Updates
March 21, 2022

Recent Developments in US Sanctions and Export Controls Targeting Russia

Following Russia's recognition of breakaway regions in Ukraine and full-scale invasion of the country, authorities in the United States, United Kingdom, European Union, and across the globe imposed a sweeping array of trade and economic sanctions, export controls, and other financial countermeasures.

Measures taken to date include:

- The imposition of blocking sanctions on key financial institutions, state agencies and enterprises, and political leaders and oligarchs in Russia and its ally, Belarus, as well as companies critical to the Russian economy;
- Certain restrictions on transactions and dealings with the Russian Central Bank as well as its largest commercial bank, Sberbank;
- Export controls on goods essential to the defense, oil and gas, and maritime industries;
- A ban on the export to Russia of U.S. luxury goods and U.S. dollar-denominated banknotes;
- A ban on the import of Russian oil, petroleum, coal, liquidized natural gas, seafood, alcohol, and diamonds into the United States; and
- Removal of several Russian banks from the Society for Worldwide Interbank Financial Telecommunications (SWIFT) financial messaging system.

Barely one month into what may become a protracted conflict—with increasingly dire humanitarian consequences—additional sanctions and trade restrictions appear likely.

We first wrote about these issues in a update released on March 2, 2022. Below we discuss developments since that date and key takeaways for U.S. companies and financial institutions.

OFAC Sanctions

The United States has not yet imposed comprehensive, countrywide sanctions on Russia. Thus, in contrast to Cuba; Iran; Syria; North Korea; and the Donetsk, Luhansk, and Crimea regions of Ukraine, U.S. companies and financial institutions are not entirely barred from activities in and transactions with Russia. In the aggregate, however, the sanctions implemented against Russia may be approaching a total embargo in practice. Many U.S. companies have decided to discontinue business in Russia for the time being. Although such a posture is not required as a matter of law, many companies have determined that the risks and compliance burdens (as well as potential reputational impact) of Russia-facing activity outweigh the benefits of continuing to operate in the country. They also may be concerned regarding obtaining payment for their goods and services from Russian counterparties.

Almost daily since the beginning of the conflict in late February, the Office of Foreign Assets Control (OFAC) has continued to add Russian and Belarusian entities and individuals to its Specially Designated Nationals and Blocked Persons (SDN) list. These broad sanctions have primarily targeted Russian government and business leaders (and their family members), key financial institutions, and state-owned entities, as well as other private enterprises viewed as critical to the Russian economy. In the absence of specific or general authorization from OFAC, U.S. persons are prohibited from conducting or facilitating transactions or dealings of any kind with any person or entity on the SDN list. U.S. persons must block (i.e., freeze) any property or interest in property in their possession that belongs to an SDN. Further, under the "50 Percent Rule," any other entity in which one or more SDNs owns, directly or indirectly, a 50% or greater interest must be treated as a blocked property even if the other entity is not itself listed on the SDN list. In practice, these designations have caused significant disruption for companies doing business directly or indirectly with Russia, particularly with regard to several large Russian banks that have been added to the SDN list as well as Western relationships with the many global businesses in which designated Russian business leaders own interests.

New BIS Export Controls on Russia and Belarus

New Export Controls to Belarus

The U.S. Department of Commerce's Bureau of Industry and Security (BIS) expanded export controls to Belarus based on the country's enabling of Russia's invasion of Ukraine. The new restrictions are intended to target defense, aerospace, and maritime sectors of Belarus, adding new license requirements and review policies that mirror those imposed on Russia.

New BIS License Requirement Targeting Russia's Oil Refinery Sector

BIS has issued numerous export controls regarding Russia, Belarus, and the breakaway regions of Ukraine. In response to the continued conflict, BIS expanded existing Russian industry sector sanctions by adding a new export license requirement under the Export Administration Regulations (EAR) that targets the oil refinery sector in Russia. The changes restrict the Russian oil sector by prohibiting export, re-export, or in-country transfers of items needed for oil refining. Sale of gasoline is a major source of revenue for Russia, and these limitations reduce Russia's ability to generate the revenue the country needs to support its military capabilities.

BIS's new rule amends EAR Part 746, "Embargoes and Other Special Controls" to include a new general prohibition on export of items under certain Harmonized Tariff Schedule (HTS) numbers. Specifically, oil refinery sector related items (listed by HTS number and Schedule B codes) now have a license requirement to Russia. There is a policy of denial for related license applications, however, a case-by-case review will be undertaken by BIS for any items that may be needed for health and safety reasons.

