

December 31, 2020

OFAC Issues New Guidance on Sanctions Targeting Communist Chinese Military Companies

OFAC Clarifies the Scope of E.O. 13959 with New FAQs and Issues Communist Chinese Military Companies List

SUMMARY

In order to clarify the scope of Executive Order 13959, which prohibits U.S. persons from purchasing publicly traded securities of communist Chinese military companies, the Department of the Treasury's Office of Foreign Assets Control has released new Frequently Asked Questions. OFAC has also issued a list containing the names of entities identified in or pursuant to E.O. 13959 as communist Chinese military companies, along with additional identifying information where possible. The new FAQs address some – but not all – of the significant ambiguities in the text of the Executive Order. These include the extent to which the prohibitions reach subsidiaries of communist Chinese military companies, challenges in identifying companies covered by the order, the definition of “publicly traded securities,” and the application of the Executive Order to investment funds holding covered securities. On the day of the release of OFAC's guidance, Secretary of State Michael Pompeo issued a press statement suggesting that the Trump Administration believes that the Executive Order requires U.S. persons to divest from covered securities by a certain date.

BACKGROUND

On November 12, 2020, [President Trump issued Executive Order 13959](#), imposing certain restrictions under the International Emergency Economic Powers Act (“IEEPA”) and other authorities on transactions involving publicly traded securities of identified communist Chinese military companies (“CCMCs”).¹

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Specifically, the Executive Order prohibits transactions (defined in the Executive Order as “purchase for value”) by U.S. persons in “publicly traded securities, or any securities that are derivative of, or are designed to provide investment exposure to such securities” of CCMCs included in the annex to the Executive Order, or subsequently identified by the Treasury or Defense Departments. These prohibitions go into effect on January 11, 2021 for CCMCs listed in the annex to the Executive Order, or 60 days after listing for a subsequently identified CCMC. The Executive Order authorizes U.S. persons to engage in transactions necessary to divest from CMCC securities for a period of time after the prohibitions take effect—through November 11, 2021 for CCMCs listed in the annex to the Executive Order, or 365 days after listing for a subsequently identified CCMC.

NEW GUIDANCE

The text of Executive Order 13959 introduced a number of significant ambiguities that required clarification from OFAC. On December 28, 2020, OFAC published five FAQs that addressed some of the key areas of ambiguity and issued a new Non-SDN Communist Chinese Military Companies List (“NS-CCMC List”) identifying issuers and securities tickers for CCMC securities.² On the same day, Secretary of State Pompeo issued a press statement that indicated the Trump Administration is adopting broad interpretations of the Executive Order’s provisions to, among other things, require “full divestment” by U.S. persons from CCMC securities.³

A. TREATMENT OF CCMC SUBSIDIARIES

In the new FAQ 857, OFAC confirmed that subsidiaries of CCMCs are not automatically covered and that the prohibitions under the Executive Order will only apply 60 days after a given subsidiary is publicly listed by Treasury or the Department of Defense.⁴ OFAC announced its intention to publicly list as subsidiaries any entities that are (1) 50 percent or more owned by one or more CCMC, “consistent with OFAC’s 50 Percent Rule Guidance” or (2) determined to be controlled by one or more identified CCMC. Therefore, investors can look to OFAC to identify CCMC subsidiaries that are subject to prohibitions under the Executive Order, but should be aware that CMCC-owned or -controlled subsidiaries that are not currently listed may be subject to future identification and public listing.

B. IDENTIFICATION OF COVERED CCMCS

An ambiguity arising out of the Executive Order was the lack of specificity regarding the identification of CMCCs subject to the prohibitions. For example, though the annex to E.O. 13959 includes “Huawei,” it was unclear whether this entry referred to manufacturer Huawei Technologies Co. or its parent Huawei Investment & Holding Co., Ltd. OFAC has now addressed the matter by issuing the NS-CMCC List, which includes, in addition to the name of the CMCC included in the annex to E.O. 13959 or subsequently identified by the Defense Department, also known as (“A.K.A.”) names for those CCMCs, the name under

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which the CMCC issues securities, and the Equity Ticker code it uses on public exchanges.⁵ OFAC also issued FAQ 858, which states that the prohibitions of E.O. 13959 apply to publicly traded securities of “an entity with a name that exactly or closely matches” an identified CMCC. OFAC did not provide additional guidance at this time regarding how the phrase “closely matches” should be understood.

