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Western Countries Enact Sweeping Sanctions Packages in Response to Invasion of Ukraine

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The February 2022 invasion of Ukraine has set in motion some of the most consequential security- and foreign policy-related developments for the West since the Second World War. With Ukraine outside the NATO alliance, the U.S., EU, U.K., Canada, and others have been coordinating a response primarily focused on imposing economic sanctions and export controls on the Russian Federation, its leaders and elite, and financial institutions. While Western officials have been clear that while NATO military forces will not be deployed to fight in Ukraine, they and increasingly other countries are pursuing unprecedented economic sanctions in response to the Russian invasion.

The Biden Administration, European Council, U.K., Canadian, and increasingly other governments have brought forth against Russia between February 21, and February 28, 2022, what may amount to the most draconian and punitive set of sanctions ever imposed on a large economy, threatening to largely cut Russia off from the global banking system. The sanctions appear intended to serve three strategic goals: (i) impose unprecedented economic costs on the Russian regime and economy; (ii) leave a path for even more draconian sanctions that could be enacted should the situation further escalate; and (iii) while at the same time preserving certain European countries' ability to receive and pay for natural gas and oil shipments from Russia, on which some depend for a significant portion of their energy needs.

Although, it appears these sanctions—which include the sanctioning of the Russian Central Bank and disconnection of certain Russian banks from the SWIFT messaging system—are likely to impose the dramatic costs the West intends; it remains to be seen whether they will have the conflict-containing effects that the Western powers also seek. It also remains to be seen—largely driven by how facts on the ground evolve—whether they will remain, or be supplemented by additional, even stronger measures that could result in the almost total disconnection of Russia from global economic activity.

The following sets out the sanctions measures enacted by the U.S., EU, and U.K. to date, and then posits some scenarios that—based on current facts at least (as of the morning of Feb. 28, 2022) —may arise in the coming days.

Sanctions Enacted During the Week of February 21, 2022

U.S. Government Sanctions

On Monday, February 21, the Biden Administration issued Executive Order (E.O.) 14065 imposing an effective embargo on U.S. person dealings with the so-called Donetsk People's Republic (DNR) and

Luhansk People's Republic (LNR) regions of Ukraine. This EO prohibits U.S. persons from making new investments in the covered regions and bars the importation into the U.S. of any goods, services, or technology from, or exportation from the U.S. of any goods, services, or technology to these regions. These measures are broadly equivalent to those imposed on the Crimea region of Ukraine by the U.S. government in 2014. In administering these sanctions, the U.S. Government will permit a wind-down period, which extends to 12:01am, U.S. Eastern time, on March 23, 2022.[1]

A number of General Licenses (GL) were issued providing for the export or reexport to the DNR and LNR of food, medicine, and medical devices;[2] the continuing operation of telecommunications and internet services, as well as mail services;[3] the continued flow of personal remittances;[4] and the ability of international organizations to be able to provide aid to people in the regions.[5]

On Tuesday, February 22, OFAC also placed two Russian state-owned banks, State Corporation Bank for Development and Foreign Economic Affairs Vnesheconombank (VEB), and Promsvyazbank Public Joint Stock Company (PSB) with 42 of their subsidiaries, on the SDN list, effectively barring any such ties with the U.S. and its financial system.[6]

OFAC also targeted on February 22, additional individuals with ties to Putin and increased restrictions on sovereign debt.[7] In particular, under Directive 1A, sovereign debt prohibitions now cover not only participation by U.S. financial institutions in the primary market but also in the secondary market for sovereign Russian bonds issued after March 1, 2022, by certain Russian entities.[8]

Two General Licenses were issued along with Directive 1A, permitting the service of bonds issued by VEB before March 1, 2022, and authorizing a wind-down period for transactions involving VEB that will expire on March 24, 2022.[9]

In response to the continued escalation and actual invasion of Ukraine on Thursday, February 24, the Biden Administration then announced the following additional sanctions:

- designation of Russia's second largest bank as an SDN subject to full blocking sanctions;[10] and
- imposition of correspondent and payable-through account (CAPTA) sanctions on Russia's largest bank.[11]

The sanctions were very significant at that juncture of the crisis, as they were imposed on the top financial institutions in Russia, and threatened to cut off access for those institutions to the U.S. financial system. Specifically, correspondent and payable-through account sanctions prohibit U.S. financial institutions from opening or maintaining such accounts and requiring them to reject any future transactions.[12] According to OFAC, the two sanctioned banks "combined [made] up more than half of the total banking system in Russia by asset value."[13]

