

# **The National Security Law – Its impact on Hong Kong as an International Financial Centre**

December 2020, Hong Kong

## **A. BACKGROUND**

1. Since the early 1960's HongKongers and outside observers have speculated about threats to Hong Kong's sustainability as an international financial centre. This paper examines potential impacts of the recently enacted National Security Law<sup>1</sup> ("NSL") on Hong Kong's future as an international financial centre ("IFC").
2. The NSL's ink is barely dry but now is the time to start examining the potential effect of the NSL on Hong Kong's status as an IFC. In particular, this paper looks at how the law might influence a person's decision to (i) have their trust administered here (by a Hong Kong or non-Hong Kong incorporated trustee); (ii) choose Hong Kong law as the proper law of the trust - wherever it is administered and (iii) choose a Hong Kong company as a holding company when its assets include non-Hong Kong situated assets.
3. The greatest jurisdictional threats to asset holding structures such as trusts and companies come from within. The prime examples are confiscation and expropriation of assets and nationalization of industries on unjust terms. Corrupt or incompetent judiciaries or government departments are huge threats. The sudden imposition of exchange controls, taxes and stifling business regulation can ruin financial jurisdictions – especially an IFC's reputation and appeal. Poor professional support for efficiently maintaining structures in the forms of legal accounting and financial services is detrimental. Unwieldy and inflexible laws that govern companies trusts and other asset-holding structures present a distinct disadvantage.

1. NSL English version - [http://www.xinhuanet.com/english/2020-07/01/c\\_139178753.htm](http://www.xinhuanet.com/english/2020-07/01/c_139178753.htm)

## **B. SOME HISTORY**

4. Hong Kong began its path to becoming an IFC<sup>2</sup> in the 1960's. This happened largely through a confluence of various factors set out below - in no particular order of significance as their relative significance has changed over time. These factors are grouped into internal and external factors.

### Internal factors

- Its political neutrality caused, in part, by the British sovereign's "hands off" approach
- Its economic freedom from exchange controls, e.g. convertibility of the domestic currency which is pegged to the US dollar
- Its light business regulation
- Its low and relatively simple sourced-based taxation system
- Its non-discriminatory attitude to foreign versus local market participants
- A free press
- The quality of the light touch civil service, the spirit of excellence and entrepreneurialism of the local population and their command of English
- Its strict adherence to the principles of the Rule of Law, especially a truly independent, honest and talented judiciary
- Confidence in the legal system's protection of private property rights, in particular that the government would never confiscate or expropriate the property of individual companies or trusts except perhaps when that property was proven to represent the proceeds of crime
- A safe, stable and convenient place to live and work
- Strong educational institutions
- Access to mainland financial markets through Stock Connect etc.
- CEPA (a free trade agreement between HKSAR and the Mainland)
- Cultural and linguistic connections with the PRC
- Participation in the Mainland's Belt and Road and Greater Bay initiatives
- Deep and well-regulated debt and equity markets

<sup>2</sup>. IFC as opposed to an OFC – Offshore Financial Centre

- The most active offshore RMB hub

#### External factors

- The rise of global trade and the emergence of the PRC
  - The abandonment of exchange/capital controls by the major trading nations starting in the 1960's
  - The high tax era of big Western economics which motivated individuals and corporates to seek lower tax jurisdictions
  - The number of large and sophisticated global banks, investment houses and multinational corporations which established outposts here along with their highly trained staff and the lawyers, accountants and other financial professionals who followed to support them
  - Technological advances such as the Internet
5. Since the sixties (with the exception of the 1967 riots), Hong Kong enjoyed a smooth ride. It is the pre-eminent regional financial centre and a global IFC ranked alongside London and New York.
6. The first bump in the upward road was the announcement of the 1984 Sino-British Joint Declaration between the UK and the PRC concerning the return of sovereignty of Hong Kong.<sup>3</sup>

### **C. THE JOINT DECLARATION AND THE BASIC LAW**

7. While the Joint Declaration gave many people the jitters, leading to a "brain drain" of locals migrating abroad to Canada and Australia, in particular, between 1985 and 1997, this did not presage an onset of panic. The two-page Joint Declaration, signed in Beijing on 19 December 1984 envisaged an orderly return of sovereignty to the PRC 13 years later, and specifically contemplated the following issues in an annexure to it:

<sup>3</sup>. Part was territory over which leases had expired and part the handover of freehold land which had been ceded to Britain

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|----------------------|---|
| I. CONSTITUTION      | IX. CIVIL AVIATION                          |
| II. LEGAL SYSTEM     | X. EDUCATION                                |
| III. JUDICIAL SYSTEM | XI. FOREIGN AFFAIRS                         |
| IV. PUBLIC SERVICE   | XII. DEFENCE                                |
| V. FINANCE           | XIII. BASIC RIGHTS AND<br>FREEDOMS          |
| VI. ECONOMIC SYSTEM  | XIV. RIGHT OF ABODE, TRAVEL,<br>IMMIGRATION |
| VII. MONETARY SYSTEM |   |
| VIII. SHIPPING       |   |

