July 21, 2020

President Trump Signs the Hong Kong Autonomy Act into Law and Issues an Implementing Executive Order

On July 14, 2020, President Trump signed the Hong Kong Autonomy Act (the "HKAA") into law and issued an Executive Order (the "Order") implementing the law.[1] Congress unanimously passed the HKAA on a bipartisan basis in response to the PRC's application of a new national security law to Hong Kong (the "PRC National Security Law"). The HKAA and the Order require the sanctioning of non-U.S. persons that are found to be involved in the undermining of Hong Kong's autonomy as well as of foreign financial institutions ("FFIs") that engage in certain transactions with such identified non-U.S. persons. The Order also authorizes Treasury to impose sanctions on other non-U.S. persons involved in the drafting of the PRC National Security Law and in its imposition on Hong Kong under the President's authority to declare a national emergency with respect to the situation in Hong Kong. The Order also directed various U.S. agencies to rescind Hong Kong's preferential status compared to mainland China.

The President did not immediately impose any sanctions under the HKAA or the Order, and the exact timing of when sanctions will be imposed under these authorities remains uncertain.

The HKAA requires the Secretary of State to submit a report to Congress within 90 days that identifies non-U.S. persons who "materially contribute" to the failure of the PRC government to meet its obligations under the 1984 joint declaration of the UK and PRC governments regarding the status of Hong Kong.[2] The HKAA definition of an action that "materially contributes" to a failure of the PRC government to meet its obligations under the joint declaration includes actions 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 reduced the high degree of autonomy of Hong Kong.[3]

The HKAA requires the President to impose certain sanctions on persons listed in this report within one year of their inclusion in the report. However, The HKAA permits the President to waive the required imposition of sanctions if doing so is in the national security interests of the United States. Given this waiver authority and the power of the Secretary of State to determine the non-U.S. persons that are to be included in this report, the President and executive branch have significant discretion as to whom to sanction under the HKAA.

The HKAA authorizes sanctions on persons listed in the Secretary of State's report that include the imposition of a visa ban as well as a prohibition of listed persons' ability to transact in any property with a U.S. nexus. Although not described expressly as such within the HKAA, these property-related sanctions seem designed to function as, and therefore are likely to be implemented as, blocking sanctions.

After the Secretary of State has submitted the report regarding non-U.S. persons to Congress, the HKAA then requires the Secretary of the Treasury to submit (not less than 30 days, but not more than 60 days, after the Secretary of State's report) a report to Congress identifying any FFI that knowingly conducts a "significant transaction" with a non-U.S. person identified in the Secretary of State's report.[4]

Notably, the HKAA does not define what constitutes a "significant transaction" and therefore the Secretary of the Treasury will have significant discretion as to which FFIs will be included in the list. However, the term "significant transaction" is used in other sanctions programs administered by the Department of the Treasury's Office of Foreign Assets Control ("OFAC"). For example, for sanctions imposed pursuant to the Countering America's Adversaries Through Sanctions Act ("CAATSA"), OFAC considers a number of facts to determine whether a transaction is "significant," including: (i) the size, number, and frequency of the transaction(s); (ii) the nature of the transaction(s); (iii) the level of awareness of management and whether the transaction(s) are part of a pattern of conduct; (iv) the nexus between the transaction(s) and a blocked person; (v) the impact of the transaction(s) on statutory objectives; and (vi) whether the transaction(s) involve deceptive practices. It is likely that OFAC will interpret the term "significant transaction" in a similar manner for sanctions imposed under the HKAA.

The HKAA then requires[5] the President to impose (i) at least five of the ten types of sanctions listed in the HKAA (included in the bullets below) within one year of a FFI's inclusion in the report and (ii) all ten of the sanctions within two years of the institution's inclusion in the report.[6] The types of sanctions for identified FFIs in the HKAA are:

- prohibiting the FFI from receiving loans or credit from U.S. financial institutions;
- prohibiting the FFI from being designated as a primary dealer in U.S. government debt instruments;
- prohibiting the FFI from serving as an agent of the U.S. government or a repository for U.S. government funds;
- prohibiting the FFI from performing any foreign exchange transactions that involve the U.S. financial system;
- prohibiting the FFI from conducting transfers of credit or payments that involve the U.S. financial system;

