

## Biden Administration Revamps Sanctions Program Targeting Publicly Traded Securities of Designated Chinese Military Companies

June 7, 2021

### Key Points

- On June 3, 2021, President Biden issued an EO that affirms and re-defines the Trump administration policy of restricting the purchase or sale of publicly traded securities (and derivatives of such securities) of certain Chinese companies that have been identified as a threat to U.S. national security interests.
- The new U.S. sanctions program established by this EO rescinds and supersedes the previous CCMC sanctions regime imposed by the Trump administration in November 2020 effective immediately. Corresponding new OFAC FAQ guidance also supplants guidance on the previous CCMC measures issued under the Trump administration. A two month effective grace period applies to the new sanctions measures before they become effective on August 2, 2021.
- The new sanctions apply to publicly traded securities and derivatives of 59 "CMICs" based on their operations in the "defense and related materiel sector or the surveillance technology sector" of the PRC economy. The targeted companies include 31 entities that were previously sanctioned by the Trump administration under the CCMC regime plus 28 additional companies. At the same time, the new CMIC list removes restrictions for 19 companies that were previously targeted with CCMC sanctions.
- The stated purpose of the CMIC measures is to prevent "U.S. investment from supporting the Chinese defense sector, while also expanding the U.S. Government's ability to address the threat of Chinese surveillance technology firms that contribute—both inside and outside China—to the surveillance of religious or ethnic minorities or otherwise facilitate repression and serious human rights abuses."
- While the termination and replacement of an established sanctions program in this case is unique, fundamentals of the new CMIC regime are grounded in overlapping U.S. national security concerns and policy objectives of the preceding CCMC program.

### Overview of the New CMIC Sanctions Program

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On June 3, 2021, President Biden issued [Executive Order 14032](#) (Addressing the Threat from Securities Investments that Finance Certain Companies of the People's Republic of China) ("CMIC EO") that modifies the Trump-era investment ban on "Communist Chinese Military Companies" (CCMC).<sup>1</sup> The new "Chinese Military-Industrial Complex Companies" (CMIC) sanctions program retains the basic parameters of the previous CCMC sanctions program by restricting U.S. persons from engaging in certain kinds of transactions in the publicly traded securities (and derivatives) of designated Chinese entities—while providing greater specificity on the restrictions actually imposed and broadening the scope of the listing criteria to reflect stated foreign policy priorities of the Biden administration.

The CMIC EO relies on, and further expands the scope of, the national emergency initially declared by President Trump concerning the People's Republic of China (PRC)'s Military-Civil Fusion strategy and targets companies associated with the defense and related materiel sector or surveillance technology sector of the economy of the PRC.

Significantly, the CMIC EO rescinds the Trump administration's CCMC sanctions program, while imposing a similar sanctions regime that specifically prohibits U.S. persons from purchasing or selling publicly traded securities, or derivatives of such securities of designated companies. At the same time, the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) issued eight new and seven amended [FAQs](#) providing significant guidance on the scope and implementation of the new CMIC sanctions program.

- **Prohibitions:** Specifically, beginning August 2, 2021, at 12:01 a.m. eastern daylight time, U.S. persons are prohibited from engaging in **"the purchase or sale of any publicly traded securities, or any publicly traded securities that are derivative of such securities or are designed to provide investment exposure to such securities"** of identified CMICs ("covered securities").
- **Permitted Divestment Period:** Divestment of the covered securities is permitted during the 365-day period following designation (i.e., through June 3, 2022, for those CMICs designated on June 3, 2021) and purchases or sales made solely to effect the divestment, in whole or in part, of such covered securities by U.S. persons are also permitted during that period. As discussed below, while holding covered securities following the expiration of such divestment period is not prohibited, based on the lack of any contrary guidance to date, it would appear that separate authorization would be required to effect divestment following such expiration.
- **CMIC List:** The CMIC EO includes an Annex identifying 59 CMICs subject to the prohibitions and OFAC simultaneously released its ["Non-SDN CMIC List,"](#) which provides additional details on those identified entities.<sup>2</sup>
- **Prior Prohibitions Lifted; No Prohibitions in Effect until August 2, 2021:** Importantly, because the CMIC EO rescinds the prior CCMC and the new CMIC sanctions will not take effect until August 2, 2021, there are currently no prohibitions in effect on any entity previously identified as a CCMC or now identified as a CMIC.<sup>3</sup>

