



Observatoire ARGA

**SECONDARY SANCTIONS RISKS AND COMPLIANCE ASYMMETRY:
A STRUCTURAL ASSESSMENT OF THE IMPACT ON ASIA'S BANKING SYSTEM
AND INVESTMENT FLOWS**

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1. EXECUTIVE SUMMARY

Sanctions policies adopted by leading global powers exert cross-border effects on Asia's financial systems regardless of whether regional jurisdictions formally participate in such regimes. Even in the absence of a direct sanctions designation, secondary sanctions risks and reputational signals may trigger defensive compliance, leading to restrictions in banking services, reassessment of investment decisions, and structural shifts in capital flows.

Singapore and Hong Kong occupy a distinctive institutional position: they are deeply integrated into the global financial infrastructure—including US dollar clearing, correspondent banking networks, and international capital markets—while simultaneously seeking to preserve regulatory autonomy, institutional neutrality, and predictability of legal enforcement.

The core structural risk lies in compliance asymmetry:

- sanctions regimes are formulated outside the region;
- Asian banks must account for their extraterritorial impact;
- algorithmic compliance systems amplify even indirect signals;
- market reactions often precede formal legal qualification.

This report analyzes the mechanisms of secondary sanctions exposure, their impact on banking resilience, private banking, investment funds, and listing venues, and proposes a system of safeguards to ensure proportionality and transparency in compliance decision-making.

2. THE GLOBAL SANCTIONS ARCHITECTURE AND ASIA'S POSITION

The contemporary sanctions architecture is primarily shaped by the United States, the European Union, and the United Kingdom. It includes:

- primary sanctions;
- secondary sanctions;

- sectoral restrictions;
- export controls on technology and financial transactions;
- personal sanctions lists.

Their influence extends through:

- correspondent banking relationships;
- US dollar and euro clearing infrastructure;
- global payment systems;
- international banks and investment funds.

Asian financial centers function as “receiving jurisdictions”: they do not design global sanctions regimes but must account for their practical impact on access to international financial infrastructure.

This creates an institutional balance between:

- compliance with international standards;
- preservation of regulatory autonomy;
- maintenance of investment neutrality.

3. THE CONCEPT OF SECONDARY SANCTIONS RISKS

Secondary sanctions risks arise where no formal prohibition exists, but adverse consequences may result from indirect exposure or association.

They include:

- termination of banking relationships due to indirect exposure;
- denial of services without a formal sanctions designation;
- restriction of investment operations due to reputational exposure;
- enhanced due diligence absent explicit legal requirements.

Secondary risks are amplified through:

- third-party screening systems;
- adverse media and reputational signals;
- network analytics (second- and third-level connections);

- automated risk scoring mechanisms.

Thus, secondary risk is not primarily legal in nature but compliance- and reputation-driven, although its economic consequences may be comparable to those of direct sanctions.

4. COMPLIANCE ASYMMETRY AND DEFENSIVE COMPLIANCE

4.1. Drivers of Defensive Compliance

- substantial fines in global enforcement practice;
- ambiguity in the interpretation of secondary sanctions;
- pressure from correspondent banks;
- dependence on US dollar infrastructure;
- algorithmic amplification within AML systems;
- fear of reputational damage.

As a result, banks often choose to minimize potential exposure even in the absence of a formal prohibition.

4.2. Consequences

- closure of accounts or refusal to onboard clients;
- denial of investment or financing opportunities;
- contraction of private banking relationships;
- withdrawal from complex cross-border structures;
- increased internal monitoring and compliance costs.

While this approach may reduce individual institutional risk, it can generate systemic disproportionality.

5. IMPACT ON BANKS, FUNDS, AND PRIVATE BANKING

Private banking and wealth management are particularly sensitive to reputational signals, as their model relies on trust and long-term client relationships.

Under secondary sanctions risk:

- clients may relocate assets to alternative jurisdictions;

- banks intensify enhanced due diligence (EDD) and risk scoring;
- service costs increase;
- appetite for complex ownership structures declines.

Investment funds likewise factor sanctions exposure into portfolio construction, influencing capital allocation across jurisdictions and sectors.

6. IMPACT ON INVESTMENT FLOWS AND LISTING VENUES

Secondary sanctions signals may:

- reduce IPO attractiveness;
- limit participation of international investors;
- increase valuation discounts;
- heighten market volatility;
- complicate secondary offerings.

Even at early stages of investigations—or in the absence of formal sanctions—markets may react preemptively. This creates the risk that reputational signals translate into tangible market shocks.

7. RISK OF FINANCIAL FLOW FRAGMENTATION

If defensive compliance becomes the dominant strategy:

- market segmentation intensifies;
- banks avoid certain client categories;
- cross-border investments decline;
- alternative, less transparent channels emerge.

Financial fragmentation reduces the efficiency of global capital allocation and may undermine regional economic integration.

8. SAFEGUARDS AND STANDARDS OF PROPORTIONALITY

To mitigate disproportionality, the following measures are proposed:

1. Secondary verification of indirect sanctions signals with mandatory human review.
2. Clear differentiation between formal sanctions and reputational risk.

3. Implementation of explainable AI within compliance procedures.
4. Rapid review mechanisms following changes in legal status.
5. Guidance on proportionality in defensive compliance, including minimum documentation standards.
6. Limits on automatic amplification of network-based signals without contextual assessment.

9. RECOMMENDATIONS FOR MAS, HKMA, AND APG

- Develop regional principles for managing secondary sanctions risks.
- Integrate compliance asymmetry into macroprudential analysis.
- Promote transparency of algorithmic compliance models and audit trails.
- Facilitate dialogue with banks on proportionality standards.
- Establish an expert platform on sanctions asymmetry and risk governance.
- Design a regional stress test to assess sanctions-related turbulence.

10. CONCLUSION

Asian financial centers play a critical role in the global financial system. Their resilience depends on the ability to manage external sanctions signals without sacrificing proportionality or institutional predictability.

A balanced, transparent, and risk-based approach to secondary sanctions risks can:

- strengthen investor confidence;
- preserve competitiveness;
- prevent financial fragmentation;
- support regional integration.

ARGA Observatory considers this report a contribution to the development of constructive international dialogue on sanctions resilience, institutional autonomy, and financial stability in Asia.