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## Contextualizing the U.S.-China Relationship Amid Hong Kong and Wider Sanctions Developments

*The world of sanctions continues to make headlines due to recent actions by the United States and China in the context of deteriorating diplomatic relations. The sheer volume of these new measures poses significant compliance challenges for the sanctions community, which must navigate and keep abreast of a continually changing and complex geopolitical environment.*

*This briefing paper contextualizes the current geopolitical business-risk environment. We examine some of the high-level executive and regulatory activity and legislative developments, discuss their potential implications, and explore what may be the horizon – including potential conflicts of regulatory obligations. The paper draws upon compliance community discussions in a number of ACAMS-hosted virtual roundtables over the previous months, held both with our specialist International Sanctions Compliance Task Force as well as wider cross-industry groupings.*

### About the ACAMS Global Sanctions Program

ACAMS is the largest international membership organisation dedicated to enhancing the knowledge, skills and expertise of AML/CTF, sanctions and other financial crime prevention professionals through training, best practices and professional development. As part of the ACAMS [Global Sanctions Program](#), the International Sanctions Compliance Task Force was created with the aim of facilitating dialogue by bringing together sanctions specialists and subject-matter experts from a wide array of sectors. As a high-level inter-industry forum, one of the key priorities of the Task Force is to enable and support cross-industry dialogue on global sanctions compliance topics. Sitting alongside the Task Force, the ACAMS sanctions program is strategically structured with a world-class global sanctions certification (CGSS), sanctions masterclasses and other learning modules, networking forums, monthly news updates and thought leadership opportunities for professionals at different stages of their careers in sanctions compliance.

### Contextualizing Recent U.S. – China Sanctions Developments: A Dizzying Sweep of Legal Instruments

As tensions have heightened between the U.S. and China, sanctions measures have increasingly become the policy tool of choice. Recent months have seen a dizzying sweep of U.S. actions on China, with one legal instrument being used after another. As industry attempts to contextualize these developments, it is necessary to look back to the end of 2019, namely, the passing of the Hong Kong Human Rights and Democracy Act and the Uighur Human Rights Policy Act of 2019.

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As we moved into 2020, a new trigger point arose, the imposition of the controversial Hong Kong National Security Law (NSL) by the National People's Congress of the People's Republic of China. The NSL passed into law on 30 June, with U.S. Congress passing the Hong Kong Autonomy Act (HKAA) extraordinarily quickly (just 3 days later, on 02 July). On 14 July 2020, the President signed the [Hong Kong Autonomy Act](#) (H.R. 7440) into law, authorizing sanctions against foreign persons and foreign financial institutions in response to the adoption of the National Security Law.

Immediately following his signature on the Hong Kong Autonomy Act, the President moved ahead with his policy directive by determining that Hong Kong should no longer be accorded special trade status, and issued [Executive Order 13936](#) (E.O. 13936) on Hong Kong Normalization. The loss of its long-standing preferential status has resulted in Hong Kong being treated the same as China for export-control purposes, thereby necessitating updates to compliance and export-control programs.

The Executive Order (E.O.) essentially builds upon and implements the provisions of the Hong Kong Human Rights and Democracy Act of 2019 and the Hong Kong Autonomy Act of 2020, utilizing the [International Emergency Economic Powers Act](#) (IEEPA) amongst others to do so. It declares a national emergency with respect to the situation in Hong Kong and provides for the imposition of sanctions on actors engaged in undermining democratic processes and institutions in Hong Kong. Pursuant to E.O. 13936, OFAC on 7 August designated 11 officials in Hong Kong, including Chief Executive of the Hong Kong Special Administrative Region, Carrie Lam.

