Enhanced Global Russian Sanctions and Export Controls to Counter Circumvention

June 2, 2023

On May 19, in response to Russia's ongoing invasion of Ukraine, the United States, in coordination with allies and partners, announced new sanctions restrictions and export controls targeting Russia's evasion networks, critical technology-acquisition channels, energy extraction capabilities and financial conduits. A key new reporting obligation has also been created for holders of property of the Russian Central Bank and Ministry of Finance.

These measures align with expected forthcoming restrictions imposed by the United Kingdom and an anticipated 11th tranche of EU sanctions and underscore a pronounced enforcement focus on sanctions evasion through third countries in Europe, Central Asia and the Middle East.

United States

Action Against Evasion/Circumvention Networks

As previously reported, one major focus of the Department of the Treasury's Office of Foreign Assets Control (OFAC) continues to be preventing individuals and entities from evading or circumventing economic sanctions aimed at degrading Russia's military-industrial complex. The latest round of sanctions restrictions have touch points in more than 20 third countries and regions and include the addition of 126 individuals and entities to OFAC's Specially Designated Nationals and Blocked Persons (SDN) List. The breadth of these designations underscores OFAC's view that "Russia has turned to evasion and circumvention to attempt to acquire the goods its military-industrial complex desperately needs." In further designating entities across Europe, Asia and the Middle East, OFAC stated that "[t]hese targets implement the G7 Leaders' call for third countries or other international actors who seek to evade or undermine economic restrictions to cease providing material support to Russia's war, or face severe costs." Counter-evasion and anti-circumvention is likely to remain a priority area.

New Legal Instruments: Architecture, Engineering and Russian Government Property Reports

Effective May 19, 2023, OFAC has further expanded sanctions authorities by issuing determinations under Executive Orders (EOs) 14024 and 14071 to target additional sectors of Russia's economy and prevent Russia from accessing new categories of services.

- EO 14024 determination – This determination provides that persons operating in "the architecture, engineering, construction, manufacturing, and transportation sectors of the Russian Federation economy" may now be subjected to full blocking restrictions in section 1(a)(i) of EO 14024. OFAC guidance explains that "[a] sector determination pursuant to E.O. 14024 exposes persons that operate or have operated in an identified sector to sanctions risk; however, a sector determination does not automatically impose sanctions on all persons who operate or have operated in the sector." As such, Russia's architecture, engineering, construction, manufacturing and transportation sectors have now been formally identified as extremely high-risk sectors, along with defense/aerospace, financial services, marine, accounting, management consulting and others, which were the subjects of previous determinations. *See* FAQ 1126.
- EO 14071 determination – Subject to a brief wind-down period and certain exclusions, this determination prohibits the provision of "architecture services or engineering services" by US persons or from the United States to any person located in the Russian Federation under EO 14071. OFAC has issued guidance clarifying the scope of architecture and engineering services, respectively. *See* FAQ 1128. Notably, this determination does not prohibit US persons from providing services to persons located outside of Russia, which are owned or controlled by persons located in Russia, so long as the provision of services is not an indirect export to a person located in Russia. *See* FAQ 1059. Nor does this determination necessarily apply to entities located in Russia that are "owned or controlled, directly or indirectly, by a United States person." *See* FAQ 1061. However, the determination's prohibitions do apply to services provided to a parent company located in the Russian Federation by a US subsidiary. *See* FAQ 1062.

In addition to the expanded coverage of industrial sectors, OFAC has also revised Russia-related Directive 4 issued under EO 14024 to include a detailed reporting requirement. Although Directive 4 prohibitions effectively immobilize "any assets of the Central Bank of the Russian Federation, the National Wealth Fund of the Russian Federation, or the Ministry of Finance of the Russian Federation . . . that are held in the United States or by U.S. persons," they do not impose blocking sanctions. *See* FAQ 1004. Rather, US persons must reject transactions involving the Directive 4 entities, unless such transactions are exempt or authorized by OFAC. *Id.* Further, Directive 4 "does not prohibit trading in the secondary markets for debt or equity of the Central Bank of the Russian Federation, the National Wealth Fund of the Russian Federation, or the Ministry of Finance of the

Russian Federation . . . , provided that no Directive 4 entity is a counterparty to such a transaction," unless prohibited by other sanctions. *See* FAQ 1005.

