



THE CHINA QUESTION

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China's Export Control Law: 10 steps to setting up a compliance programme

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In many industries, China plays a key role for sourcing and manufacturing products, in addition to providing a critical consumer base. However, with escalating trade tensions, China accelerated the development of an advanced export control regime that could create significant complexities for many exporters. 2020 saw major developments in the establishment of China's export control policies. As a first step, in late 2020, China implemented the Export Control Law ('ECL') that consolidated regulations and established a uniform framework for controlling the export of dual-use items, or any item or technology that may impact national security. One day later, the first product-based control lists addressing commercial cryptography were announced, and became effective on 1 January 2021, creating new licensing requirements. Exporters had little time to adjust to these new requirements that exist in parallel to China's other long-standing export requirements. However, it

is likely that the changes have only just begun as the implementing regulations that will specifically define the ECL's requirements have not been issued.

Yet exporters should not wait to assess and adjust their compliance programmes, particularly as the Chinese Ministry of Commerce ('MOFCOM') recently released guidance about establishing an export compliance programme. A proactive, methodical approach to analysing the ECL's impact on both current and future supply chains will give most exporters a head-start on achieving compliance. In this article, we propose a process for getting ahead of China's export control law so that once the implementing regulations are released the business is positioned to seamlessly continue operations.

1) Familiarise yourself with China's Export Control Law

China's ECL is intended to unify and centralise China's export control

regulations of dual-use items with both civilian and military applications, military arms and goods, nuclear items and any item necessary for 'safeguarding national security and interests'. It also includes technical data. Given the focus on both 'national security' and 'interests', it will be broadly applicable to a wide swathe of companies doing business in China.

Although the implementing regulations that will provide granularity into the law's mechanics have not yet been issued, there is some information about how the law will operate. The ECL established a framework for State export control authorities to identify controlled products or technologies through published control lists and has incorporated the Cryptography Control List. Further, this law is applicable to citizens, corporations, and unincorporated organisations who provide controlled products to foreign organisations or individuals.

The law further imposes a high burden

on companies that will likely present management challenges. These include:

- Assessing whether a proposed export should be controlled and proactively applying for a licence even when it is currently uncontrolled;
- Deemed export provisions limiting the transfer of information within China;
- Temporary restrictions on uncontrolled technologies and services for up to two years; and
- Extraterritoriality requirements applicable to companies or individuals violating its provisions outside of China

Further, the consequences of violations can be steep depending on the violation. Financial penalties may be up to RMB 5 million or ten times the illegal gains of the transactions. Additional sanctions include imprisonment, licence withdrawal, business suspension, and loss of ability to export.

To help put these requirements in the context of individual business practices, it's important to spend some time reviewing the details of how the law operates and what this may mean for current supply chains. Further, understanding the nuances of the law may mean coordinating with the local China team to proactively determine risk points.

2) Assess other dual-use export control regimes

Globally, export control regulations are taking a front seat with regulators – meaning that the impact of the ECL should not be assessed in isolation. Once the export compliance team has a working knowledge of the ECL, they should take a step back to identify what other regimes may also control products. For instance, does the EU's emerging export control law apply to the products or information under review? How are the US regulations involved and what do they control? In particular, the extraterritorial nature of both US and Chinese laws means that export compliance teams sitting in third countries must juggle at least three jurisdictions' laws: the US, China, and their home country. But knowing in advance where and how each product is controlled will help validate that transactions are compliant and shipments are not delayed.

3) Validate China's existing lists of items controlled for export

Once the trade department has assessed the ECL and other jurisdictions' regulations, a secondary analysis should be conducted to determine if any of China's existing

regulations apply. There are two in particular exporters should be aware of: (1) the Catalogue of Technologies Prohibited or Restricted from Export; and (2) the Catalogue of Dual-use Items and Technologies Subject to the Administration of Import and Export Licenses.

The Catalogue of Technologies Prohibited or Restricted from Export is separate from the ECL and contains its own requirements. In the August 2020 amendment, additional products were subjected to control, including certain cryptographic security technology. The Catalogue's controls are description-based so compliance professionals will probably need to team closely with engineers or product development specialists to achieve an advanced knowledge of potentially controlled items.

Finally, it is imperative to understand whether a company's goods are also controlled under the Catalogue of Dual-use Items and Technologies. Following the release of the cryptography control lists, China revised the Catalogue of Dual-use Items and Technologies Subject to the Administration of Import and Export Licenses. It's notable that to determine whether the product or technology is controlled, the exporter needs the HS code, product name and description.

While exporters may not have products controlled under each regime, it is likely there is some overlap. Clearly defining when a licence is needed and who on the China team has responsibility for making this determination will be critical to ensure that there are no impediments to moving goods.

4) Analyse current and future China supply chains

Once the ECL-impacted products have been identified, the compliance team needs to validate its understanding of product flows. In most cases, achieving the requisite level of knowledge means engaging with business stakeholders. The export compliance team should consider sitting down with the supply chain, marketing, and sales teams to assess the entire life cycle of controlled products. Further, a pre-meeting questionnaire is sometimes issued to help focus the meeting on the most important issues. During the meeting, the teams should review how products and technical data are transferred today and any planned changes. Having this information enables the compliance team to prioritise supply flows with the highest risks, assign actions, gather information and develop a monitoring plan.

