

# Ukraine-related sanctions: Key issues for financial institutions

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## What is the status of the evolving international sanctions against Ukraine and Russia?

Since the recent escalation of the Ukraine crisis in March, there have been almost daily developments regarding economic sanctions – ranging from details of implementation to proposals for new or tougher measures. This report provides a snapshot of the current sanctions, how they apply to financial institutions doing business in or with Ukraine and Russia and their customers and counterparties, compliance requirements in different scenarios, and where sanctions might be headed in the near future.

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## I. Current Sanctions

### A. Who has imposed sanctions?

A number of jurisdictions have introduced sanctions measures in response to the situation in Ukraine, including the United States (US), the European Union (EU), Canada, and Australia, and other countries may do so. Russia also has responded with its own sanctions, imposing a travel ban on specified US officials. This report will focus on the main sanctions imposed by the US and the EU.

### B. What are the current US and EU sanctions measures?

In March 2014, the US issued three Executive Orders pursuant to which the Obama administration has since imposed sanctions in announcements made in March and April on 45 individuals and 19 entities.<sup>1</sup> These Executive Orders also set the stage for more sweeping sanctions that potentially may be imposed against individuals and entities in various sectors of the Russian economy.<sup>2</sup> In addition, on April 3, 2014, the US also enacted legislation that supplements the Executive Orders and authorizes potential sanctions against additional categories of Ukrainian and Russian persons.<sup>3</sup>

In particular, the US sanctions issued to date require US persons (including US citizens, banks incorporated in the US, including foreign branches, and any individual or entity located in the United States including US branches of non-US banks) to block (freeze) all property or interests in property of designated parties, where such property or interests in property are or come within the United States or the possession or control of US persons anywhere in the world. The US sanctions also prohibit US persons from engaging, directly or indirectly,

1 The entities include Bank Rossiya (designated on March 20, 2014), Chernomorneftgaz (designated on April 11, 2014; the designation refers only to the entity in Crimea at the address listed, and not its parent company), and 17 Russian banks and companies (designated on April 28, 2014).

2 The Executive Orders (13660, 13661, and 13662) can be accessed here: <http://www.treasury.gov/resource-center/sanctions/Programs/Pages/ukraine.aspx>. The list that identifies designated parties (i.e., the Specially Designated Nationals and Blocked Persons List ("SDN List")) is maintained by the U.S. Treasury Department's Office of Foreign Assets Control ("OFAC"), and can be accessed here: <http://www.treasury.gov/resource-center/sanctions/SDN-List/Pages/default.aspx>.

3 The legislation, the *Support for the Sovereignty, Integrity, Democracy, and Economic Stability of Ukraine Act of 2014*, can be accessed [here](#).

in any dealings with, or for the benefit of, designated parties. Non-US financial institutions also may be subject to these restrictions if they act in the United States or their transactions have some other US nexus. Designated individuals also are subject to a visa ban.<sup>4</sup>

The Executive Orders also target entities that are owned or controlled by designated parties. As a general rule, entities with 50% or greater ownership interest held by a designated party, directly or indirectly, are deemed blocked by operation of law (together with designated parties, referred to as “blocked persons”) even in the absence of a specific designation. Absent a license, US persons likewise must block (freeze) the property of such blocked parties and are restricted from dealing with them, directly or indirectly. With respect to entities in which a designated party has a significant ownership interest that is less than 50%, or which a designated party may control by means other than a majority ownership interest, US persons are advised to act with caution as these parties may be designated in the future.

