

Implications of the New Hong Kong Related Sanctions Restrictions

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On June 30, 2020, the People's Republic of China (PRC) passed the "Law of the People's Republic of China on Safeguarding National Security in the Hong Kong Special Administrative Region" (National Security Law), implementing new national security measures in Hong Kong, which previously fell outside of PRC's jurisdiction based on the "one country, two systems" principle in place since Hong Kong's return to China from the United Kingdom in 1997.

As a result of the enactment of the National Security Law, on July 14, President Trump signed into law the [Hong Kong Autonomy Act](#) (HK Autonomy Act) and simultaneously issued [Executive Order 13936](#), on Hong Kong Normalization (HK Normalization E.O.) that implements many of its provisions.

Practical Implications

Designation Authority

As explained in detail in the background section, the HK Normalization E.O. changes the structure of the HK Autonomy Act and provides the immediate authority to impose sanctions on certain individuals, i.e., it is not necessary to wait until the U.S. Department of State (State) issues a report within 90 days of the implementation of the HK Autonomy Act. This, of course, accelerates the need for companies and Financial Institutions (FIs) doing business in Hong Kong and China to adjust compliance programs in order to ensure they are nimble and can address potentially rapidly evolving events.

Exposure to Sanctioned Entities or Exposed to Potential Sanctions

Even when companies are not engaged in activities covered by the HK Autonomy Act or HK Normalization E.O., there is a risk for counterparties, business partners, etc., to be designated. When subject to U.S. jurisdiction, a company shall freeze any business relationship with a designated entity. Given the extraterritoriality effect of U.S. sanctions, even if a company is not subject to U.S. jurisdiction they may face a secondary designation themselves or pressure from FIs or counterparties to comply with U.S. sanctions.

Foreign Financial Institutions (FFIs)

Under the HK Autonomy Act, State shall identify FFIs that undertake a “significant” transaction for a designated person and to incentivize the FFI to change its behavior by only mandating sanctions 12 months later if the FFI remains on the list. Note that the definition of FFI used in the new legislation is broad and includes insurance companies, travel agencies, pawnbrokers, etc.

The Treasury Report that will be issued between November 11 and December 10 (30 to 60 days from enactment) likely will identify a significant number of FFIs. If an FFI is mentioned in the report, other FIs and companies need to consider the risk of dealing with such entities, as they might be sanctioned within a year of their inclusion in the report. This could include large Chinese banks, insurers, other financial institutions, and others (based on the broad definition).

Conflicting Compliance Obligations

The National Security Law, passed after over a year of pro-democracy protests in Hong Kong, targets protest activities and sets strict penalties, including a maximum sentence of life in prison for secession, subversion, terrorism, and collusion with foreign or external forces. It also imposes liability on accessories who assist in these offences. Assistance can be in the form of abetting, inciting or providing financial assistance for the commission of those offences. More importantly, Article 29 prohibits anyone from “directly or indirectly” receiving instructions from a foreign country to impose sanctions against Hong Kong. The National Security Law also has extraterritorial application.

In practice, FIs and companies doing business in Hong Kong and subject to U.S. jurisdiction or involved in transactions with U.S. nexus, should carefully assess the practical risks under both the National Security Law and U.S. economic sanctions.

Legislative Background

HK Autonomy Act

Since 2019, and as response to the protests in Hong Kong, the United States has taken measures to create the authority to impose sanctions. In particular, the President signed into law the “2019 Hong Kong Human Rights and Democracy Act” amending the United States-Hong Kong Policy Act of 1992 which, among other customs and import privileges, allowed free exchanges between the U.S. dollar and the Hong Kong dollar. Further, Congress passed unanimously the HK Autonomy Act creating the structure for the potential future imposition of sanctions. In particular, it requires State to issue a report within 90 days after its enactment and annually thereafter (the first such report due by October 12, 2020).

The Hong Kong Autonomy Act will initially allow (but not require) the President to impose blocking sanctions and/or visa restrictions on persons (entities and individuals) named in the State report. Subsequently, and within one year of the inclusion in the report, sanctions would become mandatory.

The new Act also targets FFIs, as defined by the U.S. Bank Secrecy Act, 31 U.S.C. § 5312(a). Specifically, 30 to 60 days after State submits its report, the U.S. Department of the Treasury (Treasury) in consultation with State, must submit a report to Congress identifying FFIs that “knowingly conduct a significant transaction with a foreign person identified in the report.” Within one year of including an FFI in the report, the President would be required to impose at least five of the menu of sanctions described below. Within two years of the inclusion in the Treasury report, the President would be required to impose all ten restrictions provided in the menu of sanctions. The restrictions are as follows:

(1) Prohibition on U.S. banks from lending or providing credit; (2) Prohibition on designation as primary dealer; (3) Prohibition on service as a repository of the U.S. government; (4) Prohibition on foreign exchange transactions when subject to U.S. jurisdiction; (5) Prohibition of transfers, credits or payments between financial institutions; (6) Prohibition in dealing or transacting with property subject to U.S. jurisdiction; (7) Prohibition on exports, reexports, and transfers; (8) Ban of investment in equity or debt of the FFI; (9) Exclusion from the U.S. of alien corporate officers or shareholders with controlling interests; (10) Similar sanctions (1 to 8) to principal executive officers.

The President may impose sanctions on other non-U.S. persons mentioned in that initial State report or any subsequent report. If the non-U.S. person is mentioned in any two reports the President “shall” impose blocking sanctions.

HK Normalization E.O.

The HK Normalization E.O. creates, in practice, a new Hong Kong / China-related sanctions program targeting non-U.S. persons making “material contributions” to help the situation evolve from ‘one country, two systems’ to one-country, one system. Note that the effects of the new Hong Kong related measures on export controls is treated in a separate alert.

The HK Normalization E.O. provides additional designation criteria beyond those enumerated in the Hong Kong Autonomy Act. Specifically, it grants either the Secretary of State or the Secretary of the Treasury (in consultation with the other) to designate for blocking sanctions any non-U.S. person they determine to:

- Be, or have been, involved directly or indirectly, in the coercing, arresting, detaining, or imprisoning of individuals under the authority of, or to be, or have been, responsible for or involved in developing, adopting, or implementing, the National Security Law;
- Be responsible for or complicit in, or to have engaged in, directly or indirectly, in (i) actions or policies that undermine democratic processes or institutions in Hong Kong; (ii) actions or policies that threaten the peace, security, stability, or autonomy of Hong Kong; (iii) censorship or other activities with respect to Hong Kong 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; or (iv) the extrajudicial rendition, arbitrary detention, or torture of any person in Hong Kong or other gross violations of internationally recognized human rights or serious human rights abuse in Hong Kong;
- Be, or have been, a leader or official of: (i) an entity, including any government entity, that has engaged in, or whose members have engaged in, any of the activities described in subsections (a)(i), (a)(ii)(A), (a)(ii)(B), or (a)(ii)(C) of this section; or (ii) an entity whose property and interests in property are blocked pursuant to this order;
- Have materially assisted, sponsored, or provided financial, material, or technological support for, or goods or services to or in support of, any person whose property and interests in property are blocked pursuant to this section.

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