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DISPUTES & INVESTIGATIONS

Preparing your business for sanctions against Russia

Russia is already subject to sanctions. A suite of measures including asset freezes, travel bans and trade restrictions were imposed following Russia's annexation of Crimea in 2014. However, recent developments suggest that a potentially significant escalation in the severity of sanctions imposed may be imminent.

The United States has vowed to unleash "*the mother of all sanctions*" while the European Union has stated that it has prepared "*robust*" sanctions to deploy if Russia invades Ukraine. The United Kingdom has similarly threatened an "*unprecedented package of sanctions*". At the same time, the imposition of the type of measures being discussed, as well as any Russian counter measures, would take their toll on the global economic system and cause ripple effects across businesses in many industries.

As the geo-political crisis deepens, this article examines:

- What sanctions are likely to be imposed?
- How businesses can prepare for such sanctions.

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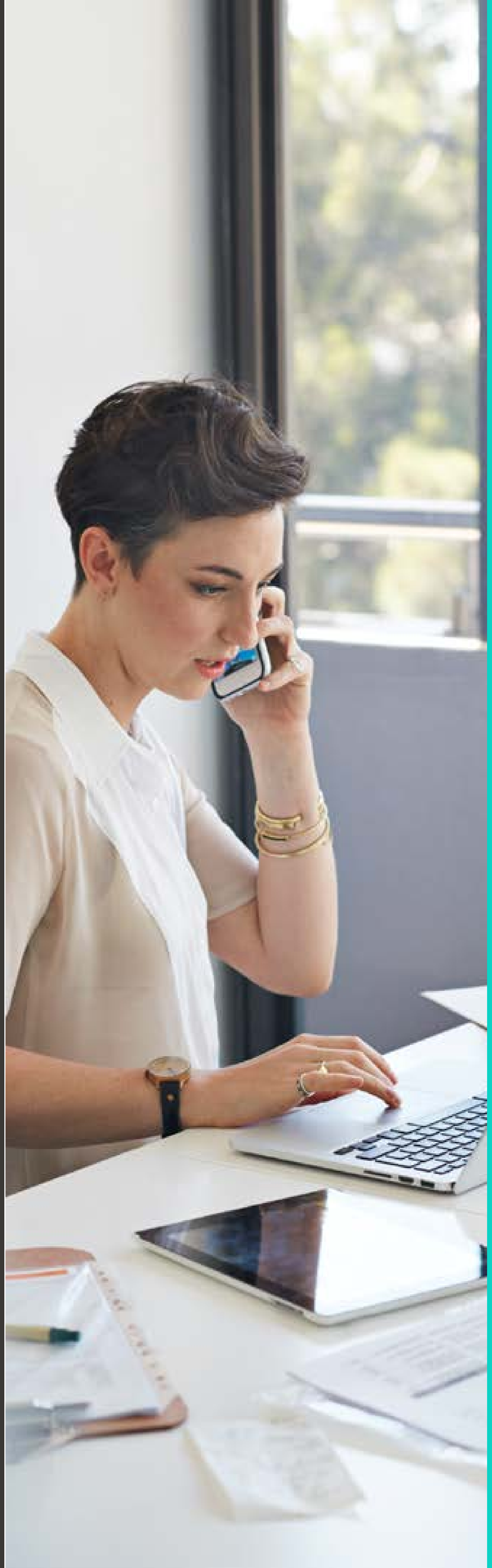
What measures are likely to be imposed?

