

# Current Status of Restrictions on Securities of Chinese Military Companies

January 10, 2021

As noted in our previous [blog post](#), Executive Order (EO) 13959 introduced novel sanctions prohibiting U.S. persons from purchasing publicly traded securities (debt or equity) issued by companies designated by the U.S. Government as “Communist Chinese military companies” (CMCs), as well as an ill-defined group of securities “designed to provide economic exposure” to the targeted Chinese securities.<sup>1</sup> These restrictions go into effect on Monday, January 11. While over the last two weeks, the U.S. Department of Treasury’s Office of Foreign Assets Control (OFAC) has begun to issue guidance regarding the implementation of EO 13959, significant uncertainties and market confusion remain. This memorandum summarizes the current status.

The Executive Order has led to significant uncertainty in the market. EO 13959 was issued under the International Emergency Economic Powers Act (IEEPA), as sanctions administered by OFAC generally are, but it does not follow the pattern of typical OFAC sanctions in substance or in language, and the intended scope of the new language is often unclear. The situation remains fluid in the closing weeks of the Trump Administration, with further clarification and additional designations of CMCs possible, and whether and how quickly the Biden Administration will turn to this program is unclear.

## I. Key Takeaways

At a high level, under EO 13959 and related OFAC guidance:

- As of Monday, January 11, U.S. persons are prohibited from purchasing for value any “security,” within the meaning of the Securities Exchange Act of 1934 (’34 Act),<sup>2</sup> that is issued by a designated CMC that is either traded on an exchange or in the OTC market, anywhere in the world and in any currency. OFAC’s

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<sup>1</sup> Executive Order 13959, 85 Fed. Reg. 73185 (Nov. 12, 2020), <https://www.govinfo.gov/content/pkg/FR-2020-11-17/pdf/2020-25459.pdf>.

<sup>2</sup> The prohibition also extends to certain short-term debt instruments excluded from the definition of “security” under the ’34 Act.



guidance does not provide further clarity on what may constitute an “OTC market.” U.S. persons may continue to hold and to sell these securities.

- U.S. persons are also prohibited from purchasing securities that are “designed to provide investment exposure to” restricted CMC securities. OFAC has provided no guidance on the meaning of this term, other than to say that it includes (but is not limited to) ADRs, GDRs, ETFs, index funds, and mutual funds; in the case of funds, any holding of restricted CMC securities at all, regardless of proportion, taints the fund unless the fund is in the process of divesting its holdings prior to November 11, 2021.
- The prohibition further extends to derivative products linked to CMC securities or funds holding CMC securities, but not derivatives that are not “securities” for ’34 Act purposes (notably, certain futures on broad-based index funds).
- A list of CMCs is maintained on [OFAC’s website](#). OFAC’s typical “50 percent rule” does not apply, and subsidiaries of CMCs are not automatically covered by the restrictions unless they themselves are designated as CMCs. After a chaotic series of developments over the past days, OFAC’s list is currently definitive.
- If additional CMCs are designated, the ban on U.S. persons’ purchasing the affected securities will take effect 60 days following designation, and the apparent ban on sales (see below) will take effect one year following designation.
- U.S. persons are permitted to facilitate transactions in CMCs (including clearing, execution, settlement, custody, transfer agency, back-end services, and “other such support services”) so long as the buyer is not a U.S. person. Market intermediaries are further permitted to rely upon information ordinarily available to them in order to ensure compliance with permitted facilitation transactions. (This also permits payments and other transactions cleared through the U.S. financial system for non-U.S. buyers.)
- Foreign subsidiaries of U.S. persons are not directly covered by the sanctions. However, involvement of the U.S. parent entity may create some risk, the precise scope of which is unclear.
- There is a second deadline, November 11, 2021, that appears to be intended to be a date after which U.S. persons may no longer sell CMC securities. However, the provisions of EO 13959 and OFAC’s guidance are conflicting and unclear, and it is at this point uncertain what the effect of the second date will be.
- As a result of the remaining uncertainties (and in some cases taking conservative positions well beyond the scope of those uncertainties), we are observing a wide range of reactions by market participants. This may narrow as further guidance is promulgated and market practice gels.

