



Financial Services Management

Anti-China Sanctions

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<https://www.congress.gov/bill/117th-congress/senate-bill/1260>

Impact Assessment

- Banks doing business with U.S. banks, domiciled in the U.S., and/or under U.S. jurisdiction would face franchise-level legal and reputational risk related to doing business with the People's Republic of China, its officials, citizens, companies, and financial institutions as well as persons or entities related to any such Chinese person or entity.
- Although the Administration is assessing the extent to which sanctions effectively transmit U.S. policy, the bill relies heavily on sanctions and expands them to new areas (e.g., private-sector cyber attacks, IP theft) often resolved by law enforcement or corporate-dispute resolution. Challenges predicting actions resulting in such sanctions would require significant monitoring and systems readiness given the magnitude of sanctions-violation penalties.
- The global payment system could face fragmentation due to U.S. sanctions related not only to Chinese financial institutions, but also its payment system based on the outcome of a study mandated by this legislation.

Overview

The Senate has passed by a wide margin legislation taking an array of actions to counter the threat now seen to be posed by the People's Republic of China. Among these are optional and mandatory sanctions against a far wider range of targets linked directly or indirectly to China engaging in or benefiting from "malign" activities. Far broader use of sanctions would create additional legal, reputational, and even charter risk for banks and other financial institutions doing business in the U.S. or with U.S. financial institutions. New law makes it possible to, when such sanctions are invoked, impose them extraterritorially by virtue of any correspondent relationship with a U.S. bank by the parent company even if that correspondent

relationship is not otherwise within the scope of U.S. law.¹ The bill also seeks to accelerate ongoing work to build a registry of beneficial ownership in the U.S.,² perhaps leading FinCEN to prioritize reporting related to any entities from or affiliated with China.

Impact

The purpose of this legislation is to ramp up and, in some cases, force economic sanctions against a wide range of Chinese official and unofficial actors, companies, corporate officers, and financial institutions that directly, indirectly, or in some cases even accidentally engage in, facilitate, or benefit from controversial Chinese foreign-policy and human-rights actions at home and abroad. The bill also covers an array of criminal ventures including cyber-attacks and trade-secret theft.

Even financial institutions with no known relationships that might be subject to sanctions could find themselves at risk if, for example, an entity to which they have credit outstanding is sanctioned because it "enabled" or facilitated" a cause for sanction and then ceases to be willing or able to honor its commitments. The challenges of tracking webs of direct and indirect entities and persons (e.g., corporate directors) at risk due to their own activities or those with whom they are in some way affiliated would prove daunting, especially for foreign financial institutions with deeper ties to international customers to whom U.S. banks may have more limited relationships due to their own business plans and/or risk-management considerations.

As noted, the bill focuses in part on the beneficial-ownership registry established in AML legislation earlier this year. FinCEN has begun to build this out under heavy pressure from Congress despite the lack of appropriated funds sufficient to ensure rapid deployment. This bill increases pressure on FinCEN to move quickly in general terms but its focus on China might lead Treasury to do so to the extent possible initially in ways deemed most likely to capture the type of shell companies used by Chinese beneficial owners or the real estate often acquired to prevent ownership trails. Should it prove difficult to build out specific anti-China standards for beneficial-ownership reporting – which could well be the case – banks and other financial institutions could find themselves quickly subject to more law-enforcement demands and FinCEN inquiries regarding the extent to which required suspicious-activity and/or currency reports have been filed.

An additional complication for companies subject to this legislation would be the need to prepare for sanctions in order to meet OFAC reporting requirements.³ These cover a wide range of financial transactions as well as those in goods and services and subject companies failing quickly to file requisite reports to significant penalties akin in many ways also to those mandated by the bill. Thus, even if the President did not choose directly to impose the most severe penalties possible under the bill (see below), OFAC might still do so if a firm failed to comply with applicable reporting standards.

¹ See **AML133**, *Financial Services Management*, January 12, 2021.

² See **AML133**, *Financial Services Management*, January 12, 2021.

³ See **SANCTION14**, *Financial Services Management*, July 8, 2019.