The CMIC EO also delegates authority to the U.S. Department of the Treasury, rather than the Department of Defense (DoD), to implement and play the principal role in

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determining CMIC sanctions designations, consistent with normative practice in the administration of U.S. sanctions programs generally. Specifically, the CMIC EO provides that the Secretary of the Treasury, in consultation with the Secretary of State, and as deemed appropriate, the Secretary of Defense, has principal authority for modifying the sanctions regime, including the companies listed. Under the CCMC sanctions program initiated by the Trump administration, authority for such designations had been delegated to both the Secretary of Defense and the Secretary of the Treasury. This change eliminates the Trump administration's linkage of the CCMC measures to Section 1237 requirements under the fiscal year (FY) 1999 National Defense Authorization Act (NDAA).

Under the CMIC EO, "publicly traded securities" means any "security," the definition of which includes (but not is expressly limited to) any "'security,' as defined in section 3(a)(10) of the Securities Exchange Act of 1934 ("1934 Act"), Public Law 73-291 (as codified as amended at 15 U.S.C. 78c(a)(10)), denominated in any currency that trades on a securities exchange or through the method of trading that is commonly referred to as 'over-the-counter,' in any jurisdiction."<sup>4</sup> As in the prior CCMC sanctions program, the definition of security in the CMIC EO is not expressly limited to securities as defined in the 1934 Act, leaving some ambiguity as to what else might be captured within scope.

Examples of affected financial instruments under the new measures include derivatives (e.g., futures, options, swaps that are deemed to be "securities"), warrants, American depositary receipts (ADRs), global depositary receipts (GDRs), exchange-traded funds (ETFs), index funds and mutual funds, to the extent such instruments also meet the definition of "publicly traded security" under the CMIC EO.<sup>5</sup>

The CMIC EO also prohibits "[a]ny transaction that evades or avoids, has the purpose of evading or avoiding, causes a violation of, or attempts to violate any of the prohibitions" set forth in the EO. It is worth noting that the CMIC EO removed language previously in EO 13959 that limited this provision to any transaction "by a United States person or within the United States."

## Key Elements

### 1. Clarification of the scope of CMIC designations

The new CMIC sanctions program eliminates substantial uncertainty regarding the reach of previous CCMC sanctions to specific entities.

- OFAC's Non-SDN CMIC List provides definitive identifying information for each listed entity, including address, equity and debt stock tickers, and national registration numbers (such as China's Unified Social Credit Codes), as well as aliases for the names of such companies ("akas").
- The CMIC sanctions program expressly provides that only entities whose names **exactly** match an entity on the Non-SDN CMIC List will be subject to the prohibitions. The new measures abandon the Trump administration's previous assertion for the CCMC sanctions restrictions to extend to unlisted entities whose names "closely match" the name of a listed entity, but were not specifically listed.<sup>6</sup> Note that aliases of the 59 CMIC entities have also been listed separately on the OFAC Non-SDN CMIC List.

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- OFAC guidance provides that the “50 percent rule” does not apply to entities included on the Non-SDN CMIC List. Accordingly, subsidiaries of entities on the Non-SDN CCMC List are not subject to these sanctions restrictions unless they are explicitly designated and added to the CMIC list.<sup>7</sup>

## 2. Elimination of express prohibition on “possession” of affected securities

Under the previous CCMC sanctions program, the mere possession of a covered security by a U.S. person after the relevant effective date was prohibited. However, the CMIC EO does not include that restriction. Moreover, OFAC has removed previous FAQs stating that U.S. persons were required to divest their holdings of covered securities. Rather, as amended by the Biden administration’s action, EO 13959 now provides that the divestment of covered securities “in whole or in part” is permitted through June 3, 2022 (or 365 days after a new listing), suggesting that only partial divestment may be permissible. Under a plain reading of the CMIC EO, therefore, U.S. persons possessing covered securities of a CMIC listed entity 365 days after the listing date of the CMIC entity are not required to fully divest, but may no longer purchase or sell them without prior OFAC authorization.

