U.S. Senate Responds to New National Security Law for Hong Kong

June 30, 2020

In anticipation of China's adoption of a new national security law for Hong Kong, on Thursday, June 25, 2020, the U.S. Senate passed the Hong Kong Autonomy Act (S.3798) (the "HKAA") by unanimous consent. The HKAA now moves to the U.S. House of Representatives, where a companion bill has been introduced. The U.S. House also may adopt the bill, which would then go to President Trump for his signature.

As discussed further below, the HKAA calls on sanctions against (1) non-U.S. individuals, entities or organizations that "materially contribute" to China's failure to preserve Hong Kong's autonomy and (2) non-U.S. financial institutions that "knowingly conduct significant transactions" with such persons.[1]

Why Did the U.S. Senate Pass the HKAA? The HKAA was passed in response to a new national security law for Hong Kong that has been criticized by U.S. officials as contradicting commitments made by China to preserve Hong Kong's autonomy. China does not accept the view that it has broken any prior commitments in regard to Hong Kong or that any aspects of the national security law are improper. Press reports indicate that the law will become effective July 1, 2020.

What Sanctions Would the HKAA Authorize Against Foreign Individuals and Entities?

- The HKAA would require the U.S. State Department, in consultation with the U.S. Treasury Department, to submit a report to Congress identifying any foreign individuals and entities that materially contributed to China's failure to comply with its commitments to Hong Kong's autonomy and describing the activity underlying such identification. This report would be updated on an ongoing basis and re-submitted each year.

- The HKAA would, initially, allow (but not require) the President to impose blocking sanctions (asset freezes) on an individual or entity and visa restrictions on an

[1] The text of the Act is available here.

individual named in the State Department report. Subsequently, and within one year of such individual or entity's inclusion in the report, sanctions would be mandatory.

What Sanctions Would the HKAA Authorize Against Foreign Financial Institutions?

- Following the submission of the State Department report, the HKAA would further require the U.S. Treasury Department, in consultation with the U.S. State Department, to submit a report to Congress identifying any foreign financial institutions that "knowingly conduct[ed] a significant transaction" with any individuals and entities identified in the State Department report. The Treasury Department report would be updated in a similar manner to the State Department report.

- The HKAA defines "knowingly" so as to impose an "actual knowledge" standard for a foreign financial institution's conduct in connection with foreign individuals or entities identified in the State Department's report. The term "significant transaction" is not expressly defined in the HKAA, but presumably would be subject to the same multi-factor test that the Office of Foreign Assets Control uses under the Countering America's Adversaries Through Sanctions Act ("CAATSA").[2]

- Within one year of a foreign financial institution's inclusion in the report, the President would be required to impose not fewer than five of the sanctions in a menu of 10 possible restrictions. Within two years of a foreign financial institution's inclusion in the Treasury Department's report, the President would be required to impose all 10 of the restrictions provided in the menu of sanctions. The menu includes:

    - Prohibition on U.S. banks from lending to the institution;

    - Prohibition on the institution's designation by the Federal Reserve as a primary dealer in U.S. treasuries;

    - Prohibition on exports, re-exports or in-country transfers of U.S. commodities, software or technology to the institution;

    - Prohibition on U.S. banks from providing a USD correspondent account to the institution; and

    - Blocking sanctions (asset freezes) on the institution.

[2] See OFAC FAQs #542, 545, available here.

How Is "Financial Institution" Defined by the HKAA? The HKAA definition of "financial institution" cross-references the U.S. Bank Secrecy Act, 31 U.S.C. § 5312(a), which contains a broad definition of the term and includes banks, securities broker-dealers and other types of financial institutions.

Are There Any Exclusions or Limits?

- The HKAA provides that the President may waive or terminate the imposition of sanctions under the HKAA (*i.e.*, not impose sanctions on a person or foreign financial institution listed in a report), with Congress retaining a right, similar to provisions seen earlier in CAATSA, to override such a Presidential waiver or termination by passing a joint resolution of disapproval.

What Happens Next?

- The website of the House Committee on Foreign Affairs has announced a hearing—"*The End of One Country, Two Systems?: Implications of Beijing's National Security Law in Hong Kong*"—for tomorrow morning, July 1, 2020. Presumably, this relates to the House's consideration of the HKAA's companion bill. If passed by the House, the HKAA will move to the President for signature or veto.

- Press reports indicate that the Trump Administration has expressed concerns about the HKAA, believing it would impinge upon the Administration's ability to conduct diplomacy with China and could give the U.S. Congress too much power over foreign relations.

- However, President Trump may find it difficult not to sign the bill, and his administration has already taken limited action to impose trade related penalties over this issue. Yesterday, the U.S. Secretary of State remarked that the Trump Administration can no longer "distinguish between the export of controlled items to Hong Kong or to mainland China" and announced that the United States will extend, effective immediately, the same restrictions on U.S. defense and dual-use technologies applicable to Hong Kong as already apply to China. Relatedly, the U.S. Commerce Secretary announced his department's "suspension" of regulations that afford preferential treatment to Hong Kong over China, including the availability of export license exceptions.

- Even if the President does sign the Act, there is no guarantee that the sanctions it authorizes would be implemented. President Trump would retain discretion over the initial determinations that trigger sanctions being imposed under the Act.

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Please do not hesitate to contact us with any questions.

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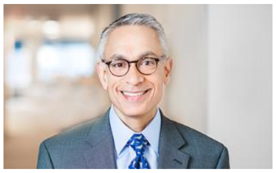

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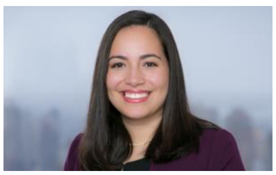

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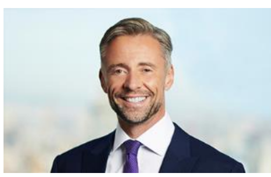

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