The bill's impact on U.S.-China trade is also far-reaching. Chinese ventures rapidly setting up shop in the U.S. for legal businesses – e.g., bitcoin miners – could, for example, find themselves subject not only to disclosures of all of their corporate owners, but also to sanctions if any of their activities here or in home- or third-country locations is deemed to facilitate cyber-attacks or any of the many illicit-finance activities also detailed in the bill. A financial institution doing business with Chinese ventures for which there is no known sanction risk could still prove problematic if similar forms of enabling or facilitating are found by U.S. authorities.

Conversely, the bill puts additional pressure on U.S. companies doing business in China. Nothing in it bars doing so nor are specific practices for doing so mandated. However, U.S. firms are encouraged to adopt codes of conduct that would prove difficult to satisfy given current conditions in the Chinese marketplace. As a result, some companies might find it difficult to expand or even continue significant Chinese operations. Again, they would also be at heightened risk if any of the activities in which they engage in China is found to have enabled or facilitated malign activities.

For all its tough provisions, the bill includes only mandatory reports rather than taking action in many key areas. Among these is the role of China in the global payment system. Absent a specific case related to sanctions, no restrictions are imposed on the ability of companies in the U.S. to send transactions through Chinese-owned or -controlled messaging or payment systems, but the study could lead to additional restrictions should Treasury, the Fed, or other agencies find significant AML, security, or related concerns. Any such barriers to cross-border payments could have significant implications for the ready, rapid, and free flow of funds across the global financial system with repercussions for Chinese-based manufacturing, trading, and financial operations as well as the ability of U.S.-domiciled or -located payment-system participants to handle dollar-denominated transactions.

What's Next

The Senate passed this bill by a vote of 68-32 on June 8. There is no precise companion to it in the House but many measures deal with aspects of the provisions discussed below along with those related to the U.S. supply chain and other matters that are the principal focus of the Senate measure. All of these provisions and differing approaches complicate the odds for final passage, but it does seem likely that much of what is in the Senate bill related to sanctions and the financial sector – the result of a bipartisan agreement on language deemed by many to be relatively noncontroversial – is likely to be enacted in whatever advances.

Analysis

As noted, this consultation focuses on private cryptoassets, not CBDC.

A. Beneficial Ownership and Business Conduct

1. U.S. Policy

Following a series of findings about the risks of shell corporations that focuses in particular on China, the bill expresses the sense of Congress that the efforts to prevent money laundering required in last year's legislation should be implemented as quickly as possible in accordance with relevant statutory deadlines. Further, work on beneficial ownership should specifically address risks raised by China and its citizens.

2. Reports and Task Forces

Provisions in the legislation here would:

- establish a task force on Chinese market manipulation and antitrust violations consisting of Justice, the FTC, Treasury, and many other agencies. The task force is to focus in particular on critical industry sectors also named in the bill. The first task-force report must come from the President within 180 days with recommendations if needed for revisions to antitrust and competition law to address identified harm;
- expand an ongoing study of Chinese money laundering to address how illicit finance may lead to official Chinese corruption; and
- set U.S. policy to support business practices that are open, transparent, support workers' rights, and are environmentally "conscious." The policy also reaffirms U.S. commitment to "economic freedom," freedom of expression, U.S. supply-chain security, a welcome for Chinese citizens lawfully in the U.S., against xenophobia, and recognizes the risks China poses to many aspects of the U.S. economy. The policy also would include a lengthy condemnation of Chinese business and human-rights practices. U.S. companies are also told to commit to best practices and to develop codes of conduct for doing so. This code would also need to disclose support received from Chinese official sources.

B. Sanctions

This section also includes extensive findings highly critical of China.

1. Definitions

Those of most note here include "knowingly," which is defined as knowing or "should have known." U.S. person includes aliens admitted for permanent residence, entities doing lawful business in the U.S., expressly including branches of foreign entities, or any person in the U.S. "Malign" behavior by China covers an array of foreign-policy, trade, financial-sanctions-violation, drug-trafficking, and human-rights activities.

