

Biden Administration Overhauls Chinese Securities Investment Restrictions

June 14, 2021

On June 3, 2021, President Biden issued [Executive Order \(EO\) 14032](#), which amended, and effectively replaced, an existing ban on U.S. persons trading in securities of companies determined to be linked to the Chinese military.¹ The previous restrictions² have been rescinded effective immediately and—subject to a two-month grace period ending August 2, 2021 and a one-year divestment period ending June 3, 2022—replaced with a prohibition against U.S. persons (individuals or entities) trading publicly traded securities (debt or equity) issued by companies designated by the U.S. Government in a new [“Chinese Military-Industrial Complex Company” \(CMIC\) list](#), as well as any publicly traded securities “derivative of” or “designed to provide investment exposure to” such securities.³ In parallel with the issuance of the new executive order (the CMIC EO), the U.S. Department of the Treasury’s Office of Foreign Assets Control (OFAC) released [new and amended Frequently Asked Questions](#) (FAQs) clarifying the scope of the restrictions.⁴

If you have any questions concerning this memorandum, please reach out to your regular firm contact or the following authors

WASHINGTON

Chase Kaniecki
+1 202 974 1792
ckaniecki@cgsh.com

Samuel Chang
+1 202 974 1816
sachang@cgsh.com

¹ Executive Order 14032, 86 Fed. Reg. 30145 (June 3, 2021), <https://home.treasury.gov/system/files/126/14032.pdf>.

² Executive Order 13959, 85 Fed. Reg. 73185 (Nov. 12, 2020), <https://www.govinfo.gov/content/pkg/FR-2020-11-17/pdf/2020-25459.pdf>; see also Executive Order 13974, 86 Fed. Reg. 4875 (Jan. 13, 2021) (amending EO 13959), <https://home.treasury.gov/system/files/126/13974.pdf>.

³ OFAC, Non-SDN Chinese Military-Industrial Complex Companies List (NS-CMIC List) (June 3, 2021), <https://home.treasury.gov/policy-issues/financial-sanctions/consolidated-sanctions-list/ns-cmic-list>.

⁴ OFAC, Frequently Asked Questions: Chinese Military Companies Sanctions, <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/topic/5671>.

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I. Key Takeaways

As described in our previous [Alert Memorandum](#),⁵ the earlier restrictions on trading in securities of “Communist Chinese Military Companies” (CCMCs) issued under EO 13959 led to significant uncertainty and resulted in a wide range of reactions by market participants. The new restrictions under the CMIC EO and accompanying OFAC guidance retain the general structure of the previous prohibitions while also updating and clarifying a few key issues:

- **Chinese Military-Industrial Complex Companies.** Most fundamentally, the CCMC list of covered issuers is replaced with the CMIC list, which includes companies determined by the Secretary of Treasury to “operate or have operated in the defense and related materiel sector or the surveillance technology sector” of the Chinese economy. The CMIC list is published on [OFAC’s website](#).⁶ OFAC’s typical “50% rule” (pursuant to which entities 50 percent or more owned by designated parties are subject to the same restrictions as their parent company) does not apply, and affiliates of CMICs (even those with a name that closely matches) are not automatically covered by the restrictions unless they are specifically designated as CMICs.
- **General restrictions.** As of August 2, 2021, U.S. persons⁷ are prohibited from purchasing (and, as of June 3, 2022, selling) any “security,” within the meaning of the Securities Exchange Act of 1934 (‘34 Act), that is issued by a designated CMIC and that is either traded on a securities exchange or “over-the-counter” (which remains undefined), anywhere in the world and in any currency. U.S. persons are also prohibited from purchasing (and, as of June 3, 2022, selling) “publicly traded” securities that are “derivative of” or “designed to provide investment exposure to” CMIC securities. The prior CCMC restrictions applied to securities derivative of or designed to provide investment exposure to CMIC securities regardless of whether they were publicly traded.
- **Timeline.** Given that the CCMC restrictions are no longer in effect and the CMIC restrictions are subject to a 60-day grace period, U.S. persons are not prohibited from purchasing securities of companies on either list before August 2, 2021. If additional CMICs are designated, the ban on U.S. persons purchasing the covered securities will take effect 60 days following designation. Purchases and sales of covered securities for purposes of divestment are permitted through June 2, 2022, or 365 days after any subsequent designations. There is no longer an express prohibition on U.S. persons possessing covered securities, including after June 2, 2022.
- **Facilitation.** Unlike most other OFAC sanctions programs, the CMIC sanctions permit a wide range of intermediary and supporting transactions by U.S. persons so long as the underlying purchase or sale of CMIC securities does not itself violate sanctions, including activities by securities exchanges; activities relating to clearing, execution, settlement, custody, transfer agency, back-end services, and “other such support services;” as well as market making, investment advisory, investment management, and “similar services”—so long as the buyer (or, in 12 months, the seller) is not a U.S. person. U.S. person employees of non-U.S. entities are likewise permitted to facilitate transactions on behalf of their non-U.S. employer in

