



Sanctions on Mainland China and the Chinese Anti-Foreign Sanctions Law

China is no stranger to economic sanctions. In fact, the US has maintained sanctions against China from the inception of the People's Republic of China in 1949 until 1972. Sanctions were reimposed on China by the US and the European Union following the Tiananmen Square student riots in 1989, which are still maintained today. The Donald Trump Administration in August 2018 signed the National Defence Authorisations Act for the fiscal year of 2019 (NDAA 2019), which banned Huawei and ZTE equipment from being used in the US. This was seen as the 'first blow', in the latest series of sanctions programmes that would be imposed on China by Western Governments and would ultimately push China into creating their own 'Anti-Foreign Sanctions Law' and to reform their old alliance with Russia and other countries that have been adversely affected by Western sanction programmes like Iran and Turkey.

US Sanctions Programmes Imposed on China.

Sectoral Sanctions, Ban on US Persons Purchasing Securities of Certain Chinese Companies (CMIC) – On 3 June 2021, the Biden Administration issued Executive Order 14032. The EO addresses the threat from securities investments that finance Chinese Communist Military Companies. EO 14032 effectively simplified this sanction programme by removing elements embedded by the Donald Trump Administration. The regime will continue to prohibit the purchase or sale by US persons of publicly traded securities, or any publicly traded securities that are derivatives of securities that are designed to provide investment exposure to securities, of certain Chinese companies listed in the annex of the EO or determined by the Secretary of the US Treasury to:

- a) operate or have operated in the defence or the related material sector or the surveillance technology sector of the economy of the Peoples Republic China; or
- b) to own or control, or to be owned or controlled by, directly or indirectly, by a CMIC.

It should be noted that this sanction regime is a 'Primary' US sanction programme. It is not at this time supported by US secondary sanction legislation. It follows that this regime will only apply to US persons. However, OFAC has made it clear that US persons are not prohibited from providing investment advisory, investment management or similar services to non-US persons in connection with a non-US person purchase or sale of a restricted security. This is as long as the purchase or sale does not breach the prohibitions of the sanction regime. Firms are advised to evaluate their direct and indirect holdings of CMIC securities, implement controls to prevent prohibited purchases or sales, and carefully monitor any changes to OFAC's CMIC list. As this is a non-asset freezing regime, the firm can take a risk-based approach, as to whether they wish to exit clients that are identified as CMICs.

US SDN Sanctions with respect to China and Hong Kong.

Hong Kong Autonomy Act 2020 (HKAA) – On July 14, 2020, US President Donald Trump issued Executive Order 13936 (Order) and signed into law the Hong Kong Autonomy Act 2020 (HKAA). The HKAA and the Order are a response to the perceived threat of China's National Security Law to Hong Kong's autonomous status. The National Security Law took effect on June 30, 2020. The HKAA introduces property (assets) and visa blocking sanctions on foreign persons who are determined to have 'materially contributed' to China's actions in Hong Kong, as well as a variety of sanctions on foreign financial institutions (FFI) who 'knowingly conduct significant transactions' with such person (material contributors). The term 'material contributors' refers to Chinese officials behind the National Security Law, although it is possible that many other individuals and entities could be identified as 'material contributors' as this regime evolves. Persons that are listed as 'material contributors', within Annex of the Order would be subject to SDN restrictions. This restriction prohibits all transactions by US persons (anywhere in the world) that involves any property or interests in property (assets) of an SDN, a.k.a. a blocked person. This would include all property owned directly or indirectly 50% or more by a block person. The element within an SDN restriction that would affect Insurance firms would be the 'making of any contributions or provisions of funds, goods, or services directly or indirectly that would be of benefit to a block person'.

It is important for all firms to conduct screening for sanctions, and, depending on risk, potentially screening daily. Beneficial-ownership is a particular area which sanction red flags are identified, especially during customer onboarding or periodic customer risk reviews. Firms are encouraged to perform a health check of their operations in, or related to, China and Hong Kong to ensure:

- a) Effective list management controls ensuring lists are updated in line with any these changes of this regime;
- b) Conduct sanctions screening on all counterparties; and
- c) Perform due diligence on all third parties to ensure they are not doing business with sanctioned entities, nor entities with controllers or beneficiaries who are designated persons to avoid breaches to economic sanctions. If a firm identifies a positive match for a blocked person, the firm must immediately consider freezing all funds and facilities available to the blocked person and also to consider a report on the identification and value of the frozen funds to OFAC. If a firm wishes to exit the blocked person, it may be a breach of the SDN restriction to do so without authorisation from OFAC.

UK, US, EU and Canada implement Human Rights Targeted Sanctions on Chinese Nationals and Entities. This analysis only focuses on the UK implementation of this regime.