2. Optional Sanctions

The President is told to use all of his power to combat malign behavior by China, entities it owns or controls, and Chinese individuals or entities responsible for the activity.

3. Mandatory Sanctions

The President would need to impose economic sanctions if Chinese officials, entities, or individuals are found to have knowingly engaged in or assisted cyber-

attacks on the U.S. Government or private sector. Persons (e.g., corporate officers) or entities in which such activities occurred or that benefited from them could also face significant sanction, as would any financial institution operating in the U.S. found to have assisted any of these parties. The President would need to report within 180 days and annually thereafter on these actors and demonstrate that sanctions were imposed on them in accordance with a schedule of increasingly severe sanctions (including property forfeiture) detailed in the legislation.

Sanctions specific to financial institutions are also detailed, clearly intended to discipline institutions that may not be directly linked to Chinese cyber-attacks but may be found to have supported entities or individuals who materially and knowingly did so. These sanctions include:

- denying primary-dealer status;
- a ban on serving as a repository of government funds; or
- denial of payment-system access.

The President could also bar U.S. persons from investing in the debt or equity of a sanctioned entity. However, as is often the case, the President may waive sanctions that would otherwise be required upon a finding that sanctions are not in the national-security interest. Any such waivers would need, however, to be promptly reported to Congress.

Sanctions similar to those outlined above for cyber-attacks would also apply in cases of significant trade-secret theft from U.S. persons or facilitation of such an activity (including via financing for it). These sanctions would apply to activities related to engaging in or benefiting from trade-secret theft after the date of enactment; unlike the cybersecurity provisions, sanctions are not demanded for activities prior to enactment. As with cyber sanctions, those for trade-secret theft may be waived on a finding of national security and a report to Congress.

C. Export-Import Bank

The President may – but need not – direct the Ex-Im Bank to cease financing for entities sanctioned under the voluntary or mandatory powers granted to the President.

D. Financial Institutions

1. Credit

The President may also prohibit U.S. financial institutions (defined to include FBOs) from making loans or providing credit of over \$10 million in any year to sanctioned entities other than those which would relieve human suffering.

2. Sanctions

Reiterating financial-sector sanctions, the bill also expressly allows financial institutions to be sanctioned for dealing with any sanctioned entity as follows:

- denial of primary-dealer status;

- a ban on being a U.S. Government repository; or
- a prohibition on providing any goods or services to the federal government. As drafted, this could be read to ban access to the payment-system to the extent a contract with the Federal Reserve is required to do so.

U.S. directors at international financial institutions could also be required by the President to vote against financing for such entities unless relief is clearly targeted.

3. Foreign Exchange

Pursuant to rules that would need to be issued either ahead of time or perhaps concurrently, the President could also prohibit foreign-exchange transactions with a sanctioned entity. The bill does not make clear which agency would issue such rules.

E. Investments

The President may also prohibit "significant" debt or equity investments in a sanctioned entity by any person over whom the U.S. has jurisdiction.

F. Reports

In addition to those related to beneficial-ownership noted above, reports on the following would be required:

- risks to the U.S. from Chinese companies related to national security, human-rights, or tax hazards to the U.S. with a focus on the OTC market and equity indices;
- malign activities by Chinese state-owned enterprises;
- the use of sanctions related to Hong Kong, focusing on possible confusion or duplication as well as effectiveness. Recommendations for improving sanctions effectiveness (but only for those germane to Hong Kong) are also required;
- how information on foreign investments is exchanged between the U.S. and other nations;
- Chinese messaging and cross-border payment systems and alternatives to them being developed in other countries. This study is to focus on national-security, AML, CFT, and financial risk. Recommendations for ensuring strong, trustworthy, and reliable messaging in cross-border payments are required from Treasury, in collaboration with the Secretary of State and the Board of Governors of the Federal Reserve, within 180 days of enactment. This study is to have both classified and unclassified sections;
- the economic impact of China's move to a free-floating currency;
- the exposure of the U.S. financial system to China due from Treasury, Fed, SEC, and CFTC one year after enactment. Recommendations on ways to protect the U.S. are also requested; and
- investment reciprocity with China.