It is worth noting that this type of

collaboration is much easier when there is a good relationship in place between the business teams and export compliance. Not only will the business teams be more inclined to assist if they view export compliance as a partner, but the compliance team will get more complete answers to critical questions.

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5) Document supply chains against controlled items

With visibility into how products and technical data move, documenting these product flows in a central location is important. This mapping should highlight the jurisdictions and third parties involved in the products' life cycles. It should also indicate points at which the product becomes controlled as this will not always be at the origination point. Once documented, the product flows should be widely accessible so that individuals whose responsibilities impact export compliance have access to the mapping. Additionally, a team member should be tasked with updating or validating the flows on a pre-determined basis.

6) Remediation

In going through the deep-dive review process, it is not uncommon to discover violations. These are often associated with improper classification determinations, licensing mistakes, or sanctioned party errors. Fixing the past before making substantive changes to the export compliance programmes is important. This will likely include disclosing the errors to the appropriate government agencies. As part of the remediation process, the compliance team should plan to conduct a thorough root cause analysis to identify the underlying reasons these errors occurred. Although always important, it is particularly important when adjusting a compliance programme

to accommodate a new export control regime. The export compliance team should use the results of the root cause analysis to craft measures that will prevent future similar violations. This means understanding whether the violation occurred because of a systemic error that was the result of a key control failure, a third-party error, a systems-related flaw, or some other reason. Without identifying the underlying cause, the export compliance team may miss an opportunity to permanently remediate the problem.

7) Development and implementation of processes and procedures

Regardless of whether violations are discovered, processes and procedures will likely need to be substantially revised or, potentially, completely changed to accommodate the ECL. As a first step, the export compliance team should confirm current processes. This should include assessing what third parties are involved (e.g., freight-forwarders or logistics providers) and how their activities will be monitored. In many cases, companies might consider conducting a risk assessment based on the ECL. The risk assessment's results will help the compliance team understand how to prioritise programme modifications.

It will be equally important to overlay the MOFCOM Internal Compliance Guidelines for Export of Dual-use Items with current compliance activities. While these guidelines are not mandatory, an effective export compliance programme will be considered a mitigating factor in the event of a violation. These guidelines contain China-specific considerations and a close review should be taken, with the assistance of a local professional, to validate that compliance processes align with the MOFCOM's expectations.

At the conclusion of this step, the export compliance team should have documented processes and procedures to help support trade under the ECL. While some of the guidance may need to be revised once the implementing regulations

are available, this step will be the foundation for managing China trade.

8) Development of a risk-based testing plan

Once the new export compliance framework is in place, the team should shift its attention to developing a testing plan. Ideally, this testing plan will be based on the results of a risk assessment, which will also help determine testing frequency. If a comprehensive risk assessment was not completed earlier, the export compliance team should perform one prior to developing a testing plan.

Of particular importance will be including key control assessments for new compliance activities. Building in key control validation will help the team monitor effectiveness, limiting the potential for long-term systemic errors. Further, it will help imprint the importance of key control maintenance into the organisation's compliance culture.

9) Training

Successfully adapting an organisation to new export control regulations, coupled with revised compliance processes, is best achieved through thoughtful change management supported by well-executed training. There is likely to be a high degree of confusion about the ECL, how it impacts the business, and the effect of new procedures on the business. Training should address each of these areas at the level appropriate for the audience. This may mean developing introductory ECL training that is supplemented based on individuals' roles and responsibilities. Additionally, the export compliance team should hold an over-view training on process changes but follow it with on-the-job training. Additionally, during this transition period, regular, mandatory trainings should be held to answer questions as issues arise. Depending on the export profile and the needs of the business, the export compliance team may consider setting up a helpdesk to coordinate assistance and track inquiries. Regardless of the approach taken,

providing relevant, well-developed training will be important to sensitising stakeholders to new responsibilities.

10) Establishing export compliance as a key business stakeholder

Although listed last, the export compliance team should approach the previous nine steps as opportunities to further integrate into the business. Export controls management is not simply the final task before a product ships but, rather, is closely tied into the entire supply chain. When the

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trade team is included in business planning meetings, it provides an early opportunity to identify and develop solutions for compliance challenges. Further, with the ECL's emergence, the complexity of the trade environment increases the likelihood of possible violations. If the compliance and the business teams are not in sync, it is likely that violations will occur. Breaking down silos enhances visibility and enables the compliance team to provide guidance at critical decision-making points, instead of retroactively correcting errors.

Although there is still much uncertainty around how the ECL will impact companies, exporters should not wait for the implementing regulations before taking action. In fact, following the proposed steps will help set companies up for success as they will be prepared to pivot in whatever direction necessary once more information becomes available. □



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A close-up, black and white photograph of a watch movement (mechanical gears and components). A bright yellow highlight is applied to a specific gear and its surrounding components, drawing attention to the intricate mechanical details. The background is dark and textured, suggesting the inner workings of the watch.

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