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Hong Kong Autonomy Act: new sanctions law signed by the president in response to Hong Kong National Security Law

15 July 2020

On Tuesday, 14 July 2020, President Donald Trump signed into law H.R. 7440, the Hong Kong Autonomy Act (the Act). The Act had previously passed both Chambers of the U.S. Congress unanimously. If the Administration enforces the Act to the maximum extent provided for, there could be significant impacts on Asian and multinational banks determined to have engaged in "significant transactions" with certain foreign persons, such as senior Hong Kong or Chinese government officials or Chinese companies, identified by the U.S. government as having eroded Hong Kong's autonomy. There are a range of menu-based sanctions available to the U.S. government for targeting such banks. If the most severe sanctions were applied, the Treasury Department could cause such banks to lose access to the U.S. financial system, including access to U.S. dollar clearing services. The Administration could also designate or take other actions against foreign persons or entities that have been found to have "materially contributed" to the erosion of Hong Kong's autonomy, which could for instance affect companies operating in Hong Kong that facilitate or support the Chinese or Hong Kong government's ability to monitor the populace and/or suppress civil liberties in Hong Kong.

Separately, on the same day, the president issued an Executive Order on Hong Kong Normalization, implementing a number of changes to U.S. policy that will eliminate the favorable treatment afforded to Hong Kong in a variety of areas, including customs, immigration, and export controls. These changes will include subjecting Hong Kong to the quota limits for "green card" purposes that apply to the People's Republic of China (PRC), as well as treating Hong Kong the same as the PRC for visa reciprocity purposes, potentially resulting in shorter validity of visas. The Executive Order also instructs the Secretary of State and Secretary of Treasury to sanction "foreign persons" involved in developing, adopting, or implementing China's National Security Law, among other actions. We will discuss this Executive Order, and the extent to which it overlaps with the Act, in greater detail in a subsequent client alert.

What happened

The legislation was first introduced in response to the Chinese Government's alleged infringement on Hong Kong's autonomy in recent months, especially the enactment of a national security law that would enable Chinese authorities to exercise expansive emergency authority in Hong Kong. Prior to the Senate's passage of the legislation, the White House requested certain technical changes, which were made. In addition, the White House issued a signing statement with the respect to the Act, taking the position that the national security waiver provisions of the Act may be inconsistent with Article II of the U.S. Constitution and therefore, in some instances, will treat the provisions as "advisory and nonbinding."

What does this mean?

The Act both authorizes and mandates sanctions on foreign person (defined as both individuals and entities) and foreign financial institutions (e.g., banks) that do business with such persons involved with the erosion of Hong Kong's autonomy. Specifically, the Act requires that within 90 days of the bill becoming law, the Secretary of State prepare a list of foreign persons who are materially contributing, have materially contributed, or attempt to materially contribute to China's failure to meet its obligations under the Joint Declaration[1] or the Basic Law[2] and report to Congress. Not earlier than 30 days but not later than 60 days after that report, the Secretary of Treasury is further required to identify and report on any foreign financial institutions that knowingly conduct a "significant transaction" with a foreign person identified in the Secretary of State's report. The Act requires the president to impose sanctions on foreign persons identified in the Secretary of State's report no later than one year from the date of the report. Similarly, the Act requires the president to impose initial sanctions (see below for a detailed description of such measures) on foreign financial institutions identified in the Secretary of Treasury's report no later than one year from the date of the report and, if a financial institution has not been removed by the process of presidential waiver or removal from subsequent reports, expanded sanctions on financial institutions no later than two years from the date of the report.

In terms of timing, the timeframe for imposing sanctions on foreign persons (individuals and entities) could range anywhere from immediately to over a year. The timeframe for imposing sanctions on foreign financial institutions similarly could range from a matter of months to a maximum of 17 months.

With respect to potential impact, the sanctions that may be imposed on individuals range from blocking of property to visa revocation. For foreign financial institutions, the menu of options provides a range from excluding corporate officers from the United States to complete exclusion from the U.S. financial system (see below for a full list of the menu-based sanctions).