New Additions to the BIS Entity List

On March 4, 2022, BIS added 91 entities to its "Entity List" that have been involved in, contributed to, or otherwise supported the Russian security services, military and defense sectors, and military and/or defense research and development efforts. All items "subject to the EAR" now require a license for export to these entities. For 86 of the 91 entities, there is an export license policy of denial. The remaining five entities also carry a policy of denial except to government space programs. Importantly, no EAR license exceptions are available.

Luxury Goods Restricted

On March 11, 2022, pursuant to Executive Order (EO) 14068, BIS restricted exports, re-exports, or in-country transfer of a long list of "luxury goods" to or within Russia or Belarus, as well as to certain oligarchs and malign actors of Russia/Belarus wherever located.

Executive Orders

EO 14066, "Prohibiting Certain Imports and New Investments With Respect to Continued Russian Federation Efforts To Undermine the Sovereignty and Territorial Integrity of Ukraine," published March 8, 2022

EO 14066 bans, among other things, import into the United States of certain Russian-origin energy products and new investments in the Russian energy sector. Specifically, it prohibits imports of crude oil; petroleum; petroleum fuels, oils, and products of their distillation; liquefied natural gas; coal; and coal products of Russian origin into the United States. However, OFAC published General License 16, which grants a wind-down period until April 22, 2022, for contracts entered into before March 8, 2022.

This EO also broadly bans all "new investment in the energy sector in the Russian Federation." The term "new investment" is defined by OFAC, to include any "transaction that constitutes a commitment or contribution of funds or other assets for, or a loan or other extension of credit to, new energy sector activities (not including maintenance or repair)." See OFAC FAQ 1019.

EO 14068, "Prohibiting Certain Imports, Exports, and New Investment With Respect to Continued Russian Federation Aggression," published March 11, 2022

EO 14068 prohibits a number of activities implicating Russian entities and industries. These include the importation into the United States of the following products of Russian Federation origin: seafood, alcoholic beverages, and non-industrial diamonds, as well as any other items that may be later identified. The EO also prohibits the exportation, re-exportation, sale, or sale from the United States (or any U.S. person) of certain luxury goods (as noted above). Finally, it bans the sale or supply of U.S. dollar-denominated banknotes to the government of Russia or any person located in Russia.

Broad Potential Prohibition of New Investment in Key Industries

As noted above, EO 14066 (March 8) implemented prohibitions that targeted new investment in the energy sector. While EO 14068 (March 11) did not target any particular industry, it signaled that more industries are likely to be targeted by including a provision prohibiting "new investments by U.S. Persons in any sector of the Russian economy as to be determined by the Secretary of the Treasury." Given this language, it is possible that other critical industry sectors—such as the technology sector—eventually may be targeted with such prohibitions, especially given the focus of other trade restrictions on the technology industry.

Treasury Department Advisory on Sanctions Evasion

Sanctioned Russian and Belarusian persons may seek to evade sanctions through various means, such as through non-sanctioned Russian and Belarusian financial institutions and financial institutions in third countries as well as through use of foreign exchange houses, cryptocurrency, and pass-through transaction parties intended to hide the true parties in interest. Anticipating substantial efforts to evade these sanctions, the Financial Crimes Enforcement Network (FinCEN) has issued multiple targeted warnings to financial institutions to be vigilant against these evasion efforts, including discussion of numerous specific red flags to which global businesses should remain alert.

Specifically, in March 7, 2022, and March 16, 2022, alerts, FinCEN identified key red flags to assist in identifying potential sanctions evasion activity. It also used the opportunity to remind financial institutions of their Bank Secrecy Act (BSA) reporting obligations, including with respect to convertible virtual currency (CVC) (which is widely expected to play a key role in efforts to evade these sanctions) and to encourage banks to make full use of their ability to share information consistent with the USA PATRIOT Act. FinCEN further highlighted the risk of sanctions evasion efforts involving real estate, luxury goods, and other high-value assets of sanctioned Russian individuals and entities.

The following are some red flags identified by FinCEN:

- Use of corporate vehicles to obscure ownership, source of funds, or countries involved.
- Use of shell companies and/or trusts or other third-party intermediaries to conduct international wire transfers or purchase real estate and luxury goods.
- Accounts in jurisdictions or with financial institutions that are experiencing a sudden rise in value, without a clear economic or business rationale.
- The dilution of equitable interest held in real property by sanctioned Russian elites and their proxies, by the addition of, or the transfer of real estate to, an individual not affiliated with the buyer or seller.
- Newly established accounts that attempt to send or receive funds from a sanctioned institution or an institution removed from SWIFT.
- A customer's transactions are connected to CVC addresses listed on OFAC's SDN list.
- A customer initiates a transfer of funds involving a CVC mixing service.
- The involvement of law firms or other service providers based in global and offshore financial centers that have historically specialized in Russian clientele or in transactions associated with sanctioned Russian elites and their proxies.