Additional Russian financial institutions were designated as SDNs (altogether, the sanctions impacted almost 90 Russian financial institutions) and prohibitions on dealings in new debt of longer than 14 days maturity and equity of Russian state-owned enterprises are now being implemented.[14]

Eight new GLs were issued covering international organizations and entities; agricultural and medical commodities and the COVID-19 pandemic; overflight and emergency landings; energy; dealings in certain debt or equity; derivative contracts; the wind down of transactions involving certain blocked persons; and the rejection of transactions involving certain blocked persons.[15]

Notably, GL 8 authorizes transactions related to energy with certain entities through June 24, 2022.[16] "Related to energy," as defined in the GL covers extraction, production, refinement, through to transport and purchase.[17] GL 9, for its part, authorizes transactions incident to dealings in debt or equity with several entities, including VEB and VTB, through May 25, 2022, "provided that any divestment or transfer, of, or facilitation or divestment or transfer of, covered debt or equity must be to a non-U.S. person."[18] Such incidental transactions include facilitating, clearing, and settling transactions.[19] Finally, GL 11 provides for a wind down of transactions involving certain blocked persons through March 26, 2022.[20]

The U.S. response also includes significant export controls intended to "restrict Russia's access to technologies and other items that it needs to sustain its aggressive military capabilities."[21] In order to restrict the ability of Russia to acquire foreign produced items, BIS is implementing a series of Foreign Direct Product Rules, in a manner similar to those utilized previously against a prominent Chinese telecommunications company. These rules will place limits on foreign produced items that are either: (i) the direct product of U.S.-origin technology or software; or (ii) produced by certain plants or with major components of plants that are themselves direct products of U.S. origin software or technology.[22]

In addition, new license requirements for the export, re-export, or in country transfer of items subject to the Export Administration Regulations ("EAR")[23] to or within LNR and DNR, a policy of denial will be implemented on such applications.[24] Targeted items include those that would assist Russia's defense, aerospace, and maritime sectors.[25]

BIS has placed further restriction on items subject to the EAR that are classified under ECCNs in Categories 3-9 of the Commerce Control List.[26] Such items will be prohibited for export, reexport, or in-country transfer to or within Russia without a license; although, certain license exceptions will apply.[27]

On Friday, February 25, the Biden Administration continued to ramp up its response, in coordination with Western allies, by formally designating as SDNs the Russian Federal President Vladimir Putin himself, Russia's Minister of Foreign Affairs, and its Minister of Defense, the Chief of the General Staff of the Russian Armed Forces, and other members of Russia's Security Council.[28]

EU and U.K. Sanctions

Reflecting coordinated U.S., EU, and U.K. responses, the EU and U.K. also imposed or announced similar measures during the February 21-25 time period:

- On February 23, 2022, the European Council adopted a package of sanctions covering all 351 members of the State Duma of the Russian Federation, as well as 27 individuals and entities who have "played a role members of the State Duma of the Russian Federation."[29] The sanctions include but are not limited to an asset freeze, travel ban, and import ban on goods coming from the areas of Donetsk and Luhansk that are not under the Ukrainian government's control.

- On February 25, after days of negotiations, the EU agreed on a package of individual and economic sanctions in response to continued military aggression carried out by the Russian Federation against Ukraine. Following the United States' announcement earlier that day of blocking sanctions against Putin, the EU issued similar sanctions against Putin and expanded restrictions in Russian financial institutions. According to the EU, the sanctions "will target 70% of the Russian banking market."[30] Notably, the sanctions prohibit the listing and provision of services in relation to shares of Russian state-owned entities on EU trading venues and prohibit the acceptance of deposits exceeding certain values from Russian nationals and residents (EUR 100,000), the holding of accounts of Russian clients by the EU Central Securities Depositories, as well as selling of euro-denominated securities to Russian clients.[31] In addition, a series of export controls taking aim at the energy and transportation sectors were put in place, as were restrictions on certain visas.[32]

- Additionally, the German government announced on February 22, that it had stopped the certification process for the controversial Nord Stream 2 gas pipeline, citing Russia's "grave breach" of international law.[33] The Biden Administration followed suit on February 23, by revoking the national security waiver it had previously granted to the parent company overseeing the Nord Stream 2 AG natural gas pipeline from Russia to Germany, and its corporate officers, resulting in that entity's and those individuals' designations.[34] The U.S. issued a GL authorizing a wind-down period until March 2, 2022.[35]