In modified form, Directive 4 now establishes reporting requirements for "United States persons who are in possession or control of property in which any entity determined to be subject to the prohibitions of this Directive has an interest of any nature whatsoever, direct or indirect[.]" Such US persons "must submit a report" to OFAC on or before June 18, 2023, and annually thereafter by June 30, including six categories of information typically included in OFAC reports on blocked or rejected transactions.

New Energy Sector Sanctions

OFAC has also expanded its focus on Russia's energy sector, now blocking as SDNs several of Russia's energy educational institutions, energy-related research institutes and entities that provide funding for Russia's energy sector. These include universities that research extraction and processing of raw materials, develop geological exploration technology, engage in technical training, and conduct studies involving oil and gas production. The designations also cover institutions focused on prospecting and exploration, enhanced oil recovery, transportation, refining, and development of polymers used by Russia's oil and gas industry. In addition, OFAC has targeted firms that provide funding and consulting services for Russia's energy sector.

Financial Sector Sanctions

Building on previous actions against Russia's financial sector, OFAC has taken additional measures to disrupt Russia's use of the international financial system and target those willfully supporting the financing of Russia's war. These include designating entities headquartered or based in Switzerland, the United Arab Emirates, Cyprus, Singapore, Malta, the United Kingdom, Hong Kong and Estonia that engage in asset management, private equity, corporate restructuring and investment banking on behalf of Russian entities.

To further degrade Russia's financial sector, OFAC has now imposed full blocking sanctions under EO 14024 against the largest Russian gold miner, Public Joint Stock Company Polyus (Polyus), along with certain related parties. Given the potential impact of this designation, OFAC has issued general licenses (GL) 66-67 to authorize a wind-down period through August 17, 2023, for certain transactions involving Polyus and its majority-owned subsidiaries, or involving certain debt, equity or derivative contracts.

FinCEN & BIS Joint Alert

On May 19, the US Treasury Department's Financial Crimes Enforcement Network (FinCEN) and the US Commerce Department's Bureau of Industry and Security (BIS) issued a joint alert to supplement their previously issued alert. The alert provides financial institutions with information regarding new BIS export control restrictions related to Russia, while reinforcing US government engagements and initiatives aimed at constraining and preventing Russia from accessing the technology and goods to supply and replenish its military-industrial base.

A key element of the alert's guidance "details evasion typologies, highlights for financial institutions nine high priority Harmonized System (HS) headings [that are prone to evasive transactions], and identifies additional transactional and behavioral red flags to assist financial institutions in identifying suspicious transactions relating to possible export control evasion." These include electronic integrated circuits; processors and controllers, such as microcontrollers; memories, such as SRAM; amplifiers, such as op amps; and other items, such as field programmable gate arrays, certain communication equipment and certain capacitors.

Evasion typologies include entities obfuscating the involvement of SDNs or parties on the BIS Entity List in transactions and obscuring the true identities of Russian end users. These entities use various methods, including:

- Using front companies to route goods to Russia through permissive jurisdictions.
- Engaging in layering to obfuscate buyers/end users of goods.
- Having shell/front companies establish and use foreign bank accounts to transmit funds back to the supplier, which may also involve the transmittal of funds through a US correspondent bank.
- Using a non-designated Russian supplier to procure goods through a subsidiary of an authorized reseller of defense and dual-use items.
- Having procurement agents create both shell companies with foreign bank accounts and transshipment companies that may order and receive dual-use goods from multiple, but similar, suppliers to attract less attention than would large-volume transactions.

