

US Response to China and Hong Kong: Recent events, potential future actions, and what it means

July 15, 2020

On July 14, 2020, President Trump signed into law the [Hong Kong Autonomy Act](#) and an [Executive Order](#) on “Hong Kong Normalization.” We address in this briefing the active US responses and additional anticipated actions, as well as explain how these could impact business with China. The United States might ultimately not be alone in its response, as other countries are also reacting to the Hong Kong National Security Law (*NSL*).

After over three years of shifting US policy toward China, the United States is setting into motion a multifaceted response, including in reaction to the adoption of the (*NSL*) on June 30, 2020. Within the United States, there is broad support across the political spectrum for US countermeasures to the NSL, including export control restrictions and sanctions. The United States has also accelerated and taken new action against China on unrelated issues.

As covered in more detail below, the US response to China has thus far included:

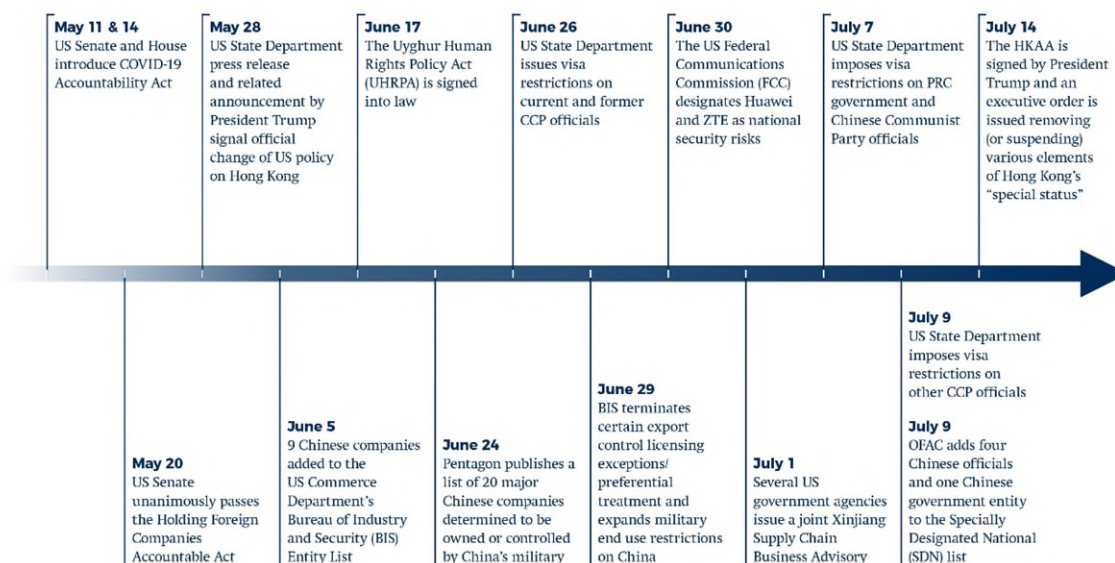
- a new sanctions program targeting foreign financial institutions (Hong Kong Autonomy Act);
- Hong Kong increasingly being treated the same as mainland China through the removal of the so-called “special status” (United States-Hong Kong Policy Act of 1992; Executive Order on Hong Kong Normalization);
- a Hong Kong arms embargo (International Traffic in Arms Regulations);
- the termination of Hong Kong export control preferences (Export Administration Regulations);
- sanctions designations and warnings related to Hong Kong, Xinjiang, and Tibet (Global Magnitsky Human Rights Accountability Act of 2016; Uyghur Human Rights Policy Act of 2020; Reciprocal Access to Tibet Act of 2018);

- the expansion of Chinese telecom and technology export restrictions, as well as the targeting of additional companies (Export Administration Regulations; DOD List; FCC);
- threatened delisting of Chinese companies (Holding Foreign Companies Accountable Act);
- the introduction of COVID-19 and Hong Kong retaliation bills (COVID-19 Accountability Act); and
- potential US dollar restrictions.



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Timeline: US Response to China



Even where the US government and Trump administration's actions do not have an immediate impact, responding to China is an active US policy priority and regulatory focus that should be taken into account when doing business, conducting due diligence, or considering strategy related to China and Hong Kong.

