



[Trade, Industry, and Public Affairs Newsletter] U.S. Sanctions on Hengli and the Possibility of Secondary Sanctions on Chinese Big Banks

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Featured Analysis

[U.S. Sanctions on Hengli and the Possibility of Secondary Sanctions on Chinese Big Banks] An Era of Conflict Between Dollar Hegemony and China's Counter-Sanctions Legal Order: Exposure and Response of Korean Companies and Financial Institutions

I. Overview: China's First-Ever Direct Response to the Sanctions System

On 24 April 2026, the US Treasury Department's Office of Foreign Assets Control (OFAC) added the Chinese oil refiner Hengli Petrochemical (Dalian) to its 'Specially Designated Nationals' (SDN) list, marking a new turning point as the geopolitical conflict between the US and China spilled over into the financial sector. The US determined that Hengli had purchased billions of dollars' worth of Iranian crude oil via a 'shadow fleet' arrangement through an oil-selling organisation affiliated with the Iranian military, and announced that secondary sanctions would be imposed on third-country companies and financial institutions transacting with Hengli, blocking their access to the U.S. financial system.

Notably, for the first time, China responded not just with protest but by invoking its own domestic law for the first time in history to confront the US head-on. The Chinese Ministry of Commerce activated, for the first time, anti-sanctions legislation (the "Rules on Counteracting Unjustified Extraterritorial Application of Foreign Legislation and Other Measures" enacted in 2021 but previously dormant) prohibiting individuals, companies and financial institutions in China from recognising, enforcing or complying with US sanctions. This marks a shift from its previous stance of merely verbally condemning the U.S. sanctions regime, to confronting it with an open legal challenge by invoking domestic

legislation, putting the institutional infrastructure underpinning U.S. global dominance to the test.

The critical impact of U.S. financial sanctions lies in the structure of dollar settlements in international transactions. Most cross-border transactions are settled in U.S. dollars, with final settlement occurring through the Clearing House Interbank Payments System (CHIPS) and the Federal Reserve's books. Even when a Korean company remits dollars to a Chinese company, both parties' banks must clear through correspondent banks in New York. Thus, if the U.S. blocks a specific company's dollar settlements, the company becomes unable to conduct even a single dollar's worth of transaction, and secondary sanctions extend this blockade to third-country companies and banks. These sanctions operate not merely by freezing accounts but by depriving the right to participate in international trade.

Although a Memorandum of Understanding (MOU) was signed between the U.S. and Iran on June 14, temporarily allowing Iranian oil sales, the main negotiations remain for core issues including Iran's denuclearization and the lifting of U.S. sanctions, which are scheduled to proceed over the next 60 days, effectively amounting to a "60-day ceasefire." At present, an optimistic outcome for reaching a final agreement remains uncertain, and the possibility of a calamity resulting from a clash during the period cannot be ruled out.

This newsletter analyzes scenarios in which the Hengli sanctions could expand to major Chinese state-owned banks, and examines the exposure and challenges and tasks faced by Korean companies and financial institutions.

II. The Structure of the Issue: Sanctions against Hengli and the US–China Confrontation

1. OFAC's SDN Designation of Hengli and Authorisation of Wind-Down of Transactions

On 24 April 2026, the Office of Foreign Assets Control (OFAC) designated Hengli Petrochemical (Dalian) Refinery Co., Ltd., China's second-largest private refiner, as a sanctioned entity pursuant to Executive Order (EO) 13902, which targets Iran's oil and chemical sectors. The grounds for the listing were Hengli's bulk purchases of Iranian crude oil since 2023, and alongside Hengli Petrochemical, approximately 40 shipping companies and vessels were also added to the SDN list. Hengli Petrochemical is the largest Chinese private refiner ever to be sanctioned by the U.S. The OFAC granted a General License V simultaneously with the SDN designation, allowing Hengli to wind down existing transactions by May 24, 2026, subject to the condition that any proceeds received by Hengli must be deposited into an interest-bearing frozen account within the United States. The aim is to permit the orderly termination of existing transactions whilst blocking Hengli's access to the proceeds from those transactions.

