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United States releases first tranche of sanctions in response to Russian actions in Eastern Ukraine

February 23, 2022 | Client Update | 9-minute read

Sanctions include blocking orders against two state-owned Russian financial institutions, expanded restrictions on Russian sovereign debt, and prohibitions on transactions in separatist regions.

Starting on February 21, 2022, the Biden administration began to issue a "first tranche" of economic sanctions against the Russian Federation in response to what President Joe Biden has called "the beginning of a Russian invasion of Ukraine."[1] On February 21, after the Russian government formally recognized the separatist regions of the Donetsk People's Republic (DNR) and Luhansk People's Republic (LNR) as "independent" states, the White House issued an executive order (EO 14065), prohibiting within U.S. jurisdiction investments, imports and exports, and financial transactions to, from, or in the separatist regions. On February 22, the Office of Foreign Assets Control of the U.S. Treasury (OFAC) issued a range of sanctions against Russia and Russian persons and entities, which included: (i) restrictions on secondary dealing in Russian sovereign debt; (ii) blocking sanctions on two state-owned financial institutions, State Corporation Bank for Development and Foreign Economic Affairs Vnesheconombank (VEB) and Promsvyazbank Public Joint Stock Company (PSB); and (iii) five individuals linked to the Russian government. The White House announced the sanctions package shortly after the European Union (EU) and United Kingdom (U.K.) announced a series of targeted sanctions on Russian banks, politicians, and "high net-worth individuals," and following Chancellor Olaf Scholz announcement that Germany had halted certification of the Nord Stream 2 gas pipeline between Russia and Europe. On February 23, the Biden administration announced the imposition of sanctions on Nord Stream 2 AG, the company that owns the pipeline, as well as one of its corporate officers, as "another piece" of the first tranche.[2]

The Biden administration has emphasized that the measures announced were merely the first wave of sanctions that the U.S. and its allies were prepared to impose on Russia. Secretary of the Treasury Janet Yellen stated that if Russia further invades Ukraine, the U.S. would not hesitate to "swiftly impose expansive economic sanctions that will have a severe and lasting impact on Russia's economy."[3] Further measures could include additional designations of prominent Russian persons and companies, broader sanctions against Russian financial institutions (which could include placing additional banks on the U.S. Treasury's Specially Designated Nationals and Blocked Persons List, or SDN List, restrictions on U.S. dollar correspondent accounts, or other measures), sanctions targeting critical sectors of the Russian economy such as oil, gas, and mining, and export control measures to cut off Russia from key U.S.-developed technology, particularly semiconductors (most of which rely on U.S.-origin technology in the manufacturing process). While the first wave of sanctions is relatively modest, the Biden administration and U.S. allies have been unified in their message that they will "continue to escalate sanctions if Russia escalates."[4] In addition to the U.S., U.S. allies including the EU, U.K., Australia, Canada, and Japan have begun to impose or signaled that they would soon impose sanctions on Russia as well.

We provide below a brief summary of the sanctions that the U.S. has imposed so far this week and the potential shape of future sanctions and export controls on Russia.

Executive Order 14065

The White House issued EO 14065 after the Russian government officially recognized the DNR and LNR regions as independent states. The executive order effectively bars all transactions involving the region within U.S. jurisdiction, including transactions involving U.S. persons or occurring in whole or in part in the United States (including related U.S. dollar payments, which typically clear through the U.S. financial system).

OFAC issued six General Licenses to authorize wind-down and divestment activities through 12:01 a.m. eastern daylight time, March 23, 2022, and to permit certain activities related to humanitarian trade, personal remittances, and communications to continue in the regions

Sovereign debt restrictions

U.S. financial institutions were already prohibited from participating in the primary market for new issuances of Russian sovereign debt under Directive 1 issued pursuant to EO 14024.[5] New Directive 1A expands that prohibition to secondary markets.[6] The new restrictions apply to both ruble and non-ruble debt issued 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 (but not entities they own or control—i.e., OFAC's usual "50% Rule"[7] does not apply) after March 1, 2022. The restrictions apply only to "U.S. financial institutions," including their overseas branches, and branches of foreign financial institutions located in the United States, not to all persons within U.S. jurisdiction; however, "U.S. financial institution" is broadly defined for these purposes and includes, for example, employee benefit plans.[8] Trading in existing Russian sovereign debt is unaffected.

Directive 1A does not define "participation in the secondary market," and its scope is somewhat unclear; however, informal guidance from OFAC on participation in the primary market under the predecessor directive made clear that acting as an intermediary (such as providing custody, paying agent, clearing, or settlement services) for participants in the primary market for new Russian sovereign debt was not prohibited. If OFAC adopts a similar approach here, U.S. financial institutions will only be barred in trading in new issuances of Russian sovereign debt for their own account, not facilitating such trading for their clients or other persons who are not U.S. financial institutions.

Designation of VEB and PSB as SDNs

OFAC also designated VEB and PSB, as well as 42 of their subsidiaries, as SDNs subject to blocking sanctions. Restrictions on dealing with VEB and PSB also apply to entities owned 50 percent or more by either entity, directly or indirectly. All transactions within U.S. jurisdiction involving PSB or VEB, including U.S. dollar transfers, are prohibited unless licensed, and their assets within U.S. jurisdiction must be blocked unless licensed, effective immediately. PSB is now focused on the Russian defense sector and has a relatively limited international presence but VEB has long been one of the primary international banks in Russia and plays an important role in government operations.