BIS Action Against Russia

BIS issued rules that impose additional restrictions by expanding controls to additional items in alignment with international partners and allies and added 71 entities to the Entity List, primarily for supporting Russia's military and defense sectors. In summary, the rule:

- Adds the remaining HTS-6 headings under three entire harmonized tariff system chapters (Chapters 84, 85 and 90; now over 2,000 total entries) to the industrial and commercial controls listed in Supplement No. 4 to Part 746 of the Export Administration Regulations (EAR), so that every HTS-6 heading under these three chapters is now controlled. The items include a variety of electronics, instruments and advanced fibers for the reinforcement of composite materials, including carbon fibers.

- Adds certain chemicals to Supplement No. 6 to part 746 of the EAR, which consists of discrete chemicals, biologics, fentanyl and its precursors, and related equipment designated EAR99 that may be useful for Russia's industrial capability or may be diverted from Belarus to Russia for activities of concern.
- Expands the list of foreign-produced items in Supplement No. 7 to part 746 of the EAR that require a license when destined to Russia, Belarus and Iran and further limits Iran's ability to provide Russia with unmanned aerial vehicles.
- Expands the destination scope of the Russia/Belarus Foreign-Direct Product (FDP) Rule, as well as other conforming changes. The rule applies the Russia/Belarus FDP Rule to the temporarily occupied Crimea region of Ukraine.

United Kingdom

Asset Freeze Designations

On May 19, 2023, the United Kingdom announced that 86 new entities had been added to its Consolidated List of asset freeze targets. These designations target individuals and organizations connected to Russia's energy, metals, defense, transport and financial sectors, including:

- Five financial institutions: JSC Dom RF, Rosbank, Tinkoff Bank, the Russian Regional Development Bank and Metallurgical Investment Bank.
- Nine organizations connected to Russia's state-owned nuclear energy company Rosatom, including two companies, UMATEX and TRINITI, that produce materials and technology used for military purposes.
- Twenty-four individuals and entities connected to the transport services sector—including Pawell Shipping Co., the State Grain Corporation and their director, Nikita Busel—which are connected to the systemic theft of Ukrainian grain.
- Six major Russian shipping companies, including Sun Ship Management, which is connected to Sovcomflot and has supported Russian sanctions evasion.
- Eight companies connected to metals production, including Severstal, Magnitogorsk Iron and Steel Works, and OMK Steel.
- Twenty military executives and companies, including JSC BMZ, which produces land mines used by Russian forces in Ukraine, and two directors of JSC Concern Kalashnikov, which produces 95% of all firearms in Russia.

Trade Sanctions

Also on May 19, the United Kingdom announced plans to ban the import of Russian-origin diamonds, copper, aluminum and nickel. The ban would complement an existing prohibition on the import of iron and steel products from Russia. The UK government said the legislation required to implement the new ban would be introduced "later this year."

Trade Sanctions Circumvention

On May 22, the Export Control Joint Unit (ECJU), the agency responsible for implementing the United Kingdom's trade sanctions regime, published a formal Notice to Exporters (NTE) warning of the risks of circumvention in procurement chains. The NTE explains how Russian companies seek to procure restricted goods using a layered approach involving multiple intermediaries and front companies to conceal their involvement.

In the NTE, the ECJU clarifies its expectation that traders implement robust internal sanctions governance and conduct due diligence on counterparties. According to the NTE, due diligence must be repeated regularly even for established counterparties to ensure risk has not changed established counterparties, and due diligence will need to be repeated regularly to ensure that the risk has not changed (for example, through a change in directors, ownership or products traded). The NTE sets out a list of risk factors relating to customers, products and jurisdiction, which traders should consider as part of their due diligence efforts.

General License for Prior Obligations

Also on May 22, the Office for Financial Sanctions Implementation issued GL INT/2023/3024200. The GL allows designated persons (DPs) under the Belarus and Russia sanctions regimes to transfer funds or economic resources to UK persons in satisfaction of a contractual obligation, provided the following conditions are met:

- The contractual obligation was signed before the DP was designated.
- The payment must be for the benefit of a UK person (i.e., a UK national or body incorporated in the United Kingdom, provided they are not themselves a DP).
- The maximum value permitted for payment under any such contract is £200,000 including VAT (or the equivalent in other currencies).
- No payments are made to another DP (though designated correspondent banks are permitted to process payments made in connection with the license).