## II. Sanctioned Entities

EO 13959 authorizes the Secretary of Treasury or the Secretary of Defense, in consultation with the Secretary of the Treasury, to designate an entity as a CMC if the entity satisfies criteria set forth in the National Defense Authorization Act for Fiscal Year 1999.<sup>3</sup>

<sup>3</sup> EO 13959, Sec. 4(a). EO 13959 references the criteria in section 1237(b)(4)(B) of Public Law 105-261, which includes in the definition of a “Communist Chinese military company” a person that is “owned or controlled by the People’s Liberation Army” and “engaged in providing commercial services, manufacturing, producing, or exporting.”

CMC issuers subject to the restrictions in EO 13959 are identified in the “Non-SDN Communist Chinese Military Companies List” published on [OFAC’s website](#).<sup>4</sup> OFAC’s initial guidance, provided December 28 in [FAQ 857](#), made clear that, unlike most sanctions programs that operate under what is known as “the 50% rule,” the restrictions of EO 13959 do not apply automatically to subsidiaries that are 50% or more owned, or controlled, by one or more CMCs.<sup>5</sup> The guidance stated that Treasury “intends” to designate such entities in the future, but until such designations are made, subsidiaries are not covered. However, this created political controversy and confusion when it became clear that a number of affiliates of CMC companies had NYSE-listed ADRs for securities issued by affiliates not named on OFAC’s list. OFAC hastily issued [FAQ 864](#) on January 6 stating that, notwithstanding its earlier guidance, the restrictions of EO 13959 automatically apply to subsidiaries with a name that “exactly or closely matches” a CMC.<sup>6</sup> This vague standard was in turn resolved, at least for the moment, by additional OFAC action on January 8, when the [CMC list was updated](#) to include the four affiliate issuers with ADRs listed on the NYSE and OFAC issued [General License 1](#), stating that trades involving securities of entities with names “closely matching” a listed CMC are authorized through January 28.<sup>7</sup> As a result, OFAC’s list of CMCs is currently definitive.

The 35 current CMCs are listed at the end of this memorandum.

### III. Transactions Prohibited

#### A. Initial Prohibitions

As of the later of January 11, 2021 or 60 days following the designation of the relevant issuer as a CMC, EO 13959 prohibits any “transaction”—importantly, defined narrowly for these purposes as “the purchase for value of any publicly traded security”—“in publicly traded securities, or any securities that are derivative of, or are designed to provide investment exposure to such securities, of any [CMC] by any United States person.”<sup>8</sup> The date of a transaction is the trade date, not the settlement date (e.g., a transaction entered into on January 9 may be settled on January 12).<sup>9</sup> Purchases made in the course of a divestiture of securities by a U.S. person (for example, purchasing restricted securities to cover a short position ultimately being delivered to a foreign buyer) are also permitted.<sup>10</sup> Because the definition of “transaction” is limited to a “purchase for value,” it does not appear that there is a restriction on the pledging of CMC securities as collateral, securities lending, or other non-purchase transactions. Repurchase transactions involving CMC securities may, however, raise issues, despite the fact that economically they are secured loans.

#### B. Persons Subject to the Restrictions

As with other OFAC sanctions programs, “U.S. persons” includes citizens and U.S. legal entities, wherever located in the world, as well as foreign citizens and legal entities acting inside the United States. Foreign subsidiaries of U.S. companies are not U.S. persons (as is typical under modern OFAC sanctions unless the program explicitly provides otherwise), and OFAC’s informal industry guidance has confirmed this. However, EO 13959 contains the usual prohibition against any transaction by a U.S. person that “evades or avoids” sanctions,<sup>11</sup> and based on OFAC’s

<sup>4</sup> OFAC, Non-SDN Communist Chinese Military Companies List (Jan. 8, 2021), [https://www.treasury.gov/ofac/downloads/ccmc/ns-ccmc\\_list.pdf](https://www.treasury.gov/ofac/downloads/ccmc/ns-ccmc_list.pdf).

