmerding, Partner in our Hong Kong office, contributed to this section. If you would like to discuss how we can help technology sector clients manage critical issues and reputational challenges, please get in touch via Ginny.Wilmerding@finsbury.com

SECTOR HIGHLIGHTS- ENVIRONMENT AND SUSTAINABILITY

China announced ambitious and specific goals for tackling climate change, including having CO2 emissions peak before 2030 and achieving carbon neutrality before 2060 (the "dual carbon goals"). During last year's COP26 in Glasgow, China re-affirmed these goals and pledged to work with the U.S. to slow global warming and take "enhanced climate actions".

It will require "whole society" participation by the government, businesses and general public to achieve these goals, through constructing large-scale wind and solar power bases, improving the treatment of solid waste and new pollutants, establishing national parks, and promoting garbage classification, as well as many other measures.

The results are already noticeable, most obviously in the improvement of air and water quality, expansion of green belts, reduction of industrial waste, and the country's growing dominance in the global EV, battery, wind and solar power sectors.

However, China's transition to a low-carbon economy faces numerous challenges given its high-carbon energy structure, high energy consumption, and high-carbon industrial structure. Therefore, the country has pursued a step-by-step approach, planning to first build up a reliable supply of clean and low-carbon energy, then safely transition out of fossil fuels. This approach was severely tested last autumn when a crippling energy shortage hit many regions across the country, forcing local governments to implement rolling blackouts for businesses and residents. In the end, Beijing had to relax the carbon emission rules by raising coal production quotas.

At the opening of the National People's Congress on March 5, Premier Li urged people to "take the 14th Five-Year Plan as a whole to look at the dual carbon targets", not to treat it as a one-size-fits-all policy, and to avoid "radical" practices. His remarks have been interpreted as a call for a rational and realistic transition to a low-carbon economy by regional and local governments. It can also be viewed as a request for patience from the international community. What is certain is that China will continue to juggle its low-carbon commitment and its need to meet the country's energy demand in the coming years.

China will continue to pursue global leadership in alternative energy and related industries such as nuclear power, wind and solar power, EV charging infrastructure and battery manufacturing. Therefore, MNCs in this sector should be prepared for stiff competition from Chinese players.

As Chinese companies expand their global market share and seek to access raw materials and natural resources in order to build a secure and sustainable eco-system, MNCs may also notice an increase in resource costs.

Finally, as China moves toward a system of ESG reporting, it will require ESG compliance in the foreseeable future. It is already one of the biggest proponents of green bonds in the world. Therefore, being ESG compliant is important for businesses that operate in the China market.

Mei Zhang, Managing Director in our Hong Kong office, contributed to this section. If you would like to discuss how we can help our clients manage critical issues and reputational challenges around environment and sustainability issues, please get in touch via Mei.Zhang@finsbury.com

OUR RECOMMENDATIONS

Political events like the 'Two Sessions' inevitably project an aura of self-assurance, stability and national purpose. For MNCs operating and investing in China, this year's gathering definitely heralds new opportunities in financial services, technology and innovation, and the green economy.

In particular, those companies aligned with China's environment and sustainability goals and whose expertise can help the transition of the country, the world's second largest economy and its 1.4 billion people, towards a low carbon economy and lifestyle will have a compelling story to tell their stakeholders and investors.

Equally, policies that emerge from China's drive towards "Common Prosperity" – which re-entered the political lexicon in 2021 and has quickly become a key aim of its next developmental phase – may provide additional opportunities if properly and sensitively formulated.

As MNCs adjust to new opportunities, in parallel with the changing regulatory landscape which will accompany them, they must first and foremost ensure they have a consistent and forward-looking strategy that is appropriate for the China market and is aligned at a global level.

- **Understand the policy environment:** To enable business growth and protect their reputation in China, MNCs require both a solid understanding of the touchpoints which have emerged from this year's Two Sessions, and immediate action to shrewdly identify which elements can be leveraged and which present fresh challenges.
- **Map your stakeholders:** MNCs must use their policy insight to develop a clear plan for engagement with existing and new stakeholders at a government and local community level and across the value chain of their companies. This engagement plan must also factor in the practical opportunities for senior C-suite visits that will arise as the mainland opens up, both internationally in the mid-term and, potentially as early as June/July, to Hong Kong.
- **Analyse the risk environment:** In parallel, they should evaluate their risk exposure and refine those early warning systems that can alert them to emerging global issues and crises. This includes being mindful of increasing geopolitical bifurcation and the pressures this may create back home, both from a regulatory and reputational perspective.

Undoubtedly, China and the global community face a myriad of underlying uncertainties and challenges in 2022. Yet, MNCs operating here still have a unique and critical opportunity to address, adjust and amplify the role China can play in their business and global reputation.

ABOUT FINSBURY GLOVER HERING AND SARD VERBINNEN & CO

In October 2021, Finsbury Glover Hering and Sard Verbinnen & Co came together to create the world's leading strategic communications firm and a leader in all aspects of strategic communications, including government affairs, corporate reputation, crisis management, and transformation and change, as well as the leading force in financial communications worldwide, with approximately 1,000 professionals operating from 26 offices in Asia, Europe, the Middle East and the United States.

OUR CHINA OFFICE:

HONG KONG

501 Henley Building,
5 Queen's Road,
Central,
Hong Kong, SAR

BEIJING

Unit 2821,
Level 28,
China World Office 1,
No. 1 Jianguomenwai Avenue,
Chaoyang District,
Beijing

SHANGHAI

28/F,
WPP Campus,
399 Hengfeng Road,
Jing'an District,
Shanghai

SHENZHEN

06A053,
Loft B,
Upper Hills,
5001 Huanggang Road,
Futian District,
Shenzhen

WE WOULD LIKE TO THANK EVERYONE WHO CONTRIBUTED TO THIS REPORT!

Editorial team

Ling Jin, Managing Director, Hong Kong
Daniel Lyons, Managing Director, Beijing
Oma Lee, Director, Beijing

THANK YOU

FINSBURY GLOVER HERING