



ARTICLE

What do Hong Kong-Related Sanctions mean for U.S. Financial Institutions?

A Swiftly Changing Landscape

Developments in Hong Kong and the U.S.'s reaction have been swift since June 30, 2020, when China's National People's Congress Standing Committee (NPCSC) passed the national security law (NSL) -- promulgated by Carrie Lam, the Chief Executive of Hong Kong Special Administrative Region (HKSAR). The U.S. considers the NSL another action by China to erode the autonomy and rights promised to Hong Kong in the 1984 Sino-British Joint Declaration on the Question of Hong Kong, an international treaty preserving Hong Kong's freedoms for 50 years from 1997 to 2047.¹

Accordingly, on July 14, 2020, President Trump signed both the [Hong Kong Autonomy Act of 2020](#) (HKAA) and [The President's Executive Order on Hong Kong Normalization](#) (E.O. 13936). The HKAA requires the President, under certain conditions, to impose sanctions against non-U.S. or "foreign" persons (i.e., entities and individuals) and financial institutions that contravene China's obligations with respect to Hong Kong's autonomy. E.O. 13936 declares the situation in Hong Kong a threat to the national security, foreign policy and economy of the U.S., due to the broad power China has given itself under the NSL to control prosecutions in Hong Kong, conduct proceedings in secret, and expel journalists, human rights organizations and other outside groups, making it more difficult to hold China accountable for its treatment of the Hong Kong people. In response, E.O. 13936 implements provisions of the HKAA and sets forth additional sanctions, including criteria for designating and blocking foreign persons and eliminating preferential treatment for Hong Kong in various areas of U.S. law, including immigration and export controls.

On August 7, 2020, the U.S. Department of Treasury [sanctioned](#) 11 individuals, including current and former Chinese officials,

¹ "The NSL criminalizes four broadly defined categories of offenses: secession, subversion, organization and perpetration of terrorist activities, and 'collusion with a foreign country or with external elements to endanger national security' in relation to the HKSAR. Persons convicted of violating the NSL can be sentenced to up to life in prison. China's central government can, at its or the HKSAR's discretion, exercise jurisdiction over alleged violations of the law and prosecute and adjudicate the cases in mainland China. The law apparently applies to alleged violations committed by anyone, anywhere in the world, including in the United States." (<https://crsreports.congress.gov/product/pdf/R/R46473>)

most notably Carrie Lam, under E.O. 13936 for “undermining Hong Kong’s autonomy and restricting the freedom of expression or assembly of the citizens of Hong Kong.”² The sanctions come in the midst of China’s recent crackdown on pro-democracy activists and journalists in Hong Kong, which has intensified under the NSL.

A New U.S. Sanctions Program

Together, the HKAA and E.O. 13936 create a new Hong Kong/China-related sanctions program, administered by the Office of Foreign Assets Control (“OFAC”) that provides for designation criteria that could impose blocking and other sanctions by the U.S. on foreign persons and foreign financial institutions (FFI). Under the HKAA, this includes any FFI that “knowingly conducts a significant transaction” with sanctioned foreign persons that have “materially contributed” to the failure of China to meet its obligations. Sanctions that could be imposed against an FFI include prohibiting U.S. Persons from: engaging in foreign exchange transactions and transfers of credits or payments involving the FFI; “significant” investments or purchases of equity or debt instruments of the FFI; and conducting transactions with respect to property in which the FFI has any interest, which effectively leads to blocking.

Building on the HKAA, E.O. 13936 allows for the imposition of sanctions for a wider range of conduct – to include any foreign person determined by the State and Treasury Secretaries to be involved, either directly or indirectly, in any of the following: development, implementation, or enforcement of NSL; actions or policies that threaten the peace, security, stability, or autonomy of Hong Kong; censorship or other actions that limit the freedoms of expression, assembly, or press in Hong Kong; or any other gross violations of internationally recognized human rights in Hong Kong. Moreover, E.O. 13936 authorizes sanctions on leaders or officials of any entity, including government entities, found to be engaged in the any of the activities listed above, as well as on any person who provides material assistance to, is owned or controlled by, or who serves as a senior executive or board member to any person sanctioned under this Order.

Assessing Your Firm’s Potential Risk

The designations announced on August 7th indicate that the U.S. government is willing to target high-level officials in Hong Kong and China.³ If the situation continues to escalate, we are likely to see additional designations in the near future that, based on the designation criteria set forth in E.O. 13936, could target a broad swath of individuals, entities, and FFIs. For example, potential targets may include companies supplying goods, technology or services, such as: those that could be used to spy, gather intelligence, or block access to communications; weapons or other dual-use goods used by military or police forces; financial services, including insurance, shipping services, and other support for transporting such goods. Targets could also include individuals on the board and senior executives of such companies. As such, financial institutions should consider their exposure to potential sanctions targets, as well as those who have been designated.