2. Secondary Sanctions Warning and Pressure on Financial Institutions

Treasury Secretary Scott Bessent had previously announced that on April 15, 2026, he had sent warning letters to two Chinese banks (names withheld) cautioning that supporting Iran-related transactions would expose them to secondary sanctions. Subsequently, on April 28, OFAC issued an official warning to the entire financial sector regarding the risk of secondary sanctions related to transactions involving Chinese private 'teapot' (i.e. small and medium-sized) refineries, demanding risk-based controls, enhanced due diligence on refineries, and communication of compliance expectations by correspondent banks to Chinese counterparts. The warning identified front companies, intermediaries, shadow

fleets, ship-to-ship transshipments, false documentation and the manipulation of vessel identification information as the main evasion methods. According to publicly available data, the four major state-owned banks (Industrial and Commercial Bank of China, China Construction Bank, Bank of China and Agricultural Bank of China) were confirmed to have provided loans to Hengli at least until 2018; and such lending could be subject to secondary sanctions after the sanctions take effect.

3. China's Dual-Track Approach: Asymmetric Instructions

China put out a meticulously dual-tracked approach aimed at two seemingly conflicting objectives: asserting its sovereignty externally, while maintaining macro-financial stability internally. On May 2, the Ministry of Commerce invoked the counter-sanctions rules for the first time, compelling companies to defy U.S. sanctions and allowing civil claims to be filed in Chinese courts against companies that sever ties with Hengli to comply with U.S. sanctions. However, on the other hand, the National Financial Regulatory Administration (NFRA), the financial regulator, issued verbal instructions to major state-owned banks just before the Labour Day holiday, directing them to suspend new yuan-denominated credit facilities to companies such as Hengli, whilst not requiring the repayment or early termination of existing loans.

This asymmetry of 'suspending new loans whilst maintaining existing ones' is a carefully designed, deliberate countermeasure to U.S. sanctions. New loans constitute "new significant transactions" under OFAC's criteria and carry high exposure, while mere retention of existing loans is more passive. By prohibiting recall or shortening of existing loans, Beijing appears to have adopted a calculated middle path: to preserve political face by enforcing counter-sanctions measures, whilst protecting systemically important state-owned banks' access to dollar clearing by blocking new exposure to avoid triggering the decisive conditions of U.S. sanctions.

III. Legal Structure of Sanctions: The Escalation Ladder

Sanctioning China's state-owned banks is not a single act but an escalation ladder, with the level determined by the evidence obtained.

1. What Triggers Sanctions?

There are two main triggers, with differing weights, that provide grounds for initiating sanctions. First, maintaining existing loans is a grey area that is open to differing interpretations. Extending maturities by even a single day, or changing interest rates or collateral terms, or allowing drawdowns within the existing loan limit after sanctions take effect can effectively be interpreted as new lending, thereby increasing the level of risk. However, these actions are less directly linked to Iran and are likely to result in lower-level measures (warnings, fines, conditional sanctions).

Second, direct settlement of Iranian oil, roundabout trade, or transaction with front companies directly constitute the trigger requirement of "knowingly conducting or facilitating significant transaction" of Iranian oil, and as fraudulent conduct is a key escalation factor, this provides the U.S. with grounds to proceed directly to the middle-to-upper tier of the sanctions ladder. Furthermore, if the transactions are conducted in renminbi (RMB), they may be interpreted as facilitating trade with sanctioned entities.

2. Two Key Measures: CAPTA and Full Blocking Sanctions

CAPTA (Correspondent Account or Payable-Through Account) sanctions prohibit or severely restrict the opening or maintenance of U.S. correspondent accounts and payable-through accounts, effectively cutting off dollar clearing access, which amounts to a “quasi-capital punishment” for global banks.

A full blocking sanction is the highest of all measures, which designates the bank as the sanctioned entity, and freezes all assets worldwide that are under U.S. jurisdiction and prohibits all U.S.-linked transactions. While applied to major Iranian and Russian banks, there is no precedent for applying them to global systemically important banks (G-SIBs), like China’s Big Four Banks.