New Sanctions Program Targets Foreign Financial Institutions

On July 14, 2020, President Trump signed into law the Hong Kong Autonomy Act (*HKAA*). The HKAA establishes a new sanctions program that involves a stepped process and broad executive discretion to target certain foreign persons and foreign financial institutions.

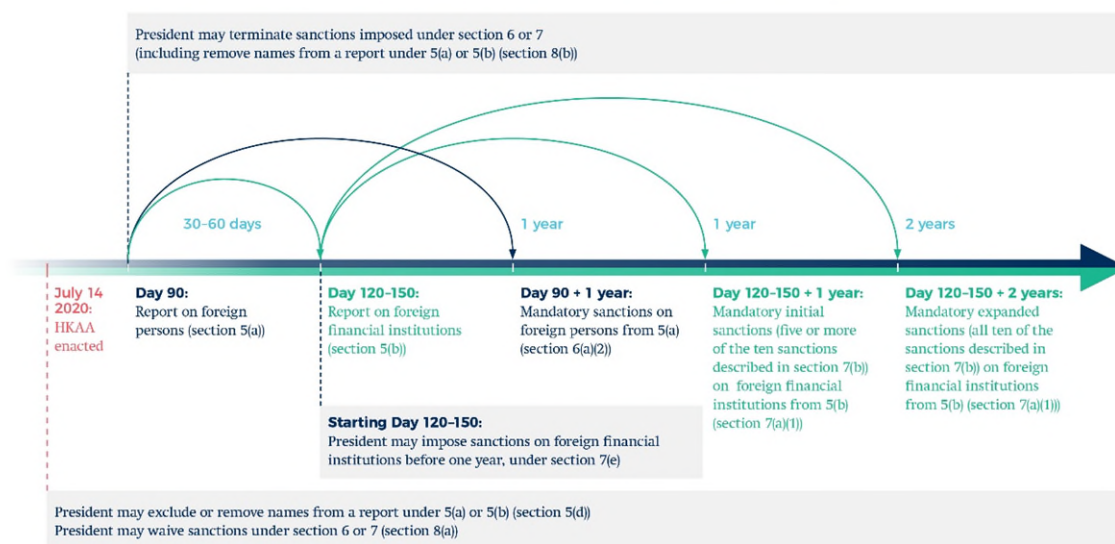
Starting July 14, the US Secretary of State has 90 days to supply Congress with a report identifying “foreign persons” who have materially contributed to “the failure of the Government of China to meet its obligations under the Joint Declaration or the Basic Law,” which sets forth the constitutional principle of “one country, two systems.” In addition, the HKAA authorizes sanctions on any foreign financial institution that “knowingly” conducts a “significant” transaction with any foreign person identified by the Secretary. Such financial institutions, if not removed from the Secretary’s periodic reports, will then be subject to “menu-based” secondary sanctions, up to and including broad restrictions on transacting in US property, access to the US financial system, and access to US dollars.

See below Timeline: Hong Kong Autonomy Act



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Timeline: Hong Kong Autonomy Act



Critically, the HKAA grants the Executive Branch broad discretion over the implementation of key elements of the new HKAA sanctions program, including discretion with respect to:

1. the definition of “materially contribute” and the criteria for a “significant” transaction;
2. reporting to Congress the identity of foreign persons and foreign financial institutions that meet the HKAA’s criteria;

3. the timeframe for imposing “mandatory” sanctions on those identified in reports, where the first imposition of sanctions might not occur for another 15 months;
4. waiving the application of sanctions;
5. excluding a foreign person or foreign financial institution from a report; and
6. removing a foreign person or foreign financial institution from a report and terminating related sanctions.

The HKAA provides a framework for this new sanctions program, and US regulators will likely provide further guidance after the HKAA becomes law. It appears for now at least that the process and timing for implementing sanctions under the HKAA are designed to allow foreign persons and foreign financial institutions an opportunity to defend against the threat of sanctions after being included in a report and to demonstrate that the alleged activity targeted by the HKAA “has been reversed or otherwise mitigated through positive countermeasures.”

The United States Begins Terminating Hong Kong’s Special Status

The US government has begun to strip Hong Kong of its special status under US law. The July 14 Executive Order on Hong Kong Normalization formally directs the administration to take all appropriate action to terminate preferential treatment of Hong Kong under US rules. The Executive Order ultimately aims to align treatment of Hong Kong with that of China for all US regulatory, immigration, and other purposes.

