

## Alert

### Russian Sanctions Update: OFAC Issues Broad Restrictions on ‘New Investment’ in Russia

June 10, 2022

On June 6, 2022, the U.S. Treasury Department’s Office of Foreign Assets Control (“OFAC”) issued new and amended Frequently Asked Questions (the “FAQs”) setting forth what constitutes a prohibited “new investment” in the Russian Federation for purposes of the Russian Harmful Foreign Activities Sanctions program.<sup>1</sup>

The FAQs provide long-awaited guidance with respect to three Executive Orders (“E.O.s”) issued earlier this year by President Biden under the Russia sanctions program. All three E.O.s include some form of restriction on “new investment” in Russia by U.S. persons. E.O. 14066, issued March 8, 2022, prohibits “new investment in the energy sector in the Russian Federation”; E.O. 14068, issued March 11, 2022, gives the Secretary of the Treasury authority to prohibit “new investment in any sector of the Russian Federation”; and E.O. 14071, issued April 6, 2022—the broadest and most consequential ban—prohibits “new investment in the Russian Federation” as a whole, regardless of sector.<sup>2</sup>

The FAQs take a broad interpretation of “new investment” and will have a significant impact on U.S. market participants, especially those operating in the capital markets. Among other things, the FAQs ban U.S. persons from purchasing both new and *existing* debt and equity securities issued by *any* entity in Russia. They also ban U.S. persons from lending funds to, or purchasing an equity interest in, entities located *outside* of Russia under certain circumstances.

While providing important guidance and much-needed clarity as to the “new investment” prohibition, the FAQs at the same time leave the scope of the prohibition unclear in many respects and create new ambiguities as to how it applies in particular instances.

We discuss some key takeaways from the FAQs below.

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<sup>1</sup> For prior Schulte Roth & Zabel Alerts relating to the Russia sanctions program, see Russian Sanctions Update: FinCEN and NYDFS Issue Guidance (April 25, 2022), available at <https://www.srz.com/resources/russian-sanctions-update-fincen-and-nydfs-issue-guidance.html>; Sanctions Update: U.S. Imposes Sweeping Sanctions Against Russia and Belarus (Feb. 28, 2022), available at <https://www.srz.com/resources/sanctions-update-u-s-imposes-sweeping-sanctions-against-russia.html>; and Sanctions Update: US Begins to Roll Out Sanctions Against Russia (Feb. 22, 2022), available at <https://www.srz.com/resources/sanctions-update-u-s-begins-to-roll-out-sanctions-against-russia.html>.

<sup>2</sup> See Exec. Order No. 14066, 87 Fed. Reg. 47 (March 8, 2022), available at [https://home.treasury.gov/system/files/126/eo\\_14066.pdf](https://home.treasury.gov/system/files/126/eo_14066.pdf); Exec. Order No. 14068, 87 Fed. Reg. 50 (March 11, 2022), available at <https://home.treasury.gov/system/files/126/14068.pdf>; and Exec. Order No. 14071, 87 Fed. Reg. 68 (April 6, 2022), available at <https://home.treasury.gov/system/files/126/14071.pdf>.

## What is meant by the term “new investment” for purposes of the E.O.s?

FAQ 1049<sup>3</sup> states that, for the E.O.s’ purposes, “investment” means “the commitment of capital or other assets for the purpose of generating returns or appreciation.” “New investment,” in turn, means “a commitment made on or after the effective date of the [applicable] E.O.[’s] prohibitions” (“New Investment”). OFAC specifically notes that New Investments include both investments made pursuant to an agreement entered into on or after the effective date of the applicable E.O.’s prohibitions (“Effective Date”) and the exercise of rights under an agreement, even if entered into before the Effective Date, where the commitment itself is made on or after the Effective Date. “Maintenance” of an investment made prior to the applicable effective date, however, is permissible.<sup>4</sup>

To illustrate these definitions, OFAC provides the following lists of transactions that, respectively, *do* and *do not* constitute New Investments:<sup>5</sup>

### New Investments include:

- The purchase or acquisition of real estate in the Russian Federation, other than for noncommercial, personal use;
- Entry into an agreement requiring the commitment of capital or other assets for the establishment or expansion of projects or operations in the Russian Federation, including the formation of joint ventures or other corporate entities in the Russian Federation;
- Entry into an agreement providing for the participation in royalties or ongoing profits in the Russian Federation;
- The lending of funds to persons located in the Russian Federation for commercial purposes, including when such funds are intended to be used to fund a new or expanded project or operation in the Russian Federation;
- The purchase of an equity interest in an entity located in the Russian Federation;<sup>6</sup> and
- The purchase or acquisition of rights to natural resources or exploitation thereof in the Russian Federation.