Under OFAC’s 50 Percent Rule, any entity owned 50% or more, directly or indirectly, by a sanctioned party is automatically treated as a blocked party, even if it is not explicitly listed as a sanctioned entity. Thus, a thorough review of Hengli’s parent company, affiliates, and offshore trading entities is required.

IV. Analysis by Scenario

At the current stage, the U.S. is more likely to request correspondent banks in the U.S. to enhance filtering of transactions involving China’s banks, rather than imposing direct sanctions. In such a scenario, New York-based correspondent banks will apply stricter screening to customers, contracts and transactions especially for dollar remittances, trade finance, L/Cs, guarantees, and oil-related settlements linked to Hengli, Iran, shadow fleets, or front companies.

If evidence emerges that the Big Four provided new liquidity to Hengli or processed payments for Iranian crude oil or circumvented trade restrictions, the following sanctions and impacts may occur, depending on the severity:

1. Scenario A — Surgical and conditional sanctions (most likely)

This approach involves pinpointing the specific branches, offshore subsidiaries or settlement departments that actually processed the transactions, rather than the parent entities of China’s Big Four banks, or applying CAPTA in the form of ‘strict conditions’, or resolving the matter through large-scale settlements with the OFAC and the New York State Department of Financial Services (NYDFS). As evidenced by the fact that the Industrial and Commercial Bank of China (ICBC) was fined approximately USD 32 million by OFAC in January 2024 for anti-money laundering (AML) compliance failure at its New York branch, the U.S. already possesses supervisory and enforcement leverage through the Big Four’s U.S.-based operations. Under this scenario, the relevant bank would have to immediately overhaul its compliance system and voluntarily withdraw from transactions linked to Hongli and Iran; in such a case, the market impact would be limited and temporary. The impact on South Korea would be minimal, although South Korean financial institutions will need to strengthen screening of correspondent and RMB accounts.

2. Scenario B — Full CAPTA Cutoff (Dollar Clearing Severed)

This would prohibit the opening or maintenance of U.S. correspondent accounts with the Big Four, effectively cutting off

their access to dollar clearings. Considering that such measures were previously reserved for smaller banks like the Kunlun Bank in 2012, applying them to the Big Four would be unprecedented and severe. In this scenario, dollar-denominated trade finance, L/Cs, and bond repayments would be paralyzed, and an exodus of global clients would curtail normal business operations. Beijing would likely retaliate, deeming it as an infringement of its financial sovereignty, and the People's Bank of China (PBOC) would pump emergency dollar liquidity while attempting to reroute transactions through the Cross-Border Interbank Payment System (CIPS). Given that around 71% of China's trade is settled in U.S. dollars, the shock would ripple throughout the global trade settlement and short-term dollar money markets, which is why the U.S. is unlikely to readily escalate to this level. The impact on Korea would also be significant, as Korean subsidiaries in China using these banks would need to urgently reroute settlements via RMB or third-party banks due to the blocked dollar trade settlement channels. This would also disrupt the KRW-CNY market-making in Seoul (carried out by the Seoul branches of Chinese banks), increasing the friction costs in the overall Korea-China trade finance.

3. Scenario C — Full Blocking Sanctions (Financial “Nuclear Option”)

This stage involves designating the parent companies of China's Big Four banks as sanction targets and freezing their assets worldwide within U.S. jurisdiction and trigger global de-risking; which would, from this point onwards, no longer be merely 'Hengli sanctions' but trigger a financial decoupling between the U.S. and China. Financial institutions worldwide that have been conducting business with these banks would simultaneously withdraw their exposures, triggering systemic contagion; with the 50 Percent Rule further extending to overseas subsidiaries and local branches. However, blocking China's Big Four banks would also create structural headwinds that accelerate global 'de-dollarization', as the world comes to realize the potential of weaponization of the dollar system. For South Korea, this represents a worst-case scenario involving a restructuring of trade settlement infrastructure, a sharp fall in the KRW and the stock market, a liquidity crunch for local subsidiaries in China, and simultaneous shocks to supply chains. Thus, Scenario C falls into the realm of Mutual Assured Destruction (MAD), and is highly unlikely that the U.S. would implement it unilaterally, unless combined with critical security issues such as a contingency involving Taiwan.