8. The most critical of the issues to be settled was the Basic Law ("BL"). The Joint Declaration provided for a Basic Law "stipulating that after the establishment of the HKSAR the socialist system and socialist policies shall not be practised in the HKSAR and that Hong Kong's previous capitalist system and life style shall remain unchanged for 50 years". This (Chinese) law was promulgated by the Chinese President on 4 April 1990 and took effect on 1 July 1997.<sup>4</sup>
9. The BL has been "Interpreted", "Explained", "Decided" upon and "Amended" by the Standing Committee of the National People's Congress ("SCNPC") since its promulgation on at least twelve occasions.

#### **D. THE NATIONAL SECURITY LAW**

10. The most recent of these changes mentioned above was the promulgation, pursuant to Article 18 of the BL with effect from 30 June 2020, which added the NSL to Annex III of the BL thus becoming part of Hong Kong's domestic law.
11. The HKSAR and the PRC Central Government said this was necessary to close loopholes in our existing national security laws (see paragraph 21 below) which were to be addressed by the HKSAR Government passing further national security laws as stipulated by Article 23 of the BL. It requires the HKSAR to "enact laws on its own to prohibit any act of treason, secession, sedition, subversion against the

4. [https://www.basiclaw.gov.hk/en/basiclawtext/images/basiclaw\\_full\\_text\\_en.pdf](https://www.basiclaw.gov.hk/en/basiclawtext/images/basiclaw_full_text_en.pdf)

Central People's Government, or theft of state secrets, to prohibit foreign political organizations or bodies from conducting political activities in the Region, and to prohibit political organizations or bodies of the Region from establishing ties with foreign political organizations or bodies".

12. It is well known that the HKSAR (for various reasons) never complied with that obligation. The HKSAR Government tried to pass laws in 2003 but were met with strong resistance from the public (500,000 HongKongers marched in protest on 1 July 2003) and the HKSAR Legislative Council ("LegCo"). No further attempt was made under Article 23.
13. This promulgation via Article 18 is controversial because it is doubtful the NSL can be promulgated via Article 18 precisely because it deals with national security matters as envisaged by Article 23. However, for the reasons set out below, this point is moot so will not be further explored here.
14. A HKSAR Government pamphlet released on 30 June 2020<sup>5</sup> states that the HKSAR Government will fulfill its responsibility under Article 23 to pass local laws as required by that article so that when that is completed those locally passed laws, existing criminal laws and the NSL will together constitute "the legal protection framework for safeguarding national security in the HKSAR".
15. That would, at least prospectively, make any doubt about the legality of the NSL (because of its potentially faulty promulgation) otiose. We would have passed national security laws consisting of new locally passed law plus existing national security laws detailed in paragraph 21 below, in addition to the NSL. Assuming the HKSAR Government continues to fail to pass domestic national security laws as required by Article 23 and there is a successful challenge in the Court of Final Appeal ("CFA") to the legality of the NSL because its promulgation is flawed, the matter

5. <https://www.isd.gov.hk/nationalsecurity/eng/pamphlets.html>

would not end there. This is because Article 158 of the BL requires the CFA to refer questions of constitutionality that arise in cases before it to the Standing Committee of the People's National Congress ("SCNPC")<sup>6</sup> for interpretation and for the courts to apply the SCNPC's interpretation in deciding those cases.

16. It is inconceivable that the SCNPC would allow a judicial striking down of the NSL to stand. This paper therefore proceeds on the assumption that the NSL in its current form, or supplemented by locally passed legislation, is here to stay. Now that there is no opposition in LegCo the HKSAR Government might well take the opportunity to pass locally further national security laws.
17. A Committee for Safeguarding National Security of the HKSAR ("the NSL Committee") has been established and head-quartered here in Wan Chai. Its decisions are not subject to judicial review and its work is secret – as was the work of the British MI6 intelligence agents stationed in Hong Kong before the handover. The Mainland has also established its own "Office for Safeguarding National Security of the Central People's Government" in the HKSAR ("the PRC National Security Agency").
18. It is useful to have a broad understanding of the NSL to gauge its potential impact on Hong Kong's status as an IFC. For a full discussion of the NSL see <https://www.haldanes.com/hong-kongs-national-security-law-overview-by-haldanes-criminal-law-partner-andrew-powner/>
19. The text of the NSL itself consists of 66 Articles and creates four main offences:
  - secession
  - subversion
  - terrorist activities
  - collusion with a foreign country or external elements to endanger national security

6. The PRC's highest legislative body

20. Secession, subversion and terrorism are already prohibited by Hong Kong's existing criminal law – Crimes Ordinance (Cap. 200).