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<sup>3</sup> OFAC FAQ 1049 (Jun. 6, 2022), available at <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/1049>.

<sup>4</sup> *Id.* OFAC provides examples of such “maintenance” in FAQ 1050 (Jun. 6, 2022), available at <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/1050>, which this Alert discusses below. OFAC also reiterates that even if a transaction does not constitute a “New Investment” pursuant to the applicable E.O., “U.S. persons engaging in the transaction must comply with all other relevant sanctions prohibitions, including those pursuant to Ukraine/Russia-Related Sanctions Regulations and Russian Harmful Foreign Activities Sanctions Regulations.” FAQ 1049, *id.*, citing, e.g., OFAC FAQ 415 (Nov. 28, 2017), available at <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/415>. By way of example, FAQ 1049 notes that the E.O.s prohibit “any approval, financing, facilitation, or guarantee by a United States person, wherever located, of a transaction by a foreign person where the transaction by that foreign person would be prohibited if performed by a United States person or within the United States.” *Id.*, citing OFAC FAQ 1053 (Jun. 6, 2022), available at <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/1053>.

<sup>5</sup> Unless exempt or otherwise authorized by OFAC. *Id.*

<sup>6</sup> *Id.*, citing OFAC FAQ 1054 (Jun. 6, 2022), available at <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/1054>, and OFAC FAQ 1055 (Jun. 6, 2022), available at <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/1055> (both of which are discussed below).

### **New Investments DO NOT include:**

- Entry into, performance of or financing of a contract to sell or purchase goods, services or technology to or from an entity in the Russian Federation pursuant to ordinary commercial sales terms (*e.g.*, a payment of an invoice for goods, where payment is made within the contracted time period and such payment does not involve participation in royalties or ongoing profits);
- Maintenance<sup>7</sup> of an investment in the Russian Federation provided the investment was made prior to the Effective Date, including maintenance of pre-existing entities, projects or operations in the Russian Federation and their associated tangible property; and
- Wind down or divestment of a pre-existing investment, such as a pre-existing investment in an entity, project or operation, including any associated tangible property, located in the Russian Federation.<sup>8</sup>

### **Are U.S. persons prohibited from purchasing debt or equity securities issued by an entity in the Russian Federation?**

Yes, FAQ 1054 states that the E.O.s “prohibit U.S. persons from purchasing both new and existing debt and equity securities issued by an entity in the Russian Federation.”<sup>9</sup> Notably, the FAQ’s reference to “existing” debt and equity securities indicates that even purchases of securities in the secondary market—where the issuer does not receive the proceeds of the sale—are prohibited as a form of “new investment.”

OFAC has not provided guidance as to what it means for an entity to be “in” or “located in” Russia. Two relevant considerations are likely to be where the entity is incorporated or organized and where it has its headquarters or principal place of business. However, other facts and circumstances may also be relevant.

FAQ 1054 permits U.S. persons to sell or divest (or facilitate the sale or divestment of) debt or equity securities issued by an entity in the Russian Federation, so long as the purchaser is a non-U.S. person.<sup>10</sup> OFAC highlights that there is no requirement for U.S. persons to divest such securities; rather, U.S. persons “may continue to hold such previously acquired securities.”

In addition, the FAQ states that “the conversion of depositary receipts to underlying local shares of non-sanctioned Russian issuers” will not run afoul of the New Investment restrictions. OFAC has not specified whether the term “non-sanctioned Russian issuers” is intended to encompass only Russian companies designated as Specially Designated Nationals (“SDNs”) or also Russian companies on the Sectoral Sanctions Identifications (“SSI”) List.

OFAC further clarifies that “the purchase of shares in a U.S. fund that contains debt or equity securities issued by entities in the Russian Federation” would not generally constitute a prohibited New Investment provided the debt or equity securities issued by the Russian Federation entity “represent

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<sup>7</sup> See FAQ 1050, *supra* note 4 (discussed below).

<sup>8</sup> FAQ 1049, *supra* note 3, citing FAQs 1053 and 1054, *supra* notes 4 and 6, respectively.

<sup>9</sup> FAQ 1054, *supra* note 6.

<sup>10</sup> *Id.*, citing FAQs 1049 and 1053, *supra* notes 3 and 4, respectively.

less than a predominant share by value of the fund’s debt or equity securities”<sup>11</sup> and the transactions do not involve blocked persons and are not otherwise prohibited (unless exempt or otherwise authorized by OFAC).