The GL does not apply to the following ineligible contracts:

- Contracts involving financial instruments, such as bonds, derivatives, credit default swaps and repo transactions.
- Professional legal fees and/or expenses, which may be authorized under the Legal Services GL (INT/2023/2954852), provided the license terms are met.
- Ongoing prior obligations (i.e., where the contract was signed before designation but services have been provided post-designation).

The GL is valid for a period of six months until November 21, 2023. A UK person wishing to rely on the GL must report any relevant payments received to OFSI within one month and retain accurate and complete records of any relevant activity for a minimum of six years.

European Union

Proposed 11th Tranche of Sanctions

On May 9, EU Commission (Commission) President von der Leyen announced a proposal for an 11th tranche of Russia sanctions in response to Russia's invasion of Ukraine. As reported, this tranche will focus on combating circumvention, mainly through measures relating to imports and exports. The Commission president described this proposal as including three main elements:

- An expansion of transit bans, intended to ensure that products "that are going to third countries via Russia will no longer end up in the Kremlin's hands." The European Union plans to extend these bans to cover new additional products, such as aircraft parts and advanced technology goods.
- A ban on "shadow" entities from Russia and third countries that intentionally circumvent EU sanctions.
- A new tool of last resort to combat circumvention, which will sanction reexports of banned goods to Russia. Commission President von der Leyen has stated that "[t]his tool will be a last resort and it will be used cautiously, following a very diligent risk analysis, and after approval by EU Member States." As reported previously, this is in response to unusual trade flows showing that prohibited goods, such as advanced chips and integrated circuits made in the European Union or other allied nations, are shipped to Russia through third countries.

This new tool providing for the sanctioning of reexports is a big step forward for EU sanctions law. According to press reports, an updated version of the proposed tranche, currently under discussion, includes a newly added clause providing that before this tool is used, "alternative measures," such as individual asset freezes, should be considered.

Press reports also indicate that the proposal provides for asset freezes on "dozens" of Russian individuals and entities, including the Russian defense ministry; the SVR foreign intelligence agency, Rostec; associates of Rosoboronexport, which is the sole state intermediary agency for Russia's exports/imports of defense-related and dual-use products; and Positive Group, a company primarily engaged in software development activities.

In addition, the proposed asset freezes have been reported to extend to "tens" of third-country companies, including from China, Iran, Uzbekistan, Kazakhstan, Syria, Armenia and the United Arab Emirates. The Chinese companies in question are active mainly in the electronics and semiconductors sectors; some are already subject to US sanctions.

As for sectoral sanctions, the proposed 11th tranche aims to close loopholes related to the restrictions on Russian oil trading by addressing ship-to-ship transfers by uninsured vessels outside the European Union. Reportedly, the new measures provide that oil tankers cannot offload in high seas or arrive in ports with their GPS trackers off. However, these measures have already been criticized as insufficient to address the problem.

Overall, the proposed 11th tranche highlights the European Union's focus on anti-circumvention, including by the sanctioning of third-country reexports and foreign entities. The adoption of the new measures is expected in June. However, the tool for the sanctioning of reexports and the increased focus on China make it likely that negotiations will take longer than usual, with some reports pointing to the end of June as a likely time for the adoption of the measures.

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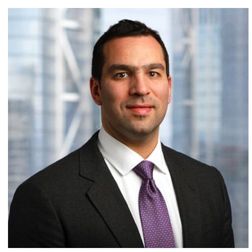

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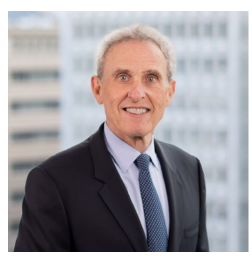

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