21. The NSL is a curious series of apparent contradictions of principle which was inserted into Hong Kong's legal system without any meaningful local consultation. On one hand it:

- provides that decisions of the NSL Committee are not reviewable by the courts
- allows the Chief Executive - not the Chief Justice - to allocate judges to hear NSL cases
- allows for the PRC authorities to take over the complete conduct of NSL cases from the Hong Kong courts in certain situations
- allows for the deportation of non-residents without judicial review
- purports to apply to the acts of persons committed outside Hong Kong
- allows for important elements of NSL offences, such as whether a matter concerns "national security" or whether evidence is something which constitutes a "state secret" to be determined by a certificate from the Chief Executive which binds the court hearing the case thus depriving a defendant the right to put the prosecution to proof on what could be critical elements of the offence charged
- imposes life sentences for egregious cases of secession, subversion and terrorism
- employs very vague language relating to whether someone incites or aids and abets another in subversion. The press, for example, is very concerned about how to report "subversive" remarks
- reverses the presumption of bail in NSL cases; this presumption is based on the presumption of innocence

On the other hand the NSL:

- commits to adhering "to the policy of One Country, Two Systems under which the people of Hong Kong administer Hong Kong with a high degree of autonomy"
- recommits to essential provisions of the BL including human rights such as the freedoms of speech, of the press, of publication, of association, of assembly, of procession and of demonstration enjoyed by HongKongers
- states that the rule of law shall be adhered to in preventing suppressing and imposing punishment for the offences it creates
- states that a person is presumed innocent until proven guilty and employs the Hong Kong judicial system to determine NSL cases except for special cases which the PRC authorities can take over.

Quite how these contradictions of principle will be resolved in NSL prosecutions will be up to the courts in the first instance. However, the NSL's final interpretation resides squarely with the SCNPC which will not, based on the experience of its previous interpretations of the BL, feel constrained by a Common Law judicial approach to statutory interpretation. It will mean what the SCNPC<sup>7</sup> wants it to mean. The contradiction of principle here is between the Common Law understanding of the Rule of Law as against a provision whereby the author of a draconian law, and not the Court, is the ultimate arbiter of its meaning. Let's not forget that the Basic Law specifically states that the Common Law applies in Hong Kong.

22. In summary, the NSL offends the Rule of Law and restricts the jurisdiction and role of the judiciary and, potentially, restricts the freedom of the press. The legal profession in Hong Kong is mostly adopting a "wait and see" approach to the NSL's development and implementation and its effect on the Rule of Law.

<sup>7</sup>. See Article 65 of the NSL



**E. THE IMPACT OF THE NSL**

23. On a positive note, Hong Kong courts remain honest, capable and independent. They can be relied upon to effectively and finally adjudicate on contractual disputes or those involving companies, trusts and individuals without any interference by the NSL, the PRC Government or its various local organs. There is nothing in the NSL that permits expropriation or confiscation of property except in exceptional circumstances. The NSL does not touch on economic freedom, business regulation, the tax system, the trust or corporate law, private property rights, market participation or other internal factors supporting Hong Kong's position as an IFC.
24. Significantly, there has been little evidence so far of significant capital flight since the introduction of the NSL nor have there been announcements by banks, finance houses, multinationals or professional firms that they intend to leave Hong Kong or even reduce their presence here. Therefore, high quality services to such structures remain available here. On the other hand there are only anecdotal accounts of funds being transferred to different jurisdictions, and no panic movements of assets affecting the IFC landscape.
25. Moreover, the HKSAR Government, the Chinese Communist Party ("CCP"), the pro-Beijing parties of the LegCo and many other HongKongers enthusiastically welcomed the NSL and credit it with the end of the turmoil caused by the attempted passage of the extradition bill in 2019. Whether the cessation of protest was caused by the NSL or by Covid 19 is an open question but, there is little doubt that the NSL has sent a chill through many locals and foreigners alike. Between 30 June 2020 and December 10<sup>th</sup> 2020 at least 35 people have been arrested under the NSL whilst three has been charged. Eight others are wanted. They include pro-democracy activists, former legislators and a media outlet owner.