The key provisions

Key provisions of the Act include:

- Executive reports to Congress identifying:
  - **Foreign persons involved in the erosion of the obligations of China under the Joint Declaration or the Basic Law** – Under Section 5(a), within 90 days after the date of enactment, if the Secretary of State, in consultation with the Secretary of the Treasury, determines that a foreign person is "materially contributing to, has materially contributed to, or attempts to materially contribute" to the failure of the government of China to meet its obligations under the Joint Declaration or the Basic Law, the Secretary of State shall submit to Congress a report that includes – (1) an identification of the foreign person; and (2) a clear explanation for why the foreign person was identified and a description of the activity that resulted in the identification. This report must be updated in an ongoing manner and, to the extent practicable, resubmitted along with the annual report required under section 301 of the US-Hong Kong Policy Act of 1992.

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[1] The "Joint Declaration" means the Joint Declaration of the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the People's Republic of China on the Question of Hong Kong, done at Beijing on December 19, 1984.

[2] The "Basic Law" means the Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China.

- **Foreign financial institutions that conduct significant transactions with foreign persons involved in the erosion of the obligations of china under the Joint Declaration or the Basic Law** – Not earlier than 30 days but not later than 60 days after the Secretary of State submits to Congress its report on foreign persons involved in the erosion of the obligations of China under the Joint Declaration or the Basic Law, the Secretary of the Treasury must submit, in consultation with the Secretary of State, a report to Congress that identifies any foreign financial institutions that knowingly conducts a "significant transaction" with such foreign persons identified in the aforementioned report on Chinese compliance with the Joint Declaration or Basic Law. Treasury's report must be updated in an ongoing manner and, to the extent practicable, resubmitted with the annual report required under section 301 of the U.S.-Hong Kong Policy Act of 1992.

    a. While "significant transaction" is not defined in the Act, the Office of Foreign Assets Control (OFAC) has provided guidance in the past on these terms in the context of Russia and Iran sanctions. There, while OFAC noted that it would consider the totality of the facts and circumstances when determining whether transactions or financial transactions are "significant," it did lay out a framework of factors which it would use to analyze a given transaction.

    b. Here, OFAC will likely similarly consider the following list of seven broad factors that can assist in the determination of whether a transaction is "significant":

        1. The size, number, and frequency of the transaction(s).
        2. The nature of the transaction(s).
        3. The level of awareness of management and whether the transaction(s) are part of a pattern of conduct.
        4. The nexus between the transaction(s) and a blocked person.
        5. The impact of the transaction(s) on statutory objectives.
        6. Whether the transaction(s) involve deceptive practices.
        7. Such other factors that the Secretary of the Treasury deems relevant on a case-by-case basis.

In addition, OFAC has indicated in guidance that a transaction is not "significant" if U.S. persons would not require a specific license from OFAC to participate in it (*i.e.*, the activities would be exempted or authorized by a general license).

- Sanctions with respect to:

    - **Foreign persons that contravene the obligations of China under the Joint Declaration or Basic Law** – Section 6(a) requires that the president impose the following sanctions on foreign persons identified in the Secretary of State's report within a year of that report to Congress:

        a. Block the property or interests in property of a foreign person named in a report/updated report to Congress.

        b. Exclude such a named individual from the United States and revocation of visa and other documents.

    - **Foreign financial institutions that conduct significant transactions with foreign persons that contravene the obligations of China under**

the Joint Declaration or Basic Law – Section 7 requires that within one year of the Secretary of Treasury's report, the president impose initial sanction on foreign financial institutions (FFIs) included in that report. For FFIs that have not been removed by the process of presidential waiver or removed from subsequent reports, the president is required to further impose expanded sanctions no later than two years after the date of report. "Initial sanctions" means "not fewer than 5" of the menu of sanctions listed below whereas "expanded sanctions" means the president shall impose all 10 options.