In parallel with the US sanctions, the EU has imposed sanctions on 48 individuals from Russia and Crimea.<sup>5</sup> These sanctions include an asset freeze, as well as an entry and transit ban.<sup>6</sup> The EU has further imposed a separate asset freeze on 22 individuals in relation to alleged misappropriation of Ukrainian state funds and human rights violations in Ukraine.<sup>7</sup> There are a few matches between the

names featured on the US sanctions list and on the EU sanctions lists, but the EU sanctions are so far relatively narrow; the main difference compared to US sanctions is that the EU has not yet designated any entities and the currently designated persons mostly consist of politicians and military officers.<sup>8</sup>

As a result of the asset freeze, all funds and economic resources belonging to, or controlled by, these EU-designated persons must be frozen. Furthermore, no funds or economic resources may be made available - either directly or indirectly - to or for the benefit of these persons. This means, for example, that funds or economic resources cannot be made available through persons or entities owned or controlled by designated parties.<sup>9</sup> In other words, if there is EU jurisdiction, one cannot as a general rule do business with these individuals, or legal persons, entities or bodies associated with them.

The concepts “funds” and “economic resources” are interpreted very broadly in the EU to include anything that can be used to obtain funds, goods or services.

### C. Are there any exceptions or carve outs?

In the US, in limited circumstances, sanctions authorities might grant a license authorizing a party to engage in certain activities that otherwise would be prohibited.<sup>10</sup> Possible examples include authorizations to wind down transactions involving designated parties pursuant to contractual commitments entered into prior to designation. OFAC also potentially could authorize financial institutions to process otherwise prohibited payments where the underlying transaction meets certain criteria, e.g., food, medicine, or humanitarian goods. The US may issue guidance on possible exceptions. Designated parties also can submit a written request to US authorities to be “delisted.”<sup>11</sup>

Under the EU sanctions, the competent authorities of the EU Member States can authorize derogations from asset freeze measures in certain specified, limited circumstances. For example, derogation from the asset freeze could be allowed if payments are intended exclusively for the payment of fees or service charges for routine holding or maintenance of

4 Effective March 1, 2014, the U.S. Commerce Department’s Bureau of Industry and Security (“BIS”) separately placed a hold on the issuance of any export licenses authorizing the export or re-export of items to Russia. BIS has stated that this practice will continue until further notice. On April 28, 2014, BIS announced that they would deny any pending applications to export or re-export any high technology item subject to the Export Administration Regulations (EAR) to Russia or Crimea that contribute to Russia’s military capabilities, and that existing licenses that meet these conditions also would be revoked. In actions taken on April 11 and 28, 2014, BIS added a total of 14 companies to the Entity List. Designation on the Entity List imposes a license requirement for the export, reexport or in-country transfer of items subject to the EAR to these companies, with the presumption of denial. On March 27, 2014, the State Department placed a hold on all pending export license applications for exports to Russia. Effective April 28, 2014, it also announced that it would deny any pending applications for export or re-export of any high technology defense articles or services regulated under the US Munitions List (USML) to Russia or Crimea that contribute to Russia’s military capabilities, and that existing licenses that meet these conditions also would be revoked.

5 See Regulation 269/2014 at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2014:078:0006:015:EN:PDF>. The list identifying designated parties is featured in Annex I. See also Implementing Regulation 284/2014 at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2014:086:0027:029:EN:PDF> and Implementing Regulation 433/2014 at [http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:JOL\\_2014\\_126\\_R\\_0002&from=EN](http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:JOL_2014_126_R_0002&from=EN). The lists identifying designated parties are featured in the Annexes to these Regulations.

6 See Council Decision 2014/145/CFSP, Article 1, at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014D0145&from=EN>.

7 See Regulation 208/2014 at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0208&from=EN>. The list identifying designated parties is featured in Annex I. See also Implementing Regulation 381/2014 at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0381&from=EN>. The list identifying designated parties is featured in Annex I, while certain

amendments to entries for previously listed parties are specified in Annex II.

8 Some additional restrictions have also recently been imposed by individual EU Member States in response to the Ukraine crisis; for example, the UK has suspended all existing and pending licences covering export to Russia of certain military and dual-use items which could be or are being deployed against Ukraine, while encouraging other European countries to do the same. See <http://blogs.bis.gov.uk/exportcontrol/uncategorized/notice-to-exporters-201406-uk-suspends-all-licences-and-licence-applications-for-export-to-russian-military-that-could-be-used-against-ukraine/>. However, confirmed individual Member State restrictions have so far focused on export control of specific goods, rather than further financial sanctions.