There is still no certainty regarding the detail, extent or timing of the sanctions that would be imposed. The final shape of the US package looks set to be targeted, sharp and sectoral with the financial services, energy and commodities (metals) sectors expected to be a particular focus. EU companies should be mindful of their potential exposure to US sanctions. Given the global clout of the US economy and the extra-territorial approach of its sanctions regime, US sanctions cast a very wide net. The EU has also issued strong warnings but faces formidable hurdles in applying sanctions. EU sanctions require unanimity from all 27 member states, some of which have close ties to Russia and others whose national interests may be disproportionately affected by the proposed sanctions. Meanwhile, the UK has been clear that its sanctions will include "*high-impact measures targeting the Russian financial sector and individuals*". Recent reports have, however, suggested a growing convergence between the US, the EU and the UK on the detail of the proposed sanctions measures. While the precise nature of the sanctions remains speculative, they may include a combination of the following:



Exclusion from the SWIFT international payments system

The most severe of the rumoured sanctions relate to the exclusion of Russia from the SWIFT system. This is the global financial messaging network used by 11,000 banks across 200 countries to make cross-border payments. Although this approach has been taken previously against the much smaller economies of Iran and North Korea, its use against financial institutions the size of Russia's is unprecedented. Analysts have noted that excluding Russian financial institutions from SWIFT would threaten the stability of the global financial system. Given the potentially significant impact of this measure and the risk of collateral damage, it seems likely that this will be considered a measure of last resort.

Restriction of Russia's access to the US dollar

The US could act unilaterally to restrict Russian banks from accessing the US financial system to settle dollar transactions. Such a move would likely cause difficulties for EU banks in clearing US dollar transactions. However, it may still be more preferable to the EU than the more aggressive act of excluding Russian banks from the SWIFT system.

Designation of many of Russia's largest banks and financial institutions

Their subsidiaries and successor entities would also likely be targeted. This could have a dramatic impact on companies that operate in or deal with Russian markets, in addition to the broader financial markets. The European Central Bank has reportedly contacted the more exposed large eurozone banks it supervises to discuss how they would prepare for various sanctions scenarios.

Expansion of US "foreign-produced direct product rule" (FPDPR)

The US is expected to tighten its export control regime in respect of Russia. In addition to restricting the trade of goods such as semi-conductors, integrated circuits and aerospace and defence products, the US is likely to expand the FDPDR. This applies to the export of certain items produced overseas that are the direct product of US technology or of a plant controlled for national security reasons. This rule would be used in sectors key to Russian innovation and development such as artificial intelligence and quantum computing. Stricter export controls and dual use licensing would likely be an area of convergence among the US and the EU.

Restriction of trading of certain Russian sovereign debt

The US has proposed a provision that would apply to non-US persons found to be trading Russian sovereign debt and the debt of certain state-owned or controlled entities. US financial institutions are currently banned from purchasing Russian sovereign debt directly from state institutions; the proposed sanctions would target, in addition, the secondary bond market. Financial institutions and trading companies in Ireland should be mindful of the expansion of this US measure. It also seems likely that the EU and UK will introduce restrictions on dealing with Russian sovereign debt.

Imposition of sanctions on Nord Stream 2 gas pipeline

Perhaps the most contentious area for agreement is in respect of energy sanctions. The recently completed Nord Stream 2 pipeline is still awaiting German approval. Whilst the US has been a strong supporter of imposing sanctions on the pipeline, individual EU member states, in particular Germany, have been more reticent due to reliance on Russian gas amidst global energy price hikes. However, Germany appears to have softened its position on this issue of late and may support sanctions on the pipeline in the event of an invasion. The UK has also indicated its willingness to take this route.

Imposition of sanctions on certain Russian extractive industries

The US has proposed sanctions focused on oil and gas extraction; coal extraction, mining and production; mineral extraction and processing and "*any other sector or industry with respect to which the US President determines the imposition of sanctions is in the national security interest of the United State*". However, the Biden administration has also expressed concerns about the effect these sanctions could have on global energy supplies.

Designation of individuals

The US and UK have threatened to sanction Moscow's political elite, including Vladimir Putin. However, imposing sanctions on heads of states is generally a measure of last resort when all diplomacy has failed and it is not clear what such measures would achieve in practice above and beyond the sanctions already discussed above.

How could Russia respond?

