

OFAC Issues Guidance Regarding Ban on Transacting in Securities of “Communist Chinese Military Companies”

Key Notes:

- The ban is effective January 11, 2021.
- Executive Order 13959 bans U.S. persons from transacting in publicly traded securities or derivatives or similar securities of publicly traded Chinese companies designated by the U.S. Department of Defense as enabling Chinese military aims.
- OFAC has identified, and will continue to add, subsidiaries of the named companies, which will be subject to the same restrictions.
- Divestiture of securities is permitted until November 11, 2021 or 60 days after listing of the company, whichever comes last.

On November 12, 2020, President Trump issued [Executive Order 13959](#), prohibiting U.S. persons from transacting in publicly traded securities or derivatives or similar securities of publicly traded Chinese companies designated by the U.S. Department of Defense as enabling Chinese military aims (“Chinese Communist military company” or “CCMC”). (See our November 24, 2020 *International Trade Update*, [“Executive Order Prohibits U.S. Investment in ‘Communist Chinese Military Companies,’”](#) for additional details.) The ban is effective January 11, 2021. Since issuance of the E.O., the DoD and the U.S. Department of the Treasury have added a number of companies to the [list of designated entities](#) released by the Office of Foreign Assets Control.

OFAC has prepared guidance in the form of a series of Frequently Asked Questions (FAQs), some of which are summarized below. However, aspects of the E.O.’s implementation remain unclear.

Subsidiaries and the 50% Rule

[FAQ 857](#) confirms that the prohibition applies to transactions in any securities (or derivatives) of subsidiaries of a CCMC, *only after* the subsidiary is publicly listed by OFAC. OFAC intends to publicly list as subsidiaries “any entity that issues publicly traded securities and that is (1) 50 percent or more owned by one or more Communist Chinese military company(ies) identified in or pursuant to [the E.O.], consistent with OFAC’s [50 Percent Rule Guidance](#); or (2) determined to be controlled by one or more Communist Chinese military company(ies) identified in or pursuant to [the E.O.]” Although the prohibitions do not apply to unlisted entities, investors should be mindful that the list will likely be regularly updated.

Entity Identification/Name Matches

[FAQ 858](#) clarifies that the prohibition applies to entities “with a name that exactly or closely matches the name of an entity identified” and listed by OFAC.

[FAQ 864](#) further confirms that the prohibitions in the E.O. apply to entities “with a name that exactly or closely matches” the name of an entity identified in the E.O. annex. It also confirms that “[t]ransactions in the securities of any Communist Chinese military company subsidiary (whether expressly listed or not) are prohibited if the subsidiary’s name exactly or closely matches the name of these or any other entities identified in the Annex to E.O. 13959 or the name of any Communist Chinese military company listed by the Departments of the Treasury or Defense.”

U.S. persons are expected to also rely on additional identifying information where possible and in general not to rely only on an exact name match. OFAC's listing of the entities provides some AKAs and ticker number identifying information.

Scope of "Publicly Traded Securities"

[FAQ 859](#) states that OFAC will interpret the term "publicly traded securities" to include securities 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.

Scope of Coverage: Derivatives, Mutual Funds and Other Instruments

[FAQ 860](#) more clearly defines how OFAC intends to interpret the term "financial instruments" to include, without limitation, derivatives (e.g., futures, options, swaps), warrants, American depositary receipts (ADRs), global depositary receipts (GDRs), exchange-traded funds (ETFs), index funds and mutual funds, to the extent such instruments also meet the definition of securities as set forth in the E.O.

[FAQ 861](#) confirms that transactions in U.S. or foreign funds, such as ETFs or other mutual funds, that hold publicly traded securities of a CCMC are prohibited. The State Department has further indicated that the ban includes direct, indirect or other passive investments, including "those linked to educational, ETFs, 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." OFAC's guidance does not specify any "de minimis" amount; therefore, a mutual fund for which only a small percentage of its holdings are in a CCMC would still be the subject of the E.O. prohibitions.

Support Services

[FAQ 863](#) instructs that activity by U.S. persons related to the following services is considered permissible, to the extent that such support services are not provided to U.S. persons in connection with prohibited transactions:

clearing, execution, settlement, custody, transfer agency, back-end services and other such support services.

Divestiture

The E.O. authorizes transactions necessary for the divestiture of securities issued by the prohibited entities until November 11, 2021 or 60 days after the listing of the entity, whichever is later. The E.O. does not expressly mandate divestiture, and "transaction" is defined as "the purchase for value of any publicly traded security." [FAQ 862](#) confirms that the E.O. does not require U.S. persons to divest their holdings in publicly traded securities by January 11, 2021.

Edited January 14, 2021: On January 13, 2021, President Trump [amended](#) his previously issued executive order to address confusion regarding whether U.S. persons must divest in any securities in a Communist Chinese military company. Under the amended executive order, U.S. persons that on January 11, 2021, held any securities in a Communist Chinese military company must divest such holding by November 11, 2021: "Effective at 11:59 p.m. eastern standard time on November 11, 2021, possession of any such securities by a United States person is prohibited." Further, should the Department of Defense designate additional Chinese companies as CCMCs, U.S. persons will have 365 days from the date of any such designation to divest any securities held in the designated companies.

Investment Compliance and Disclosures

- U.S. persons should reassess their investments' risk profiles and consider divestment on or before November 11, 2021. Investors should also continue to monitor guidance and further regulations to determine whether divestment might be mandated.¹ They should also consider the impact that potential future sanctions, particularly blocking sanctions, would have.
- U.S. persons should scrutinize investments going forward to ensure they do not engage in prohibited investment in CCMCs. Prohibited investments include mutual funds and other bundled investment vehicles that hold securities in the CCMC entities.

- Funds that hold securities of designated CCMCs should consider whether disclosures are required if selling to U.S. persons.
- Non-U.S. persons should be mindful that assisting a U.S. person in prohibited transactions in covered securities and investments may be considered to “cause” a U.S. person to violate E.O. 13959, which may itself be a violation.
- U.S. persons should be vigilant for forthcoming additions to the CCMC list.

FOR MORE INFORMATION

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¹ A [press statement](#) issued December 28, 2020, by Secretary of State Mike Pompeo has produced some uncertainty about the scope of the E.O.