

President Trump Issues Executive Order Prohibiting Transactions Involving “Communist Chinese Military Companies,” Signs Holding Foreign Companies Accountable Act

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This article summarizes two recent developments relevant to China-based issuers whose securities are publicly traded in the United States. These developments may have a significant impact on U.S. persons that invest in those securities, including U.S. investment funds and their managers.

Executive Order 13959 and Subsequent Developments

On November 12, 2020, then-President Donald J. Trump issued Executive Order 13959, *Addressing the Threat from Securities Investments That Finance Communist Chinese Military Companies*. Under existing statutory authority, the U.S. Department of Defense (DOD), acting in coordination with the U.S. Department of the Treasury, identifies and publishes a list of “Communist Chinese military companies” (CCMCs) that operate directly or indirectly in the United States or its territories or possessions. Executive Order 13959 prohibits U.S. persons from purchasing securities of issuers so identified as CCMCs, as well as securities of other issuers identified by the Secretary of the Treasury as meeting the criteria of a CCMC or of a publicly listed subsidiary of a CCMC. The executive order applies to investments in publicly traded securities of identified CCMCs and any securities that are derivative of, or that are designed to provide investment exposure to, those securities. An annex to the executive order listed 31 companies identified as CCMCs, investments in which would be subject to the executive order. Following the issuance of the executive order, additional CCMCs have been identified, including nine additional CCMCs named by DOD on January 14, 2021.

The sanctions against trading in CCMC securities took effect on January 11, 2021 with respect to CCMCs initially designated on November 12, 2020. For additional CCMCs designated after November 12, 2020, the trading ban takes effect 60 days after the date of designation.

After the issuance of the executive order, the Department of the Treasury’s Office of Foreign Assets

Control (OFAC) issued guidance in the form of Frequently Asked Questions to clarify various provisions of the order. Importantly, the FAQs make it clear that the executive order would apply to derivatives (including futures, options and swaps), warrants, depositary receipts, mutual funds, exchange-traded funds and index funds that hold or otherwise provide exposure to publicly traded securities of CCMCs, noting that transactions in those securities are “prohibited regardless of such securities’ share of the underlying index fund, ETF, or derivative thereof.”

On January 6, 2021, the SEC’s Division of Examinations issued a risk alert regarding the executive order. In the risk alert, the Division encouraged investment advisers, broker-dealers and other market participants to review and assess the impact of the executive order on their own investments as well as on the investments their investors and clients, and to evaluate related processes. On January 13, 2021, then-President Trump issued Executive Order 13974, amending certain provisions of the original November 12, 2020 executive order, including, notably, adding a provision prohibiting "possession" by U.S. persons of CCMC securities as of 11:59 p.m. ET on the date 365 days after the CCMC was designated as such. Following the amended executive order, OFAC issued additional guidance expressly stating that U.S. persons are required to divest their holdings of CCMC securities by the end of the applicable wind-down period and are "prohibited from holding covered securities after the relevant deadline."

In the latest development, on January 27, 2021, OFAC issued General License No. 1A to Executive Order 13959, authorizing, until 9:30 a.m. ET on May 27, 2021, transactions in securities of any entity "whose name closely matches, but does not exactly match, the name of a [CCMC]." The Biden administration could further modify or repeal the executive orders.

The November 12, 2020 executive order is available [here](#); the January 13, 2021 executive order is available [here](#).

The OFAC FAQs relating to the executive order, as well as the current list of prohibited companies published by OFAC, are available [here](#).

The SEC Division of Examinations risk alert relating to the initial executive order is available [here](#).

Holding Foreign Companies Accountable Act

On December 18, 2020, then-President Donald J. Trump signed the Holding Foreign Companies Accountable Act (HFCA Act) into law. The HFCA Act, an amendment to the Sarbanes-Oxley Act of 2002 that garnered bipartisan support in the House and the Senate, is intended to address rising concerns over audit inspections of China-based issuers. The HFCA Act requires auditors of foreign public companies to allow the Public Company Accounting Oversight Board (PCAOB) to inspect their audit work papers; issuers whose foreign auditors go three years without a PCAOB inspection will be prohibited from having their securities publicly traded in the United States. Although the HFCA Act as drafted is not specific to China-based issuers, authorities in China have historically prohibited audit firms located in China and Hong Kong from providing the PCAOB access to audit work papers.

Under the HFCA Act, the SEC is required to identify all issuers subject to the periodic reporting requirements of the Securities Exchange Act of 1934 whose audited financial reports are prepared by an accounting firm located in a foreign jurisdiction and that the PCAOB is unable to inspect due to a position taken by an authority in that jurisdiction. If the PCAOB is unable to inspect the issuer’s auditor for three consecutive years, the issuer will be prohibited from having its securities listed for trading on a U.S. exchange or otherwise traded in over-the-counter markets subject to the jurisdiction

of the SEC. The HFCA Act contains cure provisions for companies whose securities have been delisted pursuant to the provisions of the HFCA Act but that later take actions to engage auditors that submit to PCAOB inspections. However, if the trading prohibition is so removed and the issuer's auditor has a recurrence of non-inspection during the same year, the issuer's securities will be subject to a minimum five-year trading prohibition. The HFCA Act contains additional disclosure requirements for issuers identified by the SEC as having auditors that the PCAOB is unable to inspect, including, among others, the percentage of the shares of the issuer owned by governmental entities in the jurisdiction in which the issuer is organized and the name of any official of the Chinese Communist Party on the issuer's board of directors.

After the HFCA Act was signed into law, SEC Chairman Jay Clayton issued a statement noting that he was "pleased with the bipartisan, multi-agency approach to addressing these critical investor protection issues," while noting that the HFCA Act "requires significant Commission action to implement." Mr. Clayton stated that prior to passage of the HFCA Act, the SEC was finalizing recommendations for proposed rules regarding the same matter. Due to overlap between the HFCA Act and the SEC's proposal, Mr. Clayton stated that he directed the SEC staff to consider providing a single consolidated proposal on issues related to PCAOB's access to audit work papers, exchange listing standards and trading prohibitions, and noted that the SEC would likely consider the proposal following his departure from the agency.

The text of the HFCA Act is available [here](#).

Mr. Clayton's statement regarding the HFCA Act is available [here](#).

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