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United States expected to block U.S. dollar payments on Russian sovereign debt

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The U.S. Treasury indicated that it will likely block payments on Russian debt after May 25, 2022. This follows several rounds of sanctions and export control restrictions, including a ban on new investments and the export of accounting, corporate formation, and management consulting services to persons in Russia.

Secretary of the Treasury Janet Yellen stated on May 18, 2022 that the U.S. Treasury is "unlikely" to extend the general license that permits (among other things) U.S. dollar payments on Russian sovereign debt, which is set to expire on May 25.[1] While Directive 4 under Executive Order 14024 generally prohibits transactions within U.S. jurisdiction involving the Russian Ministry of Finance, Central Bank, or National Wealth Fund, the general license (GL 9C) authorizes transactions required for receipt of "interest, dividend, or maturity payments" by holders of Russian government debt.[2] If GL 9C is allowed to expire, it will no longer be possible to clear U.S. dollar payments relating to Russian sovereign debt, which will likely push the Russian Federation into default for the first time in over one hundred years. Because U.S. dollar payments clear through the U.S. financial system, the license is necessary for Russia to make any such payments. Although Secretary Yellen stated that the Treasury had yet to make a final decision on the matter, she noted that GL 9C was intended to be "time-limited," and that it is "reasonably likely that the license will be allowed to expire."[3]

Secretary Yellen's statement followed a number of additional sanctions provisions, many of uncertain scope, that have further restricted operations in or involving Russia. Major new initiatives have included:

- A ban on the provision of accounting, trust and corporate formation, and management consulting services to persons in Russia
- A ban on new investment in Russia
- Even tighter export controls on dual-use goods and technologies (including foreign-made items produced with U.S. technology) and other basic industrial and commercial products to Russia.
- Continued tightening of sanctions on the Russian financial sector
- New sanctions targeting state-controlled media and Russia's maritime sector.

Many of these steps have been coordinated with the United Kingdom, European Union, and other allies, and they continue the "smart sanctions" approach of targeting sectors in which Russia's government and military are dependent on the West. A White House official characterized the approach as "applying economic pressure where we have an asymmetric advantage, where we and our allies produce something Russia needs and can't easily get from anywhere else."[4]

Lapse of GL 9C

Transactions within U.S. jurisdiction involving Russian sovereign debt are permitted under GL 9C, which the Office of Foreign Assets Control (OFAC) issued in connection with Directive 4 under Executive Order 14024, which prohibits "any transaction involving" the Central Bank of Russia, the National Wealth Fund of Russia, or the Russian Ministry of Finance.[5] GL 9C authorizes U.S. persons to engage in transactions that are "ordinarily incident and necessary to the receipt of interest, dividend, or maturity payments in connection with debt or equity" of the Central Bank of Russia, the National Wealth Fund of Russia, or the Russian Ministry of Finance. Secretary Yellen stated that the carve-out for sovereign debt payments was intended to "allow a period of time for an orderly transition to take place, and for investors to be able to sell securities."[6] The license is necessary not only for U.S. holders of Russian sovereign debt, but for transactions involving persons of any nationality processed in whole or in part through the U.S. financial system—including not only securities transfer and custody involving U.S. intermediaries but payments of dividends, principal, or interest in U.S. dollars, which in the absence of GL 9C could not be cleared.

Although Russia has continued to make payments on its foreign debt in the face of multiple rounds of U.S. sanctions, the lapse of GL 9C will likely effectively push Russia into default by closing the legal channel for payments. The broader consequences of such a default remain unclear (beyond the likely legal challenges from the Russian government). [7] Secretary Yellen stated that she believes a default would not represent a "significant change in Russia's situation" observing that "Russia is already cut off from global capital markets, and that would continue."[8] Russian sovereign debt issued after March 1, 2022, was already outside the scope of the GL 9C authorization, and U.S. financial institutions were barred from any dealings in new sovereign debt.

Ban on new investments

On April 6, in response to what the Biden administration described as "evidence of war crimes" in Bucha, Ukraine,[9] the White House issued Executive Order 14071, which broadly prohibits "new investment in the Russian Federation by a United States person, wherever located."[10] EO 14071's ban on "new investments" is significantly broader than the energy sector-specific investment restrictions that the Biden administration had imposed previously, and its scope remains unclear. To date, OFAC has yet to release any public guidance clarifying the scope of the new investment prohibition in EO 14071, nor has it issued any general licenses specifically related to this prohibition.