V. Implications and Action Points for Korean Companies and Financial Institutions

From the perspective of South Korean companies and financial institutions, the more pressing risk at this stage is not the impact from the Big Four banks, but the fact that Hengli (and its parent company, affiliates and offshore subsidiaries) is imposed with sanctions. If a South Korean financial institution processes Hengli-related payments through a dollar correspondent bank, it would face primary sanction risks; therefore, the cut-off date for counterpart screening should be set and reviewed as of April 24, 2026, the designation date.

Meanwhile, even if evidence is secured that Chinese banks have violated U.S. sanctions, Scenario A remains the most likely course of action for the U.S., whilst Scenario B is conditional and Scenario C is considered unlikely. The most probable outcome is that 'the U.S. will impose sanctions under Scenario A whilst retaining Scenarios B and C as bargaining chips, and China will curb new exposure whilst avoiding a head-on confrontation'.

In this scenario, Korean exposure arises mainly through four channels, with indirect transactions—especially those

involving specific Chinese bank branches and third-country intermediaries—being most risky: (i) Corporate commercial transaction channels (Chinese refinery and petrochemical customers; purchases of Chinese petrochemical customers, purchases of Chinese PTA/PX/MEG/naphtha, Hengli affiliates as end-users); (ii) financial transaction channels (L/Cs, guarantees, remittances, syndicated loans issued by China’s Big Four); (iii) shipping, logistics and insurance channels (shadow fleets, suspicious ship Automatic Identification System (AIS) activity, ship-to-ship transshipments, P&I and reinsurance), and (iv) contractual and legal dilemma channels (dual constraints posed by U.S. sanctions compliance clauses and Chinese counter-sanctions laws).

Effective response requires establishing a contingency plan that maps South Korea’s exposure and alternative payment routes in advance, based on Scenarios A and B. The immediate top five priorities are: first, mapping main transaction banks for Chinese subsidiaries, which is often overlooked but has high exposure; second, screening Hengli and affiliates/circumvention entities (as of April 24, including the 50 Percent Rule and circumvention by equity restructuring); third, securing alternative correspondent banking and payment lines in advance to prevent paralysis caused by Scenario B; fourth, identifying instances of dual constraints where contractual sanctions clauses conflict with China’s anti-sanctions laws; fifth, establishing monitoring triggers and reporting systems for immediate response to escalation.

VII. Conclusion

The Hengli sanctions reveal that the conflict is no longer about individual refiners but a direct clash between the U.S. ‘dollar regime’ and China’s ‘counter-sanctions legal order.’ Beijing’s strategy of ‘freezing new loans, whilst maintaining existing loans’ is a deliberate design to keep the U.S. at the lowest-level scenario of the escalation ladder, and indeed, the U.S. is also forced into mutual restraint given the global systemic importance of the Big Four banks, the cost of escalation rises for both sides. Consequently, whilst an implicit balance that avoids a head-on collision is likely to be maintained for the time being, this is an unstable equilibrium that could fluctuate significantly depending on the Trump–Xi Jinping negotiations, the situation in Iran, OFAC’s interpretation of loan maturity extensions, and whether the Big Four’s deceptive practices can be substantiated. South Korean companies and banks, which are heavily reliant on dollar settlements whilst simultaneously relying heavily on China for their manufacturing supply chains, have no choice but to walk a precarious tightrope, weighing up the pressures from both sides. It is now time to move beyond individual regulatory compliance or short-term diversification of funding sources and begin establishing a comprehensive risk management framework that proactively incorporates exposure mapping and payment contingency plans.

