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A New Hong Kong? Business Risks After the National Security Law and US Decertification

Concern over the operating environment in Hong Kong has risen dramatically in recent weeks and months as longstanding issues between mainland China and the city and between China and the US have come to a head. Recent moves around Hong Kong's autonomy will take weeks or months to be implemented, both in Beijing as well as in Washington, with the longer-term impact for businesses operating in the city yet to be determined. RANE spoke to a number of experts in our network to identify key issues to monitor in order to mitigate potential risks.

WHAT TO KNOW

On 28 May, China's legislature [approved](#) the "Decision of the National People's Congress (NPC) on Establishing and Completing the Hong Kong's Special Administrative Region's Legal System and Implementation Mechanisms for the Preservation of National Security," giving its rubber stamp of approval to a yet-to-be implemented National Security Law (NSL). Within the approved draft is a clause allowing the mainland government to impose the Law on Hong Kong, bypassing the need for the city's legislative approval.

- Hong Kong and international analysts [argue](#) that the NSL will effectively end the "One Country, Two Systems" paradigm that has allowed Hong Kong such a high degree of autonomy since the 1997 handover. Beijing, of course, [contests](#) this, arguing that it is simply fulfilling part of the handover agreement that the Hong Kong government has so far failed to do.
- Some analysts also [argue](#) that the purpose of the legislation is to break the will of the protest movement before Hong Kong's COVID-19 related social distancing legislation expires and protests start anew. The Chinese government, says the Council on Foreign Relations' [Jerome Cohen](#), is taking a "high-stakes gamble," choosing to act decisively now rather than continuing to rely on the local government to address the issue.

There are three main sections to the approved National Security Law as it currently stands.

- First, the law states that the government "firmly opposes any foreign or overseas forces interfering in the affairs of Hong Kong" and it will "stop and punish foreign and overseas forces' use of Hong Kong to carry out separatist, subversive, infiltrative, or destructive activities." Mainland government outlets often labeled the protesters as [terrorists](#) and separatists and claimed that [foreign](#), primarily US, influence was responsible for the unrest.
- Second, Hong Kong "shall establish and complete institutions and enforcement mechanisms for the preservation of national security" and the agencies of the "Central People's Government relevant for the protection of national security are to set up institutions in the Hong Kong Special Administrative Region." Among others, this is an indirect reference to the Ministry of Public Security (MPS), China's national domestic police, and Ministry of State Security (MSS), China's equivalent of the CIA, according to RANE experts. While before the agencies relied on [kidnappings](#) to bring people back to the mainland for criminal charges, they will now be able to operate openly in the city.
- Whether extradition, the igniting issue of last year's protests, is included in the final National Security Law is uncertain. The

Chinese government will either include it, or empower the Hong Kong legal system, and its public safety agencies newly established in the city, to try criminals under laws similar to those in the mainland.

- Third, the mainland government “is authorized to draft laws related to the establishment and completion of the Hong Kong’s Special Administrative Region’s legal system and enforcement mechanisms for the preservation of national security.” This gives the mainland government the ability to bypass Hong Kong’s Legislative Council for laws relating to national security.

Following the announcement of the National Security Law, US Secretary of State Pompeo declared that Hong Kong is no longer autonomous from the mainland government, which prompted President Trump to “begin the process” of ending the city’s special status.

The President said that the government would be undoing “the full range of agreements we have with Hong Kong.”

- President Trump [outlined](#) a few measures the US would take, but was vague on details. The President said the US will: “eliminate policy exemptions that give Hong Kong different and special treatment;” “sanction PRC and Hong Kong officials directly or indirectly involved in eroding Hong Kong’s autonomy;” and examine “the differing practices of Chinese companies listed on the US financial markets, with the goal of protecting American investors.”
- The lack of detail in Trump’s announcement, either in what exactly the government would do or when it would do it, creates significant uncertainties for international businesses in Hong Kong. “This could be devastating or of limited consequence depending on how the US proceeds,” [said](#) the Center for Strategic and International Studies’ Scott Kennedy.

