

US Amends Sanctions Targeting Investments in Securities of Chinese Companies

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06 / 11 / 21

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On June 3, 2021, President Joe Biden issued Executive Order 14032 (EO 14032) amending and, in effect, recasting Executive Order 13959 of November 12, 2020 (EO 13959), which restricted U.S. persons from purchasing and selling publicly traded securities in companies identified as Communist Chinese military companies (CCMCs).¹ EO 13959, as amended by EO 14032, imposes substantially similar restrictions on investments in 59 Chinese Military Industrial Complex Companies (CMICs) identified in the annex to EO 14032, of which many — but not all — were previously listed as CCMCs or are subsidiaries of previously listed CCMCs. While EO 14032 does not materially change the applicable prohibitions, EO 14032 and the guidance contemporaneously issued by the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) modify EO 13959 in several notable ways, and also provide additional clarity to the private sector regarding the scope of the restrictions. EO 14032, which comes as the Biden administration undertakes a thorough review of the actions taken in the final days of the Trump administration, also signals that China will continue to be a focus of the Biden administration's sanctions policy.

Recasting EO 13959

EO 14032 amends EO 13959 by replacing its operative sections in their entirety. As amended by EO 14032, EO 13959 prohibits any U.S. person 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 any entity identified as a CMIC. A CMIC is any person (i) listed in the annex to EO 14032, (ii) determined by the secretary of the treasury to operate or have operated in the defense and related materiel sector or the surveillance technology sector of the economy of the People's Republic of China (PRC); or (iii) determined by the secretary of the treasury to own or control, or to be owned or controlled by, directly or indirectly, a person who operates or has operated in any such sector or is listed on the annex. OFAC's Non-SDN Chinese Military-Industrial Complex Companies List (NS-CMIC List) replaces and supersedes the Non-SDN Communist Chinese Military Companies List, which was removed from OFAC's website.

EO 14032 effectively resets the clock for those Chinese companies that had already been sanctioned under EO 13959, as any CCMCs that remain subject to EO 13959, as amended by EO 14032, and are now listed as CMICs. The restrictions applicable to the entities identified as CMICs in the annex to EO 14032 take effect at 12:01 a.m. EDT on August 2, 2021, and the restrictions applicable to any entity identified in the future as a CMIC will take effect at 12:01 a.m. EDT 60 days after its identification and addition to the NS-CMIC List. U.S. persons will have 365 days from the effective date of any listing to divest any CMIC-restricted securities.

Substantive Changes to EO 13959

While the substantive restrictions under EO 13959, as amended by EO 14032, largely align with the restrictions on publicly traded securities that had been in effect since January 2021, there are several notable differences to the scope of the sanctions:

- OFAC, and Not the Department of Defense, Is Now in Charge of Targeting CMICs.

The entities targeted by the restrictions are no longer tied to the Department of Defense's List of CCMCs. EO 14032 places primary authority for identifying targeted companies in the hands of the Department of the Treasury, while at the same time

¹ See our November 17, 2020 client alert discussing EO 13959, “US Imposes New Restrictions on Chinese Military Companies.”

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broadening the criteria for potential designation. OFAC stated that it expects to use its discretion to target, in particular, persons whose operations include or support, or have included or supported, (i) surveillance of persons by Chinese technology companies that occurs outside of the PRC; or (ii) 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.²

- **The Mere Holding of Restricted Securities After the 365-Day Divestment Period no Longer Appears To Be Prohibited.** EO 14032 revoked Executive Order 13974 of January 13, 2021, (EO 13974) in its entirety. EO 13974 had made certain amendments to EO 13959, including — most notably — stating that after the expiration of the applicable 365-day divestment period, the mere holding of CCMC securities by U.S. persons would be prohibited. By explicitly revoking EO 13974, the Biden administration appears to be signaling that the holding of CMIC securities will not be prohibited upon the expiry of the divestment period. Sales of securities after the 365 days, however, will be prohibited.
- **EO 14032 Amends the Definition of Publicly Traded Securities.** The term “security” was previously defined in EO 13959 as encompassing both (i) the definition of “security” under Section 3(a)(10) of the Securities and Exchange Act of 1934 (‘34 Act), and (ii) currency or any note, draft, bill of exchange or banker’s acceptance that has a maturity at the time of issuance of not exceeding nine months. EO 14032 amends EO 13959 by tying the definition of “security” exclusively to the ‘34 Act definition. EO 13959, as amended by EO 14032, continues to apply to securities denominated in any currency that trade on a securities exchange or “over-the-counter” in any jurisdiction.

New and Updated OFAC Guidance

Along with the release of EO 14032, OFAC published certain new FAQs and updated several previously issued FAQs relating to EO 13959.

OFAC had previously confirmed that activities by U.S. persons related to the following support services are considered permissible under EO 13959, to the extent that such support services are not provided to U.S. persons in connection with prohibited transactions: clearing, execution, settlement, custody, transfer agency and back-end services, as well as other such support services.³ OFAC also previously confirmed that market intermediaries and other participants may engage in ancillary or intermediary activities that are (i) necessary to effect divestiture

during the relevant wind down periods or (ii) that are otherwise not prohibited under the EO 13959.⁴ This guidance remains valid.

In its latest guidance, OFAC clarifies that (i) U.S. persons are not prohibited from providing investment advisory, investment management or similar services to non-U.S. persons in connection with the non-U.S. persons’ purchase or sale of a restricted security, as long as that underlying purchase or sale would not be prohibited by EO 13959, as amended (*e.g.*, neither the purchase nor sale of the covered security is for the ultimate benefit of a U.S. person and/or the purchase or sale is not a willful attempt to evade the prohibitions of EO 13959, as amended); (ii) U.S. persons employed by non-U.S. entities are not prohibited from being involved in, or otherwise facilitating, purchases or sales of restricted securities on behalf of their non-U.S. employer, provided that the activity is in the ordinary course of their employment and the underlying purchase or sale would not be prohibited by EO 13959, as amended; and (iii) U.S. market makers are permitted to engage in activities that are necessary to effect divestiture during the 365-day divestiture period or that are not otherwise prohibited under EO 13959, as amended.⁵

OFAC also issued new guidance on the level of diligence U.S. persons are expected to undertake to assess whether an underlying transaction is prohibited under EO 13959, as amended. Specifically, OFAC stated that U.S. persons “may rely upon the information available to them in the ordinary course of business.”⁶

Additionally, OFAC cleared up a source of confusion stemming from earlier guidance by deleting its FAQ that stated that entities whose names “closely match” the names of listed entities are subject to the same sanctions as the listed entity. Thus, only those entities whose names exactly match the names of the entities on the NS-CMIC List are subject to the prohibitions in EO 13959, as amended, and not unlisted subsidiaries or close matches.

Conclusion

With the issuance of EO 14032, financial institutions and other companies now have much greater clarity on how the Biden administration intends to approach this new model of sanctions put into place in the last days of the Trump administration. Companies will need to evaluate their direct and indirect holdings of CMICs, implement controls to prevent prohibited purchases and sales, and carefully monitor for changes to OFAC’s CMIC List.

² OFAC, Frequently Asked Questions 900.

³ OFAC, Frequently Asked Questions 863.

⁴ OFAC, Frequently Asked Questions 865.

⁵ OFAC, Frequently Asked Questions 902, 903 and 904.

⁶ OFAC, Frequently Asked Questions 901.