How We Can Help

The Trade & Industry Policy Center at Shin & Kim LLC provides the following advisory services for Korean companies and financial institutions exposed to the risks associated with the Hengli sanction:

1. Support sanctions exposure analysis and mapping, including the often frequently overlooked main transaction banks of local subsidiaries in China, dependence on correspondent/RMB clearing, and a comprehensive identification and classification of risks associated with Hengli and the parent companies, affiliates, and offshore entities (as of April 24, 2026, including the 50 Percent Rule).
2. Design payment and liquidity contingency plans: Assuming a CAPTA correspondent bank block (Scenario B), we advise on securing alternative settlement and correspondent lines in advance; as well as RMB (CIPS) and third-

currency workarounds, re-engineering of foreign exchange hedging in line with currency conversion (USD → CNY/KRW), and response to trapped funds, in the event of a cutoff of access to U.S. dollars.

3. Review contractual sanctions clauses and identify areas subject to dual constraints. We strengthen sanctions clauses covering secondary sanctions, CAPTA and the 50 Percent Rule, as well as provisions on prior authorisation for third-party payments and currency changes, and clauses on force majeure, refusal to perform and termination. We also identify areas of conflict between US sanction compliance and China's anti-foreign sanctions law violations, that impose dual constraints.
4. Refine trade finance and transaction screening protocols. We conduct comprehensive checks on letters of credit, guarantees and remittances issued by Chinese banks, covering the issuing bank, branch, applicant, beneficiary, goods, vessel and country of origin; and establish the criteria for filtering and escalation to counter evasion tactics such as front companies, shadow fleets, ship-to-ship transshipments and country-of-origin relabelling.
5. Support crisis response and policy monitoring. In the event of sanctions designation, transaction rejection or asset freezing, we assist with transaction settlement, reporting, payment suspension and consultation with the authorities. We also continuously track trends in US-China trade, financial and technology regulations, as well as triggers for escalation, to provide timely analysis across the full spectrum of investment strategies and government responses.

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Global Trade & Industry Issue FOCUS 1

Kazakhstan: From Crude Oil to New Cities – Expansion of Scope of Cooperation

The Strait of Hormuz is a transit route for approximately 70% of Korea's crude oil imports. This heavy reliance has underscored the need to find and secure alternative supply routes. That is why Minister of Trade, Industry and Resources Jeong-Kwan Kim chose Kazakhstan as the first destination of his 12-day overseas mission. Kazakhstan is not only a key candidate for diversifying Korea's crude oil imports 'away from the Middle East' but also a strategic partner offering immense opportunities for cooperation in natural resources and emerging industries.

1. Resumption of High-Level Consultative Meeting after Two Years

From June 7 to 9, 2026, Minister Jeong-Kwan Kim chaired the 11th Korea–Kazakhstan Joint Committee on Cooperation in Trade, Economy, Science and Technology meeting in Astana. Such joint committee as above is a highest-level

bilateral consultative body established and operated under the trade agreement between the two countries with Korea's Minister of Trade, Industry and Resources and Kazakhstan's Minister of Industry and Construction serving respectively as the chief representative. The 11th meeting of the committee was held two years after the 10th meeting in May 2024 to review agenda items that have been submitted for two years.

2. Reshaping of Trade Framework through 'CEPA'

A key outcome of the meeting is the official launch of discussion on the conclusion of a Korea–Kazakhstan Comprehensive Economic Partnership Agreement (CEPA). A CEPA is virtually a free trade agreement covering tariff reduction and investment protection. Therefore, once concluded, the Korea-Kazakhstan CEPA will provide an institutional foundation for the elevation of economic cooperation between the two nations to a new level. Korea and Kazakhstan also agreed to work together to address business challenges faced by Korean companies with existing business operations in Kazakhstan, particularly in the electronics, automotive and plant sectors.

3. New Crude Oil Supply Route via the Black Sea

Energy cooperation was the most pressing item on the agenda of the bilateral meeting. Minister Kim met with Kazakhstan's Minister of Energy Yerlan Akkenzhenov to examine the progress of the implementation of a plan for crude oil importation following the visit of Presidential Special Envoy Hoon-Sik Kang to Kazakhstan in April, 2026. Korea and Kazakhstan agreed to continue working closely to enhance the stability of crude oil supplies.