<sup>5</sup> OFAC, FAQ 857 (Dec. 28, 2020), <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/857>.

<sup>6</sup> OFAC, FAQ 864 (Jan. 6, 2021), <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/864>.

<sup>7</sup> OFAC, General License 1 (Jan. 8, 2021), [https://home.treasury.gov/system/files/126/chinese\\_military\\_gll1.pdf](https://home.treasury.gov/system/files/126/chinese_military_gll1.pdf).

<sup>8</sup> EO 13959, Secs. 1(a), 4(e).

<sup>9</sup> FAQ 864.

<sup>10</sup> EO 13959, Secs. 1(b), 1(c).

<sup>11</sup> EO 13959, Sec. 2(a).

general practice it would probably be unwise for a U.S. parent to direct its subsidiary to purchase restricted securities. As discussed below, there is also some uncertainty surrounding EO 13959's application to securities "designed to provide investment exposure to" publicly traded CMC securities, though we believe (particularly in light of OFAC's informal guidance that foreign subsidiaries are not covered) that in general foreign subsidiaries acting independently of their U.S. parents should not be prohibited from purchasing restricted securities. Foreign persons and entities located outside the United States are not subject to the restrictions, even (unlike standard OFAC sanctions) when their transactions may clear through U.S. persons or the U.S. financial system.

#### C. Facilitation of Purchases by Non-U.S. Persons

Moreover, unlike typical OFAC sanctions programs, but consistent with OFAC sanctions restricting purchase of specific [Venezuelan securities](#) to non-U.S. persons,<sup>12</sup> there is no prohibition against U.S. persons' providing services in connection with purchases of CMCs by non-U.S. persons. [FAQ 863](#) confirms that U.S. persons are permitted to provide clearing, execution, settlement, custody, transfer agency, back-end services, and "other such support services" in connection with transactions that are not otherwise prohibited under EO 13959.<sup>13</sup> In the Venezuela context, OFAC provided guidance that entities with direct customer relationships are generally responsible for determining whether transactions involve a prohibited purchase by a U.S. person, and market intermediaries were permitted to rely upon "the information ordinarily available to them" and to process transactions if they did not know or have reason to know that the transaction was prohibited.<sup>14</sup> OFAC has informally advised industry groups that the same applies to EO 13959. Given this interpretation, and the absence of any prohibition in EO 13959 against providing services that benefit CMCs, it would appear to follow logically that there is no prohibition against U.S. persons' facilitating transactions in restricted securities more generally, so long as the underlying transaction is not prohibited by EO 13959.

#### D. Possible Subsequent Prohibition on Sales by U.S. Persons

It is unclear what the position will be as of November 11, 2021. EO 13959 states: "Notwithstanding subsection (a)(i) of this section [prohibiting any "transaction," defined as "the purchase for value of any publicly traded security" by a U.S. person after January 11], purchases for value or sales made on or before 11:59 p.m. eastern standard time on November 11, 2021, solely to divest, in whole or in part, from securities that any United States person held as of 9:30 a.m. eastern standard time on January 11, 2021" in a CMC are permitted.<sup>15</sup> However, despite this permissive language, nowhere in EO 13959 is there an actual prohibition against sales of a restricted security to a non-U.S. person, at any time. Adding to the confusion, in the context of an exemption permitting U.S. persons to continue to acquire shares in a fund that is in the process of divesting its holdings in CMCs, [FAQ 865](#) states that "[d]ivestment must be completed by November 11, 2021."<sup>16</sup> However, there is nothing in EO 13959 that even hints at a prohibition on merely continuing to hold CMC securities, as opposed to purchasing or selling them, and no other OFAC program requires divestiture of pre-sanctions interests. The substantive prohibitions that will be in effect after November 11, 2021, and the knock-on effects on questions such as

<sup>12</sup> See Cleary Trade Watch, "OFAC Issues New Venezuela General Licenses 3C and 9B and Amends Previous Guidance" (Feb. 11, 2019), <https://www.clearytradewatch.com/2019/02/ofac-issues-new-venezuela-general-licenses-3c-9b-amends-previous-guidance/>.

