

4 October 2021

Representation to FSTB, HKMA and SFC on Hong Kong Anti-Sanctions Law

I. INTRODUCTION

In order to aid the Hong Kong Monetary Authority (“HKMA”), Securities & Futures Commission (“SFC”), and Financial Services and the Treasury Bureau (“FSTB”), ASIFMA has gathered feedback from its members concerning the proposal to incorporate elements of the PRC Anti-Foreign Sanctions Law of 10 June 2021 (the “PRC-AFSL”) into the law of the Hong Kong Special Administrative Region (“HKSAR”) through the amendment of Annex III of the Hong Kong Basic Law and/or through a legislative process leading to the adoption of a Hong Kong Anti-Foreign Sanctions Ordinance (the “HK-AFSO”) or similar measures. This document summarizes the feedback received from ASIFMA members. It does not endorse any particular viewpoint.

Some members expressed the general view that a HK-AFSO would not be desirable or is not needed. The reasons cited included the potential for increased regulatory complexity and operational or reputational considerations, as well as a desire to avoid being drawn into tensions that are not directly relevant to their commercial activities. On the whole, members acknowledged the current political and diplomatic environment while indicating a preference that any HK-AFSO or similar measures be implemented in a manner that would minimize disruption to companies in the HKSAR, a view which has also been expressed by various HKSAR officials in recent weeks.¹ While acknowledging current difficulties, some members also commented that they were hopeful that incremental improvements in the US-China relationship over time could lead to fewer sanctions and countermeasures and perhaps lessen the need for a HK-AFSO or the stringent application of it.

II. SUMMARY OF FEEDBACK AND QUESTIONS

Legislative Process

Members asked whether the HKSAR government could anticipate the mode by which the HK-AFSO or other measures would be adopted, for example, through the amendment of Annex

¹ See, e.g., https://www.news.gov.hk/eng/2021/08/20210817/20210817_104020_541.html; <https://www.scmp.com/news/hong-kong/politics/article/3144482/hong-kong-legislature-should-apply-anti-sanctions-law-city>; <https://www.bloomberg.com/news/articles/2021-08-04/hong-kong-minister-seeks-to-ease-firms-worries-on-sanctions-law>

III, a local legislative process, or a combination thereof, and the timing of the adoption of the measure.

Some members stated that they would value the opportunity to participate in a consultative process involving the Hong Kong business community or public at large. Others stated that they believed that a consultative process would enable the HKSAR government to craft a measure that would be sensitive to the needs of the local business community, allowing more time for parties to think through the issues and potential impacts and mitigating strategies. They highlighted the importance of a consultative process between local regulators such as the HKMA and SFC and financial institutions who would be most impacted by a HK-AFSO, noting that local regulators would be in the best position to understand and account for the needs and concerns of their constituencies. Several members remarked on the importance of providing financial institutions sufficient time to implement new practices in an orderly fashion. Some members asked whether the HKSAR government would consider leveraging other existing legal authorities, such as other sanctions-related ordinances, to achieve similar effects as the PRC-AFSL in lieu of the adoption of a new ordinance.

There was strong consensus among members on the need to protect Hong Kong's status as a vibrant and competitive international financial center. Members expressed their concerns about how new laws and measures—whether from foreign governments or the central or HKSAR governments— may have on the financial markets in Hong Kong and the long-term viability of Hong Kong as a major financial hub in the Asia region. Some noted that certain recent foreign sanctions have already had a negative effect on trading of specific products, particularly by US financial institutions, and that new or conflicting rules could exacerbate confusion and lead to an unintended further reduction in liquidity in other products.

Some members expressed concern that a HK-AFSO could cause some foreign financial institutions to reduce their exposure to the HKSAR or mainland China. They drew attention to the potential for a “conflict of law” between a HK-AFSO and foreign laws or regulations, including those administered by the US Treasury Department's Office of Foreign Assets Control (“OFAC”). They noted that, in some cases, US law authorizes the use of “secondary sanctions” which would be intolerable for many financial institutions given their reliance on the US financial system. Although such risks may not apply in each and every example, multinational financial institutions generally give great regard to sanctions of the United States, the European Union, the United Kingdom, and other jurisdictions, and have developed global compliance policies, programs, and systems that are largely based upon these regimes.