Additionally, the Executive Order authorizes sanctions against persons determined to be involved in or responsible for certain activities related to the National Security Law.

The Executive Order follows a US State Department report on May 28, 2020, and a related announcement by President Trump that signaled the official change of US policy on Hong Kong and directed the US government to begin the process of eliminating Hong Kong’s special treatment. US Secretary of State Michael Pompeo then certified to Congress that Hong Kong does not continue to warrant differential treatment under the United States-Hong Kong Policy Act of 1992 (*USHKA*). Even prior to the Executive Order, the United States has suspended preferential export licensing exemptions and officially extended the US-China arms embargo to Hong Kong.

Under the USHKA, Hong Kong previously benefitted from preferential treatment under US export controls and arms restrictions: Hong Kong was treated as a different export destination than mainland China, and the US arms embargo on China did not apply to Hong Kong. Hong Kong’s preferential export treatment under the USHKA was premised on Hong Kong being a more trustworthy recipient of US technology and arms than

mainland China. But as of June 29, 2020, Hong Kong no longer benefits from preferential export control treatment in many respects and is now covered by the US arms embargo on China.

Some US preferences for Hong Kong remain intact. Specifically, the various tariffs that the United States imposes on China – including under Section 301 (unfair trade practices), Section 201 (injury to domestic industries), and Section 232 (threat to national security) – still do not apply to imports of Hong Kong origin goods. It is not clear if US import tariffs on China will be expanded to cover imports from Hong Kong. (Note that imports from Hong Kong of Chinese-origin goods have generally been subject to these higher tariffs, unless the goods are further processed in Hong Kong such that the goods are deemed to become of Hong Kong origin.)

US Imposes Sanctions and Issues Warnings Concerning Hong Kong, Xinjiang, and Tibet

The United States has taken various actions in recent weeks against Chinese government and Chinese Communist Party (**CCP**) officials related to the situation in Hong Kong, Xinjiang, and Tibet. The most decisive action comes from the US Treasury Department's Office of Foreign Assets Control (**OFAC**), which on July 9, 2020, added four Chinese officials and one Chinese government entity to the List of Specially Designated Nationals and Blocked Persons (**SDN list**) in connection with human rights abuses against ethnic minorities in the Xinjiang Uyghur Autonomous Region (**XUAR**). The Treasury Department imposed the OFAC sanctions under [the Global Magnitsky Human Rights Accountability Act](#), which is increasingly being used to target and sanction those involved with human rights abuses around the world.

The US State Department also imposed visa restrictions (but not asset-freezing sanctions) on named and unnamed Chinese government and CCP officials for undermining Hong Kong's autonomy; for human rights abuses targeting Uyghurs, ethnic Kazaks, and other minorities; and for obstructing travel to the Tibetan Autonomous Region under the Reciprocal Access to Tibet Act of 2018.

Additional sanctions and visa restrictions may be forthcoming because the Uyghur Human Rights Policy Act (**UHRPA**), which was signed into law on June 17, 2020, requires that the President provide a list of senior Chinese government officials responsible for serious human rights abuses against Turkic Muslims in China's XUAR. The UHRPA also requires State Department reporting on human rights in Xinjiang (including estimates of the internment camp populations in XUAR) and targets Chinese harassment or intimidation of Uyghurs living in the United States.

In an unusual step, [several US government agencies issued a joint Xinjiang Supply Chain Business Advisory](#) on July 1, 2020, that warns companies of the potential risks presented from doing business in China related to Xinjiang internment camps or labor. Although the advisory, visa restrictions, and UHRPA do not impose sanctions, they caution companies of the potential perils of engaging in certain activities and may be harbingers of future sanctions or other actions.

Export Controls Target Chinese Telecom, Technology and Other Companies

US export controls on China and Chinese companies have been on the rise for several years, notably since the US Commerce Department's Bureau of Industry and Security (**BIS**) imposed a Denial Order on ZTE in 2018. The most recent and significant export control actions against China occurred when BIS added Huawei to its entity list in 2019, continued to ramp up restrictions on Huawei, and (effective June 29, 2020) terminated certain export control licensing exceptions and expanded military end use restrictions for China.