– **Menu-based sanctions applicable to foreign financial institutions** – The sanctions available for the president to impose on FFIs are listed below and range in terms of severity from excluding corporate officers from the United States to complete exclusion from the U.S. financial system:

1. Prohibit FFIs from receiving loans or credit from any U.S. financial institution.
2. Prohibit FFIs from being designated or continuing to serve as a primary dealer in U.S. government debt instruments.
3. Prohibit FFIs from serving as an agent of the U.S. government or serving as a repository for U.S. government funds.
4. Prohibit FFIs from being involved with transactions in foreign exchange that are subject to the jurisdiction of the United States.
5. Prohibit FFIs from being involved with banking transactions subject to the jurisdiction of the United States.
6. Prohibit FFIs from being involved with property transactions subject to the jurisdiction of the United States
7. Prohibit FFIs from receiving exports, reexports, and transfers subject to the jurisdiction of the United States.
8. Prohibit U.S. persons from investing in or purchasing significant amounts of equity or debt instruments of the FFI.
9. Exclude FFI's corporate officers from the United States.
10. Apply sanctions enumerated in items 1-8, as appropriate, to principal executive officers of the FFI.

In practice, rather than specifying which specific menu-based sanctions will be imposed on an individual or entity, the Administration has in similar scenarios (such as under various Iran sanctions statutes mandating similar menu-based sanctions) chosen to designate parties on the list of Specially Designated Nationals and Blocked Persons (SDN List), which has the practical effect of imposing all of the restrictions described above. While the Administration could choose to use its authorities under the Act in a more surgical manner, it also would not be surprising if it took an approach consistent with past actions under prior statutes and chose to designate persons or entities specified in the reports required under the Act on the SDN List.

- Waiver and termination of sanctions:

- **Waiver:** Unless Congress enacts a resolution of disapproval, the president may waive the application of sanctions against foreign persons or foreign financial institutions if the president: (1) determines that the waiver is in the national security interest of the United States and (2) submits a report to Congress on the reasons for the determination.

- **Termination:** Unless Congress enacts a resolution of disapproval, the president may terminate the application of sanctions against foreign persons or FFIs if the Secretary of State, in consultation with the Secretary of the Treasury, determines that the actions taken by the foreign persons or foreign financial institutions that led to the imposition of sanctions: (1) do not have a significant and lasting negative effect that contravenes the obligations of China under the Joint Declaration and the Basic Law, (2) are not likely to be repeated in the future, and (3) have been reversed or otherwise mitigated through positive countermeasures taken by that foreign person or foreign financial institution.

- Disapproval and termination resolution:

  - **Disapproval resolution** – Congress is afforded the option of enacting a joint resolution disapproving the waiver or termination of sanctions with respect to: (1) foreign persons contravening the obligations of China with respect to Hong Kong or (2) foreign financial institutions that conduct significant transactions with such foreign persons. Special procedures for the introduction and consideration of disapproval resolutions apply.

  - **Termination resolution** – Congress is afforded the opportunity to enact a joint resolution terminating sanctions with respect to foreign persons that contravene the obligations of China with respect to Hong Kong and foreign financial institutions that conduct significant transactions with such foreign persons. Special procedures for the introduction and consideration of disapproval resolutions apply.

Next steps

If you have specific questions about this Hong Kong Autonomy Act or its impact on you and your business, the Hogan Lovells team would welcome the opportunity to discuss it with you further. Please contact:

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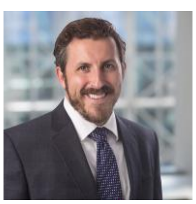

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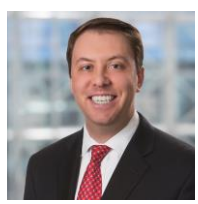

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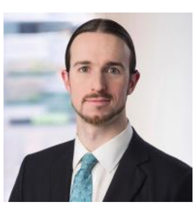

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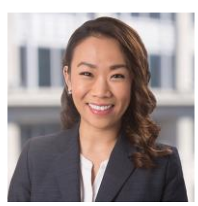

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