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# Biden Administration Refines Chinese Military Companies Sanctions

On June 3, 2021, President Biden signed an Executive Order titled “Addressing the Threat from Securities Investments that Finance Certain Companies of the People’s Republic of China” (the “Executive Order”). Although the Executive Order supersedes executive orders targeting “Communist Chinese Military Companies” issued in the final months of the Trump Administration, the Executive Order largely retains the structure of the investment-based sanctions introduced in late 2020. The Executive Order’s prohibitions will take effect on August 2, 2021. In the interim, the prohibitions introduced under the related Trump-era executive orders (described below) are rescinded temporarily.

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## Background

On November 12, 2020, then-President Trump issued Executive Order 13959, titled “Addressing the Threat from Securities Investments that Finance Communist Chinese Military Companies” (“E.O. 13959”). E.O. 13959 introduced a novel sanctions program, the Chinese Military Company Sanctions. E.O. 13959 (1) prohibited U.S. persons from transacting in publicly traded securities of designated “Communist Chinese Military Companies,” as well as securities derivative of, or designed to provide investment exposure to, such securities, within 60 days of designation; and (2) required U.S. persons to divest any preexisting interests within 365 days of designation. Designated “Communist Chinese Military Companies” are included on the Non-SDN Communist Chinese Military Companies List (the “Non-SDN CCMC List”).

Executive Order 13974 (“E.O. 13974”), issued in mid January 2021, made minor amendments to E.O. 13959, including by clarifying that possessing targeted securities beyond the applicable divestment deadline would constitute a substantive violation of E.O. 13959.

## The Executive Order

Although the Executive Order supersedes most of E.O. 13959 and rescinds E.O. 13974, the Executive Order largely retains the structure of the Chinese Military Company Sanctions program. The Executive Order also clarifies some—but not all—open questions regarding the Office of Foreign Assets Control’s (“OFAC”) interpretation of the prohibitions introduced by E.O. 13959.

### *Refinements to E.O. 13959*

Pursuant to the Executive Order, the Chinese Military Companies Sanctions remain focused on concerns within the U.S. government regarding China’s military-industrial complex and the threat that it poses to U.S. national security.

As noted above, the Executive Order retains the basic structure of the Chinese Military Company Sanctions program, as introduced by E.O. 13959. Specifically, U.S. persons will be prohibited from engaging in the purchase or sale of publicly traded securities, as well as securities derivative of, or designed to provide investment exposure to, such securities. This prohibition will take effect on August 2, 2021 for entities listed in the Appendix to the Executive Order (and 60 days after designation, with respect to subsequently designated entities). In addition, U.S. persons will be required to divest of targeted securities of entities listed in the Appendix to the Executive Order by June 3, 2022 (or 365 days from designation, with respect to subsequently designated entities).

The Executive Order departs from the existing Chinese Military Companies Sanctions program in three key respects:

- *First*, the Executive Order highlights the U.S. government's concern with the use of Chinese surveillance technology "to facilitate repression or serious human rights abuse," thereby refocusing the criteria by which a Chinese company could become subject to the investment-based restrictions.<sup>1</sup> In particular, designation criteria now extend to companies deemed (1) to operate or have operated in the defense and related materiel sector or the surveillance technology sector of China's economy; or (2) to own or control, or to be owned or controlled by, parties operating in these sectors and/or designated pursuant to the Executive Order. This shift in focus signals that companies involved in the Chinese government's activities in the Xinjiang region of China and/or the development or sale of human surveillance technology are at increased risk of being targeted by sanctions going forward. For example, in an accompanying Frequently Asked Question ("FAQ"), OFAC states that parties that may be targeted include those involved in "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." OFAC FAQ #900.
- *Second*, the Executive Order replaces the Non-SDN CCMC List with a new Non-SDN Chinese Military Industrial Complex Companies List (the "Non-SDN CMIC List"). While this change reflects a shift in terminology, it is relevant because (1) the Executive Order designates new companies via its Appendix; and (2) the applicable investment prohibition and divestment deadlines for companies previously included on the Non-SDN CCMC List have shifted.
- *Third*, the Executive Order clarifies that the U.S. Department of the Treasury—rather than the U.S. Department of Defense—will drive designations going forward.

