WILMERHALE

US Targets Major Russian Financial and Energy Firms in Sector-Specific Sanctions

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This week, the United States announced new sanctions against Russia in response to what the Obama Administration describes as Russia's continued attempts to destabilize Ukraine. This represents a significant expansion into new territory for US sanctions policy: in addition to blocking or "freezing" the assets of newly listed Ukrainian separatists and Russian individuals and entities, the United States has now also established a new category of "targeted, sector-specific sanctions" that initially includes four of the largest Russian energy and financial firms: OAO Novatek and Rosneft, and Gazprombank OAO and Vnesheconombank (VEB), respectively. While narrower than previous designations of Russian entities, these new sanctions are designed to be "targeted and designed to have the maximum impact" while minimizing the "spillover" effect on the US economy by limiting the entities' access to US capital markets.

The EU, meanwhile, has reached political agreement to expand sanctions—including, potentially, by targeting Russian entities—but the precise scope of such expansion is currently unclear.

I. New US SDN Designations

The US Department of the Treasury's Office of Foreign Assets Control (OFAC) added new Russian and Ukrainian individuals and entities to its Specially Designated Nationals and Blocked Persons (SDN) list, including eight Russian state-owned defense technology firms, four Russian government officials, two entities and one individual determined to threaten the peace and security of Ukraine, and one key oil shipping facility in the Crimean Peninsula. As a result of these designations, any property or property interests of the new SDNs that are within US jurisdiction must be blocked, and transactions by US persons or within the United States involving the SDNs are generally prohibited.

II. A New Sanctions Front: Sectoral Sanctions Identifications (SSIs)

OFAC has also created a new category of sanctions by establishing the Sectoral Sanctions Identifications (SSI) list.[1] Under Executive Order 13662 (Mar. 20, 2014), the President had authorized sanctions against various sectors of the Russian economy due to instability in Ukraine, including financial services, energy, metals and mining, engineering, and defense and related materiel.[2]

On July 16, 2014, OFAC acted under that authority to add four major Russian energy and financial firms to its SSI list for the purpose of limiting their access to US financial markets for new issues of debt and/or equity. These hybrid “targeted, sector-specific” sanctions are much narrower than those imposed against SDNs because the SSI-designated firms are not blocked (*e.g.*, US persons are not required to block their property interests) and only certain longer-term financial transactions have been prohibited.

Specifically, Directive 1 issued pursuant to Executive Order 13662, which applies to the two financial firms, Gazprombank and VEB, prohibits transacting in, providing financing for, or otherwise dealing in (including the provision of services in support of) new debt of longer than 90 days maturity or new equity of the two firms or their interests in property.[3]

Directive 2 issued pursuant to Executive Order 13662, which applies to the two energy firms, OAO Novatek and Rosneft, prohibits transacting in, providing financial for, or otherwise dealing in (including the provision of services in support of) new debt of longer than 90 days maturity, but establishes no prohibitions with respect to equity.[4]

Importantly, the SSI sanctions are prospective in nature, prohibiting dealings in “new” debt or equity (*i.e.*, debt or equity issued as of July 16, 2014), as well as the rollover of certain existing debt, described below.[5] US financial institutions may continue to maintain correspondent accounts and process US dollar-clearing transactions for the SSI designees, so long as those activities do not involve prohibited transactions.[6] The same requirements also extend to “new” debt or equity issued by entities owned 50 percent or more by the SSI designees.

A. Special Issues for the Financial Sector

The SSI designations raise new compliance obligations for the US financial sector. OFAC has published initial guidance and granted a new general license so that firms may begin to assess how to address SSI-related risks and challenges.

OFAC’s Frequently Asked Questions (FAQs) cover several technical aspects of compliance with the new SSI list, including key definitions and further information on the parameters of the prohibitions.[7] Highlights include:

- “Equity” is defined to include “stocks, share issuances, depositary receipts, or any other evidence of title or ownership;”
- “Debt” is defined broadly and includes “bonds, loans, extensions of credit, loan guarantees, letters of credit, drafts, bankers acceptances, discount notes or bills, or commercial paper;”
- “New debt” and “new equity” are debt and equity, respectively, “issued after {sic} on or after

July 16, 2014" and that are "by, on behalf of, or for the benefit of" the SSI designee;

- US financial institutions may continue to provide correspondent services—including dollar clearing—for the SSI designees, provided that the "activities do not involve transacting in, providing financing for, or otherwise dealing in prohibited transaction types identified by these directives;"
- OFAC clarified that the SSI sanctions extend to the "provision of services" related to the prohibited activities. For example, this restriction would encompass custodial services;
- OFAC also emphasized that SSI sanctions do not include asset-blocking requirements. Rather, if US financial institutions or other US persons identify a possible prohibited transaction, they must reject the transaction and report the event to OFAC within 10 business days.

