Updates
July 20, 2020

Hong Kong Autonomy Act Signals Significant Shift in US-Hong Kong Relations

The U.S. government on July 14, 2020, took two significant steps to address the evolving situation in Hong Kong. These were primarily in response to the enactment of the Law of the People's Republic of China on Safeguarding National Security in the Hong Kong Special Administrative Region (Hong Kong National Security Law), which increases Beijing's law enforcement authority within Hong Kong and which many members of the U.S. Congress and the Trump administration believe is inconsistent with the Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China (Basic Law) that serves as Hong Kong's de facto constitution.

First, President Trump signed into law the Hong Kong Autonomy Act (HKAA), which imposes certain economic sanctions with respect to (1) foreign persons whom the U.S. government deems to have "materially contributed" to the recent actions of the Chinese government under the Hong Kong National Security Law and (2) financial institutions that have knowingly conducted significant transactions with them.

Second, President Trump issued an Executive Order on Hong Kong Normalization, which broadly eliminates the preferential treatment that the United States had previously afforded to Hong Kong and also imposes certain blocking sanctions.

The Hong Kong Autonomy Act

Identification of Sanctioned Parties

Like previous economic sanctions legislation, the HKAA does not itself designate the persons subject to new sanctions. Rather, the HKAA directs the secretaries of state and treasury to designate persons falling within two groups subject to potential sanctions:

Foreign Persons: Within 90 days of the HKAA's enactment, the secretary of state, in consultation with the secretary of the treasury, must designate any "foreign person"—i.e., foreign individual or entity—determined "to be materially contributing to, or that has materially contributed to, or attempted to materially contribute to the failure of the Government of China to meet its obligations under the . . . Basic Law." The designation must provide Congress with a clear explanation of the foreign person's activities that caused the designation, which under the HKAA must be one of the following: "action that resulted in the inability of the people of Hong Kong to enjoy freedom of assembly, speech, press, or independent rule of law, or to participate in democratic outcomes; or otherwise . . . reduces the high degree of autonomy of Hong Kong."

Foreign Financial Institutions: Between 30 days and 60 days after submission of the list of foreign persons described above to Congress, the secretary of the treasury, in consultation with the secretary of state, must identify any foreign "financial institution"[1] that knowingly conducts a "significant transaction"[2] with a designated foreign person.

The HKAA directs the secretaries of state and treasury to update the lists of designated foreign persons and foreign financial institutions on an ongoing basis, including in conjunction with the annual reports that the secretary of state must make until 2024 pursuant to the United States-Hong Kong Policy Act of 1992.[3]

Sanctions to be Imposed on Foreign Persons

Once a foreign person is designated by the secretary of state, the HKAA sets up a two-tiered timeline for imposition of sanctions. The president *may* impose the following sanctions on a foreign person at any time following the foreign person's designation; however, he *must* impose them no later than one year after the foreign person's designation. Subject to the timeline described above, pursuant to the HKAA, the president shall:

- Prohibit any person from:
  - Acquiring, holding, withholding, using, transferring, withdrawing, transporting, or exporting any property that is subject to U.S. jurisdiction with respect to which the foreign person has any interest
  - Dealing in or exercising any right, power, or privilege with respect to such property
  - Conducting any transaction involving such property
- With respect to foreign persons who are individuals, exclude such individual from the United States or deny a visa, other than as required by the agreement regarding the headquarters of the United Nations

Sanctions to be Imposed on Foreign Financial Institutions

The HKAA similarly sets up a two-tiered timeline for imposition of sanctions once a foreign financial institution is designated by the secretary of the treasury. Within one year of designation, the president must impose at least five of the sanctions listed below, and within two years of designation, he must impose *all* the listed sanctions. Subject to the timeline described above, the president shall:

- Prohibit any U.S. financial institution from making loans or providing credits to the foreign financial institution
- Prohibit the foreign financial institution from serving as a primary dealer in U.S. government debt instruments
- Prohibit the foreign financial institution from serving as an agent of the U.S. government or as repository for U.S. government funds
- Prohibit the foreign financial institution from engaging in any foreign exchange transaction subject to U.S. jurisdiction
- Prohibit the foreign financial institution from engaging in any transfers of credit or payments subject to U.S. jurisdiction
- Prohibit any person from:
  - Acquiring, holding, withholding, using, transferring, withdrawing, transporting, importing, or exporting any property that is subject to U.S. jurisdiction with respect to which the foreign financial institution has any interest
  - Dealing in or exercising any right, power, or privilege with respect to such property
  - Conducting any transaction involving such property
- Restrict or prohibit exports, reexports, and transfers of commodities, software, and technology subject to U.S. jurisdiction directly or indirectly to the foreign financial institution
- Prohibit any U.S. person from investing in or purchasing significant amounts of equity or debt instruments of the foreign financial institution
- Exclude from the United States any alien that is determined to be a corporate officer or principal of, or a shareholder with a controlling interest in, the foreign financial institution
- Impose any of the above sanctions on the principal executive officer or officers, or equivalent persons, of the foreign financial institution

Exception for Importation of Goods

The HKAA explicitly prohibits the president from imposing sanctions on the importation into the United States of any "good," which the HKAA defines as "any article, natural or manmade substance, material, supply, or manufactured product, including inspection and test equipment," but which does not include technical data.

Waiver or Termination of Sanctions

The president may elect to waive imposition of sanctions against a designated foreign person or foreign financial institution if the president (1) determines the waiver is in U.S. national security interests and (2) submits a report to Congress explaining the basis for his determination.

