The Legal Risks Of US Restrictions On Investments In China

By **Samuel Chang, Chase Kaniecki and Robert Williams** (May 23, 2025)

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Beyond headline-grabbing tariff and export control policies, the second Trump administration has continued to embrace a more restrictive economic policy toward China on other fronts, including an ongoing review of further restrictions on the flow of U.S. capital to China.

Both the White House and Congress have reiterated concerns that close ties between Chinese firms and the Chinese government or military risk enabling U.S. capital to support a strategic rival. In recent weeks, for example, the House Select Committee on the Chinese Communist Party has issued request letters to a number of U.S. companies concerning their China-related activities.[1]

In light of the increased regulatory and political uncertainty, investors and financial institutions may better evaluate potential risks by considering the legal tools available to the Trump administration to restrict investments in China. These include statutes, executive orders and regulations issued during both the first Trump and the Biden administrations, spanning U.S. economic sanctions, outbound investment restrictions, and securities laws administered by various offices within the U.S. government.

Early planning and enhanced diligence can reduce exposure to legal compliance, economic and other related challenges resulting from further restrictions.

OFAC-Administered Restrictions

By restricting some or all dealings with sanctioned companies, sectors or countries, the second Trump administration may limit investments in China through various sanctions restrictions administered by the U.S. Department of the Treasury's Office of Foreign Assets Control.

List-Based Sanctions

OFAC's most commonly used and most severe tool is the designation of individuals and entities on the list of specially designated nationals and blocked persons. Such designations effectively prohibit all transactions and dealings within U.S. jurisdiction that relate to the sanctioned entity or its property — including, but not limited to, securities issued by the sanctioned entity — and require all property of such entity within U.S. jurisdiction to be blocked.

Given the comprehensive nature of these restrictions, designations can — and frequently do — result in extensive secondary effects affecting companies that are not directly related to the sanctioned parties. For this reason, U.S. policymakers also may consider more tailored sanctions that specifically target investment activities.

For example, the Chinese military-industrial complex sanctions administered by OFAC offer an alternative framework through which OFAC may target investments in specific issuers.

Executive Order No. 13959, issued by Trump in the closing weeks of his first term and subsequently amended by Biden, prohibits U.S. persons from purchasing or selling publicly traded securities (i.e., traded on an exchange or over-the-counter) relating to designated companies that the U.S. government has determined to be linked to the Chinese military-industrial complex. These restrictions extend to securities traded anywhere in the world and in any currency, including index funds containing any amount of Chinese military-industrial complex securities.

The U.S. government also may consider additional tailored designations against Chinese companies. For example, in response to the Russian annexation of Crimea in 2014, the U.S. imposed so-called sectoral sanctions prohibiting certain dealings relating to the debt or equity — whether publicly traded or not — of designated companies operating in the Russian financial services, energy and defense sectors.

Nonlist-Based Sanctions

Under the International Emergency Economic Powers Act, the president has broad authority to issue sector- or country-specific investment bans. For example, past presidents have issued an investment ban on Myanmar (formerly Burma), and more recently, prohibited new investment in, and the provision of certain professional services to, Russia in response to the war in Ukraine.

Accordingly, the Trump administration also may implement broader investment- or services-related prohibitions relating to China or certain sectors of the Chinese economy. Similar measures could be implemented relatively quickly with far-reaching consequences.

Outbound Investment Security Program

In August 2023, Biden issued Executive Order No. 14105, leading to the final rule issued in October 2024 by the Treasury establishing the Outbound Investment Security Program.

Under the OISP, effective Jan. 2, U.S. persons are prohibited from engaging in, or are required to notify the Treasury regarding, a broad range of transactions involving entities engaged in certain activities relating to semiconductors and microelectronics, quantum information technologies, and artificial intelligence systems in countries of concern — presently limited to China, Hong Kong and Macau.

In contrast to list-based restrictions such as the Chinese military-industrial complex sanctions, the OISP places the burden of diligence on private actors to determine which companies meet the technical criteria to be targeted. The Treasury is currently reported to be coordinating with Congress on the Foreign Investment Guardrails to Help Thwart, or FIGHT, China Act.

The OISP framework, as presently enacted, represents a significant mechanism for limiting investments in China that could be expanded in several ways. In particular, the America First Investment Policy issued in February directed the current administration to consider expanding the sectors covered by the OISP to include biotechnology, hypersonics, aerospace, advanced manufacturing, directed energy and other areas connected to China's military-civil fusion strategy.[2]

The America First Investment Policy also contemplates the possibility of eliminating or narrowing an exception for publicly traded securities, which presently limits the OISP's effect on public market investments. This change would potentially extend the OISP's restrictions to secondary trading, American depositary receipts and other products in capital markets.

Securities Laws and Regulations

In addition to OFAC sanctions and the OISP, U.S. policymakers also have proposed leveraging securities laws and regulations, particularly the Holding Foreign Companies Accountable Act and certain provisions of the Securities Exchange Act, to restrict Chinese companies' access to U.S. capital markets.

Holding Foreign Companies Accountable Act

The Holding Foreign Companies Accountable Act was enacted in 2020 to address how Chinese authorities were limiting Public Company Accounting Oversight Board access to China-based, PCAOB-registered auditors auditing the financial statements of China-based issuers listed on U.S. exchanges or trading in U.S. over-the-counter markets.

Under the HFCAA, when an issuer files two consecutive annual reports including financial statements audited by an auditor that the PCAOB identified as one it cannot fully inspect because of Chinese government restrictions, the HFCAA requires the U.S. Securities and Exchange Commission to ban trading of the issuer's securities on U.S. exchanges or over-the-counter markets.