WHAT TO THINK ABOUT

Regardless of whether protesters return to the streets in numbers similar to 2019, the

pro-democracy movement’s efforts to ensure Hong Kong’s autonomy will continue. So far in 2020, protesters have had less impact than they had last year.

- In the face of the mainland government’s intervention, an aggressive and newly adaptable police force, and an intransigent city government, many protesters [feel](#) that their fight, always difficult, is now impossible. Widespread demoralization threatens to sap the movement of its most powerful tool to date: massive street protests.
- A key potential risk moving forward will be the escalation of protester violence. While last year’s protesters were primarily peaceful, a large contingent called “[frontliners](#)” did often engage directly with police. While Beijing’s efforts to control the city may ultimately lessen the number of protesters, it may also radicalize others into more violent acts.
- Hong Kong police have issued [multiple](#) reports of finding ingredients for, or fully ready, [improvised explosive devices](#). An anti-government bombing campaign may become more likely as Beijing tightens its grip.

Even before the National People’s Congress announced the National Security Law on 21 May, Hong Kong’s protest movement was beginning to return to the streets from its COVID-19 induced lockdown. The movement returned to find the police force willing to more aggressively and proactively [respond](#) to protests than in 2019.

- The police force, deploying in larger numbers to known protester hot spots, now takes action to prevent protesters from forming large groups that could easily overwhelm police positions or disrupt traffic for hours. Police are now also arresting more protesters and doing so earlier.
- The city government reactivated 6,000 anti-riot police, including the Special Tactical Squad, nicknamed “Raptors,” a week earlier than planned. The Raptors are a particular

target of [protester anger](#), as force members have gone undercover to infiltrate the protest movement and, protesters allege, incite violence to prompt arrests.

- On 27 May, protesters attempted to storm the Legislative Council (LegCo) building during a debate on a controversial National Anthem bill. The building was surrounded by anti-riot police who arrested nearly 400 protesters. The police kept protesters far from the LegCo building, a far cry from last year when protesters [successfully](#) stormed the building.
- Since March, the police have relied heavily on COVID-19 related [social distancing regulations](#) that prohibited gatherings of more than four, and later eight, people to arrest and charge protesters. As those restrictions are lifted on 18 June, protests are likely to see larger numbers.
- The government and police can and have acted in a restrained manner when necessary. For example, although the government activated thousands of riot police for the officially banned 4 June Tiananmen vigil in which thousands of protesters illegally gathered in Victoria Park, the police allowed the demonstration and there were only minor protester-police skirmishes elsewhere in the city.

Even as the government and police have taken steps to solidify their position, so too have the protesters. What began as a leaderless movement now has protest-aligned government officials and unions supporting it.

- Last November, [pro-protest candidates](#) won overwhelmingly in the district council elections. While the district councils are largely devoid of citywide political power and are focused on local quality of life issues, the election gave the protest movement new political power and an officially recognized platform to [call](#) for greater democracy.
- Under Hong Kong's governing system, [unions](#) can vote for 60 members of the

1,200-member election committee that chooses the city's Chief Executive. City regulations, however, mandate that unions must be active for one year before voters register, which for the upcoming elections meant being active for one year ending May 2020.

- Unions can exert power outside of the election committee, as well. The newly formed Hospital Authority Employees Alliance (HAEA) counts 25 percent of the employees that run the city's hospitals as members. Union members went on strike to [pressure](#) the government to close the border with China during the early days of the city's COVID-19 outbreak; the city largely gave in to union demands.
- Unions have to be approved by the government; the government typically only processes 10 to 30 applications a year, but over 1,500 new unions have applied for registration thus far in 2020, most associated in some way with the protest movement.

Considerations for Businesses in the City

Businesses in Hong Kong will have some time to adjust to whatever the new reality is. In the short term, companies should reevaluate their safety and security protocols in anticipation of a prolonged protest movement, and possibly higher levels of violence than street clashes with police, says RANE expert firm [SVA](#).