Since Brexit, U.K. sanctions are governed by U.K. legislation, namely the Sanctions and Anti-Money Laundering Act 2018, known as SAMLA. Sanctions in the U.K. are decided by the U.K. government and introduced by Regulations issued under SAMLA. Although under SAMLA, there is likely to be significant alignment with EU sanctions. The U.K. Russia sanctions regime has been in place for some years. The Office of Financial Sanctions Implementation (OFSI) maintains a Consolidated List of Asset Freeze Targets that contains details of designations (individuals and entities) specifically for financial sanctions where asset freeze measures apply.[36] There are currently 190 individuals and 59 entities designated under the U.K.'s Russia regime. The most recent Russia sanctions include:

- five Russian banks and three Russian individuals on February 22;[37]
- the second largest financial institution in Russia, as well as an additional set of individuals on February 24;[38]
- President Vladimir Putin and Sergei Lavrov on February 25;[39]
- three Russian banks on 28 February;[40] and
- On 28 February, the U.K. government announced it intended to take further restrictive measures targeting Russian institutions including the Central Bank of the Russian Federation, the Russian National Wealth Fund, and the Ministry of Finance of the Russian Federation. Further related designations are also expected41.

OFAC is also targeting 24 Belarusian individuals and entities it believes have supported and facilitated Russia's invasion of Ukraine.[42] Among the sanctioned entities are state-owned banks and those entities in the defense and security industries.[43]

Sanctions Announced February 26-28

The sanctions enacted and announced by the U.S., U.K., and EU between February 21 and February 25 themselves were unprecedented against an economy the size of Russia's. The escalating nature of the crisis, however—and the efforts of the Ukrainian leadership, troops, and general population to resist conquest—has led the Western alliance to announce over the weekend of February 26-27, the most draconian set of sanctions attempted on a major economy. On February 26-27, the U.S., EU, U.K., Canada, and others announced that they would be sanctioning the Russian Central Bank, and that they would be disconnecting a set of Russian banks (as yet unidentified as of noon on February 28, US time) from the SWIFT system, which facilitates payments between banks globally.

These measures had been considered and not implemented in the past by the West largely due to their potential to devastate the Russian economy, and to cut Western households off from critical energy supplies. While we understand there will remain some exceptions for oil and gas procurement purposes, and some important Russian banks may not be disconnected from SWIFT, these announced actions have the potential to bring unprecedented economic pain to the Russian Federation. No central bank of the size of the Russian Central Bank has ever been directly sanctioned, which will deprive the Russian government of their ability to use Russia's sizable foreign exchange reserves to defend the value of the Ruble—potentially leading to a currency crisis, bank runs, and significant inflation. Disconnecting certain banks from the SWIFT network also is likely to have the effect of eliminating their ability to process payments and transactions in hard currency inside and outside the Russian federation. While the German and certain other European governments had resisted these steps, resistance to them dropped over the weekend of February 26-27, whereupon the U.S., U.K., EU, Canadian, and other governments announced they would be implemented, with exceptions to facilitate the continued delivery of oil and gas from Russia to Europe.[44]

Making good on its promise, on the morning of February 28, 2022, the U.S. announced its sanctions against the Russian Central Bank, the National Wealth Fund of the Russian Federation, and the Ministry of Finance of the Russian Federation.[45] These sanctions, guided by the newly issued Directive 4 (also known as the "Russia-related Sovereign Transactions Directive") prohibit any transaction with the above-named entities by U.S. persons.[46] Under General License 8A, OFAC will continue to allow transactions "relating to energy" with the sanctioned entities through June 24, 2022.[47] OFAC also sanctioned three entities "critical to managing one of Russia's key sovereign wealth funds" along with the CEO of two of those entities—a prominent member of Putin's inner circle.[48]

The reaction of the financial markets today, Monday, February 28, 2022, and hereafter will likely profoundly—and negatively—impact the Russian economy in the face of these measures. Where the trajectory of sanctions goes from here will depend largely on events as they unfold in the Russia-Ukraine conflict. Should the outcome of battle ultimately favor Russia, there would still remain the possibility of barring additional Russian financial institutions from SWIFT, targeting the Russian energy and extractive sectors, and the potential—should certain European countries secure alternative energy supplies, to target the Russian energy sector as well. Such an eventuality would approach a wholesale rupture of the Russian economy from that of Western Europe and the world, with potentially draconian effects on the Russian population as a whole.

We at Paul Hastings are monitoring this situation closely and in real-time, and are updating our clients and friends accordingly.

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[3] OFAC, Ukraine General License No. 19, https://home.treasury.gov/system/files/126/ukraine_gl19.pdf; OFAC, Ukraine General License No. 22, https://home.treasury.gov/system/files/126/ukraine_gl22.pdf.

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[26] Fact Sheet, *supra* note 24.

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