Scope and Application of a HK-AFSO

Members stated that it was their understanding that the PRC-AFSL does not ordinarily have legal effect in Hong Kong. They asked for confirmation of this understanding and for guidance confirming that organizations in Hong Kong are currently out of scope for Article 11 of the PRC-AFSL, pending the implementation (if any) of such measures under Hong Kong law. Additionally, clarification was sought on what types of companies or individuals would be subject to a HK-AFSO. For instance, the HK-AFSO could apply to Hong Kong or PRC-headquartered, incorporated, and/or based entities and Hong Kong persons, in keeping with other HKSAR ordinances.

Members also noted that Article 4 of the PRC-AFSL refers to “individuals and organizations that have directly or indirectly participated in the formulation, decision on or implementation of discriminatory restrictive measures,” who may be included in a countermeasures list. They asked whether such persons could include foreign individuals, organizations, or governments that are involved in developing and imposing sanctions or other measures, or whether incidentally the focus may also be on individuals and organizations that follow the requirements of the measures, such as a company that complies with the law of their home jurisdiction or an internal policy requiring compliance with sanctions (including the individual staff of such company).

In this regard, some members noted that the language of Articles 4 and 11 in the PRC-AFSL differed and could, subject to an official interpretation, suggest that corporate compliance does not fall within the scope of Article 4.

Some members stated that it was their understanding that the PRC-AFSL and a proposed HK-AFSO would not have extra-territorial application, for example, by requiring compliance in respect of transactions conducted in RMB or HKD regardless of its location.

Definitions of Terms

Members asked for clarification around definitions and terms which may be included in, or would be relevant to, the HK-AFSO. They noted that some terms in the PRC-AFSL have not yet been defined, including “indirectly participate,” as used in Article 4; “senior executives,” “actual controllers,” and “immediate” family members, as used in Article 5; and “other necessary measures,” as used in Article 6.

Specifically, the phrase “discriminatory restrictive measures” was identified as a critical phrase for the purposes of the PRC-AFSL and one that would be essential to anticipating the potential impact of the HK-AFSO. Members urged careful consideration of how the HK-AFSO would define this term and the process through which the HKSAR government would follow in identifying such measures.

Members queried whether such measures would be limited to foreign sanctions specifically targeting persons in China and the HKSAR, such as US Executive Order 13936. Members also sought clarification on the meaning of the phrase “basic norms of international relations,” as used in Article 3 of the PRC AFSL. Some asked whether a HK-AFSO would seek to protect the interests of Hong Kong companies, or whether it would extend to those of companies from mainland China, in the identification of foreign discriminatory restrictive measures.

Prohibited Acts under a HK-AFSO

Members asked about the types of acts that could be prohibited under a HK-AFSO. Several members remarked that the prohibitions under a HK-AFSO should be sufficiently clear to allow financial institutions to adjust their global or local compliance practices, which could require investing significant time and resources. Additional clarity could help companies mitigate the risk of adopting an unnecessarily extensive interpretation of the HK-AFSO that goes beyond the effects intended by the HKSAR government. Generally speaking, members

indicated that it would be preferable if a HK-AFSO were narrowly tailored such that it would not be necessary for multinational companies to overturn existing global compliance practices, noting that such an outcome could discourage participation in the Hong Kong markets.

Noting that the PRC government has introduced several measures in recent months (including the PRC-AFSL, the Ministry of Commerce (“MOFCOM”) Order No. 1 of 2021 and Order No. 4 of 2020, and various sanctions announced by the Ministry of Foreign Affairs (“MFA”)), members asked whether the HK-AFSO would implement some or all of these measures. For instance, MOFCOM Order No. 4 of 2020 provides for the creation of an Unreliable Entity List (“UEL”). Members asked whether a HK-AFSO could create an equivalent mechanism to the UEL (or other PRC countermeasures) or whether PRC countermeasures would instead become directly applicable in Hong Kong.