C. DEFINING PUBLICLY TRADED SECURITIES

E.O. 13959 did not specifically define the term “publicly traded securities.” When the Executive Order was released, it was unclear whether the prohibitions were intended to be construed narrowly, applying only to securities traded on public exchanges, or more broadly to include, e.g., securities traded over-the-counter. FAQ 859 defines publicly traded securities as “includ[ing] securities (as defined in section 4(d) of E.O. 13959) denominated in any currency that trade on a securities exchange or through the method of trading that is commonly referred to as ‘over-the-counter,’ in any jurisdiction.”⁶

D. DERIVATIVES AND INVESTMENT FUNDS

OFAC also clarified the scope of the prohibitions as they relate to derivatives and investment funds. Section 1(a)(i)–(ii) of the Executive Order prohibits transactions (defined in the Executive Order to mean “purchase for value”) by U.S. persons in “any securities that are derivative of, or are designed to provide investment exposure to such” publicly traded securities. FAQ 860 makes clear that this provision would include, but is not limited to, transactions in “derivatives (futures, options, swaps), warrants, American depository receipts (ADRs), global depository receipts (GDRs), exchange-traded funds (ETFs), index funds, and mutual funds.”⁷ The breadth of this interpretation was underscored by Secretary of State Pompeo’s concurrent statement that identified “venture funds, private equity, Real Estate Investment Trusts, commodities, endowments, pensions, or any other investment funds tracking bonds, loans, lease lines, debt or equity indices that include securities of CCMCs or subsidiaries publicly listed by the U.S. government” as within the scope of this provision.

E. INVESTMENTS IN FUNDS HOLDING CCMC SHARES

Although the Executive Order specified that purchases of securities designed to provide exposure to covered CCMC securities is also prohibited, it did not specify the extent to which U.S. person investors are prohibited from purchasing shares of funds that hold CCMC shares. According to FAQ 861, U.S. persons are prohibited from investing in U.S. or foreign funds that hold publicly traded securities of a CMCC, regardless of the CMCC securities’ share of the underlying fund.⁸ Under Section 1(a)(i)–(ii), the prohibitions on trading in covered securities go into effect either on January 11, 2021 for CMCCs identified in the annex to E.O. 13959 or 60 days after identification for entities subsequently added to the CMCC List by Treasury or the Department of Defense. It therefore appears that a U.S. person would be prohibited from investing in a U.S. or foreign fund holding CMCC securities from the date the relevant prohibition goes into effect despite the fact that, in the case of a U.S. fund, it would be authorized to engage in transactions to divest

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from such securities until the conclusion of the wind-down periods described in Section 1(b)–(c). As reflected in Secretary of State Pompeo’s concurrent press statement, the Trump Administration appears to interpret the Executive Order as requiring (rather than permitting) “full divestment” by U.S. persons by November 11, 2021 in the case of CCMCs listed in the annex to the Executive Order or 365 days after listing for a subsequently identified CCMC.

CONCLUSIONS

Although the OFAC guidance clarified several important ambiguities left by the Executive Order, various questions and ambiguities remain. Nevertheless, the prohibitions will be effective within just a few weeks, on January 11, 2021. Investors and investment funds with existing positions in CCMC securities must consider the impacts that the Executive Order will have on their ability to continue to hold those positions and, in the case of funds, on their ability to accept new investment from U.S. persons while holding such a position. Investors and investment funds should also evaluate holdings in securities of subsidiaries and controlled companies of covered CCMCs in anticipation of the listing of those entities pursuant to OFAC’s suggestion in the published guidance.

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ENDNOTES

- 1 Executive Order 13599, 85 Fed. Reg. 73185 (Nov. 17, 2020).
- 2 United States Dep't of the Treasury, Office of Foreign Assets Control, Publication of Communist Chinese Military Companies Frequently Asked Questions and Related List (Dec. 28, 2020), *available at* <https://home.treasury.gov/policy-issues/financial-sanctions/recent-actions/20201228>.
- 3 Michael R. Pompeo, Sec'y of State, United States Dep't of State, "Protecting U.S. Investors from Financing Communist Chinese Military Companies" (Dec. 28, 2020), *available at* <https://www.state.gov/protecting-u-s-investors-from-financing-communist-chinese-military-companies/>.
- 4 United States Dep't of the Treasury, Office of Foreign Assets Control, FAQ 857 (Dec. 28, 2020), *available at* <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/857>.
- 5 United States Dep't of the Treasury, Office of Foreign Assets Control, FAQ 858 (Dec. 28, 2020), *available at* <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/858>.
- 6 United States Dep't of the Treasury, Office of Foreign Assets Control, FAQ 859 (Dec. 28, 2020), *available at* <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/859>.
- 7 United States Dep't of the Treasury, Office of Foreign Assets Control, FAQ 860 (Dec. 28, 2020), *available at* <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/860>. A covered instrument would need to meet the definition of "security" in Section 4(d) of the Executive Order, which includes a "security" as defined in the Securities Exchange Act of 1934 ("Exchange Act"), as well as "currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding 9 months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited."
- 8 United States Dep't of the Treasury, Office of Foreign Assets Control, FAQ 861 (Dec. 28, 2020), *available at* <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/861>.

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