

ALERTS

Sanctions Update: US Begins to Roll Out Sanctions Against Russia

February 23, 2022

On Feb. 22, 2022, President Biden announced sanctions on Russia in the wake of Russia's decision to recognize and deploy troops to the so-called Donetsk People's Republic ("DNR") and Luhansk People's Republic ("LNR") regions of Ukraine. This announcement follows the issuance of an executive order on Feb. 21, 2022, imposing sanctions on the DNR and LNR regions. The announced sanctions target Russian sovereign debt, two major Russian state-owned financial institutions and five Kremlin-connected members of the Russian elite.[1]

Russian Sovereign Debt

First, the U.S. Department of the Treasury's Office of Foreign Assets Control ("OFAC") has expanded and superseded Directive 1, a directive previously issued on April 15, 2021, under Executive Order 14024 ("Directive 1"). Directive 1 prohibited U.S. financial institutions from participating in the primary market for ruble or non-ruble bonds issued by, or from lending ruble or non-ruble denominated funds to, the Central Bank of the Russian Federation, the National Wealth Fund of the Russian Federation, or the Ministry of Finance of the Russian Federation.[2] Directive 1A expands those prohibitions to now additionally prohibit U.S. financial institutions from participating in the secondary market for ruble or non-ruble bonds issued by the same entities after March 1, 2022.[3] Directive 1A does not prohibit other financial transactions with these entities, and OFAC's "50 Percent Rule" does not apply (i.e., transactions with entities owned or controlled by the Central Bank of the Russian Federation, the National Wealth Fund of the Russian Federation, or the

Ministry of Finance of the Russian Federation are still permitted). Directive 1A is designed to cut off a core method through which Russia has raised money.

Directive 1A defines “U.S. financial institution” to include “any U.S. entity (including its foreign branches) that is engaged in the business of accepting deposits, making, granting, transferring, holding, or brokering loans or credits, or purchasing or selling foreign exchange, securities, futures or options, or procuring purchasers and sellers thereof, as principal or agent.”[4] The definition covers a broad range of financial institutions, including “depository institutions, banks, savings banks, money services businesses, operators of credit card systems, trust companies, insurance companies, securities brokers and dealers, futures and options brokers and dealers, forward contract and foreign exchange merchants, securities and commodities exchanges, clearing corporations, investment companies, employee benefit plans, dealers in precious metals, stones, or jewels, and U.S. holding companies, U.S. affiliates, or U.S. subsidiaries of any of the foregoing.”[5] Foreign financial institutions are covered by the prohibition only with respect to their branches, offices and agencies located in the United States (and specifically excluding the above institutions’ foreign branches, offices or agencies).

Financial Institution Designations

Second, President Biden has designated Russian financial institutions Corporation Bank for Development and Foreign Economic Affairs Vnesheconombank (“VEB”) and Promsvyazbank Public Joint Stock Company (“PSB”) as Specially Designated Nationals (“SDNs”), along with each of their 42 subsidiaries.[6]

These designations cut off VEB and PSB from the U.S. financial system, and “constrain[] Russia’s ability to finance defense-related contracts and raise new funds to finance its defense-related contracts and raise new funds to finance its campaign against Ukraine.”[7] These designations are intended to target Russia’s ability to finance aggression and should immediately impair each institution’s ability to access the international financial system.

VEB is “crucial to Russia’s ability to raise funds,” because it services Russia’s sovereign debt, finances exports and serves as a \$20 billion

funding source for investment projects.[8] VEB and its subsidiaries are a critical part of Russia's national economic development, financing large-scale projects related to domestic infrastructure and other revenue-generating industries.[9] PSB is "critical to Russia's defense sector," servicing "nearly 70 percent of Russia's defense contracts" and providing financial services to Russian military personnel.[10] The Government of Russia "has also tasked PSB with providing credit to entities under U.S. and partner nations' sanctions so that other lenders . . . can offload the risk of conducting business with sanctioned entities." [11]

In connection with the designation of VEB, OFAC issued General License No. 3, which authorizes a wind-down period for otherwise prohibited transactions involving VEB, or an entity 50% or more owned by VEB, directly or indirectly, until midnight on March 24, 2022.[12]

In addition, OFAC has issued General License No. 2, which permits certain bond servicing transactions involving VEB related to bonds issued before March 1, 2022 by the Central Bank of the Russian Federation, the National Wealth Fund of the Russian Federation or the Ministry of Finance of the Russian Federation.[13]

Russian Individual Designations

In addition to the Russian financial institutions described above, OFAC has designated five Russian elites close to Putin and their families. The list includes: (1) Denis Aleksandrovich Bortnikov, Deputy President of Russian-state owned financial institution VTB Bank Public Joint Stock Company and a Chairman of the VTB Bank Management Board and son of (2) Aleksandr Vasilievich Bortnikov, the Director of the Federal Security Service of the Russian Federation and permanent member of the Security Council of the Russian Federation; (3) Petr Mikhailovich Fradkov, Chairman and CEO of PSB and son of Mikhail Efimovich Fadkov, former Prime Minister of Russia and former Director of the Russian Foreign Intelligence Service; and (4) Vladimir Sergeevich Kiriienko, current CEO of VK Group, the parent company of Russia's top social media platform, son of (5) Sergei Vladilenovich Kiriienko and the First Deputy Chief of Staff of the Presidential Office.[14] Aleksandr Bortnikov and Sergei Kiriienko were previously designated and have been re-designated.[15]

Takeaways

Tuesday's sanctions, as well as the DNR and LNR sanctions, are just the first sanctions to be issued in connection with rising tensions with Russia. President Biden has promised swift and continued action if Russia continues to be an aggressor against Ukraine. U.S. persons who transact with Russia or its citizens should be mindful of the prohibitions already imposed, as well as the potential for stronger sanctions, in examining current and contemplated business arrangements.

Other governments and supranational organizations, including the United Kingdom and European Union have also been rolling out their own sanction programs targeted at Russia. Persons (including non-U.S. persons) operating in these markets should keep abreast of these developments and assess their implications on their trading activities and investor base.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

[1] Press Release, U.S. Dep't of Treasury, "U.S. Treasury Imposes Immediate Economic Costs in Response to Actions in the Donetsk and Luhansk Regions" (Feb. 22, 2022), available here ("Economics Cost Press Release").

[2] FAQ No. 965 (Feb. 22, 2022), available here; *see also* U.S. Dep't of Treasury, "Directive 1A Under Executive Order 14024" (Feb. 22, 2022), available here ("Directive 1A").

[3] Economics Cost Press Release.

[4] Directive 1A at 1.

[5] *Id.*

[6] Economics Cost Press Release.

[7] Economics Cost Press Release.

[8] *Id.*

[9] *Id.*

[10] *Id.*

[11] *Id.*

[12] GL 3 (Feb. 22, 2022), available here.

[13] See GL 2 (Feb. 22, 2022), available here.

[14] Economics Cost Press Release.

[15] *Id.*

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