Neither FAQ 1054 nor any of the other FAQs released on June 6 specifically addresses derivative instruments. FAQ 1054’s prohibition on purchasing securities “issued” by an entity in the Russian Federation suggests that a cash-settled derivative whose value is tied to securities issued by a Russian entity, but does not involve the purchase of any securities issued by the entity, falls outside the scope of the New Investment prohibition.

### **Are U.S. persons prohibited from lending funds to, or purchasing an equity interest in, entities located outside of the Russian Federation?**

No, according to FAQ 1055, provided that (1) the funds are not specifically intended for new projects or operations in the Russian Federation and (2) the target entity’s revenues are not “predominantly derived from its investments in the Russian Federation.”<sup>12</sup> Therefore, even a loan to, or a purchase of an equity interest in, a non-Russian entity may constitute prohibited New Investment if either of these conditions apply. OFAC has not provided guidance on what it means for an entity’s revenues to be “predominantly derived” from investments in Russia.

FAQ 1055 further provides that U.S. persons, including financial institutions, “may reasonably rely upon the information available to them in the ordinary course of business” for purposes of assessing whether a potential transaction meets the aforementioned criteria.

### **Do the New Investment FAQs affect trading in Russian sovereign debt?**

Yes. Previously, OFAC had issued Directives and related FAQs making clear that U.S. persons are prohibited from participating in the primary market for Russian sovereign debt (whether ruble or non-ruble denominated) and from participating in the secondary market for Russian sovereign debt issued after March 1, 2022. OFAC permitted U.S. persons to participate in the secondary market for Russian sovereign debt issued *prior* to March 1, 2022. However, the ability of U.S. persons to receive interest, dividend or maturity payments on Russian sovereign debt came to an end on May 25, 2022, when a general license allowing receipt of such payments expired.<sup>13</sup>

FAQ 1054 now prohibits U.S. persons from purchasing “existing debt . . . securities” issued “by an entity in the Russian Federation.” As this prohibition encompasses bonds issued by the Russian Central Bank, National Wealth Fund and Ministry of Finance (the issuers of Russian sovereign debt), it appears that U.S. persons may no longer purchase such bonds even if the bonds were issued prior to March 1, 2022. As part of the actions taken on June 6, OFAC updated a previously issued FAQ relating to Russian

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<sup>11</sup> See *id.* (“the purchase of shares in a U.S. fund that contains debt or equity securities issued by entities in the Russian Federation generally would not be considered a prohibited ‘new investment,’ under the respective E.O.s, so long as these holdings represent less than a predominant share by value of debt or equity securities issued by entities in the Russian Federation”).

<sup>12</sup> FAQ 1055, *supra* note 6.

<sup>13</sup> OFAC, Directive 1A under E.O. 14024, 87 Fed. Reg. 32303 (Feb. 22, 2022), available at [https://home.treasury.gov/system/files/126/russia\\_directive\\_1a.pdf](https://home.treasury.gov/system/files/126/russia_directive_1a.pdf); OFAC FAQ 1005 (as released on Mar. 2, 2022), available at <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/1005>; OFAC, General License 9A (Authorizing Transactions Related to Dealings in Certain Debt or Equity), 31 CFR part 587 (Mar. 2, 2022), available at [https://home.treasury.gov/system/files/126/russia\\_gl9a.pdf](https://home.treasury.gov/system/files/126/russia_gl9a.pdf).

sovereign debt to note that the New Investment prohibitions of the E.O.s now “prohibit U.S. persons from purchasing debt and equity securities issued by an entity in the Russian Federation.”<sup>14</sup>

### **What types of transactions are excluded from the E.O.s’ prohibitions on New Investments as permissible maintenance activities?**

A New Investment “generally excludes the maintenance of investments in the Russian Federation” made prior to the Effective Date, *i.e.*, “pre-existing projects or operations,”<sup>15</sup> provided such activities do not involve blocked persons or other prohibited transactions (unless exempt or otherwise authorized by OFAC). To illustrate, OFAC provides the following examples of investment maintenance (“Maintenance”):

- Transactions to ensure continuity of pre-existing projects or operations within the Russian Federation, including payments to employees, suppliers, landlords, lenders and partners;
- The preservation and upkeep of pre-existing tangible property in the Russian Federation; and
- Activities associated with maintaining pre-existing capital investments or equity investments.