⁵ Cleary Trade Watch, “Current Status of Restrictions on Securities of Chinese Military Companies” (Jan. 10, 2021), <https://www.clearytradewatch.com/2021/01/current-status-of-restrictions-on-securities-of-chinese-military-companies/>.

⁶ OFAC, Non-SDN Chinese Military-Industrial Complex Companies List (NS-CMIC List) (June 3, 2021), <https://home.treasury.gov/policy-issues/financial-sanctions/consolidated-sanctions-list/ns-cmic-list>.

⁷ Similar to other U.S. sanctions programs (except those targeting Cuba and Iran), foreign subsidiaries of U.S. companies are not directly subject to the restrictions.

the ordinary course of employment as long as the underlying purchase or sale would not otherwise violate the CMIC EO.

- **Diligence.** According to guidance from OFAC, for purposes of assessing whether purchases and sales are permitted under the CMIC EO, financial institutions, registered broker-dealers in securities, securities exchanges, and other market intermediaries and participants may rely upon information available to them in the ordinary course of business.⁸

II. Sanctioned Entities

The CMIC EO authorizes the Secretary of Treasury to designate as a CMIC any entity determined by the Secretary of Treasury, in consultation with the Secretary of State (and, as the Secretary of the Treasury “deems appropriate,” the Secretary of Defense): (i) to operate or have operated in the “defense and related materiel sector or the surveillance technology sector” of the Chinese economy,” or (ii) to own or control, or to be owned or controlled by, directly or indirectly, a person who operates or has operated in such sectors or a person designated under the CMIC EO.⁹ OFAC guidance explains that 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 outside of China, 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.”¹⁰

This designation criteria encompasses a broader and clearer category of companies than the previous CCMC designation criteria, which had been subject to several recent successful legal challenges by designated issuers.¹¹ As described below, companies subsequently designated as CMICs in the future will become subject to the prohibitions set forth in the CMIC EO 60 days after they are designated, after which purchases and sales by U.S. persons to divest the relevant securities are authorized for an additional ten months (365 days from the date of designation).¹²

Covered issuers are limited to those whose name “exactly match” any entity identified on the CMIC list published on [OFAC’s website](#).¹³ OFAC’s guidance in [FAQ 857](#) further clarifies that, unlike most sanctions programs that operate under what is known as “the 50% rule,” the restrictions set forth in the CMIC EO do not apply automatically

⁸ OFAC, FAQ 901, 902 (June 3, 2021), <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/901>.

⁹ EO 13959, as amended, Sec. 1(a).

¹⁰ OFAC, FAQ 900 (June 3, 2021), <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/900>.

¹¹ Former section 4(a) of EO 13959 referenced 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.” *See also, e.g., Xiaomi Corporation v. Department of Defense*, No. 1:21-cv-00280-RC (D.D.C. 2021); *Luokung Technology v. Department of Defense*, No. 1:2021-cv-00583-RC (D.D.C. 2021).

¹² EO 13959, as amended, Sec. 1(b)-(c).

¹³ Under the prior version of EO 13959, there was considerable confusion regarding the names covered as a result of errors in the initial designations and subsequent guidance providing a possibility that names that “closely match” a designated entity could be sanctioned. OFAC, FAQ 899 (June 3, 2021), <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/899>; *see ccmc_gl1b.pdf*

to subsidiaries that are 50% or more owned by one or more designated entities.¹⁴ As a result, OFAC’s current list of CMICs is definitive.