Article 12 of the PRC-AFSL states that no organization or individual may implement or assist in implementing discriminatory restrictive measures. Some members observed that compliance with foreign sanctions as a matter of corporate policy is often motivated by a desire to avoid the implementation of US “secondary sanctions” and expressed that such concerns should ultimately be balanced against the intended effect of Article 12 or a similar provision under a HK-AFSO. By way of example, some members hypothesized that some multinationals may be compelled to exit the Hong Kong market in order to avoid breaching the HK-AFSO and at the same time avoid becoming subject to draconian penalties imposed by a foreign government. For this reason, they stated that it is essential for the HKSAR government to carefully consider the scope of any HK-AFSO to minimize the potential risk of an overwhelming conflict of law.

Similarly, some stated that export controls administered by foreign agencies such as the US Commerce Department’s Bureau of Industry and Security (“BIS”) pursuant to the Export Administration Regulations (“EAR”) present a special case, noting that export controls amount to a licensing requirement that is under the discretion of a foreign agency such as BIS and is often imposed as part of a multilateral regime. They suggested that seeking such a license, or taking other steps to comply with the EAR or foreign export controls should fall outside the scope of a HK-AFSO.

Members noted that current Hong Kong regulatory guidelines call for financial institutions to consider the impact of foreign sanctions on their business. The issue is noted, for example, in paragraph 6.11 of the HKMA’s Guideline on Anti-Money Laundering and Counter-Financing of Terrorism. Some members expressed the view that financial institutions should be allowed to continue to screen customers against foreign sanctions lists to enable them to make a full assessment of potential risks, and to mitigate those risks, even if the foreign sanction was not complied with, per se. Some expressed the view that guidance should make clear that Hong Kong financial institutions are permitted to make decisions about accepting or terminating business based on a wide range of commercial and risk-management principles, provided they comply with the terms of the HK-AFSO. Others noted that the most likely scenario is that a financial institution would encounter a party who is sanctioned under a foreign regulation that is unrelated to China or Hong Kong, which presumably would not be within scope for a HK-AFSO.

Several members noted the operational risks that could arise from having to reconfigure their customer or transaction screening systems, particularly in cases where key elements of those systems are centralized in other locations.

Other examples of activities cited by members as presenting particular challenges included:

- Conducting screening against the names of sanctioned persons, and related persons, contained in commercially available databases and government-issued lists as part of their ordinary customer due diligence and transaction monitoring processes.
- Reminding a customer who is a US national of their potential risk under US Executive Order 13959 which prohibits US persons from purchasing and selling publicly traded securities of certain Chinese companies.
- Stopping the processing of an international wire transfer that would be blocked (frozen) if allowed to transit a US correspondent account due to the involvement of a Specially Designated National (“SDN”).

Liabilities under the HK-AFSO

Members asked about the potential consequences and liabilities for asset management firms and other companies operating in Hong Kong. This includes potential liability that may be imposed under the HK-AFSO on individual employees and senior management and overseas parent companies in respect of violations by their Hong Kong entities. On the issue of individual liability, some members expressed the view that imposing liability on individual employees would raise significant concerns and challenges for many financial institutions, particularly those employing large numbers of expatriates in Hong Kong.

Some noted that the potential for extra-territorial enforcement would attract considerable attention and having clarity on this point, in particular, would be of importance to the financial markets.

Members queried whether a HK-AFSO would exempt some entities from some or all of its provisions, noting, for example, that the EU Blocking Regulation (Council Regulation (EC) No 2271/96) contains carve outs for certain companies that are *directly* subject to the laws of their home jurisdictions and under other conditions. Members also noted that Article 8 of MOFCOM Order No. 1 of 2021 allows Chinese organizations and individuals to seek an exemption from complying with a prohibition order issued pursuant to Order No. 1. Some expressed the view that a similar mechanism may be considered as part of a HK-AFSO.