Kazakh crude oil has attracted particular attention thanks to its transportation route. Crude oil produced at the Tengiz oil field in western Kazakhstan is transported through the Caspian Pipeline Consortium (CPC) pipeline to the Russian Black Sea port of Novorossiysk, from where it is shipped to Korea. Stretching 1,511 kilometers, such pipeline as above was constructed in the late 1990s and has been in operation since 2001. As the pipeline bypasses the Strait of Hormuz, it has emerged as a viable alternative for the diversification of Korea's crude oil supply routes 'away from the Middle East.'

4. Plant and Power Generation to Offer Business Opportunities to Korean Companies

Resource cooperation between Korea and Kazakhstan will open up new business opportunities for Korean companies. The two nations agreed to support the smooth implementation of the Karachaganak gas processing plant project, which has been awarded to Korean companies. Karachaganak is one of Kazakhstan's largest gas and condensate fields, and the expansion of its gas processing infrastructure presents significant business opportunities for Korean Engineering, Procurement and Construction (EPC) companies. Seoul and Astana also agreed to work toward the early implementation of the Ekibastuz power plant modernization project, creating additional business opportunities for Korean companies in power generation equipment and infrastructure sectors.

5. Cooperation beyond National Resources towards Emerging Industries

It is particularly noteworthy that this meeting is expected to serve as a catalyst for the expansion of bilateral cooperation between Korea and Kazakhstan well beyond the natural resources sector. In connection with Kazakhstan's flagship Alatau New City development project, the two nations shared Korea's experience in the implementation of smart city development projects and discussed ways to encourage the participation of Korean companies. In particular, Seoul and Astana agreed to promote cooperation between companies from both countries in the field of urban air mobility (UAM) within the new city, broadening the scope of bilateral collaboration to include next-generation mobility technologies.

In the digital and intellectual property sectors, Korea and Kazakhstan agreed to continue cooperating for the protection of intellectual property rights and the eradication of counterfeit goods. The two states also discussed ways for environmental cooperation, including those relating to international greenhouse gas mitigation projects under the Paris Agreement, water management technologies, and forest restoration and climate change response.

How We Can Help

Korea's cooperation with Kazakhstan extends far beyond a single crude oil import transaction as it encompasses a broad range of interconnected issues, including trade agreement, natural resource development, receipt of orders for plant construction, expansion into emerging industries, intellectual property rights and carbon regulation. To help Korean companies capitalize on business opportunities created by the cooperation with Kazakhstan, the Trade and Industry Policy Center of Shin & Kim LLC provides legal advisory services in the following three sectors.

First, Shin & Kim LLC's Trade and Industry Policy Center provides legal advisory services on matters relating to trade agreements, international trade, and natural resource investment. In line with the expected progress of negotiations on the Korea-Kazakhstan CEPA, the center helps its clients develop strategies for utilizing provisions on tariffs, rules of origin, and investment protection and offers advisory services on equity acquisition and joint venture structures for overseas resource development projects, including those involving the Tengiz oil field and the CPC pipeline infrastructure. In addition, the center assists refiners and general trading companies importing Kazakh crude oil in their negotiations over crude oil sale and purchase agreements, including provisions on price indexing mechanism, minimum offtake obligations, and the allocation of insurance and logistics risks associated with transportation via the Black Sea and the Port of Novorossiysk.

Second, Shin & Kim LLC's Trade and Industry Policy Center provides legal advisory services on matters relating to plant and power generation projects and expansion into emerging industries. The center supports Korean companies throughout the lifecycle of EPC projects, such as the Karachaganak gas processing plant project and the Ekibastuz power plant modernization project, by providing legal advisory services on procurement and construction contracts, subcontracting arrangements, local licensing and permitting requirements, and dispute resolution procedures. The center also provides companies in the construction, mobility and smart city sectors that are engaged in emerging industry projects, including the Alatau New City development project and Urban Air Mobility (UAM) project with legal advisory services on the establishment of joint ventures, compliance with local laws and regulations, and technology licensing agreements.