The initial CMIC list contains 59 companies that—with the exception of a few removals and additions—substantially overlap with the prior CCMC list, including China Mobile, China National Offshore Oil Corp (CNOOC), China Railway Construction Corporation (CRCC), Hikvision, Huawei, and other entities in the telecommunications, technology, energy, and transportation sectors. The current designated entities are listed at the end of this memorandum.

III. Transactions Prohibited

A. Purchases and Sales

As of the later of August 3, 2021, or 60 days following a subsequent designation of a CMIC, the CMIC EO prohibits the purchase by a U.S. person of any publicly traded securities of a CMIC or any publicly traded securities that are “derivative of such securities or are designed to provide investment exposure to such securities.”¹⁵ U.S. persons are permitted to engage in transactions to dispose of such securities (including purchases made in the course of a divestiture) until the later of June 3, 2022, or 365 days following the designation of an issuer as a CMIC; thus, effectively, U.S. persons can purchase or sell covered securities until August 2, 2021, and divest them until June 3, 2022, after which U.S. persons are prohibited from selling the securities.¹⁶

The CMIC EO does not require U.S. persons to sell covered securities and does not otherwise prohibit U.S. persons from possessing such securities following the applicable divestment period. Although OFAC guidance permitting ancillary transactions (including those relating to certain “support services” and activities by securities exchanges) increases the feasibility for the receipt of coupon payments, dividends, and other distributions associated with continuing to hold covered securities following the wind-down period, written guidance to date does not address the issue and OFAC has previously indicated to industry groups with respect to the CCMC restrictions that it was continuing to consider the issue.

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.¹⁷ Foreign persons, including foreign subsidiaries of U.S. companies, are not U.S. persons (as is typical under modern OFAC sanctions unless the program explicitly provides otherwise).

C. Facilitation of Transactions by Non-U.S. Persons

Unlike typical OFAC sanctions programs, U.S. persons are permitted to provide a number of enumerated services in connection with purchases of covered securities by non-U.S. persons that would generally be prohibited under traditional facilitation principles. Indeed, [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

¹⁴ OFAC, FAQ 857, (June 3, 2021), <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/857>. Moreover, as of its June 3, 2021 amendment, FAQ 857 no longer states that Treasury “intends” to designate subsidiaries of listed entities.

¹⁵ EO 13959, as amended, Sec. 1(a)-(b).

¹⁶ *Id.*, Sec. 1(c).

¹⁷ *Id.*, Sec. 3(d).

with transactions that are not otherwise prohibited under the CMIC EO.¹⁸ In addition, new and amended FAQs issued concurrently with the CMIC EO further expand the enumerated list of permissible ancillary activities, clarifying that U.S. persons may “provid[e] investment advisory, investment management, or similar services to a non-U.S. person, including a foreign entity or foreign fund,”¹⁹ conduct “transactions and activities by securities exchanges operated by U.S. persons,”²⁰ and, if they are employed by a non-U.S. entity, “be[] involved in, or otherwise facilitate[e], purchases or sales related to a covered security on behalf of their non-U.S. employer, provided that such activity is in their ordinary course of employment.”²¹ While these activities are not exhaustive, they are broad and non-exclusive, and strongly indicate that there is no general prohibition against U.S. persons facilitating transactions in covered securities so long as the underlying transaction is not prohibited by the CMIC EO. However, a U.S. parent should not specifically direct its foreign subsidiaries to purchase covered securities in light of the CMIC EO’s inclusion of the usual prohibition against transactions that evade or avoid sanctions.²²

For purposes of assessing whether purchases or sales are permissible under the CMIC EO, OFAC has indicated that U.S. persons may rely on “the information available to them in the ordinary course of business.”²³

IV. Securities Covered

A. General Restriction

The trading restriction applies to (1) “publicly traded securities” of any CMIC, (2) publicly traded securities that are “derivative of” such publicly traded securities, and (3) publicly traded securities that “are designed to provide investment exposure to” such publicly traded securities. [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.²⁴ OFAC has not further defined “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 (ATSs), and through other off-exchange trading venues. The CMIC EO defines “securities” to include the definition of “security” in Section 3(a)(10) of the ’34 Act.²⁵

¹⁸ OFAC, FAQ 863 (June 3, 2021), <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/863>.