Additionally, it was observed that in some instances compliance with a foreign sanction would be in the interest of the parties to a transaction, for example, in a case involving an international wire transfer that would be blocked (frozen) if processed via a US-based correspondent bank. Such mitigating circumstances could be considered under a HK-AFSO or in its implementation on a case-by-case basis, along with factors such as the materiality of a

transaction. Along these lines, some members asked whether it would be permitted to offer a limited set of services (such as local HKD-denominated services) to sanctioned persons, even if other services (such as international wire transfers) were not offered.

Members asked if a HK-AFSO would have any overlap with the Hong Kong National Security Law ("HKNSL"), particularly in reference to Article 29(4) of the HKNSL, or other Hong Kong laws or legal regimes. In this regard, clarification was also sought on the HKSAR government's interpretation of Article 29(4) and the types of acts that would be (or would not be) caught as they relate to the provision of financial services in Hong Kong.

Members asked for confirmation that a HK-AFSO would not apply retroactively to actions taken before its implementation.

Lawsuits in Hong Kong

In reference to Article 12 of the PRC-AFSL, members asked whether a HK-AFSO could create a private right to action enforceable in Hong Kong courts (or other venues) and whether it would be accompanied by other enforcement mechanisms, such as regulatory penalties. Related questions included:

- Who would have standing to bring such claims in Hong Kong courts (or other venues)?
- What would be the standard of proof or causation in such cases, and would customary rules of legal privilege apply?
- Would damages be limited to direct losses, or would they include consequential losses or other types of damages?
- Could parties limit their exposure to such claims by way of contract?
- Would claims be limited to damages incurred in Hong Kong, or could events outside of Hong Kong (including in mainland China) give rise to such claims?

Some members expressed the view that for reasons including predictability, it would be preferable that such cases be heard through normal Hong Kong court proceedings along with other types of commercial disputes, rather than through specialized proceedings or tribunals for HK-AFSO cases.

Administration of the PRC-AFSL and a HK-AFSO

Members asked whether the HK-AFSO would designate one or more HKSAR government bodies responsible for issuing lists of persons and/or foreign discriminatory measures subject to countermeasures under the HK-AFSO and for issuing guidance concerning companies' compliance obligations under the law. Some members remarked that applying the same lists and countermeasures in mainland China and Hong Kong would simplify the task of compliance for financial institutions and that such lists should be made public.

With respect to the PRC-AFSL, some members remarked that relevant departments of the State Council have not yet issued guidance concerning companies' obligations under the law, and that it would be particularly important for the market to receive specialized guidance for financial institutions from the relevant regulatory agencies (e.g., the People's Bank of China ("PBOC") or the China Banking and Insurance Regulatory Commission ("CBIRC")). The absence of such guidance has created additional difficulties in predicting how a HK-AFSO could impact financial institutions in Hong Kong.

In this regard, some members observed that financial institutions operating in Hong Kong could benefit from additional guidance from their primary regulators such as the HKMA and SFC, with whom they are accustomed to dealing. They also noted that regulators that are familiar with the workings of the financial markets could play a meaningful role in shaping the implementation of a HK-AFSO. Given the complexity of the markets, it could be difficult for lawmakers to anticipate every outcome, and front-line regulatory authorities could assist in tailoring the application of rules to minimize unintended adverse consequences.

One idea proposed was for the relevant HKSAR bodies to institute a question-and-answer process to allow financial institutions or the public to receive timely guidance and interpretative assistance concerning a HK-AFSO, including on a confidential basis. Such guidance could also be made available to the public.

Members asked whether persons who could be included on a countermeasures list would receive notice in advance and would have an opportunity make submissions to the HKSAR government prior to such listing being made public.

Noting that Article 7 of the PRC-AFSL states that the decisions of relevant departments of the State Council would be final, members asked for clarifications on whether and how a HK-AFSO would provide for a process of appeal.

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