Unprecedented sanctions may trigger an unprecedented response and Russia is not without tools to retaliate. It is possible that imposing severe sanctions against Russia could trigger what analysts have described as a 'potential escalatory spiral'. Chief among the counter-measures Russia could adopt is the weaponisation of the significant amounts of oil and gas it supplies to Europe by either cutting supplies to Europe or triggering a sharp increase in oil prices. Other measures that Russia could pursue include orchestrating cyberattacks against American and European infrastructure and/or criminalising compliance with sanctions against it; the latter proposal has been pending since the 2014 sanctions were imposed on Russia.

How do I get 'sanctions ready'?

Although the crisis and the nature of proposed sanctions continues to evolve, businesses can take the following steps now to prepare:

1. Conduct a business risk assessment to identify any exposure to the Russian economy, Russian entities or potentially relevant Russian assets, directly or indirectly. Remain vigilant and update the risk assessment as the situation develops.
2. Identify the sanctions regimes applicable to your business. In particular, be mindful of 'secondary sanctions' where the United States deem certain of their sanctions to apply unilaterally, even in the absence of a US nexus. This will be significant if the US sanctions against Russia go further than those imposed by the EU.

3. Review your contracts and business relationships (both direct and indirect) to determine where these may be impacted by the anticipated sanctions. If they would be impacted, begin contingency planning and consider engaging with the counterparties to discuss potential exit strategies.
4. Review your compliance framework to ensure it is sufficiently robust and effective. Consider whether it is sufficiently resourced and capable of efficiently adapting to evolving sanctions measures. Inputs into, and the operation of, sanctions and transaction monitoring systems are complex. If any risk mitigation plans or operational upgrades are in progress, consider if they need to be amended or expedited to ensure your systems are ready to deal with any significant updates to sanctioned entities, assets or other more bespoke restrictions.
5. Consider whether it is likely that a licence or authorisation will be required by your business under the anticipated sanctions measures. If so, it may be helpful to prepare the application or communicate with the authorities in advance to mitigate business disruption.
6. Consider the likely impact of the proposed sanctions on the industry you operate in and any guidance provided by the relevant regulator. Some specific guidance for industries likely to be affected is set out below.

a. **Financial Institutions:** Regulators have already contacted financial institutions to identify their plans to deal with an expanded Russian sanctions regime, which would raise conduct of business and prudential regulatory issues. The degree of impact will depend on financial institutions' exposure to Russian clients, counterparties, collateral and other assets, and the resulting threat to their current business models. Financial institutions who operate internationally will also be mindful of differing sanctions regimes, countervailing Blocking or Anti-Boycott Statutes and the different levels of enforcement risk for institutions and their directors and senior staff.

b. **Funds Industry:** The funds industry will have similar concerns, especially those funds whose investment policy includes investment in Russian based or linked assets or whose investors will be sanctioned persons. Many fund boards, management companies and administrators have had experience of dealing with the Libyan, Russian and Belarus sanctions regimes. However, the expected breadth of any future expanded Russian sanctions regime, if realised, will still create similar difficulties as those that will be faced by financial institutions. Where it becomes clear that investors in funds may become sanctioned persons, fund boards and management companies should consider proactive engagement with their administrators and supervisory contacts in relation to the steps to be taken to ensure compliance with the funds obligations under the applicable sanctions.

c. **Aviation Leasing Industry:** The global nature of the aviation leasing business exposes aircraft lessors and lessees alike to trade and economic sanctions, and other restrictions, imposed by the United States and other governments on an ongoing basis. By virtue of an expanded Russian sanctions regime, lessees and lessors operating within Russia may be obliged to limit their business activities, may incur costs for compliance programs, and may be subject to enforcement actions or penalties for noncompliance. Depending on the measures enforced, the expanded regimes could result in non-payment of lease payments, grounding of aircraft and the repossession of aircraft; these outcomes have the potential of having a knock-on effect on the financing arrangements of aviation lessors. A thorough review of the applicable contracts is recommended to assess the risks associated with a possible expansion of Russian sanctions.

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A&L Goodbody continue to monitor these developments. For further information, in relation to this topic please contact:

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