Third, Shin & Kim LLC's Trade and Industry Policy Center provides legal advisory services on matters relating to intellectual property protection, environment and regulations. The center assists its clients in managing intellectual

property portfolios to combat counterfeit goods and unauthorized uses of Korean brands and provides them with legal advisory services on the structuring of international greenhouse gas mitigation projects under the Paris Agreement and alignment with national greenhouse gas reduction targets and emissions trading schemes. In addition, the center provides comprehensive regulatory and administrative review services for companies pursuing green business opportunities in areas such as water management and forest restoration.

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Global Trade and Industry Issues FOCUS 2

Japan's Response to China's Weaponization of Rare Earths Offers Valuable Insights for Korea

After Japanese Prime Minister Sanae Takaichi's remark that the "a Taiwan contingency could cause an existential crisis for Japan" in November 2025, China banned all exports of dual-use items to Japanese military end-users and for military purposes on January 6, 2026. Japan's response to China's "weaponization of rare earths" offers valuable insights for the Korean government and businesses.

1. Institutionalized control, not impulsive retaliation

China's control over rare earth minerals is not an impulsive retaliatory measure but operates under its Export Control Law (ECL) of December 1, 2020 and the Export Control of Dual-Use Items and Anti Sanctions of December 1, 2024. On April 4, 2025, the Ministry of Commerce and the General Administration of Customs issued Announcement No. 18, imposing an immediate licensing requirement on seven types of medium- and heavy-rare earth elements, including dysprosium and terbium. On October 9, 2025, they added five more elements, bringing the total to 12 out of 17, and extraterritorially applied the requirement (where the value of Chinese-origin materials accounts for 0.1% or more), meaning that the requirement applies to products that contain 0.1% or more Chinese rare earths. Rather than imposing a complete ban, the regulation adopts a "volume-based control" approach that adjusts the approval rate.

2. A sword pointed at Japan

Following Prime Minister Sanae Takaichi's remark, China banned exports of all dual-use items, for both civilian and military applications, effective January 6, 2026. Exports to Japan of elements such as dysprosium, terbium, and gallium

practically ceased from December 2025 onwards. China's exports of rare earths to Japan plummeted by more than 80% year-over-year in April 2026. Although the effectuation of the Announcement No. 18 was deferred for one year under the U.S.-China agreement reached in November, the licensing system for seven types of rare earth elements, implemented on April 4, was not subject to the deferral and remains in effect today.

3. Japan's multi-layered response and its limitations

Japan is buying time by drawing on its stockpiles, while also responding by diversifying its supply sources and promoting recycling. For example, Japan's JOGMEC and Sojitz jointly invested in Lynas Rare Earths in Australia, securing dysprosium from a source outside China for the first time.

At the same time, Japan is making efforts to shift toward technologies that reduce or completely eliminate the use of rare earths. A prime example is permanent magnets. Permanent magnets (NdFeB) are used in electric and hybrid vehicle motors and traditionally contained rare earth elements such as dysprosium and terbium. In collaboration with Honda, Daido Steel successfully mass-produced magnets modified to deliver the same motor performance without using any rare earth elements at all.

In 2010, Japan experienced a diplomatic conflict with China over the Senkaku Islands. At that time, China imposed an import ban on rare earth products from Japan. This was the first time Japan experienced China's "weaponization of rare earths." Since then, Japan has made steady efforts to reduce its dependence on China for rare earths, and as a result, that dependence has fallen from 90% to around 60%.

However, there are still rare earth elements for which there are no substitutes and for which Japan relies entirely on China. Dysprosium and terbium are well-known examples. While Japan has achieved some success in diversifying its overall supply sources, its dependence on China remains overwhelming for a few critical rare earth elements.