Despite the lack of formal guidance, statements by OFAC in the context of recent sanctions regimes provide some insight into how EO 14071 might be applied. OFAC's newly published Ukraine-/Russia-Related Sanctions Regulations defines "new investment" for the purposes of Executive Order 13685's prohibition on new investment in Crimea[11] as: (1) a commitment or contribution of funds or other assets for, or (2) or a loan or other extension of credit after the effective date of EO 13685. FAQ 1019, which interprets Executive Order 14066's prohibition on new investment in the Russian energy sector, is similar (though subtly different), defining "new Investment" as "a transaction that constitutes a commitment or contribution of funds or other assets for, or a loan or other extension of credit to, new energy sector activities (not including maintenance or repair) located or occurring in the Russian Federation."[12]

OFAC's focus appears to be on the contribution of new funds, and initial informal guidance from OFAC seems to indicate that EO 14071's broader investment ban is likely not intended to prohibit supporting existing operations in Russia. The line between "supporting" and "investing" in Russian operations and entities, however, remains unclear, as does the application of the principle to direct or indirect acquisitions of pre-existing assets in Russia. It does seem clear that the new investment prohibition in EO 14071 is unlikely to be read as broadly as those in some historical programs, most notably Burma (where OFAC characterized even divestment of existing businesses as facilitating new investment by third parties). It also seems apparent that simply selling goods (even capital goods) to a Russian business should not be considered "new investment."

Ban on accounting, trust and corporate formation, and management consulting services

EO 14071 also provided authority to prohibit the supply of specified categories of services to Russia involving U.S. persons or activities within the United States. On May 8, 2022, OFAC issued a determination prohibiting the "exportation, reexportation, sale, or supply, directly or indirectly," of "accounting, trust and corporate formation, or management consulting services to any person located in the Russian Federation."[13] The prohibition excludes the provision of any service to an entity in Russia that is owned or controlled by a U.S. person or any service relating to the wind down or divestiture of an entity in Russia that is not owned or controlled by a Russian person. General License 34 authorizes the wind-down of those services generally through July 6, 2022,[14] and General License 35 authorizes the provision of auditing and credit rating services through August 19, 2022.[15]

OFAC issued, and then quickly amended, FAQ 1034 defining each of the services covered as follows:

- ***Accounting services:*** Services related to the measurement, processing, and evaluation of financial data about economic entities.

– ***Trust and corporate formation services*:** Services related to assisting persons in forming or structuring legal persons, such as trusts and corporations; acting or arranging for other persons to act as directors, secretaries, administrative trustees, trust fiduciaries, registered agents, or nominee shareholders of legal persons; providing a registered office, business address, correspondence address, or administrative address for legal persons; and providing administrative services for trusts.[16]

– ***Management consulting services*:** Services related to strategic business advice; organizational and systems planning, evaluation, and selection; development or evaluation of marketing programs or implementation; mergers, acquisitions, and organizational structure; staff augmentation and human resources policies and practices; and brand management.[17]

However, substantial uncertainties remain. From public statements, it seems that these prohibitions, and similar restrictions announced earlier in the United Kingdom,[18] have as their primary aim impeding the ability of ability of Russian companies and oligarchs to use sophisticated Western services to manage affairs and, potentially, shift and conceal assets from sanctions, anticorruption, and other scrutiny. The definitions provided, however, are broad and vague, which is particularly problematic given that the prohibition is not on its face limited to external consultants (as opposed to, for example, internal functions of multinational groups), nor has there been any elaboration of the impact of "directly or indirectly" on the scope of the prohibition as applied to multinational structures that may be quite complex (a complexity that has at times resulted in significant unintended consequences and market disruption outside Russia in prior iterations of the sanctions). Additional guidance is likely as issues emerge, and OFAC does gather and take into account feedback from a variety of market participants, but the timing and scope are unknown.

Export control restrictions

In conjunction with the economic sanctions announced over the past month, the Biden administration has imposed new rules that impose broad licensing requirements on exports to Russia and Belarus. While these export restrictions have received less attention than financial sanctions, they may have a significant long-term impact on the Russian economy. As we reported in our March 1 client update, the United States previously imposed licensing requirements on many categories of U.S.-origin goods and technology destined for Russia or Belarus and subject to "dual-use" export controls and, in an even more far-reaching step, expanded the "foreign direct product rule" to cover non-U.S. origin items and components destined for Russia manufactured using U.S. technologies (so that, for example, a Chinese manufacturer using U.S.-origin controlled technology to manufacture controlled goods is also subject to U.S. licensing requirements for exports to Russia).[19] On May 9, the Department of Commerce issued a further rule restricting the export to Russia and Belarus of industrial and manufacturing items not subject to dual-use controls in order to "limit Russia's access to items and revenue that could support its military capabilities."[20] The May 9 rule expands licensing requirements (again with a presumption of denial) to a wide variety of non-controlled ("EAR99") industrial and commercial items, such as wood products, construction machinery, industrial engines, motors, chemicals, manufacturing inputs, bulldozers, and ventilation equipment.