Initially, it appeared likely that all China-based issuers would face HFCAA-mandated trading bans. However, in 2022, the PCAOB and Chinese regulators reached an agreement that resolved the impasse on inspections. The HFCAA remains a tool available to force Chinese issuers out of U.S. capital markets, but its trading prohibitions only apply in cases of auditor-inspection-related problems and are triggered only after a two-consecutive-year period.

Accordingly, implementing this tool in its current form requires both: (1) a determination that the PCAOB cannot adequately inspect China-based auditors, and (2) passage of the two-year period. Congressional action to amend the HFCAA could change the criteria for using this tool, including by shortening the two-year period required to trigger trading prohibitions.

Provisions of the Securities Exchange Act of 1934

In addition to the HFCAA, Exchange Act Section 12(j)(1) provides the SEC with authority to suspend the trading of a security in U.S. markets if, in its opinion, the public interest and the protection of investors require it. These suspensions, typically limited to 10 business days, are commonly used when there are concerns about the accuracy of a security issuer's financial reports or other public disclosures, or concerns about improper securities trading, such as insider trading or market manipulation.

Separately, Section 12(j)(2) provides the SEC with broad authority to take actions on matters within its jurisdiction to maintain markets, ensure proper settlement of securities or address market disruptions. Invoking this authority requires an emergency, which includes a major market disruption or a major disruption that threatens the functioning of securities markets.

These orders can be issued for up to 10 business days but may be extended for up to 30 calendar days. For example, the SEC exercised this authority when implementing limitations on short sales following the collapse of Bear Stearns in July 2008, which the SEC determined was necessary to maintain fair and orderly markets.

The SEC also may temporarily suspend or permanently revoke the registration of a security pursuant to Exchange Act Section 12(j) if it finds that the issuer has failed to comply with the Exchange Act or rules issued under it. Such orders can only be issued with notice to the issuer and an opportunity for a hearing.

Following the suspension or revocation of a security's Exchange Act registration, U.S. exchanges and broker-dealers are prohibited from executing transactions in the security. These orders have historically been issued against issuers that are seriously delinquent in their filing of required periodic reports, such as annual reports.

While these provisions of the Exchange Act typically are not considered tools for national security or international economic policy, they have been cited as potential tools in this context, including in a recent letter from certain congressional leaders to SEC Chair Paul Atkins.[3] The use of these provisions of the Exchange Act would require specific determinations for their implementation, which makes them less flexible for these purposes than the other measures discussed above.

Considerations

The U.S. government has a number of mechanisms at its disposal for restricting investment in China or sectors of the Chinese economy, each with distinct characteristics and implications.

The Chinese military-industrial complex designation process offers targeted, rapidly deployable restrictions on investments in publicly traded securities. The OISP provides a more open-ended framework for controlling private capital flows that could be expanded to affect public markets.

The president also has discretion to issue more novel restrictions under national security authorities. Other measures, not designed for the national security context, may be more difficult to employ.

Beyond direct regulatory restrictions, investors and financial service providers also may face potential reputational and political risks associated with China investments. For example, the House Select Committee on the Chinese Communist Party issued multiple request letters in April[4] to U.S. investment banks concerning the underwriting of an initial public offering on the Hong Kong Stock Exchange of Contemporary Amperex Technology Co. Ltd., a Chinese company designated on the Section 1260H List maintained by the U.S. Department of Defense.[5]

However, what the U.S. government considers part of China's military-industrial complex may not be immediately apparent to investors or financial service providers.

The U.S. government may determine that companies with seemingly civilian operations have connections to China's military or surveillance apparatus that are not readily apparent from public documents, and in several cases, the Chinese companies have vigorously and successfully challenged such determinations. This opacity and uncertainty create significant challenges, as companies may be designated to restrictions with no advance warning, potentially forcing rapid divestment or operational changes.

Given the evolving regulatory landscape, investors with China exposure should regularly assess the risk profiles of their assets, investments and counterparties. This includes conducting enhanced due diligence on Chinese partners, understanding supply chain connections to potentially sensitive sectors, and establishing contingency plans for possible regulatory actions.

Investment firms should consider developing China-specific risk frameworks that account for both explicit regulatory restrictions and implicit political risks. These frameworks should be regularly updated as both U.S. policy and China's strategic positioning evolve. By acting proactively, investors and companies may mitigate legal compliance, investment and political risks in an increasingly complex regulatory environment.

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[1] https://selectcommitteeontheccp.house.gov/media/letters/letter-jamie-dimon-ceo-jpmorgan-chase-co.

[2] https://www.whitehouse.gov/presidential-actions/2025/02/america-first-investment-policy/.

[3] https://selectcommitteeontheccp.house.gov/sites/evo-subsites/selectcommitteeontheccp.house.gov/files/evo-media-document/SEC Letter Updated compressed.pdf.

[4] https://selectcommitteeontheccp.house.gov/media/letters/letter-jamie-dimon-ceo-jpmorgan-chase-co.

[5] The 1260H List is a regularly updated registry of "Chinese military companies" operating directly or indirectly in the United States. It is maintained by the U.S. Department of Defense under Section 1260H of the National Defense Authorization Act for Fiscal Year 2021. The list identifies three categories of entities: those with connections to the Chinese military, contributors to China's Military-Civil Fusion strategy, and those with significant ownership relationships to such entities. Companies on the list face various restrictions including potential limitations on U.S. defense contracts, effective June 30, 2026.