### *Interpretative Guidance*

In connection with publication of the Executive Order and the Non-SDN CMIC List, OFAC issued eight new FAQs and amended seven prior FAQs, providing certain clarifications regarding OFAC's interpretation of the investment restrictions introduced by E.O. 13959.

- Application to non-U.S. organized investment vehicles: A key question surrounding E.O. 13959 involved the executive order's application to non-U.S. organized investment vehicles advised by U.S. managers/sponsors—namely, whether (1) non-U.S. organized investment vehicles, advised by U.S.-based managers/advisers, were required to comply with E.O. 13959; and (2) U.S. persons were prohibited from advising or otherwise facilitating non-U.S. investment vehicles' dealings in targeted securities. Newly published FAQs clarify that (x) 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 Executive Order (FAQ #902); and (y) U.S. persons who are employed by non-U.S. persons generally 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 (FAQ #903). The new guidance indicates that OFAC does not intend to apply the facilitation principle to the Executive Order in the same manner that the principle applies across most other OFAC sanctions programs. While the guidance does not cover all scenarios, the guidance addresses a major lingering question following publication of E.O. 13959.

<sup>1</sup> In relation to E.O. 13959, the term "Communist Chinese military company" referred to (1) any company that the Defense Department designated pursuant to Section 1237 of the National Defense Authorization Act for fiscal year 1999; (2) any company designated by the Defense Department after E.O. 13959's effective date; and (3) any company that the Treasury Department publicly listed as a subsidiary of an already designated Communist Chinese military company.

- Existing Clarifications Carry Over: In connection with E.O. 13959, OFAC had published guidance providing that (1) U.S. persons could continue to invest in funds with exposure to covered securities, so long as the funds were taking steps to comply with E.O. 13959; (2) E.O. 13959's prohibitions would not automatically apply to subsidiaries of listed companies; and (3) U.S. persons could continue to engage in transactions with designated companies that did not run afoul of E.O. 13959's investment-related restrictions. These clarifications will apply equally in respect of the new Executive Order. *See* OFAC FAQs #857, #865, and #905.

### *Open Questions Remain*

The Executive Order and accompanying FAQs do not address the full scope of open questions concerning OFAC's interpretation of E.O. 13959 (and, subsequently, the Executive Order).

For example, the Executive Order replaces the definition of "security" with a new definition of "publicly traded security." However, the new definition—on its face—arguably is open-ended, as was the case under E.O. 13959: "the term 'publicly traded securities' **includes** any 'security,' as defined in section 3(a)(10) of the Securities Exchange Act of 1934...."

Similarly, the Executive Order and related guidance do not address the treatment of U.S. persons who lack control over the investment decisions of third-party managers with whom they are invested. For example, would a U.S. investor face potential liability in connection with its investment in a non-U.S. investment vehicle if the investment vehicle (1) purchased a targeted security after the applicable prohibition date; or (2) failed to divest of a targeted security by the applicable divestment deadline? Notably, Section 2 of the Executive Order—prohibiting "[a]ny transaction that .... causes a violation of [the Executive Order's prohibitions]" is not cabined to transactions initiated by U.S. persons (as was the case under E.O. 13959), signaling that OFAC could be considering the application of the new Executive Order to foreign persons.

In addition, as noted above, E.O. 13974 clarified that possessing targeted securities beyond the applicable divestment deadline would constitute a substantive violation of E.O. 13959. Presumably, the Executive Order—which supersedes E.O. 13974—did not intend to alter this interpretation; however, the Executive Order is not explicit with respect to the treatment of continued possession of targeted securities beyond the divestment deadline, nor does it clarify how penalties for such violations would be calculated (since the Executive Order does not impose a traditional blocking requirement).

### Conclusion

Although the Executive Order refines certain Trump-era executive orders targeting China, the Executive Order does not mark a material change in approach. This signals that the Biden Administration intends to continue to take a comparable approach with respect to China. U.S. and non-U.S. investors and managers will need to familiarize themselves with the Executive Order—including its new designations and deadlines—to ensure compliance with U.S. sanctions and side letter commitments.