## 3. No de minimis limitation on CMIC restrictions

Consistent with the CCMC sanctions, any level of exposure to a covered security of a CMIC is prohibited. Accordingly, the purchase or sale of interests in both U.S. and foreign funds that hold publicly traded securities of CCMCs are prohibited regardless of the level of such holdings or exposure to such securities in the underlying fund, ETF or derivative, and regardless of where the securities are traded or in which currency the securities are denominated.<sup>8</sup>

## 4. Guidance for U.S. investment managers, U.S. person employees of non-U.S. companies, market makers, and U.S. securities exchanges

**U.S. investment managers** – Addressing a key open interpretive question from the CCMC sanctions program, OFAC issued an FAQ that specifically clarifies that U.S. persons are **not** prohibited from providing “investment advisory, investment management, or similar services to a non-U.S. person, including a foreign entity or foreign fund, in connection with the non-U.S. person’s purchase or sale of a covered security, provided that the underlying purchase or sale would not otherwise violate” the CMIC EO.<sup>9</sup>

As an example, the same FAQ explains that a U.S. person acting as a fund manager, investment adviser or investment manager for a non-U.S. investment fund is “not prohibited from advising on, authorizing, directing, or approving purchases or sales of covered securities by the non-U.S. investment fund, provided that the underlying purchase or sale would not otherwise violate E.O. 13959, as amended (e.g., neither the purchase nor sale of the covered security is for the ultimate benefit of a U.S. person, the purchase or sale is not a willful attempt to evade the prohibitions of E.O. 13959, as amended, etc.).”<sup>10</sup>

**U.S. person employees of non-U.S. entities** – In addition, OFAC has clarified that U.S. persons employed by non-U.S. entities are not prohibited from “being involved in, or otherwise facilitating, purchases or sales related to a covered security on behalf of their non-U.S. employer,” provided that such activity is “in the ordinary course of their employment and the underlying purchase or sale would not otherwise violate” the CMIC EO. The FAQ provides additional color on what would otherwise violate the

CMIC EO: “e.g., neither the purchase nor sale of the covered security is for the ultimate benefit of a U.S. person; neither the purchase or sale is a willful attempt to evade the prohibitions of E.O. 13959, as amended, etc....”<sup>11</sup>

**Market makers** – U.S. market makers, and non-U.S. market makers who employ U.S. persons, are permitted to engage in activities that are necessary to effect divestiture during the during the 365-day periods in which divestment transactions are permitted or that are not otherwise prohibited under the CMIC EO, including the conversion of American depositary receipts (ADRs) of a CMIC into underlying securities of the CMIC on the foreign exchange where the underlying securities are listed.<sup>12</sup>

**U.S. securities exchanges** – Consistent with a General License permitting securities exchanges operated by U.S. persons to allow divestment of covered securities issued under the CCMC sanctions program, OFAC has clarified that transactions and activities by such securities exchanges involving the purchase or sale of covered securities of any entity on the Non-SDN CMIC List are not prohibited.<sup>13</sup>

#### 5. Limitation of prohibitions to not bar general dealings with CMICs

Like the previous CCMC sanctions program, the CMIC sanctions prohibitions are narrowly targeted and activities with listed CMIC entities that are unrelated to the purchase or sale of covered securities, such as the purchase or sale of goods or services, are not prohibited.<sup>14</sup> In addition, the CMIC EO provides a more precise framing of general prohibitions associated with the CCMC program (i.e., adding “purchase or sale” of covered securities to the operative provision of the CMIC EO, versus “transaction” defined as “purchase **for value**, or sale”). The practical consequences of this modification in practice is unclear and remains to be seen in practice over time.