UK Global Human Rights Sanctions Regulation 2020 - On 22 March 2021, the UK in collaboration with the US, Canada and the European Union implemented sanctions on mainland China as a response to alleged serious human rights abuses in the Xinjiang Uyghur Autonomous Region (XUAR) of China. The UK Notice of Designation states that the measures target Chinese government officials and the Xinjiang security body responsible for the administration of China's so-called "re-education" policy in XUAR. The sanctions imposed on China are limited to individuals and entities that are centre to allegations of Human Rights abuses in XUAR. The measures include asset freezes and travel bans, which are usual components applied to this type of targeted action. The asset freezes prohibit (directly or indirectly) making funds or economic resources available to or for the benefit of the designated persons. The prohibition on dealing with funds or economic resources of designated persons also extends to any legal entities that they may (directly or indirectly) own or control even if that entity may not be listed on the UK Consolidated list of Financial Sanctions Targets. Again, as described above all firms are encouraged to perform a health check of their operations in, or related to, China:

- a) Effective list management controls ensuring lists are updated in line with any these changes of this regime;
- b) Conduct sanctions screening on all counterparties;
- c) Perform due diligence on all third parties to ensure they are not doing business with sanctioned entities, nor entities with controllers or beneficiaries who are designated persons to avoid breaches to economic sanctions; and
- d) . If a firm identifies a positive match for a UK designated person subject to an asset freeze, the firm must immediately consider freezing all funds and facilities available to the designated person and to consider a report on the identification and value of the frozen funds to HM Treasury's Office of Financial Sanctions Implementation (OFSI). If a firm wishes to exit the designated person, it may be a breach of the asset freeze to so without authorisation from OFSI.

China's Anti-Foreign Sanctions Law - Analysis

The new Chinese Anti-Foreign Sanctions Law goes far beyond countering sanctions imposed by other countries. It allows for countermeasures against a wide range of actors and actions that China perceives as harming its interests. The new Anti-Foreign Sanctions Law (AFSL), passed by the Standing Committee of China's National People's Congress on the 10 June 2021, is a signal to the world of what China is willing to do to protect its interests and preserve the stability of its political system.

There are a total of 16 articles in the AFSL. It is worth noting that the AFSL draws some weak parallels to the EU Blocking Statute which similarly adopts a united front against the unlawful effects of the extraterritorial legislation of third countries. Article 3 of the AFSL is of most significance. It provides that if a foreign country, "unlawfully", contains or suppresses China, takes discriminatory or restrictive measures against Chinese citizens or organisations, or interferes in China's internal affairs, China has the right to take corresponding countermeasures.

The AFSL further provides that the authorised department of the State Council of China, MOFCOM (Authorised Regulator) may decide to put individuals (Individuals Concerned) and organisations (Organisations Concerned) directly or indirectly involved in the formulation, decision-making, and implementation of Discriminatory Measures on China's counter-control list, which effectively means an asset freeze restriction (for all assets based in China only) implemented on the Individuals Concerned or the Organisations Concerned.

The Authorised Regulator may decide to take countermeasures against the following individuals or organisations (Related Individuals and Organisations):

- a) Spouse and direct family members of the Individuals Concerned;
- b) Senior management personnel or the actual controller of the Organisations Concerned;
- c) Organisation(s) in which any Individual Concerned serves in a senior management position; and
- d) Organisation(s) controlled by any Individual Concerned or Organisation Concerned or in whose establishment and operation any Individual Concerned or Organisation Concerned participates.

The countermeasures could be:

- e) Refusal to issue visas, denial of entry into China, cancellation of visas or expulsion from China;
- f) Sealing up, seizure or freezing of movable assets, real property and other assets located in China;
- g) Prohibition or restriction of individuals and organisations within China from conducting transactions with any Individuals Concerned, Organisations Concerned or Related Individuals and Organisations; and
- h) Other countermeasures as are considered necessary.

The AFSL will have a significant impact on business activities in the financial and commercial sectors:

- i) The AFSL requires organisations and individuals within China to implement the countermeasures determined by the Authorised Regulator; otherwise, the Authorised Regulator may restrict or prohibit non-compliant organisation or individual from conducting certain activities, or take other actions permitted by law. This would include any foreign subsidiaries operating in China; and
- j) The AFSL also provides that no Chinese organisation or individual, may implement, or assist the implementation of, Discriminatory Measures taken by any foreign country against Chinese citizens or organisations. If any Chinese organisation or individual breaches this provision and damages the lawful interests of any Chinese citizen or organisation, the latter may claim loss or damage against the former by starting legal proceedings in the Chinese courts. It remains to be seen how this element would work in practice.