<sup>13</sup> OFAC, FAQ 863 (Jan. 6, 2021), <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/863>.

<sup>14</sup> OFAC, FAQ 650 (Feb. 11, 2019), <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/650>.

<sup>15</sup> EO 13959, Sec. 1(b).

<sup>16</sup> OFAC, FAQ 865 (Jan. 6, 2021), <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/865>.

facilitation of transactions involving non-U.S. persons, remain uncertain in the absence of further guidance (and OFAC has indicated to industry groups that it is continuing to consider the issue).

#### IV. Securities Covered

##### A. General Restriction

The trading restriction applies to “publicly traded securities, or any securities that are derivative of, or are designed to provide investment exposure to such securities, of any Communist Chinese military company.” [FAQ 859](#) clarifies that “publicly traded securities” include securities that “trade on a securities exchange or through the method of trading that is commonly referred to as ‘over-the-counter,’” regardless of the jurisdiction or currency.<sup>17</sup> OFAC did not further define “over-the-counter”; while the precise scope is unclear, the term would appear to include bonds traded on the China Interbank Bond Market, as well as securities traded via “pink sheets,” on alternative trading systems (ATs), and through other off-exchange trading venues.

Securities that are “derivative of” or “designed to provide investment exposure to” publicly traded securities issued by CMCs are a broader and more difficult to define category. These securities need not themselves be publicly traded or issued by a CMC. EO 13959 defines “securities” using the definition in the ’34 Act, as well as certain short-term notes with maturity not exceeding 9 months.<sup>18</sup>

##### B. Derivatives and Depositary Receipts

With respect to securities derivative of a publicly traded CMC security, the critical question is whether the derivative meets the definition of a “security” under the ’34 Act; if not, the derivative is outside the scope of the sanctions.<sup>19</sup> While the ’34 Act definition of “security” is extremely broad, and GDRs, ADRs, futures, swaps, options, and so on linked to individual CMC securities are covered, purchases of derivative products that are not “securities” under the ’34 Act (such as futures on broad-based indices) are therefore permitted, which OFAC has confirmed in informal industry guidance. It also is not entirely clear from the text of EO 13959 that derivatives linked to securities that are not themselves publicly traded securities, but are “designed to provide investment exposure” to publicly traded CMCs (for example, a swap on an ETF holding CMCs) fall within the plain language of the EO, as they are not themselves derivative of a publicly traded security of a CMC (but rather derivative of securities providing investment exposure to publicly traded securities of CMCs). However, it appears that the market is treating derivatives on funds containing CMCs as restricted, and OFAC’s guidance also assumes that they are.<sup>20</sup>

<sup>17</sup> OFAC, FAQ 859 (Dec. 28, 2020), <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/859>.

<sup>18</sup> EO 13959, Sec. 4(d); 15 U.S.C. § 78c(a)(10). A full exploration of the breadth of the term “security” is beyond the scope of this memorandum, but suffice it to say that it is very broad, including “any note, stock, treasury stock, security future, security-based swap, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a ‘security’; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing.”

<sup>19</sup> OFAC, FAQ 860 (Dec. 28, 2020), <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/860>.

<sup>20</sup> See OFAC, FAQ 861 (Dec. 28, 2020), <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/861>. Indeed, given that “transaction” is defined as “the purchase of a publicly traded security,” there is a strong textual argument that the purchase prohibition does not apply to any security that is not publicly traded (e.g., non-exchange traded derivatives) at all; however, this also appears to be inconsistent with market perception and the assumptions underpinning OFAC’s guidance.

