

THE EFFECTS OF US SANCTIONS ON HONG KONG

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On 7 August 2020, the US Treasury Department's Office of Foreign Assets Control ("OFAC") added 11 individuals to the list of Specially Designated Nationals and Blocked Persons ("SDN") in connection with their roles in undermining Hong Kong's autonomy. The action was taken pursuant to Executive Order 13936, "The President's Executive Order on Hong Kong Normalisation" (the "EO") issued by President Trump on 14 July 2020 and imposes sanctions on those individuals.

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THE SANCTIONS' TARGETS

The new targets of the sanctions are Carrie Lam, the Chief Executive of the Hong Kong SAR, and ten other senior officials (together, the "Officials")¹. These Officials include the former and current Police Commissioners, the Secretary for Security, the Secretary for Justice and the Director of the Hong Kong Liaison Office. It is important to note that although the sanctions target these very senior officials, they are not expressed to target the Hong Kong government generally or any particular government authority or department. As such, the sanctions only affect the individual Officials. However, no distinction is made between an individual acting in their individual capacity and their public capacity. For example, ExxonMobil was

financed for dealing with a sanctioned executive of Rosneft merely because the official signed various documents on Rosneft's behalf².

Furthermore, if an entity is owned 50% or more, directly or indirectly, by any of the designated parties (individually or with other blocked persons), it will also be deemed to be an SDN and subject to the sanctions. The actual scope of the sanctions' targets could be wider than they might appear at first glance if the Officials have shareholdings meeting such criteria.

THE EFFECT OF THE SANCTIONS

All property and property interests of the sanctioned parties that are in the US or in the possession or control of US persons are blocked and may not be transferred, paid, exported, withdrawn or otherwise dealt with. Sanctioned parties will be cut off from the US dollar system and transactions with US persons are generally prohibited absent authorisation from OFAC. Further, US persons cannot deal in any property of the sanctioned parties that comes into the possession or control of a US person. Furthermore, a US person generally cannot “facilitate” a transaction by a non-US person that would be prohibited to a US person.

“US person” includes: (i) US citizens and permanent residents wherever located; (ii) entities organised in the US; and (iii) any individual or entity within the US irrespective of nationality. The definition does not extend to non-US subsidiaries of US persons. Sanctions can also result in penalties for non-US persons found “to have materially assisted, sponsored, or provided financial, material, or technological support for or goods or services to or in support of” any of the sanctioned Officials. The interpretation of what constitutes “material assistance” potentially entails wide discretion on the part of those enforcing the sanctions. Hence, this may present a degree of risk even for non-US companies as the potential penalty is that they may find themselves the subject of sanctions.

PENALTIES FOR NON-COMPLIANCE

Non-compliance by US persons can give rise to substantial financial penalties. The highest penalty amount (which applies to an “egregious” violation that is not disclosed) is the greater of (i) US\$307,922 (inflation-adjusted) and (ii) twice the amount of the underlying transaction, although the method of calculating the amount of said transaction is quite complex.

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LOCAL LAW IMPLICATIONS

Legal status of US sanctions in Hong Kong

As a response to the newly imposed US sanctions, on 8 August 2020, the Hong Kong Monetary Authority (“HKMA”), the city’s de facto central bank, issued a circular (the “HKMA Circular”) on the current sanctions regime in Hong Kong. It clarifies that “unilateral sanctions” imposed by foreign governments, as distinguished from the United Nations (“UN”) sanctions, have no legal status in Hong Kong, and there is no obligation on banks in Hong Kong to comply with them.

UN sanctions currently in force in Hong Kong are given effect through the United Nations Sanctions Ordinance (Chapter 537 of the Laws of Hong Kong) (and its subsidiary regulations) and the United Nations (Anti-Terrorism Measures) Ordinance (Chapter 575 of the Laws of Hong Kong), pursuant to which trade and other specified activities in Hong Kong with the sanctioned countries are subject to certain restrictions.

Foreign sanctions authorities, in principle, do not have extraterritorial reach absent a local enforcement mechanism in the territory. At present, there is no domestic legislation enacted in Hong Kong to implement US sanctions.

This does not mean that financial institutions in Hong Kong are immune from risks relating to US sanctions. As a matter of US sanctions law, the sanctions have extra-territorial effect and the enforcement agencies in the US will still be prepared to impose penalties for their breach. The position of the US as the world's leading economy and the dominance of the US dollar in international commerce and financial operations gives the US strong enforcement powers in practice. There are many examples of extraterritorial enforcement by the US authorities and most major financial institutions already take considerable effort to comply with OFAC sanctions.

Compliance with Hong Kong's National Security Law (the "NSL")

Under Article 29(4) of the NSL, a person who receives instructions, control, funding or other kinds of support from a foreign country to impose sanctions against Hong Kong or the PRC will be held criminally liable.

There is a question as to whether abiding by the US sanctions imposed on the Officials would run afoul of the NSL. To date, there is no official guidance or official interpretation on this aspect of the law. However, based on the wording of Article 29(4), it does not appear to suggest sanctions against Hong Kong or the PRC shall cover individual persons, corporate entities or government officials holding senior positions in the region.