¹⁹ OFAC, FAQ 902 (June 3, 2021), <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/902>.

²⁰ OFAC, FAQ 871 (June 3, 2021), <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/871>.

²¹ OFAC, FAQ 903 (June 3, 2021), <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/903>.

²² EO 13959, as amended, Sec. 2(a).

²³ OFAC, FAQ 901, 902 (June 3, 2021). OFAC had provided similar context in the Venezuelan context.

²⁴ OFAC, FAQ 859 (June 3, 2021), <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/859>.

²⁵ EO 13959, as amended, Sec. 3(c); 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.” In contrast to the previous CCMC restrictions, the CMIC prohibition does not appear to extend to certain short-term debt instruments excluded from the definition of “security” under the ’34 Act.

Although securities that are “derivative of” or “designed to provide investment exposure to” CMIC securities remain broader and more difficult to define, the CMIC EO substantially clarifies the scope of these categories by adding the requirement that such indirect exposures also be “publicly traded.”²⁶ Thus, if a security is not listed on an exchange or traded in a market that would commonly be described as “over-the-counter”—for example, a company’s shares in a wholly owned subsidiary or potentially certain limited partnership interests in investment funds—it is not covered.

B. Derivatives

With respect to publicly traded securities “derivative of” a publicly traded CMC security, the critical question continues to be whether the derivative meets the definition of a “security” under the ’34 Act; if not, the derivative is outside the scope of the sanctions.²⁷ While the ’34 Act definition of “security” is extremely broad, and GDRs, ADRs, futures, swaps, options, and so on linked to individual CMIC 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. The CMIC EO and updated FAQs also do not directly address whether U.S. persons are prohibited from purchasing publicly traded derivatives linked to securities that are not themselves issued by CMICs, but are “designed to provide investment exposure” to publicly traded CMIC securities (for example, a swap on an ETF holding CMIC securities). While such securities are not themselves derivative of a publicly traded security of a CMIC (but rather derivative of securities providing investment exposure to publicly traded securities of CMICs), the market has treated derivatives of funds containing CMICs as restricted, and OFAC’s guidance continues to assume that they are.²⁸

C. Securities “Designed to Provide Investment Exposure”

With respect to publicly traded securities “designed to provide investment exposure” to CMIC securities, OFAC’s guidance, which explicitly covers ETFs, index funds, and mutual funds,²⁹ is non-exclusive and OFAC continues to take an aggressive view of the degree of exposure required, stating that the proportion of the underlying fund represented by CMIC securities is irrelevant such that even a holding of a single share is enough to taint the fund.³⁰ OFAC has, however, previously indicated informally that it will not treat transactions in funds as prohibited if the fund is no longer acquiring covered CMIC securities and seeking to divest by the end of the relevant divestment period, which is consistent with but not clearly stated in [FAQ 865](#).³¹ Moreover, as with securities “derivative of” CMIC securities, the limitation to “publicly traded” securities here significantly narrows the universe of potentially covered securities and definitively rules out operating subsidiaries and potentially rules out limited partnership interests.

V. **Conclusion**

Following a review period of roughly six months, the Biden administration has set forth a much-anticipated reset of the CCMC sanctions program that was issued in haste during the closing months of the prior administration. On the whole, the CMIC EO substantially fills a number of gaps and resolves a number of issues that led to significant market uncertainty under the previous CCMC sanctions program, while also balancing political sensitivities to

²⁶ *Id.*

²⁷ *Id.*

²⁸ OFAC, FAQ 861 (June 3, 2021), <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/861>.

²⁹ OFAC, FAQs 860, 861 (June 3, 2021), <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/topic/5671>.

³⁰ FAQ 861.

³¹ OFAC, FAQ 865 (June 3, 2021), <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/865>.

maintain an aggressive posture toward China. By extending coverage to certain human rights issues (a focus of the administration's foreign policy), the new designation criteria significantly broaden the pool of potential covered issuers—leaving flexibility for future expansion and escalation of sanctions by the U.S. government. At the same time, the CMIC EO and accompanying guidance clarify a number of issues on which the market has been awaiting guidance, particularly relating to covered financial instruments and the provision of support services by U.S. persons to transactions in covered securities. However, certain ambiguities remain in these and other areas.

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

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Annex

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