### C. Funds and Other Securities “Designed to Provide Investment Exposure”

The most important ambiguity in the scope of the prohibition is its extension to securities “designed to provide investment exposure” to publicly traded CMC securities, which is not further defined and with respect to which OFAC’s guidance is broad and vague. OFAC’s guidance (consistent with public statements from the Trump Administration) explicitly covers ETFs, index funds, and mutual funds, but the list is non-exclusive.<sup>21</sup> Furthermore, OFAC’s guidance takes a very aggressive view of the degree of exposure required, stating that the proportion of the underlying fund represented by CMC securities is irrelevant and, presumably, even a holding of a single share is enough to taint the fund.<sup>22</sup> (OFAC has, however, indicated informally that it will not treat transactions in funds as prohibited if the fund is no longer acquiring restricted CMC securities and seeking to divest by November 11, 2021, which is consistent with but not clearly stated in [FAQ 865](#).)<sup>23</sup>

The question is how far the non-exclusive list of securities “designed to provide investment exposure” extends, particularly in light of the statement that the degree of exposure is irrelevant. A plain reading of “designed to” would appear to exclude investments in operating companies (for example, a foreign bank) that happen to hold securities of CMCs, as well as U.S. parents’ investments in their own operating subsidiaries that trade in CMC securities (especially given OFAC’s guidance that subsidiaries of U.S. companies are not covered by EO 13959). The position with respect to other structures, such as hedge funds that are non-U.S. entities and have greater investment discretion than the typical mutual fund, could be different. While market participants are taking their best guesses at the scope of the sanctions given their imminent implementation, the vague definition of potentially covered securities in combination with the “not a single share” guidance issued in the fund context leave the ultimate scope unclear.

### V. Conclusion

EO 13959 invokes IEEPA, the standard statute underlying OFAC sanctions, but both the structure and the language of the EO diverge from the standard OFAC sanctions paradigm, the EO itself contains gaps and contradictions, and there is neither precedent nor regulatory guidance to fill all of the holes. Unlike prior innovative sanctions programs such as the Russian sectoral sanctions and investment restrictions on Venezuela, the OFAC staff (which worked through the holidays on the CMC program) does not appear to have had an opportunity to work through this program before EO 13959 was issued. As was the case with Russia and Venezuela, we expect a period of adjustment and clarification as the market adapts, implementation issues are identified, and OFAC is able to provide further guidance (a process currently hampered by disruptions surrounding the change in administration). While we would predict that OFAC will not take an aggressive enforcement stance in the zones of uncertainty, conservative biases among some market participants are likely to lead to a wide range of approaches in the near term.

We will continue to monitor and report on developments associated with EO 13959.

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<sup>21</sup> FAQ 860.

<sup>22</sup> FAQ 861.

<sup>23</sup> See FAQ 865.

Non-SDN Communist Chinese Military Companies List  
as of January 08, 2021

<b>Name of Company</b>	<b>A.K.A.<sup>1</sup></b>	<b>Issuer Name<sup>2</sup></b>	<b>Equity Ticker<sup>3, 4</sup></b>
Aero Engine Corporation of China	Aero Engine Corp of China	Aero Engine Corp of China	1546063D CN
Aviation Industry Corporation of China (AVIC)	Aviation Industry Corporation of China, Ltd. (AVIC)	Aviation Industry Corp of China Ltd	CAICPZ CN
China Academy of Launch Vehicle Technology (CALT)		China Academy of Launch Vehicle Technology	1268213D CN
China Aerospace Science and Industry Corporation (CASIC)	China Aerospace Science & Industry Corporation (CASIC)	China Aerospace Science & Industry Corp Ltd	CASZ CN
China Aerospace Science and Technology Corporation (CASC)	China Aerospace Science & Technology Corporation (CASC)	China Aerospace Science & Technology Corp	CASTCZ CN
China Communications Construction Company (CCCC)	China Communication Construction Group Company, Ltd.	China Communications Construction Co Ltd	601800 CN / 1800 HK
China Construction Technology Co. Ltd. (CCTC)		China Construction Technology Co Ltd	AABZDZ CN
China Electronics Corporation (CEC)		China Electronics Corp	CHELEZ CN
China Electronics Technology Group Corporation (CETC)		China Electronics Technology Group Corp	CETCGZ CN
China General Nuclear Power Corp.	China General Nuclear Power	China General Nuclear Power Corp	CGNPCZ CN