OFAC has issued two general licenses for VEB.[9] The first permits transactions necessary and ordinarily incident to the wind-down of transactions with VEB through March 24, 2022. The second permits VEB to continue its role in servicing existing Russian government debt (issued before March 1, 2022) following the wind-down period. There is no wind-down period for transactions with PSB.

The status of the Russian Direct Investment Fund (RDIF), Russia's sovereign wealth fund, is unclear. RDIF's management company was sanctioned under sectoral sanctions because of its relationship to VEB, and the legal status of RDIF's property under Russian law is complicated. While neither RDIF nor its management company was listed as an SDN, which seems to indicate that OFAC does not believe that RDIF is currently majority-owned by VEB, OFAC's 50% Rule applies regardless of the absence of a designation, and if the Russian Federation's interest in RDIF is held through VEB, RDIF would be a blocked entity.

Designation of individuals close to President Vladimir Putin

OFAC imposed blocking sanctions on five "Russian elites" and their family members: Aleksandr Bortnikov (and his son, Denis), Sergei Kiriyenko (and his son, Vladimir), and the Chief Executive Officer of PSB, Petr Fradkov, all of whom were designated as SDNs.

Sanctions on Nord Stream 2 AG

On February 23, President Biden announced that sanctions would be imposed on Nord Stream 2 AG, the operating company for the Nord Stream 2 pipeline, and its corporate officers, reinforcing Germany's action in revoking the pipeline's certification. The announcement was followed by SDN designations prohibiting U.S. dollar transactions (and other transactions within U.S. jurisdiction) with the company and its principal executive officer, consistent with sanctions called for under the Protecting Europe's Energy Security Act (PEESA) that were previously the subject of a national interest waiver. OFAC issued a general license authorizing wind-down transactions involving Nord Stream 2 AG and its subsidiaries through 12:01 a.m. eastern standard time, March 2, 2022.

The outlook for further sanctions

The White House and Treasury Department made clear that the United States has prepared other sanction packages that will be imposed if Russia escalates its activities in Ukraine. Although the Biden administration has not specifically identified the sanctions that would be imposed, press reports citing administration sources and a package of sanctions contained in a bill introduced by Senator Menendez of New Jersey (and cosponsored by 41 Democratic senators) indicate a number of potential measures:

- Blocking sanctions on a list of senior Russian political leaders, including the President, Prime Minister, Foreign Minister, and a range of senior military and defense officials, and additional senior officials as determined by the President;
- Blocking sanctions on additional major Russian financial institutions;
- Blocking sanctions on additional "oligarchs," which as in prior rounds of Russian sanctions would also affect companies in which they own a majority.
- A complete ban on dollar transactions involving Russian government debt;
- Secondary sanctions on significant lenders to Russian state-owned enterprises;
- Blocking sanctions on Nord Stream 2's parent entity and its officers;
- Blocking sanctions targeting additional companies in Russia's oil, gas, coal, or mineral sectors; and
- Export controls limiting Russian access to U.S. technology. This could include:
  - An expansion of the scope of the Foreign Direct Product Rule, which would require a license for the export or re-export of items that are foreign-made direct products of U.S. software, technology, or key manufacturing equipment. This measure was imposed on Huawei and severely damaged its ability to obtain semiconductor chips given the prevalence of U.S. technology in the industry.
  - Expanded license requirements for items that U.S. companies export to Russia, including previously uncontrolled equipment and technology.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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1 Press Release, White House, Remarks by President Biden Announcing Response to Russian Actions in Ukraine (Feb. 22, 2022), https://www.whitehouse.gov/briefing-room/speeches-remarks/2022/02/22/remarks-by-president-biden-announcing-response-to-russian-actions-in-ukraine/ (**February 22 Remarks by President Biden**).

2 Press Release, White House, Statement by President Biden on Nord Stream 2 (Feb. 23, 2022), https://www.whitehouse.gov/briefing-room/statements-releases/2022/02/23/statement-by-president-biden-on-nord-stream-2/.

3 Press Release, U.S. Department of the Treasury, U.S. Treasury Imposes Immediate Economic Costs in Response to Actions in the Donetsk and Luhansk Regions (Feb. 22, 2022), https://home.treasury.gov/policy-issues/financial-sanctions/sanctions-programs-and-country-information/ukraine-russia-related-sanctions.

4 February 22 Remarks by President Biden.

5 Exec. Order No. 14024 (2021). EO 14024, among other things, authorizes OFAC to impose sanctions against persons in connection with Russian harmful foreign activities, including violating core principles of international law such as respect for the territorial integrity of other states.

6 Directive 1A Under Executive Order 14024 (Feb. 22, 2022).

7 OFAC, Revised Guidance on Entities Owned by Persons Whose Property and Interests in Property Are Blocked (Aug. 13, 2014).

8 The definition is as follows: "For the purposes of this Directive, the term "U.S. financial institution" means 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. It includes 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. This term includes those branches, offices, and agencies of foreign financial institutions that are located in the United States, but not such institutions' foreign branches, offices, or agencies."

9 See General License 2 and General License 3.