9 Council guidelines provide further clarification as regards the specific terms of making funds and economic resources “indirectly” available through persons or entities owned or controlled by the listed parties, referring to factual elements such as shareholdings, participation in the decision-making process, etc. See <http://register.consilium.europa.eu/doc/srv?l=EN&t=PDF&gc=true&sc=false&f=ST%209068%202013%20INIT>.

10 The relevant principal US authority is the US Department of the Treasury’s Office of Foreign Assets Control (“OFAC”).

11 OFAC is responsible for delisting.

frozen funds or economic resources, or where a payment by a designated party is due under a contract that pre-dates the asset freeze, provided the payment does not benefit that designated party. Furthermore, the asset freeze will not prevent the crediting of frozen accounts by financial or credit institutions that receive funds from third parties, or the addition of interest or other earnings to frozen accounts.<sup>12</sup>

#### **D. What are the penalties for violating sanctions?**

US penalties for violations of the sanctions can be severe, including substantial civil and criminal fines and imprisonment. The Executive Orders also establish that the provision of support or services, including financial services, to designated persons is a criterion for potential future designation

In the EU, the competent authorities of the EU Member States are responsible for implementation and enforcement of such sanctions policy.<sup>13</sup> All Member States enforce EU sanctions through criminal law, but the precise scope of penalties (including fines and imprisonment) can therefore vary from one Member State to another.

## **II. What the sanctions mean for your financial institution**

### **A. Do the sanctions apply to your financial institution?**

With respect to US sanctions, first you must determine if you are a US Person. The sanctions apply to US Persons, which include:

- Individuals and entities located in the United States;
- US citizens and green card holders, wherever located;
- US incorporated companies and banks, including foreign branches; and
- US subsidiaries of non-US companies.

US persons are prohibited from dealing directly or indirectly with designated parties or blocked persons. US financial institutions involved in transactions with Russian entities that become designated must ensure they take the appropriate actions required under US law. For example, any US investment advisor, investor, or trading platform will need to ensure its actions going forward are consistent with the designated status of the Russian entity and the financial instruments in which that entity has an interest.

Second, financial institutions that are not US Persons still must determine on a transaction-by-transaction basis (for all activities including, but not limited to,

financings, note issues, underwritings, IPOs, syndications, trading activities, or actions that support or facilitate any of the foregoing) whether a transaction with a US nexus (denominated in US dollars, involving US persons, or somehow taking place in the United States or availing itself of the US financial system) also involves blocked persons. Under certain circumstances, US sanctions can reach non-US persons involved in transactions with blocked persons if the transaction occurs in the United States or has a sufficient US nexus. Moreover, even where there is no apparent US nexus, you should exercise extreme caution engaging in transactions with blocked persons given the fluid and evolving nature of the sanctions and the fact that the US has warned that it may designate additional parties, including those found to have provided support to designated parties. The Executive Orders specifically identify the provision of support or other services to designated parties as a basis for potential future designations.

EU sanctions are only applicable to activities falling under EU jurisdiction, i.e., when there is an EU nexus linking restricted activities to the EU. As a general rule, the EU has jurisdiction in the following five situations:

- a) within the EU territory;
- b) on board any aircraft or vessel under EU Member State jurisdiction;
- c) to nationals of EU Member States (even if outside the EU);
- d) to entities incorporated or constituted under the law of a Member State; and
- e) to entities in respect of any business done in whole or in part within the EU.

This means that non-EU companies can potentially be covered by the EU's sanctions, depending on the circumstances under which they perform business activities in the EU. For example, in such a context, there will generally be EU jurisdiction when Member State nationals are acting as employees, or when a particular (restricted) transaction relates to the company's business within the EU.