While these export controls may have less immediate and visible impact than financial sanctions, given their breadth and the extension to foreign suppliers in industries dependent upon U.S. technology (such as semiconductors) via the foreign direct product rule, they could have a significant long-term impact on Russian supply chains and industrial capabilities.

Sanctions on additional banks, state-controlled media, defense, and shipping and maritime entities

Finally, OFAC has continued to expand sanctions targeting Russian banks. OFAC imposed full blocking sanctions on Sberbank, Russia's largest financial institution,[21] as well as JSC Alfa-Bank,[22] Russia's largest private bank, and Moscow Industrial Bank (MIB), which allegedly facilitates payments for Russia's intelligence service and defense sector.[23] OFAC also designated eight current and recent members of Sberbank's executive board, along with 27 directors of Gazprombank. The U.S. did not, however, impose further sanctions on Gazprombank itself, which continues to play a central role in European payments to Gazprom for natural gas. OFAC issued a number of general licenses in connection with the sanctions imposed on Sberbank and Alfa-Bank, including new licenses relating to the wind-down of Sberbank affiliates in the United States, Europe, and Kazakhstan, and amended authorizations relating to the divestment of securities and wind-down of derivative contracts. No such licenses were issued for transactions involving MIB, however.

The Biden administration also announced further sanctions targeting Russian state-controlled media and entities in Russia's defense and maritime sectors. To limit the availability of foreign funding for media outlets that "enable Putin's propaganda machine,"[24] OFAC added three of Russia's largest state-controlled television stations—Joint Stock Company Channel One Russia, Television Station Russia-1, and Joint Stock Company NTV Broadcasting Company—to the SDN List. The three networks receive significant funding and support through foreign advertising, and the sanctions are intended to prohibit each company from benefiting from access to U.S. customers, U.S. equipment, and the U.S. financial system. A number of defense and maritime-related entities were designated for blocking sanctions, and certain Russian-affiliated vessels were barred from U.S. ports.[25]

Looking forward

With no end to the crisis in Ukraine in sight, additional sanctions actions by the United States and its allies remain likely. The high level of coordination among the United States, the UK, the EU, and other allies remains striking. The specifics of future action remain uncertain, although it is notable that the United States still has taken fewer public actions targeting Russian businessmen than either the UK or the EU. Additionally, OFAC will soon be required to make decisions concerning whether to extend or let lapse key general licenses, including GL 9C, discussed above, and GL 13,[26] which authorizes certain administrative payments to the Russian Central Bank, Ministry of Finance, and National Wealth Fund until June 24, 2022. While the pace of new actions has slowed since early March, the sanctions environment continues to evolve, and close attention to new developments remains essential.

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 U.S. Department of the Treasury, Press Release, Transcript of Press Conference from Secretary of the Treasury Janet L. Yellen in Bonn, Germany (May 18, 2022) ("Yellen Remarks"), available at https://home.treasury.gov/news/press-releases/jy0793.

2 U.S. Department of the Treasury, General License 9C, available at https://home.treasury.gov/system/files/126/russia_gl9c.pdf

3 Yellen Remarks.

4 A similar logic guided U.S. sanctions targeting Russia's Central Bank and financial sector, as well as export control restrictions relating to critical technology. *See* White House, Press Release, Background Press Call by a Senior Administration Official on the U.S. and G7 Actions to Impose Additional Severe Costs for Putin's War Against Ukraine (May 8, 2022), available at https://www.whitehouse.gov/briefing-room/press-briefings/2022/05/08/background-press-call-by-a-senior-administration-official-on-the-u-s-and-g7-actions-to-impose-additional-severe-costs-for-putins-war-against-ukraine/.

5 See U.S. Department of the Treasury, Directive 4 under Executive Order 14024 (Feb. 22, 2022), available at https://home.treasury.gov/system/files/126/eo14024_directive_4_02282022.pdf; Executive Order 14024, 86 Fed. Reg. 20249 (Apr. 15, 2021).

6 Yellen remarks.

7 Certain dollar-denominated Russian government bonds may permit payment in alternate currencies, and the Russian government may attempt to argue that payment in alternative currencies is not a default even in the absence of such a provision. While that issue is beyond the scope of this memorandum, such a potential argument has met with widespread skepticism.