- prohibiting the FFI from engaging in certain property transactions with a U.S. nexus;
- restricting the types of U.S.-origin commodities, software, and technology that may be exported, re-exported, or transferred to the FFI;
- prohibiting the FFI from obtaining equity investments or debt from U.S. persons;
- prohibiting the corporate officers of the FFI from entering the United States; and
- sanctioning of the "principal executive officers" of the FFI in the same manner as the persons listed in the Secretary of State's report.[7]

The Order also authorizes the Secretary of the Treasury to impose sanctions on non-U.S. persons determined "to be or have been involved in…developing, adopting, or implementing the [PRC National Security Law]" or to be engaged in "censorship or other activities with respect to Hong Kong…or that limit access to free and independent print, online, or broadcast media."[8] The Order further authorizes the sanctioning of persons who are leaders or officials of any entity (including government entities) found to have been engaged in such activities.[9] Because the Order took immediate effect, persons may be sanctioned pursuant to the Order in advance of the submission of the Secretary of State's report.

Finally, as a part of removing Hong Kong's preferential status, the Order also requires various U.S. government departments to commence actions within 15 days of the Order to amend their regulations and take certain other measures to treat Hong Kong in the same manner as the PRC is treated.[10] The amendments made as a result of the Order will significantly alter Hong Kong's treatment under U.S. export controls as well as for tariff and import duty purposes, among other things.

Implications

Given the criteria for imposing sanctions under the HKAA and the Order, any initial sanctions seem likely to focus on PRC government officials and entities. Companies, and in particular financial institutions, that have business dealings with officials or entities that may be involved in the recent events in Hong Kong should consider evaluating the risk that such parties may be sanctioned and determining what steps, if any, to take to modify those relationships and what steps they might take in the event sanctions are imposed. This assessment process can be continued with more specificity once the Secretary of State submits his initial list within 90 days of such parties to be sanctioned under the HKAA.

During the 30-60 day period between the submission of the Secretary of State's report and the Secretary of the Treasury's report listing FFIs that participate in a "significant transaction" with such identified persons, FFIs in particular will have an opportunity to evaluate and potentially modify or terminate any relationships they may have with the listed persons. Going forward, it will also be important for financial institutions to continue to monitor the Secretary of State's report for updates as the HKAA requires both reports to be "updated in an ongoing matter."[11]

Beyond the sanctions to be imposed, the most immediate impact of the Order will be the U.S. government's broad rescinding of Hong Kong's preferential status with the United States. Companies should evaluate the trade (both imports from and exports to) that they conduct with Hong Kong to prepare for upcoming regulatory changes.

For example, the Order specifically orders the Department of Commerce to remove the applicability of a number of license exceptions in the U.S. Export Administration Regulations to Hong Kong. This means that companies that had previously exported certain types of items to Hong Kong under these license exceptions may now have to receive export licenses for such exports, which will add complexity to and may delay such exports. Similarly, companies that have relied upon preferential import duty rates for imports from Hong Kong should now evaluate how such duties may be affected by U.S. Customs and Border Protection applying the relevant PRC rate (and any applicable tariffs) to such imports from Hong Kong. Given the arms embargo maintained by the United States against the PRC, exports of U.S.-origin defense materials controlled by the U.S. International Traffic in Arms Regulations to Hong Kong will be ceased as a result of the Order.

We will continue to monitor actions taken by the U.S. government pursuant to the HKAA and the Order and provide further updates.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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1 Hong Kong Autonomy Act, H.R. 7440, 116th Congress, available here; Executive Order 13936, *The President's Executive Order on Hong Kong Normalization*, 85 Fed. Reg. 43413 (Jul. 17, 2020), available here.

2 HKAA at § 5(a).

3 *Id*. at § 5(g).

4 HKAA at § 5(b).

5 The HKAA affords the President the same national security waiver authority with regard to the sanctions to be imposed on FFIs as it does with regard to listed non-U.S. persons.

6 HKAA at § 5(b).

7 *Id*. at § 7(a).

8 Executive Order 13936 at § 4(a).

9 *Id*.

10 *See id*. at § 3.

11 HKAA at § 5(e).