In response to the U.S. designations, the Hong Kong Monetary Authority (HKMA) and the Securities and Futures Commission (SFC) released statements (8 August) urging companies to be 'fair' in their response to U.S. sanctions. The HKMA further stated that, *'[f]or the avoidance of doubt, unilateral sanctions imposed by foreign governments are not part of the international targeted financial sanctions regime and have no legal status in Hong Kong. Therefore, no obligation is created for [Authorized Institutions] under Hong Kong law'.*

On 31 July, OFAC [imposed](#) sanctions in connection with human-rights abuses against ethnic minorities in the Xinjiang Uyghur Autonomous Region (XUAR) of China. The designations are significant as they mark the first economically substantial Xinjiang sanctions and target the major commercial enterprise Xinjiang Production and Construction Corps (XPCC). The action was taken pursuant to [E.O. 13818](#), "Blocking the Property of Persons Involved in Serious Human Rights Abuse or Corruption," which builds upon and implements the Global Magnitsky Human Rights Accountability Act. The designations came fast on the heels of the 01 July U.S. multi-agency

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[Xinjiang Supply Chain Advisory](#), which sets out risks and considerations for business with supply-chain exposure to entities engaged in forced labor and other human-rights abuses in Xinjiang. During this same period, the U.S. President issued a [statement](#) declaring that he had signed into law the Uighur Human Rights Policy Act of 2020.

In a wider move on data privacy, security and human rights, the State Department [announced](#) on the 5th August the expansion of its [‘Clean Network’ Initiative](#), which seeks to ensure that untrusted companies are not connected with U.S. telecommunication networks, U.S. mobile app stores and apps, cloud-based systems, and underseas cables. The following day, the White House published two E.O.’s under IEEPA provisions addressing Chinese social-media companies [TikTok](#) and [WeChat](#). The E.O.’s limit transactions by U.S. persons with their parent companies, China’s Tencent Holdings Ltd. and ByteDance Ltd., subject to issuance of implementing regulations. On the 14th August, the U.S. issued [an Executive Order requiring Bytedance Ltd.](#) to “divest all interests and rights in any assets or property used to enable or support the operation of TikTok” and data related to TikTok’s users in the United States.

The actions set out above help contextualize the extraordinary speed of transformation in the U.S.-China sanctions environment. Whilst highlighting some of the key developments, we should not forget that these sit alongside a wider array of economic sanctions measures, travel bans and other trade measures. Some may be largely symbolic, but others could have significant practical and compliance impact for U.S. – Hong Kong – China exposed entities.

China’s immediate response – discussed below – has so far been limited.

## Navigating a Complex and Unpredictable Global Sanctions Landscape

As industry attempts to navigate the increasingly complex geopolitical environment, it may be beneficial to assess what long-term impacts may arise from the extraordinary shift in the global sanctions environment. Many are now reevaluating their own business models in acknowledgement that recent developments could pose, not only a longer-term compliance risk, but also supply-chain vulnerabilities and potential market-access implications. Consequently, the implications for multinationals – no matter where they are based – is driving a new model of risk assessment.

## Industry Watchpoints and Relevance for Risk Assessments

At the outset it should be acknowledged that evaluating how current sanctions developments play out in the longer term is still at an early stage. There are many uncertainties and factors that will influence the longer-term risk trajectory.

At the forefront are uncertainties as to how recent measures announced by the U.S. – particularly the E.O.s targeting TikTok and WeChat – will be implemented by the U.S. Commerce Department, and what, if any, further

corresponding measures will be introduced by China. Our industry dialogue has identified a number of near-term watchpoints as to how recent actions may impact ongoing risk assessment considerations. These include:

### Impact of senior officials designated under E.O. 13936

The 11 senior officials designated on 07 August under E.O.13936 included key figures such as Hong Kong's Chief Executive, Police Commissioner and Justice Secretary. The E.O. 13936 measures do not carry applicable secondary sanctions provisions that would apply to non-U.S. persons for transactions outside of the United States and where there is no U.S. nexus.

In risk assessing the impact of the E.O. 13936 designations, there are two points worth noting:

*Firstly*, in terms of OFAC sanctions compliance the definition of U.S. person is a very broad and includes, for instance, all U.S. citizens and permanent resident aliens regardless of where they are located, all persons and entities within the United States, and all U.S.-incorporated entities and their foreign branches. Non-U.S. persons and companies could additionally face OFAC risks by engaging in transactions involving both targeted designees and U.S. persons or the U.S. financial system (e.g., wire transfers through U.S. correspondent accounts).