- Transportation disruptions remain a risk to businesses, as the Hong Kong MTR public transport system became a key flashpoint in last year's protests. City police have now bolstered their presence near MTR stations, but that will not make them immune to disruption.
- Companies should also review their social media policies, as the protest movement remains committed to a "[protest economy](#),"

and boycotts businesses considered pro-government or pro-Beijing. While local boycotts may not be a concern to some larger multinationals, the negative attention that comes from being a target of the protest movement should still be avoided.

RANE experts also advise that businesses undertake a serious assessment of why they are in Hong Kong, and how the range of possible implementations of the National Security Law and follow on implications could affect them.

Depending on how the law, and the US response, roll out, it may be worth considering leaving the city.

- Hong Kong used to be the prime location for foreign businesses to access the Chinese market, but now other cities, like Shanghai and Shenzhen can compete just as well. In 1997, Hong Kong accounted for 18 percent of China's GDP; in 2018 it [accounted](#) for less than three percent.
- [Polk](#) says that these competitive mainland cities may present better options for some businesses, especially if the NSL brings mainland business regulation to Hong Kong. If Hong Kong becomes "[just another Chinese city](#)," it may be better to be closer to major Chinese markets. Conversely, [Polk](#) also suggests that for businesses where stronger, apolitical legal systems are of higher concern, Singapore may present a better option.

WHAT TO CONSIDER

The combination of uncertainty over how China will implement the new National Security Law and what steps the US will take to punish the mainland and city governments ensures that businesses will, at the least, slow investment in the city, according to RANE experts.

- The Chinese government, however, will not let the city, one of the world's premier financial centers, fall too far or hard, as some [worry](#).

The city already factors heavily into Beijing's plans for the "[Greater Bay Area](#)," an effort to turn Hong Kong, Macau, Shenzhen, and other cities in Guangdong province into a single regional economic powerhouse.

- RANE expert [Andrew Polk](#) argues that Hong Kong has a number of advantages that will keep businesses in the city, including its geographic location at the heart of Asian supply chains and its strong financial infrastructure.
- [Polk](#) further argues that Hong Kong may simply become "another strong financial center, it does not have to be the shining star of Asia nor a backwater." Even with the NSL and US countermeasures, Hong Kong retains key components to be a financial powerhouse. It also continues to [draw](#) new businesses to its stock exchange, especially from the [mainland](#).

How China defines "national security" clearly will play an important role in the law's effect on Hong Kong. The government considers the economy a key component of national security.

- The "[National Security Law of the People's Republic of China](#)" defines national security to include "regime, sovereignty, unity, territorial integrity, welfare of the people, sustainable economic and social development" security. It goes on to note that political and economic security are the fundamental base on which national security is built.
- The Law also states that the government "shall maintain its basic economic system and the order of the socialist market economy, improve the rules and mechanisms to prevent and resolve economic security risks, and ensure the security of important industries and crucial fields related to the lifeline of the national economy."

This broad concept of national security ensures that Hong Kong's new National Security Law poses risks to businesses.