### **B. What steps can be taken to comply with the sanctions and limit exposure?**

Key steps to manage risk under the US and EU sanctions now in place include:

- Screening parties to transactions (e.g., lenders, borrowers, guarantors, debt/equity issuers) that involve a Russian or Ukrainian element against comprehensive designated party lists;
- Performing due diligence with respect to ownership of parties to transactions, including beneficial ownership;

<sup>12</sup> See Articles 4-7 of Regulation 269/2014.

<sup>13</sup> See listing of websites for more information on the EU Member States' competent authorities in this context in Annex II of Regulation 269/2014.

- Performing heightened due diligence with respect to transactions where there are red flags or otherwise may be a reason to believe a designated entity is benefiting from a transaction that on its face does not involve one;
- Considering additional contractual language, representations, warranties, covenants, and other protections in transaction documents to cover current or future Ukraine-related sanctions;
- Reviewing and ensuring that compliance programs are robust and effective, with adequate procedures and training programs, and are updated to account for the Ukraine-related sanctions;
- Monitoring and anticipating possible future sanctions; and
- Seeking OFAC or other authorization where necessary.

### III. How the sanctions scenario might change in the future

The current sanctions are fluid and volatile, and are subject to unforeseeable political and economic developments. For example, in the US, one Executive Order already authorizes future sanctions on entities operating in the financial services, energy, metals and mining, engineering, and/or the defense and related materiel sectors of the Russian Federation. In addition, the legislation passed on April 3, 2014 authorizes future sanctions on close associates or family members of Russian Government officials.

With respect to EU sanctions in response to the Crimea crisis, the EU Council recently confirmed that work is underway on a proposal for economic, trade and financial sanctions which would be applied if further steps are made by Russia to destabilize the situation,<sup>14</sup> but the details and timing of such additional restrictions are at this stage unclear. Furthermore, it has been reported that the EU will in the near future impose economic and trade restrictions against Crimea itself which would essentially treat it as an occupied territory, as a legal consequence of Russia's annexation.<sup>15</sup>

On April 17, 2014, the US, EU, Ukraine, and Russia engaged in diplomatic talks in Geneva and agreed on initial concrete steps to de-escalate the crisis. On April 28, the G-7 issued a statement promising further sanctions in light of the absence of Russian steps to implement the agreement reached in

Geneva.<sup>16</sup> The additional EU and US designations and export restrictions were announced following the G-7 statement. There continues to be talk of potential new sanctions on the horizon.

Taking a historical look at sanctions imposed in past crises may suggest alternative future scenarios, assuming there is no definitive diplomatic solution to this crisis:

- Current sanctions could continue in place largely as is for an extended period;
- Sanctions could become progressively tougher and broader in scope but still allow significant financial activity (which EU sanctions normally do in any event, as there is a tendency to avoid comprehensive country-wide sanctions measures);
- Expanded sanctions could include restrictions on additional Russian government entities (e.g., police/military, state-owned banks) or on close associates or family members of Russian Government officials, restrictions on individuals or entities in certain sectors (e.g., financial services, energy, metals and mining, engineering, and/or defense), and limitations on government procurement opportunities;
- From the US perspective, extraterritorial measures or "secondary sanctions" also could be imposed that, for example, would require no US nexus as was done in the case of Iran (e.g., prohibiting access to the US commercial and financial systems to non-US entities that engage in sanctionable conduct);
- Comprehensive country-wide sanctions that would restrict all commercial and financial activity relating to Russia (an unlikely scenario unless events escalate markedly); and
- Strengthening of sanctions by the US and EU would also likely lead to strengthening of sanctions by Russia.

<sup>14</sup> See [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/EN/foraff/142223.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/foraff/142223.pdf).

<sup>15</sup> See <http://www.euractiv.com/sections/europes-east/eus-crimea-sanctions-modelled-occupied-palestinian-territories-301573>.

<sup>16</sup> See [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ec/142405.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/142405.pdf).

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## Key Resources

For additional information related to the US  
and EU sanctions see  
[www.whitecase.com/ukraine-news-update](http://www.whitecase.com/ukraine-news-update)

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