*Secondly*, given the apparent synergies between the HKAA and E.O. 13936, industry is watching closely whether the U.S. State Department will include these 11 individuals in the reporting process under Section 5 of the Hong Kong Autonomy Act, which requires the production of a report by mid-October (90 days from 14th July). If this does occur, the risk of secondary U.S. sanctions to non-U.S. persons significantly increases. Such a scenario would appreciably increase the compliance risk and would be viewed by industry as an escalation in tensions.

### Potential growth of countersanctions/ conflict of law scenarios:

The immediate response by China to E.O. 13936 included limited retaliatory designations of certain U.S. lawmakers and leaders of organizations, including U.S. Senators Marco Rubio and Ted Cruz, and U.S. Representative Chris Smith. In a further action, unspecified sanctions were imposed on a U.S. defense contractor over a Taiwan arms transaction. In the longer-term Beijing may retaliate against foreign firms in response to evolving U.S. sanctions. There has been speculation, for instance, on whether China will utilize its own 'unreliable entities' list.

A more immediate concern for industry is the potential for legal and regulatory conflict. Article 29(4) of the Hong Kong National Security Law has raised concerns among international financial institutions over whether it could evolve into a type of blocking regulation provision. Essentially, the fear is that an entity may somehow be found to be criminally violating Article 29(4) if they comply with escalating U.S. sanctions. Unsurprisingly, questions on the scope and liability under Article 29 (4) have drawn varying legal

## Potential growth of countersanctions/ conflict of law scenarios: (Continued)

interpretations. This may be partially in response to ambiguities relating to how the legislation was drafted, and how it could be applied in the future. Whilst legal scholars have set out their [analysis](#) of limited liability under Article 29 (4), the international compliance community continues to monitor and assess the issue.

On balance, it is fair to say institutions are adopting varying interpretations as to how, or if, Article 29 (4) will be relevant. Accordingly, financial institutions may expect to see counterparties take different points of view and different positions. Some will take the point of view that it is a conflict of law, and there may be limited leverage to dispute this

Beyond Article 29 (4) deliberations, the international compliance community has turned its attention to assessing the potential for wider regulatory and legal tensions; for example, how to best implement the Hong Kong Monetary Authority (HKMA) [statement](#), which sets out ‘treating customers fairly’ obligations for authorized institutions in determining whether to continue to provide banking services to an individual or entity designated by a foreign government. Given the strong message that unilateral sanctions imposed by foreign governments have no legal status in Hong Kong, the growing challenge for authorized institutions will be how to implement their sanctions compliance obligations alongside a regulatory environment that stresses the need to treat customers fairly in such decision-making. Over time, wider aspects may equally become relevant within the Hong Kong context; for instance, whether financial sector reporting obligations may lead to potential tensions in scenarios involving persons linked to national security and human rights aspects.

## Anticipated approach of U.S. Commerce to WeChat and TikTok:

The issuance of two Executive Orders ([here](#) and [here](#)) targeting ByteDance and TenCent in respect of TikTok and WeChat could have a profound compliance implications in terms of limiting U.S. transactions with Tencent (in relation to WeChat) and ByteDance (in relation to TikTok).

In what appears to be a rather unusual move, the WeChat and TikTok E.O.s were allocated to the U.S. Commerce Department to implement rather than Treasury, despite their IEEPA citations. Accordingly, the language used is not typical of a Treasury-issued E.O. and has led to much speculation as to how Commerce may approach the issuance of regulations due mid-September (within 45 days following issuance of the E.O.). Importantly, neither E.O. includes the normal accompanying FAQs that would typically be expected to accompany a Treasury-issued E.O. Consequently, it is a case of planning for various scenarios and trying to gain insights from previous Commerce actions, although none may be readily applicable for an action of this type.

For impacted entities, a primary industry concern relates to the breadth of exposure to services provided by WeChat. As a platform, WeChat offers a broad range of products, including personal messaging, video calls and conferencing, video-sharing, social media, a mobile payment app, location-



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sharing, and so forth. Commentators have resorted to describing WeChat as a WhatsApp, Facebook, Amazon, Uber, PayPal, Instagram function all rolled into one. Although figures vary, it is reported that there are around one billion active WeChat monthly users.