#### 6. Operating in the defense and related materiel sector or surveillance technology sector of the PRC economy

Consistent with the Biden administration’s foreign policy priority focus on human rights concerns, the CMIC EO extends the scope of entities that may be subject to CMIC sanctions to include entities operating in the surveillance technology sector. OFAC expects to “use its discretion” to target, in particular, “persons whose operations include or support, or have included or supported”:

- “surveillance of persons by Chinese technology companies that occurs outside of the PRC”; or
- “the development, marketing, sale, or export of Chinese surveillance technology that is, was, or can be used for surveillance of religious or ethnic minorities or to otherwise facilitate repression or serious human rights abuse.”<sup>15</sup>

OFAC does not define the specifics or scope of what constitutes “defense and related materiel sector” of the PRC economy. However, the agency has broad discretion to designate persons determined to be engaged in sanctionable activity. The new criteria for targeting differs from the CCMC sanctions program, which focused on individuals and entities that, in relevant part, were determined to be “owned or controlled by, or affiliated with, the People’s Liberation Army or a ministry of the government of the People’s Republic of China or that is owned or controlled by an entity affiliated with the defense industrial base of the People’s Republic of China.”

In addition to the above criteria, the CMIC EO also permits entities to be designated if they are determined to “own or control, to be owned or controlled by, directly or indirectly, a person who operates or has operated in [the defense and related materiel sector or the surveillance technology of the economy of the PRC], or a person who is listed in the Annex to the [CMIC EO] or who has otherwise been determined to be subject to the prohibitions” in Section 1(a) of the CMIC EO.

7. Delegation of implementing authority to the U.S. Treasury Department, and limitation of DoD role, consistent with longstanding U.S. economic sanctions policy and practice

The CMIC EO delegates authority for implementation of the CMIC sanctions, including authority for the designation of new entities as CMICs, to the U.S. Treasury Department (i.e., OFAC), in consultation with the Secretary of State, and, at Treasury’s discretion, with the Secretary of Defense. This change aligns the CMIC sanctions program with longstanding normative past executive branch practice in the implementation of economic sanctions pursuant to International Emergency Economic Powers Act (IEEPA) authority. With that modification, the role of DoD effectively reverts to its more traditional interagency supporting role in connection with implementation of U.S. economic sanctions programs.

### **DoD Publication of Separate List of “Chinese Military Companies” Pursuant to Section 1260H of the NDAA**

Separately, on June 3, 2021, DoD **published** another new list of “**Chinese Military Companies**” (CMCs) operating directly or indirectly in the United States, as required under the recently-enacted Section 1260H of the FY 2021 NDAA (“1260H list”). This is a separate requirement from Section 1237 of the FY 1999 NDAA, which required DoD to identify CCMCs. The Section 1260H list contains 47 entities, most of which are also identified as CMICs, and many (but not all) of which identified as CCMCs by DoD pursuant to Section 1237. The 1260H list does not have any legal effect beyond the listing. Instead, the 1260H list serves as another method of identifying companies associated with China’s military. It is also possible that DoD will consider relationships with companies on the new CMIC list and its prior CCMC lists when reviewing items that require DoD approval, such as export licenses, Committee on Foreign Investment in the United States (CFIUS) cases, Foreign Military Sales and potentially even DoD contracts. Section 1260H also requires DoD to identify “military-civil fusion contributors” to the Chinese defense industrial base that operate directly or indirectly in the United States, but DoD has not released this list yet.

### **Conclusion**

The new CMIC EO issued by the Biden administration on June 3, 2021 revises and affirms U.S. sanctions restricting investment in Chinese companies based on a declaration that these companies pose a national security threat to the United States due to their linkage to the military-industrial complex of the PRC. The Biden administration has also emphasized that it views the use of Chinese surveillance technology outside of China, as well as the development or use of Chinese surveillance technology to facilitate repression or serious human rights abuses, constitute unusual and extraordinary threats that are appropriate targets for U.S. sanctions actions. This aligns with core stated foreign policy priorities of the Biden administration that support sanctions targeting of Chinese companies determined by

U.S. officials to engage in activities that undermine the national security or democratic values of the United States and U.S. allies. The Biden administration's decision to issue the CMIC EO also addresses administrative and legal concerns associated with recent U.S. court decisions reversing previous CCMC sanctions listings on substantive and procedural grounds, which cast in doubt and undermined the legal and procedural basis for the previous sanctions framework. Accordingly, the CMIC EO establishes a stronger foundation for this sanctions program while providing greater clarity to market participants, in keeping with bipartisan consensus and political pressure in the U.S. Congress to maintain a "hard line" in U.S. policy toward China.