The president may also terminate the sanctions against a designated foreign person or foreign financial institution, and remove the designation of that person or financial institution, if the secretary of state, in consultation with the secretary of the treasury, determines that the actions taken by the foreign person or foreign financial institution:

1. Do not have a significant and lasting negative effect
2. Are not likely to be repeated in the future
3. Have been reversed or otherwise mitigated through positive countermeasures by the foreign person of foreign financial institution

Congress, however, may prevent waiver or termination of sanctions by enacting a "disapproval resolution" pursuant to the procedure spelled out in the HKAA.

Penalties

A violation, including an attempt or conspiracy to violate, sanctions imposed by the HKAA is subject to the general penalties for violations of U.S. economic sanctions under the International Emergency Economic Powers Act[4]: a civil penalty equal to the greater of $250,000[5] or twice the amount of the transaction that is the basis of the violation; or a criminal penalty, for "willful" violations, of $1,000,000 or up to 20 years imprisonment.

Executive Order on Hong Kong Normalization

Elimination of Preferential Status

The president's Executive Order on Hong Kong Normalization (Executive Order) states that "it shall be the policy of the United States to suspend or eliminate different and preferential treatment for Hong Kong to the extent permitted by law and in the . . . interest of the United States." Among other measures, the Executive Order effectuates this policy by directing the relevant agency heads, within 15 days, to amend the Export Administration Regulations, International Traffic in Arms Regulations, customs regulations, the Committee on Foreign Investment in the United States (CFIUS) regulations, and immigration regulations to eliminate different treatment for Hong Kong compared to the rest of China.

Imposition of Blocking Sanctions

The Executive Order also includes a sanctions provision, which blocks all property subject to U.S. jurisdiction of any foreign person determined by either the secretary of state or secretary of treasury, in consultation with the other:

- To be or have been involved, directly or indirectly, in coercing, detaining, or imprisoning of individuals under the authority of the Hong Kong National Security Law
- To be or have been involved in developing, adopting, or implementing, the Hong Kong National Security Law
- To be responsible for or complicit in, or to have engaged in, directly or indirectly, any of the following:
  - Actions or policies that undermine democratic processes or institutions in Hong Kong
  - Actions or policies that threaten the peace, security, stability, or autonomy of Hong Kong
  - Activities that prohibit, limit, or penalize the exercise of freedom of expression or assembly by citizens of Hong Kong, or that limit access to free and independent print, online, or broadcast media
  - Serious human rights abuse in Hong Kong
- To be or have been a leader or official of an entity, including any government entity, that has engaged in any of the activities described above
- To have materially assisted[6] any person whose property and interests in property are blocked pursuant to this section
- To be owned or controlled by, or to have acted or purported to act for or on behalf of, directly or indirectly, any person whose property and interests in property are blocked pursuant to this section
- To be a member of the board of directors or a senior executive officer of any person whose property and interests in property are blocked pursuant to this section

In addition to blocking of property, the Executive Order also suspends the unrestricted immigrant and nonimmigrant entry into the United States of designated persons, immediate family members, or those acting on behalf of designated persons.

Implications for U.S. Business in Hong Kong

The HKAA and the Executive Order will have profound implications for U.S. exporters or foreign reexporters of U.S. goods, many of whom have long relied on Hong Kong as a point of entry into the broader Asian market and in many instances have established outposts in Hong Kong. If the elimination of preferential treatment for Hong Kong persists, Hong Kong's viability as a hub for trade in articles subject to U.S. export controls will be at risk.

Companies that engage in trade with Hong Kong of items subject to U.S. jurisdiction should review their compliance measures to ensure that they do not rely on export license exceptions or other provisions that previously applied to Hong Kong but do not apply to China.

In addition, U.S. companies, especially financial institutions, contemplating transactions involving Chinese individuals and entities (including in Hong Kong), and those with investments in China (as well as U.S. companies with Chinese investors), should be prepared for the possibility that the U.S. government will impose sanctions under the HKAA that affect their trade and investment.

More broadly, while little is certain regarding the future of U.S. relations with China and Hong Kong specifically, the HKAA and Executive Order present a significant shift in those relationships in the immediate term. The Chinese government has promised swift retaliation in response to enactment of the HKAA and issuance of the Executive Order, although the scope of such retaliation is unknown and will likely depend to some extent on the scope and reach of the administration's sanctions. Some measure of retaliation appears likely, however, in response to elimination of U.S. preferences for Hong Kong, particularly with respect to export controls.

Endnotes

[1] The HKAA borrows the broad definition of "financial institution" in the Federal Deposit Insurance Act, 31 U.S. Code §?5312(a)(2), which includes, among many others, insured banks, commercial banks, private banks, credit unions, currency exchanges, investment bankers, securities broker/dealers, travel agencies, casinos, pawnbrokers and any other business designated by the secretary of the treasury whose cash transactions have a high degree of usefulness in criminal, tax, or regulatory matters.

[2] The HKAA does not define what constitutes a "significant transaction," which likely leaves the secretary of the treasury with broad discretion to determine which foreign financial institutions to designate.

[3] 22 U.S. Code § 5731.

[4] 50 U.S. Code § 1705.

[5] The civil penalty is adjusted for inflation annually and is currently set at $307,922.

[6] This may include providing sponsorship or financial, material, or technological support for, or goods or services to such person.

Authors

Michael P. House

Partner
MHouse@perkinscoie.com 202.654.6288

Ann M. Nagele

Partner
ANagele@perkinscoie.com 206.359.6121

Andrew Caridas

Counsel
ACaridas@perkinscoie.com 202.654.1736

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