China International Engineering Consulting Corp. (CIECC)		China International Engineering Consulting Corp	ENGINZ CN
China Mobile Communications Group	China Mobile Communications	China Mobile Communications Group Co Ltd	CHMOBZ CN
		China Mobile Limited	CHL US / 941 HK
China National Chemical Corporation (ChemChina)		China National Chemical Corp Ltd	CHNCCZ CN
China National Chemical Engineering Group Co., Ltd. (CNCEC)		China National Chemical Engineering Group Corp Ltd	ZHJT TZ CN
China National Nuclear Corp.	China National Nuclear	China National Nuclear Corp	CNNZ CN
China National Offshore Oil Corp. (CNOOC)		China National Offshore Oil Corp	CNOZ CN
		CNOOC Limited	CEO US / 883 HK / CNU CA
China North Industries Group Corporation (Norinco Group)	Norinco	China North Industries Group Corp Ltd	CNIZ CN
China Nuclear Engineering & Construction Corporation (CNECC)		China Nuclear Engineering & Construction Corp Ltd	601611 CN
China Railway Construction Corporation (CRCC)		China Railway Construction Corp Ltd	601186 CN / 1186 HK
China Shipbuilding Industry Corporation (CSIC)		China Shipbuilding Industry Corp	CSIZ CN
China South Industries Group Corporation (CSGC)		China South Industries Group Co Ltd	CSIGCZ CN
China Spacesat		China Spacesat Co Ltd	600118 CN



China State Construction Group Co., Ltd.		China State Construction Group Co Ltd	CSECCZ CN
China State Shipbuilding Corporation (CSSC)		China State Shipbuilding Corp Ltd	0763828D CN
China Telecommunications Corp.	China Telecommunications	China Telecommunications Corp	CNTELZ CN
		China Telecom Corporation Limited	CHA US / 728 HK
China Three Gorges Corporation Limited		China Three Gorges Corp	CJSXGZ CN
China United Network Communications Group Co Ltd		China United Network Communications Ltd	600050 CN
		China Unicom (Hong Kong) Limited	CHU US / 762 HK
CRRC Corp.	CRRC Corporation	CRRC Corp Ltd	601766 CN / 1766 HK
Dawning Information Industry Co (Sugon)		Dawning Information Industry Co Ltd	603019 CN
Hangzhou Hikvision Digital Technology Co., Ltd. (Hikvision)	Hikvision	Hangzhou Hikvision Digital Technology Co Ltd	002415 CN
Huawei		Huawei Investment & Holding Co Ltd	KMCACZ CN
Inspur Group		Inspur Group Co Ltd	LANZ CN
Panda Electronics Group	Panda Electronics	Nanjing Panda Electronics Co Ltd	600775 CN / 553 HK
Semiconductor Manufacturing International Corp. (SMIC)		Semiconductor Manufacturing International Corp	688981 CN / 981 HK
Sinochem Group Co Ltd		Sinochem Group Co Ltd	1001Z CN

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<sup>1</sup> The A.K.A.s provided in this document refer to the names listed in or pursuant to Executive Order (E.O.) 13959 in order to provide additional identifying information for those names listed by the Department of Defense as “Qualifying Entities Prepared in Response to Section 1237 of the National Defense Authorization Act for Fiscal Year 1999 (PUBLIC LAW 105-261).”

<sup>2</sup> The prohibitions in E.O. 13959 apply to transactions in securities of any Communist Chinese military company (whether expressly listed or not) with a name that exactly or closely matches the names of these or any other entities identified in or pursuant to E.O. 13959. See FAQs 858 and 864.

<sup>3</sup> Other securities, including debt securities, issued by identified issuers are also subject to prohibitions under E.O. 13959. See FAQs for additional information, in particular numbers 859 and 860.

<sup>4</sup> The equity tickers provided in this document are followed by the International Organization for Standardization (ISO) 3166 Alpha-2 code for the country in which the equity ticker is registered.