

President Biden resets sanctions targeting U.S. investment in companies linked to China's military

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On June 3, 2021, President Biden issued a new **Executive Order**, “Addressing the Threat From Securities Investments That Finance Certain Companies of the People's Republic of China” (“**E.O. 14032**”). E.O. 14032 effectively rescinds and replaces the sanctions put into place late in the Trump administration pursuant to E.O. **13959** and E.O. **13974** that prohibited U.S. persons from purchasing, selling, and (after a one-year wind-down period) possessing securities issued by or linked to “Communist Chinese Military Companies” named in or pursuant to E.O. 13959 (the “**CCMC Sanctions**”) with similar restrictions that will apply to securities issued by or linked to a revised list of Chinese companies.¹ E.O. 14032 amends E.O. 13959 by completely replacing its operative provisions and revokes E.O. 13974 entirely, meaning that the prohibitions that had applied under the CCMC Sanctions have been lifted with immediate effect.

The new sanctions program (the “**CMIC Sanctions**”) created by E.O. 13959, as amended by E.O. 14032 (the “**Amended E.O. 13959**”) takes effect on **August 2, 2021** and will prohibit U.S. persons from purchasing or selling publicly traded securities issued by or linked to the 59 entities listed in E.O. 14032's annex (the “**Annex**”), some of which were previously subject to the CCMC Sanctions. The Amended E.O. 13959 also authorizes the Secretary of the Treasury to impose the same restrictions on securities of or linked to companies determined to operate in the defense or surveillance sectors of the economy of the People's Republic of China (“**PRC**”) or such companies' affiliates. The U.S. Department of the Treasury's Office of Foreign Assets Control (“**OFAC**”) will list the entities identified in the Annex or otherwise designated pursuant to the Amended E.O. 13959 on a new Non-SDN Chinese Military-Industrial Complex Companies List (“**NS-CMIC List**”).²

The White House **framed** the changes as designed to “solidify and strengthen” previous attempts to prohibit U.S. investments in the “military-industrial complex” of China, particularly in light of recent district court decisions enjoining the enforcement of the CCMC Sanctions against certain Chinese companies that had been listed pursuant to E.O. 13959 by the Department of Defense during the Trump administration. While these new CMIC Sanctions appear to be designed to rest on a sounder legal basis than the prior CCMC Sanctions, they also reflect a somewhat narrower and more targeted approach than was taken by the previous administration.

We provide below a brief overview of E.O. 14032, highlighting the key differences between the CMIC Sanctions and CCMC Sanctions. We also summarize important guidance issued by OFAC in the form of frequently asked questions (“**FAQs**”) concerning the implementation of the CMIC Sanctions and compliance expectations of U.S. financial institutions and other market participants.

¹ Our prior client memoranda concerning the CCMC Sanctions are available [here](#) and [here](#).

² The NS-CMIC list, available [here](#), replaces and supersedes in its entirety the Non-SDN Communist Chinese Military Companies List, which has been deleted from OFAC's website.

Overview of E.O. 14032

Section 1 of E.O. 14032 replaces and supersedes sections 1 through 5 of E.O. 13959 in their entirety. Section 1(a) of the Amended E.O. 13959 prohibits the following activities by a United States person: 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 person listed in the Annex to the order or of any person determined by the Secretary of the Treasury, in consultation with the Secretaries of State and, as appropriate, Defense:

- to operate or have operated in the defense and related materiel sector or the surveillance technology sector of the economy of the PRC; or
- to own or control, or 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 sector, or a person who is listed in the Annex, or who has otherwise been determined to be subject to the prohibitions in Section 1(a).

Section 1(b) notes that the prohibitions in Section 1(a) will take effect on August 2, 2021, with respect to any person listed in the Annex to the order. For any person subsequently listed by OFAC, the prohibitions will take effect 60 days after the date of the determination.

Section 1(c) permits the purchase or sale of publicly traded securities described in section 1(a) made solely to effect the divestment, in whole or in part, of such securities by a United States person prior to:

- June 3, 2022, with respect to any person listed in the Annex to the order; or
- 365 days after being added to the NS-CMIC List.

Section 2 of the Amended E.O. 13959 prohibits any 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 order, as well as any conspiracy formed to violate any of the order's prohibitions.

While the basic framework for the CMIC Sanctions is substantially similar to the CCMC sanctions, there are a number of key differences. In particular:

- The criteria for imposing sanctions are more precise and authority to add new companies to the NS-CMIC List and to delist listed companies will reside exclusively with the Department of the Treasury,³ which appears to have the intended effect of making designations under the Amended E.O. 13959 less vulnerable to legal challenge.
- Unlike its predecessor, amended E.O. 13959 will not prohibit U.S. persons from possessing securities covered by the order following the conclusion of the 365-day divestment period, though any sale of such securities after that date would require authorization from OFAC.
- OFAC has clarified in revised FAQ [857](#) that sanctions apply only with respect to securities of or linked to the companies specifically included in the NS-CMIC List and that securities of or linked to subsidiaries of listed companies are only subject to sanctions if that subsidiary is itself separately listed, abandoning the legally dubious position it had taken with respect to the CCMC Sanctions that a subsidiary whose name "closely matched" that of its parent was covered by the sanctions applicable to the parent.