26. Hong Kong has, since coming under British rule in 1841, always been vulnerable to Mainland powers. It was commonly accepted that at least since the end of the Chinese Civil War in 1950 that the People's Liberation Army ("PLA") could have taken Hong Kong by force at any time of its choosing or even turn off the water supply. Many non-Hong Kong people do not realize that the PLA has had a garrison discreetly situated in Central, the heart of Hong Kong, since the handover.
27. This paper concludes, on balance, that for the reasons stated the NSL will have a negligible effect on the jurisdictional and the internal matters in the short term at least that would influence the decisions set out in paragraph 3.
28. However, the NSL's longer term impact is much more difficult to predict because this involves questions of overall trust and confidence in the jurisdiction. These questions are both multi-faceted and ephemeral in nature.
29. Many factors distinguish a post-handover Hong Kong from Mainland China: demonstrations; individual freedoms; judicial independence; the Judiciary's role as a check on Executive power; freedom of the press, and a strong desire for genuine universal suffrage are the most significant factors that make Hong Kong a successful IFC in the eyes of the world. These fundamental differences lie at the heart of the conundrum presented by the return of Hong Kong – which was never a self-ruled democracy but nonetheless blessed with the most important trappings of one – to a country to which those concepts were antithetical. Deng Xiaoping's "One Country, Two Systems" formula was the elegant solution to the problem and it remains so.
30. Since the handover, Hong Kong has fared pretty well – at least until the Umbrella Movement arose followed by the recent unrest. This surely reflects the world's acceptance of Hong Kong's return to Chinese sovereignty under Deng Xiaoping's "One Country, Two Systems" formula.

31. There has been endless argument about the meaning of this simple expression. In practice, the most active anti-CCP cohort say it is a form of separatism while the most strident CCP supporters emphasize the "One Country" part of the formula over the "Two Systems". They believe Hong Kong is an integral part of China and that it is indisputable that Hong Kong's legal system will eventually be subsumed by the Mainland's. 2047 beckons.
32. The NSL is the strongest measure used by the CCP since the handover to exercise its influence in Hong Kong and to demonstrate its sovereignty. By directly making a very Chinese and very "un-Hong Kong" law part of Hong Kong's legal landscape, without any public consultation, discussion with Hong Kong legislators, or reference to the Executive, the NSL is viewed by the rest of the world as a clear breach of the Joint Declaration and the BL itself and certainly not in the spirit of "One Country, Two Systems". Some suggest this intervention, not to mention the very recent constitutionally doubtful disqualification of four Hong Kong legislators by direct non -appealable Central Government diktat, at a time when the Hong Kong and Mainland cultures are far from one, smacks of a different, far less desirable formula, that is, "One System, Two Countries". So far, many western Governments have reacted angrily to the NSL's passage. The US imposed sanctions on the Chief Executive and others among other retaliatory measures including the suspension of extradition treaties. The UK and Australia have announced easier pathways for HongKongers to enter and attain their citizenship.
33. Plainly, none of this can help Hong Kong's reputation as an IFC even though law and order has been restored following the NSL's introduction. The major concern is whether the CCP will continue down a road of quasi direct rule and degrade Hong Kong's status to "just another Chinese city". And who, it might be fairly asked, would have their non-Chinese assets administered out of Shenzhen or Shanghai?

34. One answer to that question is that even though locals and foreign users could take fright with that idea, Mainlanders probably would not. The increasingly large volume of Mainland money and other assets managed in Hong Kong, including the proceeds of Hong Kong listings of Mainland enterprises, demonstrates confidence in Hong Kong. Increasing Chinese tax transparency rules means Mainlanders are very likely to continue using Hong Kong administered and incorporated structures to hold their wealth and to make further investments outside Hong Kong and China. Likewise, foreign investment into China will continue to flow largely through Hong Kong despite the NSL. Naysayers' view that Hong Kong's days as an IFC are already behind it is contradicted by evidence that Hong Kong remains the prime two-way financial bridge to the PRC and that this will be more than sufficient to fuel future success.

## **F. CONCLUSIONS**

35. The broader questions posed by this paper will be largely determined by the future behavior of the CCP and its local organs. It would help dispel uncertainty if the HKSAR Government took action to address the root causes of the ongoing protests and disaffection. It would also be very helpful for Hong Kong's democratic forces to loudly disavow violence, separatism and any idea of changing the Mainland system. The CCP have made their point. They are in charge. If they are inclined to return to the restraint of, say, the first 15 years after the handover and take incremental steps towards universal suffrage for the election of the Chief Executive and LegCo (perhaps as offered in 2014), faith in "One Country, Two Systems" may be restored.

36. Undoubtedly, the PRC wants Hong Kong to thrive as an IFC so logic dictates that what's good for Hong Kong is also good for the PRC. In recent times, it seems that Hong Kong has been unable to put that case convincingly to the PRC. Hong Kong's future will be assured when the PRC fully comprehends the mutual benefits of the

territory's success and the fragility of both the "One Country, Two Systems" formula and our global reputation.

37. What should clients with Hong Kong administered and incorporated holding structures do in response to the passage of the NSL and other recent developments? First, they should not panic and take unnecessary precipitous actions. Second, if they have any qualms or concerns they should prepare an exit strategy from those holdings structures which can be quickly and effectively executed if necessary.

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