Market guidelines relating to treatment of customers

In the HKMA Circular, the HKMA adds that boards and senior management of authorised institutions should have particular regard to the "treat customers fairly" principles. Similarly, in a statement made by the Securities and Futures Commission on US sanctions on 8 August 2020, it expects any response from financial businesses to the sanctions to be necessary, fair, and have regard to the best interests of their clients and the integrity of the market. Such principles do not really envisage any potential conflict with overseas sanctions laws so there is no particular guidance as to how institutions should act should one arise. Said principles regarding fair treatment of customers are laid down in the codes of practice in the banking and securities and futures sectors, which, despite not having statutory force, market participants are expected and encouraged to follow. A financial institution may conclude that compliance with the OFAC sanctions is either not contrary to, or can override, the principles depending on the circumstances. In any event, they should give full consideration to the issues at hand before taking action.

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Guidance

It is clear from the above that the new sanctions pose a range of new challenges for financial institutions and other entities with dealings involving Hong Kong persons. In the past, OFAC sanctions have tended to target countries where entities operating in Hong Kong would have little or no business, and it was relatively simple for such entities to have a blanket policy of not having any dealings with those countries or individuals from those countries. In the context of these new sanctions, this will not be an option for businesses based in Hong Kong or having material business interests there. We set out below some areas for particular attention:

"Know Your Customer procedures should not only consider whether the client is one of the Officials, but also whether the parties include companies that are owned by the Officials."

- Financial institutions are advised to review their know-your-client procedures. It is expected that the names of the Officials will be automatically included in the usual compliance search databases so they can be identified in the context of new business. Such institutions should also consider reviewing their existing client relationships to see if there is any impact;
 - Financial and other institutions should have a good understanding as to how their own structure affects their exposure to OFAC-related risk. The definition of US persons is a starting point for determining which entities within a larger corporate group will be subject to restrictions, though in practice the reach of the sanctions can be further. Consider an example where a foreign subsidiary of a US company is considering a business relationship with one of the Officials. Whilst this subsidiary is not within the definition of a US person, if it relies on support from its US parent, this could result in a breach by the parent insofar as this constitutes "facilitation";
- Know Your Customer procedures should not only consider whether the client is one of the Officials, but also whether the parties include companies that are owned by the Officials. It is understood that Officials serving in the Hong Kong government are required to declare their business interests, but it cannot be assumed that those declarations are complete and up to date, and the Officials, who are PRC nationals, are not under any obligations to make any declarations under Hong Kong law at all. Special care must be taken here, because the ownership may be indirect. For example, there may be nominee companies involved, or family members may hold assets on behalf of one of the Officials. Another possibility is that the Official holds the shares indirectly through multiple holding vehicles, or through one or more funds, and when these indirect shareholdings are aggregated, they exceed the 50% required for the company to be subject to the sanctions. Financial institutions are advised to look carefully into arrangements where participant companies have diverse ownership structures;
 - Although a transaction may involve an Official or one of their companies, it does not automatically follow that it is prohibited by the new sanctions. This may be, for example, where there is no direct US person counterparty, and where no US dollar payment is involved. However, parties should also consider circumstances where US involvement may be one step removed. Where for example, there is an acquisition where US dollars are converted into the purchase currency, there is a question mark as to whether there is any US person involvement even where the conversion is not mentioned in any of the transaction documents involving the principal parties;
 - Financial institutions will often have sanctions compliance provisions included in their transaction documents. These may be in a subscription agreement for a capital markets transaction, or in a facility agreement for a loan transaction. Such financial institutions are advised to re-visit their compliance language to see if amendments are required. It may be necessary to update the language to ensure it covers the new individuals and their companies. Alternatively, it may even be necessary to reduce the scope of the language if, for example, they presently prohibit all transactions involving countries with sanctioned individuals (which would now include the sanctioned Officials).

CONCLUSION

The new sanctions can have implications for those doing business involving Hong Kong persons. Financial institutions and other companies may have to make changes to their procedures for doing business, including training for front-line and compliance staff. Ideally, even if staff are not well positioned to become experts in this area, they would at the very least be able to identify the issues and know when to escalate. It is clear there are going to be situations that are borderline in terms of whether they breach the OFAC sanctions. In such cases, it may be necessary to seek expert legal advice to determine the risks involved and establish a way forward. The situation may evolve further in the near future so there will be much to gain for institutions that are ready in advance.

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Dean Young, a former Senior Consultant in our Hong Kong office, also contributed to this article.

For more information on the effects of the US withdrawal from the Hong Kong Tax Treaty, issued in President Trump's same Executive Order, please read our article authored by New York Partner Daniel Pilarski [here](#).

[1] <https://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Pages/20200807.aspx>

[2] <https://www.wfw.com/wp-content/uploads/2017/07/ExxonMobil-sanctions-July2017.pdf>] The fines were later reversed in court on technical grounds.

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