Based on the experience of FTI Consulting experts in designing, implementing, and managing sanctions programs, we offer the following initial recommendations for financial institutions to consider for assessing and managing their current and potential sanctions risk exposure in this evolving environment:

- **List Management:** Develop criteria to create an evolving list of individuals and entities with potential sanctions exposure (in addition to those already designated).
- **Customer Portfolio Review:** Undertake a formal, risk-based review of the entire customer population, across all lines of business, prioritizing the newly identified names on the list.

² <https://home.treasury.gov/news/press-releases/sm1088>

³ In addition to Carrie Lam, the following individuals were designated under E.O. 13936: Chris Tang, Commissioner of Hong Kong Police Force (HKPF); Stephen Lo, Former Commissioner of HKPF; John Lee Ka-chiu, HKSAR Secretary for Security; Teresa Cheng, HKSAR Secretary for Justice; Erick Tsang, HKSAR Secretary for Constitutional and Mainland Affairs; Xia Baolong, Director of the Hong Kong and Macao Affairs Office of the State Council; Zhang Xiaoming, Deputy Director of the Hong Kong and Macao Affairs Office of the State Council; Luo Huining, Director of the Hong Kong Liaison Office; Zheng Yanxiong, Director, Office for Safeguarding National Security in Hong Kong; Eric Chan, Secretary General, Committee for Safeguarding National Security of the HKSAR

- **Network Analysis:** Utilize technology to bring together all customer relationship information and data, centralizing it into a single view, mapping out the connections between relevant entities and resulting in a clear understanding of real-world relationships.
- **Periodic Review:** Immediately launch a periodic review on the evolving list of customers in relation to whom there is potential sanctions exposure. If not already classified as high risk and flagged for accelerated periodic review, these customers' risk rating should be adjusted, as appropriate, and the decision should be documented.
- **Relationship Strategy:** Define and document scenario-based retention or exit strategies for customers that are designated or not officially designated but for some other reason pose potential reputational or sanctions risk based on the financial institution's documented risk appetite.
- **Risk Decisions and Governance:** Establish appropriate reputational or sanctions-specific risk committees and forums, where questions related to retention or exit decisions are assessed, determined and documented by senior management, as well as appropriately communicated.
- **Training & Communication:** Ensure there is an appropriate internal and external communication strategy. Critically, all relevant staff should receive and acknowledge having received refreshed sanctions training.
- **Feedback Loop:** Ensure the ownership for implementation of mitigating controls is clearly assigned, tracked and reported for completion. This may include actions ranging from sanctions or watchlist screening list updates; enterprise sanctions risk assessment update/adjustment; enhanced transaction monitoring; adjustments to customer risk ratings; frequency of periodic reviews; and appropriate customer-, account- or transaction-level restrictions.
- **Correspondent Banking:** Initiate a review of correspondent banking relationships, particularly in context of the provision of USD clearing services. Financial institutions should also assess their contractual ability to access information on their customers' customers.
- **Episodic Transactions/Deals:** Undertake pre-transaction due diligence in the context of investment banking deals and capital markets transactions, focusing on counterparties and their senior management, beneficial owners, and any additional parties involved.
- **Suppliers:** Review and, as appropriate, refresh any counterparty due diligence in relation to existing or contemplated third party relationships.

How FTI Consulting Can Help

FTI Consulting is uniquely positioned to assist U.S. financial institutions in understanding the full scope and implications of these recent measures on their OFAC compliance program, including identifying potential risk areas and enhancing controls based on each institution's unique business and risk profile. Relevant services include:

- Performing transactional counterparty and customer enhanced due diligence, including in-depth investigations to uncover direct and indirect links to current and potential sanctions targets
- Risk assessments to identify accounts, lines of business and other areas where new or enhanced controls are needed, particularly in the event of increasing sanctions developments
- Risk governance and strategic and reputational risk services
- Updating and implementing appropriate controls, policies and procedures
- Designing and delivering training programs
- Data analytics and management services

FTI Consulting works with financial institutions to meet the expectations of regulators, shareholders, and the public. Our professionals offer definitive solutions to protect against the unprecedented scrutiny and pressures in today's highly competitive and heavily regulated environment. We enjoy a success filled history of helping financial institutions of all sizes navigate the challenges and evolving landscape of regulatory compliance, governance and risk management.

FTI offers end-to-end sanctions, anti-money laundering, anti-corruption and anti-fraud services. Our experts understand that each financial institution has differentiating factors and we can apply the best approach to service your needs. We offer client solutions of unmatched breadth and depth based on our diverse backgrounds, which includes:

- Distinguished technical and subject matter experts
- In-house licensed private investigators
- Former bankers, compliance and operations executives, internal and external auditors, regulators, prosecutors and law enforcement officials, data scientists, technology experts, attorneys and forensic specialists
- Top-rated data warehouses and analytical computing power

For information on what the recent U.S. sanctions mean for financial institutions in Hong Kong, please see FTI Consulting's Financial Crimes Compliance article [here](#).

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