Who Has to Comply with MOFCOM's Prohibition Orders?

The Blocking Rules are clear that Chinese citizens and companies (including Chinese subsidiaries and affiliates of foreign companies) are expected to comply with the Authorised Regulator's prohibition orders. Violation of a prohibition order by "a Chinese citizen, legal person or organization" is subject to administrative penalties, including warning, correction order, and a fine to be specified. In addition, they may be sued by an adversely affected Chinese citizen/entity for damages in a Chinese court.

In addition, the Blocking Rules appear to suggest that third country individuals and entities may also be sued by an adversely affected Chinese citizen/entity for damages in a Chinese court. Specifically, the Blocking Rules state that "a person" may be sued for damages in a Chinese court by a Chinese citizen or entity that has suffered damages from the person's compliance with a foreign law or measure that has been blocked by a prohibition order. In addition, the Blocking Rules allow "a person" benefiting from a judgment or ruling that is made based on a blocked foreign law or measure to be sued by a Chinese citizen or entity in a Chinese court if such a judgment or ruling has caused damages to a Chinese citizen or entity. But please note that it is not yet clear whether "a person" is intentionally different from "a Chinese citizen, legal person or organization" and covers "any" person, including third country persons.


What You Can Do as Part of Your Firms Strategy?

With the introduction of this new radical Chinese legislation to counteract Western sanctions, it will undoubtedly change the way global financial institutions interact with China. However, as China is still keen to attract foreign investment and business, this may influence the Authorised Regulator of China to choose a more conservative approach in the implementation of the AFSL.

Further, it should be anticipated that in implementing countermeasures under Article 3 and 6(2), that the Authorised Regulator will evaluate "territory" in a manner consistent with the State Council's interpretation. As written, by referring to the territory of the People's Republic of China without qualification, the geographical scope of the AFSL would include Hong Kong and Macao which are generally subject to their own legislation.

There is need for further specification and clarity, however outlined below are some practical steps that affected parties may wish to consider as part of their compliance and response strategies:

- a) Given the complexities of US economic sanctions and export controls, and the amount of civil and criminal penalties that have been imposed for violations or conduct that allegedly contravened such laws, reducing the size and scale of business activities (with particular consideration to a nexus with US persons) might be an appropriate approach to comply with US laws. However, this approach may need to be re-assessed in the context of business activity in China as it may cause new liabilities if the Chinese blocking regime is potentially applicable.
- b) For commercial dealings that involve both the US and China, companies can evaluate if there are actions, they can take to reduce the risk of being caught in a conflict of laws. Depending on the specific circumstances, those actions may include engagement with both US and/or Chinese government authorities. Preparation and implementation of effective internal guidance is also key for 1st and 2nd Line staff. Additionally, companies should establish internal mechanisms to monitor the actions of the Chinese government.
- c) Mitigating potential legal and business risks, firms should re-examine their contractual clauses (or terms and conditions in non-contractual business forms) as well as compliance policies that have been adopted in connection with US sanctions, export controls, or other laws that may have an extraterritorial element to them. This examination should include an assessment as to whether the clauses create potential liability under the new Blocking Rules, and whether modifications would be warranted. These contractual clauses are often in the form of representations and warranties, indemnification, governing law and venue, force majeure, dispute resolution, and possibly other relevant clauses. Compliance policies or procedures that may dictate the utilisation of such safeguards may need to be reviewed, with a view to maintaining the appropriate protections against US legal and Chinese Blocking Rules liability.



Lastly, the opinions and point of view set-out in this paper do not constitute legal advice. Firms should consider seeking their own legal advice with regard to the implications of the AFSL and their proposed response, given the unprecedented nature of the AFSL and legal ambiguity that currently exists.

AUTHORS

Manmeet Lotay
Manager
E-mail: manmeet.lotay@plenitudeconsulting.com
Tel: +44 (0)203 102 9525
Mobile: +44 (0)7917 303508

ABOUT PLENITUDE

Plenitude are Financial Crime, Risk and Compliance specialists, offering advisory, transformation services and innovative cloud-based RegTech subscription products. We help our clients meet their regulatory obligations and reduce their financial crime risk exposure by providing deep subject matter expertise, advisory and transformation services. Our RegTech subscription products which are used by leading financial institutions, offer clients enhanced insight into the vast array of FCC laws, regulations, guidance and risk indicators globally.

Our consultants come from a variety of backgrounds and disciplines across consulting, in-house financial crime compliance, regulators, government and law enforcement. As experts in financial crime compliance, we fully understand the financial crime compliance challenge, and have the expertise and skills to design and implement effective programmes or initiatives.

To find out more go to: www.plenitudeconsulting.com