4. The lessons we can learn from Japan

Today, Korea's situation is similar to that of Japan in 2010, before the Senkaku Islands dispute. According to the Korea International Trade Association, Korea's reliance on imports of permanent magnets containing rare earth elements stands at 87.9%, which is approximately 2.8 times higher than Japan's 31.1%. Since Korea's response to rare earth elements at the national level began only after the announcement of the Critical Minerals Security Strategy in 2023, to put it simply, Korea is about 13 years behind Japan in this regard.

Korea's dependence on China for industrial urea used to be 97.7%. In 2021, Korea experienced a severe urea shortage crisis, and learned the lesson that the cheaper and more common a material is, the more entrenched the reliance on a single source becomes, and that if that single source is cut off, the entire industry comes to a standstill.

Japan's response to China's weaponization of rare earths can be summarized as stockpiling, diversifying supply sources, recycling, and developing technologies that reduce reliance on rare earths. Recently, Prime Minister Takaichi even proposed joint stockpiling ahead of the G7 summit. It is imperative that we, too, explore these measures—including

international cooperation—such as stockpiling, diversifying supply sources, recycling, and technological innovation, at both the government and corporate levels.

How We Can Help

The Trade Industry Policy Center of Shin & Kim LLC provides the following three types of advisory services, integrating trade, contracts, and policy finance, on China’s weaponization of rare earths and responses by Japan and Korea.

First, export control and sanctions compliance, as well as trade remedies. We provide guidance on the licensing system (7 categories) introduced in April, the expansion (12 categories) in October, the 0.1% *de minimis* threshold, extraterritorial application, the 50% Rule, which items fall under the dual-use export ban to Japan, calculation of the proportion of value derived from Chinese-origin materials, end-user due diligence, and the review of strategic goods under Korea’s Foreign Trade Act. Our guidance also covers WTO disputes (the China-Rare Earths DS431, 432, and 433 precedents), an analysis of the consistency between Article 11 of the GATT and national security exceptions, and import-side trade remedies such as anti-dumping and countervailing duties.

Second, we provide advice on supply chain contracts and structure transactions involving critical minerals. We allocate the risks of non-performance or delays caused by export controls through force majeure and hardship clauses, and design mechanisms for price adjustments, renegotiation, and notification. In Japan, Australia, and the United States, JARE, the U.S. International Development Finance Corporation (DFC), and MP Materials are leading firms engaged in rare earth mining and refining. With reference to equity investments in these companies, joint venture and off-take agreements, we arrange connections with policy-based financing from the Korea Mine Rehabilitation and Mineral Resources Corporation and the Korea Export-Import Bank, while addressing the restructuring of Chinese ownership structures under U.S. FEOC (Foreign Entities of Concern) regulations.

Third, we focus on legislative responses related to economic security, stockpiling, and resource recovery. Korea’s key legislation in these fields includes the Framework Act on Supply Chain Stabilization, the Special Act on National Resource Security, and the Special Act on Materials, Components, and Equipment. We provide advisory services on the designation of key items under these laws and the utilization of funds, tax incentives, and subsidies, while coordinating regulatory exemptions and permits for the resource recovery of permanent magnets from waste magnets and batteries. Furthermore, we will continue to monitor the regulatory trends of the U.S. and China and Korea’s role as chair of the Forum on Resource Geostrategic Engagement (FORGE), among other multilateral cooperation efforts, to serve as a partner that transforms risks into business opportunities.

Center for Trade, Industry and Public Affairs

The Center for Trade, Industry and Public Affairs (“**TIPA Center**”) at Shin & Kim LLC is a **strategic counseling practice** that goes beyond conventional legal risk assessment to help companies navigate rapidly evolving

geopolitical, trade, and industrial dynamics — and turn them into opportunities. The Center analyzes the impact of national regulatory regimes — including economic security measures, export controls, and tariffs — within their broader policy contexts, and integrates these insights into clients' overseas expansion strategies, investment structures, and supply chain decisions. The Center focuses on strategic industries including defense, energy and infrastructure, shipbuilding, batteries, semiconductors, and artificial intelligence, and offers an integrated approach to managing regulatory risks across the three major economic blocs — the United States, the European Union, and China — as well as other key jurisdictions.

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