BIS has also targeted dozens of Chinese companies and organizations for their activities related to Xinjiang by adding them to the Entity List – most recently, 28 entities on October 9, 2019, including Dahua Technologies and Hikvision, followed by another nine entities on June 5, 2020. This is in addition to a great number of Chinese organizations on the Entity List for other reasons including circumventing US export controls or engaging in military-related activities, such as the 24 Chinese organizations that were also added on June 5th.

Other countries around the world are also ramping up restrictions on Chinese telecom and technology companies, including the UK's announcement on July 14, 2020, that it will begin implementing a ban on Huawei in UK 5G mobile networks and eventually other networks.

In what appears to be more of a political than practical move against Chinese companies, the US Department of Defense (**DOD**) released a list on June 24, 2020, of 20 major Chinese companies that DOD determined to be owned or controlled by China's military. Under apparent pressure from US Senators, DOD compiled the list as mandated in a provision of a 1999 law that had never before been exercised. The list includes Chinese corporations active in the telecommunications, technology, aviation, and other sectors in China. The list does not impose sanctions and, based on BIS guidance, does not appear to presumptively result in export control restrictions.

More recently, on June 30, 2020, the US Federal Communications Commission (*FCC*) issued its long-anticipated designation of Huawei and ZTE as national security risks, thereby effectively cutting them off from the FCC's Universal Service Fund. US restrictions on Huawei and ZTE equipment in networks, however, are not new.

Pending Legislation Threatens to Delist Chinese and Hong Kong Companies

On May 20, 2020, the US Senate unanimously passed a bill called the Holding Foreign Companies Accountable Act that could [potentially result in the future delisting from US exchanges](#) of companies whose auditors cannot be inspected by the US Public Company Accounting Oversight Board (*PCAOB*) because a foreign governmental authority is prohibiting the inspection. This legislation could affect up to approximately 245 companies based in mainland China or Hong Kong. It is not yet clear, however, if the bill will become law (in its current form or otherwise) or whether it would ultimately require delisting of such companies before 2024 as contemplated.

NASDAQ has also filed [three proposed rulemakings](#) that would make its listing requirements more restrictive for companies principally administered in China and other emerging markets, for reasons including if the auditor cannot be inspected by the PCAOB.

Congress Introduces COVID-19 and Hong Kong Retaliation Legislation

In early May 2020, legislation was introduced in the US Senate and House called the COVID-19 Accountability Act that would authorize sanctions in connection with the Chinese government's response to the COVID-19 outbreak. The companion bills would authorize sanctions on Chinese officials, entities, and affiliates – as well as visa restrictions on student and exchange visas for Chinese nationals – if the President cannot certify that the Chinese government (i) is cooperating with efforts related to the COVID-19 outbreak; (ii) has prohibited “wet markets” that can expose humans to health risks; and (iii) has released and dropped all charges for anyone involved in protests in Hong Kong related to COVID-19.

At this time, it is not clear whether the bill is likely to become law.

Trump Administration Contemplates US Dollar Restrictions

It has been reported that the Trump administration has been considering limiting Hong Kong banks' access to US dollars and US dollar clearing in order to damage Hong Kong's US dollar peg, but that such limitations are not likely to be imposed. Hong Kong pegs its dollar to the US dollar via the Hong Kong Monetary Authority's currency purchases and sales, in order to boost or depress the Hong Kong dollar's exchange rate against the US dollar. Because of significant US dollar reserves in Hong Kong, it has been reported that Hong Kong is more than able to defend its peg. The fact that the Trump administration may have considered such a move, however, suggests that the US government is continuing to explore novel ways to respond to the NSL.

Conclusion

Recent US government actions against China appear to be gaining momentum. Further bipartisan action by Congress or the Trump administration could become increasingly likely as the NSL is implemented and as part of the US/China trade war. For example, existing US laws impose reporting obligations on the President that could become fodder for further executive action or congressional legislation, including reports on (i) China's efforts to use Hong Kong to evade US export controls and economic sanctions; (ii) individuals responsible for committing acts that violate internationally recognized human rights in Hong Kong; and (iii) exceptions to the prohibition on export licenses for specified munitions to the Hong Kong Police Force. Additional reporting by the administration and mandatory sanctions, particularly under the HKAA, might also be expected in the coming months.

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