All transactions “ordinarily incident to” performance under a pre-existing agreement, *i.e.*, an agreement that was already in place before the Effective Date, as long as these transactions are “consistent with previously established practices and support pre-existing projects or operations,” and do not expand pre-existing projects or operations beyond those already underway prior to the Effective Date, even where such expansion is contemplated in the pre-existing agreement. Commitments pursuant to the exercise of rights are similarly prohibited if made subsequent to the Effective Date. When assessing whether activity is consistent with past practice, OFAC will take into account “all relevant facts and circumstances,” including the transaction history between the contracting parties.

Additionally, OFAC provides that U.S. persons are permitted to “modify or alter pre-existing agreements, or enter into new contracts or agreements” where any transactions pursuant to such contracts or agreements are “consistent with previously established practices” and “support pre-existing projects or operations.” By way of example, FAQ 1050 provides that “a pre-existing agreement may be modified, or new contract established, to substitute suppliers, conduct maintenance or repairs, or comply with new environmental or safety standards.”

### **Are imports and exports of goods, services or technology from the Russian Federation considered to be New Investments?**

The E.O.s’ prohibitions on New Investments do not include “the export or import of goods, services, or technology, or related sales or purchases, to or from the Russian Federation” provided the underlying transaction is made pursuant to “ordinary commercial sales terms,” *e.g.*, a one-time payment for goods, within a determined time period, with no “ongoing participation in royalties or ongoing profits.”<sup>16</sup> Such transactions may also be conducted through commercial letters of credit, documentary collections or

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<sup>14</sup> OFAC FAQ 1005 (as updated on June 6, 2022), available at <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/1005>.

<sup>15</sup> FAQ 1050, *supra* note 4.

<sup>16</sup> OFAC FAQ 1051 (Jun. 6, 2022), available at <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/1051>, citing FAQ 1049, *supra* note 3.

other traditional trade finance products, provided U.S. persons are not otherwise prohibited from entering into new contracts or agreements for such transactions.<sup>17</sup>

### **Can U.S. entities continue to fund their subsidiaries' or affiliates' pre-existing projects or operations in the Russian Federation?**

Yes, provided that the subsidiary or affiliate utilizes such funds for Maintenance purposes only.<sup>18</sup> OFAC reiterates that “U.S. persons may not fund new or expanded projects or operations undertaken by their subsidiaries and affiliates located in the Russian Federation” after the Effective Date.

### **Are transactions related to divestment permissible?**

Transactions “related to the divestment or the facilitation of divestment of a pre-existing investment” in the Russian Federation, such as a pre-existing investment in entities, projects or operations, are not prohibited as New Investments provided no blocked persons are involved and the transactions are not prohibited elsewhere (unless specifically exempt or authorized by OFAC).<sup>19</sup>

FAQ 1053 also provides that facilitating “the wind down or divestment of an existing investment in the Russian Federation” is similarly permissible, but only on behalf of the selling party. By way of example, OFAC provides that a U.S. financial institution may advise a seller in a divestment transaction concerning the sale of its equity interest in an entity located in the Russian Federation. However, OFAC notes that U.S. persons are prohibited from “providing any approval, financing, facilitation, or guarantee” to a non-U.S. buyer seeking to acquire an equity interest in any entity located in the Russian Federation.<sup>20</sup>

Schulte Roth & Zabel’s lawyers are available to assist you or address any questions you may have regarding these developments. Please contact the Schulte Roth & Zabel lawyer with whom you usually work, or any of the following attorneys:

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<sup>17</sup> *Id.* The FAQ specifically notes that “U.S. persons are prohibited or restricted by law from exporting, reexporting, or importing certain goods and services involving the Russian Federation,” including pursuant to E.O. 14068 § 1(a)(i), *supra* note 2. FAQ 1051 also points to OFAC FAQ 415 (Nov. 28, 2017), available at <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/415>, which clarifies how prohibitions and exemptions under one Directive affect prohibitions and exemptions under another for persons determined to be subject to multiple Directives.

<sup>18</sup> OFAC FAQ 1052 (Jun. 6, 2022), available at <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/1052>.

<sup>19</sup> FAQ 1053, *supra* note 4. OFAC reiterates that the E.O.s prohibit “any approval, financing, facilitation, or guarantee by a United States person, wherever located, of a transaction by a foreign person where the transaction by that foreign person would be prohibited if performed by a United States person or within the United States.” *Id.*

<sup>20</sup> U.S. persons are also permitted to advise on the requirements of U.S. sanctions laws consistent with OFAC’s *Guidance on the Provision of Certain Services Relating to the Requirements of U.S. Sanctions Laws*. *Id.* OFAC’s guidance is available at [https://home.treasury.gov/system/files/126/compliance\\_services\\_guidance.pdf](https://home.treasury.gov/system/files/126/compliance_services_guidance.pdf).

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