Many businesses operating across the APAC region utilise WeChat as a key tool for client and staff communication and community-building, a factor that has become even more relevant during the COVID-19 pandemic with many organisations moving to remote-working and deploying staff away from the office. It is clear companies utilize WeChat in many different ways, including incorporating their own services into the WeChat platform. Consequently, the compliance and business community at large are focused on how the U.S. will define the scope of the restrictions, including which WeChat 'transactions' will be prohibited, how measures may play out for subsidiaries of U.S. companies and whether certain activities will continue to be permitted. Depending on how Commerce approaches implementation, decoupling the varying personal, business, and wider WeChat functions may become an insurmountable challenge for some organizations. It should further be acknowledged that many alternative U.S. apps and social media platforms, including WhatsApp and Facebook, have increasingly become blocked for use in China.

## Clean Network Initiative

This [initiative](#), announced by U.S. Secretary of State Mike Pompeo on 5 August, expands into five lanes:

- *Clean Carrier* – ensuring that U.S. telecommunications networks are not connected with People's Republic of China carriers;
- *Clean Store* – removal of untrusted applications from U.S. mobile app stores;
- *Clean Apps* – prevention of pre-installation of trusted apps by untrusted smartphone manufacturers;
- *Clean Cloud* – prevention of sensitive information being stored on cloud-based systems accessible to untrusted companies; and
- *Clean Cable* – protection of undersea cables

At this point in time, the compliance community is focused on obtaining clarity around the expanded Clean Network Program, including how the five lanes may relate to global operations, including those within China.

## Horizon-Scanning Takeaways

Despite the enormous political uncertainty, what we can be sure of is that the world of sanctions involving U.S. and China relationships will continue to make headlines over the coming months. The geopolitical context may be entering uncharted territory that could have far-reaching consequences on how businesses operate. The compliance, financial and wider business sector would be well advised to monitor closely this rapidly evolving situation and the legal, political and diplomatic context.

In support of this, ACAMS will work with our field of industry and compliance

## Horizon-Scanning Takeaways (Continued)

experts to ensure the global compliance community have a clear picture of risk exposure. As we move forward with industry dialogue and training, we would underline a few key watchpoints to keep in mind:

- How restrictions related to Tencent (in relation to WeChat) and ByteDance (in relation to TikTok) will be defined by the Commerce Department. This will be critical in understanding the scope of how the provisions should be implemented. **Due on the 20th September (or thereabouts - within 45 days of issuance of the two E.O.s).**
- Financial institutions in particular should follow closely how the reporting process under Section 5 of the Hong Kong Autonomy Act plays out. Key watchpoints include whether the 11 senior officials designated on 07 August will be reported to Congress under Section 5(a). Will sanctions be extended to apply to foreign financial institutions that conduct significant transactions with persons named in that report and, if so, how will 'significant' be defined within the Hong Kong-China context? **This report is due mid-October time.**
- Given the upward trajectory of sanctions, industry will need to carefully consider approaches for refreshing relevant risk assessments. This should include, where required, updating internal controls and policies for managing potential legal and regulatory conflicts, plus mitigating against potential risks that may be faced by U.S. persons if processes are changed to avoid conflict-of-law scenarios.
- For exposed entities, Xinjiang risk management considerations should be paramount. The combined impact of the XPCC designation and its dominance over large swaths of commercial activity, plus the U.S. Xinjiang Supply Chain Business Advisory, should not be underestimated. Navigating ownership and control structures, including the challenge of undertaking due diligence within the impacted areas and industries, will be a lengthy and complicated task.
- The Information Communication Technology space may be coming more to the forefront of U.S. focus, not only in terms of WeChat and TikTok but also to other Chinese-apps, as the Clean Network Initiative moves forward.
- More broadly, companies with U.S. - Hong Kong - China exposure should be mindful of potential areas of escalation beyond sanctions. This could include trade tariffs, enhanced export controls and wider restrictions on technology access. South China Sea constructions and land reclamation could also be a future area of tension.

Do join us on August 25, 2020 for a special ACAMS webinar, where we will discuss the implications of these recent developments. Register for free here : <https://bit.ly/2Ei580p>