Looking ahead, it is foreseeable that the Biden administration may add additional Chinese entities to the CMIC list over time. At the same time, we expect that the administration will balance such actions with other restrictive trade mechanisms that may be further deployed in the context of a broader coordinated strategy and approach to China, including under export controls administered by the U.S. Department of Commerce, Bureau of Industry and Security (BIS), U.S. import laws administered by U.S. Customs and Border Protection (CBP) and by other means, including other sanctions and trade controls addressing U.S. foreign policy concerns associated with human rights, forced labor, and other issues. As a practical matter, the Biden administration delegation of authority for implementation of the CMIC sanctions program to the U.S. Treasury Department and OFAC effectively restores the broader status quo of normative administrative practice in the deployment of economic sanctions by the U.S. government over many decades, consistent with broader reform of executive branch operations and practice implemented in the early months of the Biden administration.

<sup>1</sup> The CMIC EO rescinds and replaces the operative provisions of EO 13959 (Addressing the Threat From Securities Investments That Finance Communist Chinese Military Companies), as amended by EO 13974 ("EO 13959") (as revised by the CMIC EO, "EO 13959, as amended"). Because technically the CMIC EO simply removed and superseded the operative portion of EO 13959 with new substantive provisions, "EO 13959, as amended," remains the operative EO for the new CMIC sanctions program that replaces the CCMC sanctions program. For a detailed discussion on EO 13959 (as amended by EO 13974), see our prior client alerts [here](#) and [here](#).

<sup>2</sup> By comparison, in total the Trump administration had only identified 48 entities subject to CCMC restrictions. In [Appendix 1](#) to this alert, we identify (i) the 31 entities among the 59 CMICs that were previously identified as CCMCs, (ii) the 28 entities that are newly subject to prohibitions, and (iii) the 19 entities that were previously CCMCs, but are not designated as CMICs (i.e., entities for which investment prohibitions have been lifted entirely).

<sup>3</sup> Consistent with the CMIC EO's direction to agencies to "take all necessary steps to rescind any orders or prohibitions issued prior to the date of this order implementing or enforcing [the prior version of EO 13959]," in [FAQ #899](#), OFAC advised that the new Non-SDN CMIC List was replacing and superseding the previous "Non-SDN CCMC List" in its entirety and that it was, therefore, deleting the latter from its website. As such, as of June 3, 2021, all prohibitions on investments in CCMCs became ineffective.

<sup>4</sup> [FAQ #859](#). Under the CCMC sanctions program, the term "security" was more broadly defined to include currency or any note, draft, bill of exchange or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited, which are not part of the definition at 15 U.S.C. 78c(a)(10).

<sup>5</sup> [FAQ #860](#).

<sup>6</sup> Per [FAQ #899](#), "[o]nly entities whose names exactly match the names of the entities on the [Non SDN]-CMIC List are subject to the prohibitions in E.O. 13959, as amended," which include entities in the Annex to the CMIC EO, or those who are subsequently identified and publicly listed as CMICs.

<sup>7</sup> [FAQ #857](#). Importantly, the amended [FAQ 857](#) deleted the statement that Treasury "intends to publicly list as subsidiaries any entity that issues publicly traded securities and that is ... 50 percent or more owned by one or

more Communist Chinese military company(ies) identified in or pursuant to E.O. 13959, consistent with OFAC's 50 Percent Rule Guidance....”

<sup>8</sup> FAQ #861.

<sup>9</sup> FAQ #902.

<sup>10</sup> Id.

<sup>11</sup> FAQ #903.

<sup>12</sup> FAQ #904.

<sup>13</sup> FAQ #871.

<sup>14</sup> FAQ #905.

<sup>15</sup> FAQ #900.

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