

State Department Sends Hong Kong Autonomy Act Report to Congress

October 15, 2020

On October 14, 2020, the U.S. State Department **announced** that it had submitted to relevant committees of Congress the **report** (the “**Section 5(a) Report**”) required under Section 5(a) of the Hong Kong Autonomy Act of 2020 (“**HKAA**”). The announcement did not involve the imposition of any new sanctions related to China or Hong Kong, as the individuals named in the report were previously sanctioned earlier this year under Executive Order (“**E.O.**”) 13936. However, the issuance of the report does create new secondary sanctions risks under the HKAA for foreign financial institutions (“**FFIs**”) that knowingly engage in “significant” transactions with the named individuals. The Treasury Department’s Office of Foreign Assets Control (“**OFAC**”) issued **guidance** in the form of responses to Frequently Asked Questions (“**FAQs**”) indicating that the U.S. government would take a measured approach to implementing secondary sanctions under the HKAA, including a commitment to contact an FFI regarding potentially sanctionable conduct before taking steps that could lead to the imposition of sanctions against the FFI. We provide below an overview of the Section 5(a) Report and its consequences under the HKAA, as well as a summary of the FAQs published by OFAC.

The Section 5(a) Report

As described in our prior **client memorandum** concerning the enactment of the statute, the HKAA required the submission of the Section 5(a) Report within 90 days of enactment. The Secretary of State was required to identify in the report foreign persons that he determined “are materially contributing to, have materially contributed to, or attempt to materially contribute to the failure of the People’s Republic of China (“**PRC**”) to meet its obligations under the Sino-British Joint Declaration or Hong Kong’s Basic Law.” To meet this obligation, the report identifies ten PRC and Hong Kong government officials out of the eleven **previously sanctioned** under E.O. 13936 on August 7, 2020. The sanctions previously imposed on these individuals satisfy the requirement under the HKAA to impose asset blocking sanctions on the foreign persons named in the Section 5(a) Report. No other individuals or entities are named in the report, and no other sanctions were announced in coordination with the announcement of the report. The only individual who previously sanctioned under E.O. 13936 and not named in the Section 5(a) Report was the former commissioner of the Hong Kong police force. No reason was given for his exclusion.

The HKAA requires the Treasury Department to submit a second report (the “**Section 5(b) Report**”) no sooner than 30 days, and no later than 60 days, after the submission of the Section 5(a) Report. The Section 5(b) Report will identify FFIs determined to have knowingly engaged in a “significant” transaction with a foreign person named in the Section 5(a) Report. Within one year of the inclusion of an FFI in the Section 5(b) Report, the President is required to impose on the FFI at least five “menu-based” sanctions from a list of ten options specified in the HKAA, and within two years the President is required to apply all ten sanctions, in each case provided that the FFI continues to be identified in the Section 5(b) Report.

OFAC Guidance

To reflect the issuance of the Section 5(a) Report and the secondary sanctions consequences of the inclusion of the ten previously-sanctioned individuals in the report, OFAC has amended the ten individuals’ listings on the List of Specially Designated Nationals and Blocked Persons (“**SDN List**”) to include the notation “Secondary sanctions risk: pursuant to the Hong Kong Autonomy Act of 2020 - Public

Law 116-149.” As noted, OFAC also issued the following FAQs to clarify the Treasury Department’s intended approach to implementation of secondary sanctions under the HKAA:

- **FAQ 848** clarifies that the Treasury Department will only identify an FFI in the Section 5(b) Report if the FFI engages in a significant transaction with a foreign person named in the Section 5(a) Report following the inclusion of that person’s name in the Section 5(a) Report (*i.e.*, in the case of the ten individuals identified in the initial report, after October 14, 2020). It also notes that: (1) transactions over the next 30 days to wind down relationships with the ten individuals will generally not be considered significant; and (2) Treasury will reach out to an FFI regarding its conduct before including the institution in the Section 5(b) Report.
- **FAQ 849** notes that an FFI can be removed or excluded from the Section 5(b) Report prior to the imposition of sanctions if the significant transaction or transactions of the FFI that merited inclusion in that report: (1) does not have a significant and lasting negative effect that contravenes the obligations of China under the Joint Declaration and the Basic Law; (2) is not likely to be repeated in the future; and (3) has been reversed or otherwise mitigated through positive countermeasures taken by that FFI.
- **FAQ 850** explains the factors that the Treasury Department may consider in determining whether a transaction is significant for purposes of the HKAA. Consistent with its interpretation of the term significant in other secondary sanctions authorities, these factors include: (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 foreign person identified in the Section 5(a) Report or in updates to that report; (5) the impact of the transaction(s) on statutory objectives, including whether the transaction(s) (A) have a significant and lasting negative effect that contravenes the obligations of China under the Joint Declaration and the Basic Law, (B) are likely to be repeated in the future, and (C) have been reversed or otherwise mitigated through positive countermeasures taken by that FFI; (6) whether the transaction(s) involve deceptive practices; and (7) such other factors that the Secretary of the Treasury deems relevant on a case-by-case basis. The FAQ also clarifies that a transaction will not be considered significant if a U.S. person would not require a specific license from OFAC to conduct or participate in the transaction.
- **FAQ 851** sets out definitions of the terms “financial institution”, and “knowingly” for purposes of the HKAA. The former definition mirrors the definition of that term set forth in the Bank Secrecy Act, as amended, **31 U.S.C. 5312(a)(2)**. With respect to the latter definition, it is notable that for purposes of the HKAA, “knowingly” requires actual knowledge and does not include acting with reason to know. In most other contexts, OFAC defines the term knowledge to include reason to know.

Taken as a whole, these FAQs suggest an intent by the Treasury Department to take a measured approach to the implementation of secondary sanctions under the HKAA. In particular, non-U.S. financial institutions can find some reassurance in the statement in FAQ 848 that the Treasury Department intends to conduct outreach to FFIs before moving forward to include them in the Section 5(b) Report, as well as the emphasis in FAQ 849 on the potential for FFIs to avoid the imposition of sanctions through taking appropriate remedial measures even after being identified in the Section 5(b) Report. Nonetheless, non-U.S. financial institutions should continue to carefully evaluate any transactions with the ten listed individuals to assess potential secondary sanctions risks. Both U.S. and non-U.S. financial institutions should also remain mindful of the prohibitions on transactions by U.S. persons or with a nexus to the United States involving the ten individuals identified in the Section 5(a) Report as a result of their inclusion on the SDN List.

Looking Forward

The fact that the Trump Administration announced the submission of the Section 5(a) Report with relatively little fanfare and without imposing any additional sanctions may be indicative of a modest reduction in tensions between the United States and China since earlier this year. However U.S. policy with respect to China, and the potential use of sanctions in support of that policy, remains subject to the vagaries of both international and U.S. domestic politics and therefore volatile and unpredictable. Affected U.S. and non-U.S. companies alike should continue to carefully monitor the situation.

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