The Chinese government has classified a number

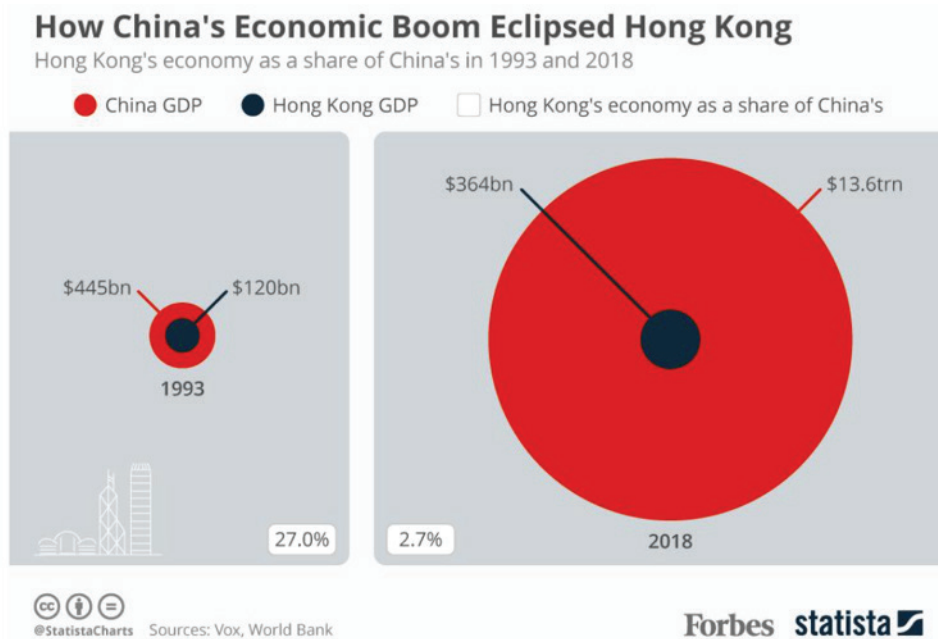
of [normal business activities](#) under “national security” considerations. For example, private companies’ infrastructure and data could soon be subject to [government audit](#), as it currently is in the mainland, presenting challenges to Hong Kong-based companies with regard to protecting intellectual property and meeting global privacy requirements.

- The National Security Law will go farther than last year’s extradition bill, which would have allowed Hong Kong to extradite wanted criminals to the mainland. International business groups came out [against the bill](#), since it would also apply to foreigners passing through the city.
- While the mainland government said that it will implement the law [narrowly](#), the government will adapt how it enforces the law to circumstances—both political and economic—as it sees fit.

The US response will also take time to fully develop. The Trump administration has often announced broad, industry shaking measures

only to find avenues to reduce their impact once US industry leaders weigh in, says RANE expert [Guillermo Christensen](#), especially in areas that have a domestic economic impact on key administration priorities such as manufacturing employment.

- Trump’s moves to limit US companies’ involvement with Chinese telecommunications giant Huawei serve as a useful example here. **Christensen** notes that this administration often seeks to act as a “[course corrector](#),” pressing businesses to reduce reliance on China. The administration itself is likely to course correct due to business concerns and the reality that supply chains cannot quickly be altered.
- **Christensen** cautioned, however, that as the Trump administration’s focus on election issues sharpens, it will be less likely to make short term moves to mitigate the impact of such measures, and more likely to hold fast on pressure on Beijing until after November.



Hong Kong's economy as a share of China's in 1993 and 2018. STATISTA

[Source: Forbes](#)

FURTHER READING

[A Messy Divorce: China and US Decoupling](#)

[China's Cybersecurity Law: Navigating Security and Compliance](#)

[New Technology Import and Export Rules Highlight Political Risks From US-China Tensions](#)

[Doing Business in China: Reasons for Optimism With a Sharp Eye on Risks](#)

[I Spy: All Eyes on China's New Intelligence Law](#)

ABOUT THE EXPERTS

Andrew Polk is the Co-Founder of Trivium China, where he leverages his experiences of conducting economic analyses on China and advising asset managers and hedge funds on developments in the Chinese economy and financial markets. Prior to Trivium China, Polk worked as a Director on China at Medley Global Advisors from 2016 to 2017, and as a Resident Economist at the Conference Board from 2011 to 2016.

Guillermo Christensen is a partner in Ice Miller's Data Privacy and Security and White Collar Defense Groups. Guillermo combines his experience as an attorney, a former CIA intelligence officer and a diplomat with the U.S. Department of State to shape and inform the advice he provides to clients on various enterprise risks involving cybersecurity and national security law. His cybersecurity experience ranges from conducting information security risk assessments that take a "whole of company" approach to managing responses to security incidents and breaches, including those where a nation-state or insider threat may be involved. Guillermo also counsels clients in managing national security reviews through the Committee on Foreign Investment in the United States (CFIUS), particularly those involving high-technology and critical infrastructure sectors.

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