It is worth noting that anti-money laundering/countering the financing of terrorism/counter proliferation (AML/CFT/CP) and sanctions compliance obligations apply to CVC transactions, just as they do to transactions involving fiat currency.

Enforcement Initiatives Ramping Up

Given the strategic foreign policy and national security implications of these sanctions, it should be no surprise that U.S. and foreign regulators appear to be ramping up for aggressive investigation and enforcement initiatives targeting sanctions evasion. On March 2, 2022, the U.S. Department of Justice (DOJ) announced Task Force KleptoCapture, a new multi-agency effort dedicated to prosecuting Russia sanctions evasion combining the resources of DOJ, the Federal Bureau of Investigation (FBI), U.S. Department of Homeland Security (DHS), U.S. Marshals Service, and Internal Revenue Service (IRS), among other agencies.

It appears that Task Force KleptoCapture will support a broader multilateral enforcement effort launched on March 16: Russian Elites, Proxies, and Oligarchs (REPO) Task Force. REPO will leverage combined investigative and enforcement resources and coordination among several powerful allies, including the United States, Australia, Canada, the European Commission, France, Germany, Japan, Italy, and the United Kingdom.

To augment this surge in resources and coordination, the U.S. Department of the Treasury has also launched a new whistleblower program: Kleptocracy Asset Recovery Rewards Program. The program authorizes awards of up to $5 million to individuals who provide information leading to the restraint or seizure, forfeiture, or repatriation linked to foreign corruption, specifically targeting Russian government officials and oligarchs.

Permanent Normal Trade Relations (PNTR) Suspension

On March 11, President Biden announced that the United States, along with the EU and remaining Group of 7 (G-7) countries, would suspend PNTR (formerly, "Most Favored Nation" status) with Russia. The U.S. House of Representatives has since voted overwhelmingly in favor of removing PNTR status from both Russia and Belarus. The bill now moves to the U.S. Senate for approval. If passed, Russia and Belarus will join Cuba and North Korea—the only two countries currently without PNTR status with the United States. Removal of PNTR with Russia and Belarus would mean significantly higher duty rates on numerous products imported from these countries.

Caveats

- This summary includes sanctions developments through March 20, 2022.
- The reaction of the government of Russia is still uncertain. Among other countermeasures, Russia could freeze USD bank accounts or ban Western products/technology. Russia has already apparently severed access to various Western media platforms and threatened to nationalize the assets of Western firms that suspend operations in Russia.
- Shipping delays should be anticipated in this region of the world.

Recommendations

As noted in our prior update, U.S. persons or entities with interests in, or exposure to, Russia should carefully consider risks presented by the new and emerging sanctions and export controls, especially given the rapid pace at which developments have occurred. In particular, and at a minimum, we recommend evaluating sanctions and export control compliance programs to determine:

- Whether counterparties are being effectively screened;
- Whether there are operations or business relationships in any of the sanctioned separatist regions of Ukraine;
- Whether there are certain services being provided remotely and, if so, whether the risk of sanctioned person or sanctioned region involvement is adequately addressed;
- Whether any foreign subsidiaries and affiliates have been alerted to the Russia/Ukraine sanctions and informed of compliance obligations (e.g., examining and possibly alerting banking relationships);
- Whether any U.S.-origin products or technology are being exported to Russia or Belarus;
- Whether products imported from Russia may be affected by new import restrictions; and
- Whether a company's sanctions screening software and tools account for the red flag indicators listed in FinCEN's recent advisories.

Conclusion

Continued developments are expected with regard to sanctions and export controls targeting Russia and Belarus. We will continue to closely monitor the responses by the U.S. government and its allies against Russia in the wake of Russia's invasion into Ukraine.

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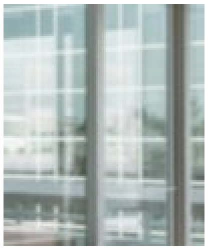

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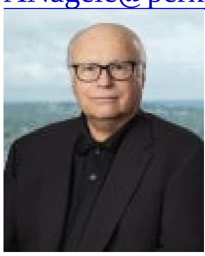

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