³ Under the CCMC Sanctions, the Defense and Treasury Secretary shared authority to designate entities as CCMCs. Under the CMIC Sanctions, however, the Treasury Secretary has sole designation authority, in consultation with the Secretary of State and, as appropriate, the Secretary of Defense.

- The Annex includes 30 entities that were previously subject the CCMC Sanctions, as well as 29 additional entities, some of which are subsidiaries of previously listed entities. It also excludes 18 companies that were previously listed.
- The Amended E.O. 13959 streamlines and rationalizes the definition of “public traded securities,” which now includes any “security” as defined in section 3(a)(10) of the Securities Exchange Act of 1934, 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.⁴

OFAC FAQs

In coordination with the issuance of E.O. 14032, OFAC issued a number of revised and new responses to FAQs, while at the same time removing certain FAQs that had applied to the CCMC sanctions but are no longer operative. In particular, these FAQs provide additional clarity to financial institutions and other securities market participants as to the scope of permissible and prohibited activity in light of the unusually narrow and focused prohibitions of Amended E.O. 13959. Specifically:

- Amended FAQ **863** reaffirms that U.S. persons may provide clearing, execution, settlement, custody, transfer agency, back-end services, as well as other such support services, to the extent that such support services are not provided to U.S. persons in connection with prohibited purchases or sales of CMIC securities.
- Amended FAQ **865** confirms that U.S. market intermediaries, including market makers, and other participants may engage in ancillary or intermediary activities that are necessary to effect divestiture during the relevant wind-down periods or that are not otherwise prohibited under E.O. 13959, as amended. Purchases or sales by U.S. persons (including investors and intermediaries) involving investment funds that are seeking to divest during the relevant wind-down periods are also permitted.⁵
- New FAQ **901** clarifies the standard of due diligence expected of U.S. persons, including market intermediaries and other participants, when assessing whether an underlying purchase or sale is prohibited under Amended E.O. 13959, noting that such persons may rely upon the information available to them in the ordinary course of business.
- New FAQ **902** states 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 Amended E.O. 13959. Such a violation could occur, for example, if the ultimate beneficiary of the transaction were a U.S. person.
- New FAQ **903** provides that U.S. persons employed by non-U.S. companies are not prohibited from being involved in, or otherwise facilitating, purchases or sales related to a covered security

⁴ Examples of financial instruments that are also prohibited by E.O. 14032 include, derivatives (e.g., futures, options, swaps), warrants, American depository receipts, global depository receipts, exchange-traded funds, index funds, and mutual funds, to the extent that such financial instruments also meet the definition of “publicly traded security” as defined in Section 3(c) of E.O. 14032 See FAQ **860**.

⁵ Per amended FAQ **861**, it remains OFAC’s position that, after the effective date of the sanctions, any purchase or sale of 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 CMIC listed on the NS-CMIC List is prohibited, regardless of such securities’ share of the underlying index fund, ETF, or derivative thereof.

on behalf of their non-U.S. employer, so long as such activity is in the ordinary course of their employment and the underlying purchase or sale would not otherwise violate Amended E.O. 13959.

- New FAQ [904](#) further emphasizes that U.S. person market makers are permitted to engage in activities that are necessary to effect divestiture during the 365-day divestiture period applicable to the relevant security, including by converting American depository receipts into underlying securities in order to sell those securities on a foreign exchange for purposes of divestment.
- New FAQ [905](#) reiterates that Amended E.O. 13959's prohibitions are limited to the purchase and sale of securities, and do not extend to other transactions involving entities named on the NS-CMIC List or subsidiaries of such entities, including trade in goods or services with such entities.

These new and updated FAQs provide clarity on a number of issues that OFAC failed to address with respect to the CCMC Sanctions. Moreover, while other questions undoubtedly remain, the FAQs should help facilitate a smoother implementation of the new CMIC Sanctions as financial institutions and other market participants prepare for the August 2 effective date.

Looking Forward

While the Biden administration's overall approach to China is still taking shape, E.O. 14032, following President Biden's [remarks](#) in his first address to a joint session of Congress that the United States is "in a competition with China and other countries to win the 21st Century," suggests that it will not diverge too dramatically from the harder line taken by former President Trump. However, there may be some differences in emphasis, as reflected in the more targeted scope of the Amended E.O. 13959 and its explicit reference to the "surveillance sector," which appears to reflect human rights concerns of the U.S. Government.⁶ Additionally E.O. 14032 appears to reflect a greater reliance on technical sanctions expertise and more attention to detail than was the case during the roll-out of the CCMC Sanctions, which is designed to put the CMIC Sanctions on a stronger and more sustainable legal footing and facilitate compliance and implementation by the private sector.

Despite the temporary reprieve before the new sanctions take effect in August, U.S. companies and investors should be mindful of both the current and future risks of engaging in transactions involving the publicly traded securities of the entities listed in the Annex, and take steps to ensure that transactions subject to U.S. jurisdiction are consistent with the Amended E.O. 13959.

⁶ OFAC noted that it expects to use its discretion to target, in particular, persons whose operations include or support "(1) surveillance of persons by Chinese technology companies that occurs outside of the PRC; or (2) 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." See FAQ [900](#).

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your usual Davis Polk contact.

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