

CLIENT ALERT

OFAC Clarifies Scope of Communist Chinese Military Companies Investment Ban, But Leaves Some Questions Unanswered Ahead of January 11, 2021 Effective Date

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AUTHORS

David Mortlock | Michael J. Gottlieb | William J. Stellmach | Nikki M. Cronin
Ahmad El-Gamal

On December 28, 2020, the U.S. Department of the Treasury, Office of Foreign Assets Control (“OFAC”) published guidance in the form of a series of Frequently Asked Questions (“FAQs”) addressing the recent sanctions imposed by Executive Order (“E.O.”) 13959 on entities designated as Communist Chinese military companies (“CCMCs”) related to securities investments. Alongside this guidance, OFAC published a [list](#) of companies identified to date pursuant to E.O. 13959 as a CCMC. E.O. 13959 prohibits U.S. persons from engaging in any transaction directly or indirectly involving the purchase or sale of publicly traded securities, or any securities that are derivative of, or are designed to provide investment exposure to such securities, of any CCMC. A comprehensive discussion of the sanctions imposed by E.O. 13959 is available [here](#) in our prior client alert.

1. Application to CCMC Subsidiaries

The newly published guidance clarifies the scope of the sanctions set forth in E.O. 13959 in several ways. With respect to the subsidiaries of listed CCMCs, OFAC clarifies that the prohibitions set forth in E.O. 13959 will apply to subsidiaries of CCMCs only after OFAC publicly lists a company as such. [FAQ 857](#) states that OFAC intends to list any entity that issues publicly traded securities and that is (1) 50 percent or more owned by one or more CCMCs, consistent with OFAC’s 50

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percent rule; or (2) determined to be controlled by one or more CCMCs identified in or pursuant to E.O. 13959. However, unlike subsidiaries of Specially Designated Nationals that are blocked pursuant to OFAC's 50 percent rule, FAQ 857 makes clear that U.S. persons will not be prohibited from dealing in the securities companies that are not specifically listed by OFAC on the CCMC list. OFAC advised that, as with other listed companies, the prohibitions against a listed subsidiary will go into effect 60 days after such subsidiary is added to OFAC's list.

2. Scope of the Prohibitions

The newly published OFAC guidance also clarifies a number of definitions key to understanding the scope of the prohibitions. OFAC's guidance at [FAQ 861](#) advises that U.S. persons are prohibited from investing in U.S. or foreign funds, such as ETFs or other mutual funds, that hold prohibited publicly traded securities regardless of such securities' share of the underlying index fund, ETF, or derivative thereof. FAQ 861 suggests that U.S. persons are therefore prohibited from investing in any fund that holds a security of a company identified under E.O. 13959, even if the fund's holdings in the prohibited securities are limited.

In addition, [FAQ 859](#) clarifies that it intends to interpret the term "publicly traded securities" to include securities (as defined in section 4(d) of E.O. 13959)¹ denominated in any currency that trades on a securities exchange or through the method of trading that is commonly referred to as "over-the-counter," in any jurisdiction. Trading in securities that are "derivative of, or are designed to provide investment exposure to such" publicly traded securities is also prohibited, and [FAQ 860](#) clarifies that such financial instruments include, but are not limited to, derivatives (e.g., futures, options, swaps), warrants, American depository receipts (ADRs), global depository receipts (GDRs), exchange-traded funds (ETFs), index funds, and mutual funds, to the extent such instruments also meet the definition of "security."

3. Unanswered Questions

While the newly published FAQs provide useful clarifying guidance, a number of questions on the scope of the prohibitions remain unanswered. For instance, E.O. 13959 provides a wind-down period allowing the divestment from securities held by U.S. persons until November 11, 2021, or 365 days after a company is listed following issuance of the

¹ For the purposes of this E.O., a "security" means 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; including any currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

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Order. It is unclear, however, whether U.S. persons would also be permitted to facilitate the divestment of such securities by foreign persons during the wind-down period, or whether the exemption attaches only to transactions to divest, in whole or in part, from securities that are held by U.S. persons. As a result, additional guidance from OFAC on this and other outstanding questions may be forthcoming ahead of the January 11, 2021 effective date.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

David Mortlock

202 303 1136

dmortlock@willkie.com

Michael J. Gottlieb

202 303 1442

mgottlieb@willkie.com

William J. Stellmach

202 303 1130

wstellmach@willkie.com

Nikki M. Cronin

202 303 1203

ncronin@willkie.com

Ahmad El-Gamal

202 303 1142

ael-gamal@willkie.com

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