OFAC has also issued a general license authorizing transactions "involving derivative products whose value is linked to an underlying asset that constitutes [] debt with a maturity of longer than 90 days or equity issued on or after July 16, 2014" by either entity.[8] The general license does not authorize the holding, purchasing, or selling of underlying assets.

B. Special Issues for the Energy and other Sectors

US energy firms and those in other sectors must also consider the implications of new prohibitions on long-term debt transactions with OAO Novatek and Rosneft, key players in the Russian energy sector. The new prohibition could significantly complicate or imperil the formation of new joint ventures by US energy firms in Russia. Formation of such enterprises will require careful scrutiny, and we recommend that firms undertake a review of their existing relationships with SSI designees to determine whether they present sanctions compliance issues (*e.g.*, obligations to deal in "new" debt of the SSI designee or entities majority- owned by them).

III. EU Sanctions

The European Council has agreed to expand restrictive measures "with a view to targeting entities, including from the Russian Federation, that are materially or financially supporting actions undermining or threatening Ukrainian sovereignty, territorial integrity and independence." It also tasks the Council with "consider{ing} the possibility of targeting individuals or entities who actively provide material or financial support to the Russian decision-makers responsible for the annexation of Crimea or the destabilisation of Eastern-Ukraine." Such an expansion will require the negotiation and drafting of a new legal instrument and the agreement of the Council over which specific individuals and entities to designate. If this occurs—the European Council contemplates new measures by the end of July—then it would be the first EU sanctions designation of Russian entities.

The European Council is also seeking additional restrictions, including the suspension of new financing by the European Investment Bank in public sector projects in Russia and restricting European investment in Crimea.

IV. Conclusion

Until Russia meets key benchmarks established by the Obama Administration, viz., de-escalation—halting the flow of weapons, return of border checkpoints to Ukrainian authorities, release of hostages, and progress on peace talks—the US Administration has signaled its intent to impose further sanctions. In the meantime, OFAC's new sanctions against Russia have given rise to numerous questions and concerns about applicable compliance requirements, which may result in further guidance issued by OFAC. The EU has also agreed, in principle, on extension of its sanctions regime. These developments warrant close monitoring, and we urge firms to assess the extent to which expanded US and/or EU sanctions against Russia create new business risks and compliance challenges.

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[1] OFAC Sector Sanctions Identifications List, July 16, 2014, *available at* http://www.treasury.gov/ofac/downloads/ssi.pdf.

[2] Executive Order 13662, Blocking Property of Additional Persons Contributing to the Situation in Ukraine, Mar. 20, *accessed at* http://www.treasury.gov/resource-center/sanctions/Programs/Documents/ukraine_eo3.pdf.

[3] Directive 1 Pursuant to EO 13992, *available at* http://www.treasury.gov/resource-center/sanctions/Programs/Documents/eo_13662_directives.pdf.

[4] Directive 2 Pursuant to EO 13992, *available at* http://www.treasury.gov/resource-center/sanctions/Programs/Documents/eo_13662_directives.pdf.

[5] *See* "Questions Related to Sectoral Sanctions under Executive Order 13622," #371, *available at* http://www.treasury.gov/resource-center/faqs/Sanctions/Pages/answer.aspx#371.

[6] *Id*.

[7] See "Questions Related to Sectoral Sanctions under Executive Order 13622," *available at* http://www.treasury.gov/resource-center/faqs/Sanctions/Pages/ques_index.aspx#sectoral.

[8] General License No. 1 Authorizing Certain Transactions Related to Derivatives under Directive 1 and Directive 2 of Executive Order 13662, July 16, 2014, *available at* http://www.treasury.gov/resource-center/sanctions/Programs/Documents/ukraine_gl1.pdf.

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