8 *Id.*

9 See White House, Press Release, Press Briefing by Press Secretary Jen Psaki and National Security Advisor Jake Sullivan (Apr. 4, 2022), https://www.whitehouse.gov/briefing-room/press-briefings/2022/04/04/press-briefing-by-press-secretary-jen-psaki-and-national-security-advisor-jake-sullivan/.

[10] Executive Order 14071, 87 Fed. Reg. 20999 (Apr. 8, 2022).

[11] 31 C.F.R § 589.326. On May 1, 2022, OFAC published a full set of implementing regulations for the 2014 executive orders issued in response to Russia's original incursion into Ukraine and annexation of Crimea. These regulations largely codify existing orders, directives, general licenses, and guidance, but do include some helpful additional definitions and interpretive provisions, as well as a handful of new general licenses.

[12] OFAC, FAQ 1019 (March 8, 2022), https://home.treasury.gov/policy-issues/financial-sanctions/faqs/1019.

[13] *See* U.S. Department of the Treasury, Determination Pursuant to Section 1(A)(Ii) of Executive Order 14071 (May 8, 2022), available at https://home.treasury.gov/system/files/126/determination_05082022_eo14071.pdf. Concurrently, OFAC issued a separate determination under EO 14024 authorizing the imposition of sanctions on persons determined to be operating in the accounting, trust and corporate formation services, and management consulting sectors of the Russian Federation economy. *See* U.S. Department of the Treasury, Determination Pursuant to Section 1(a)(i) of Executive Order 14024 (May 8, 2022), available at https://home.treasury.gov/system/files/126/determination_05082022_eo14024.pdf.

[14] *See* U.S. Department of the Treasury, General License No. 34 (May 8, 2022), available at: https://home.treasury.gov/system/files/126/russia_gl34.pdf;

[15] *See* U.S. Department of the Treasury, General License No. 35 (May 8, 2022), available at: https://home.treasury.gov/system/files/126/russia_gl35.pdf. In FAQ 1035, OFAC defined "credit rating services" to mean "services related to assessments of a borrower's ability to meet financial commitments, including analysis of general creditworthiness or with respect to a specific debt or financial obligation." Auditing services means "examination or inspection of business records by an auditor, including checking and verifying accounts, statements, or other representation of the financial position or regulatory compliance of the auditee." *See* OFAC, FAQ 1035 (May 11, 2022), https://home.treasury.gov/policy-issues/financial-sanctions/faqs/1035.

[16] In FAQ 1034, OFAC notes that "all of these activities are common activities of trust and corporate service providers (TCSPs), although they may be provided by other persons." *See* OFAC, FAQ 1034 (May 11, 2022), https://home.treasury.gov/policy-issues/financial-sanctions/faqs/1034.

[17] *Id.*

[18] *See* Russia Cut Off from UK Services (May 4, 2022) https://www.gov.uk/government/news/russia-cut-off-from-uk-services.

[19] Davis Polk, United States Escalates Sanctions and Export Controls in Response to Russian Invasion of Ukraine (Mar. 1, 2022), available at https://www.davispolk.com/insights/client-update/united-states-escalates-sanctions-and-export-controls-response-russian.

[20] U.S. Department of Commerce, Bureau of Industry Security, Expansion of Sanctions Against Russian Industry Sectors Under the Export Administration Regulations (EAR), 87 Fed. Reg. 28758 (May 11, 2022); White House, Press Release, FACT SHEET: United States and G7 Partners Impose Severe Costs for Putin's War Against Ukraine (May 8, 2022), https://www.whitehouse.gov/briefing-room/statements-releases/2022/05/08/fact-sheet-united-states-and-g7-partners-impose-severe-costs-for-putins-war-against-ukraine/.

[21] The blocking order on Sberbank, which adds Sberbank to the SDN List, expanded on existing sanctions effectively requiring U.S. financial institutions to reject ransactions involving Sberbank. The previous sanctions targeting Sberbank are discussed in our March 1, 2022 client update.

[22] Note that the Russian entity JSC Alfa-Bank is distinct from the Ukrainian entity JSC Alfa-Bank, which both OFAC and the UK sanctions authorities have explicitly recognized is a separate entity and is not sanctioned.

[23] OFAC stated that MIB has taken on business on behalf of Promsvyazbank Public Joint Stock Company (PSB), a state-owned bank that was purported to finance Russia's defense industry, following OFAC's designation of PSB on February 22, 2022.

[24] *See* White House, Background Press Call by a Senior Administration Official on the U.S. and G7 Actions to Impose Additional Severe Costs for Putin's War Against Ukraine, *supra* note 1.

[25] Proclamation 10371 (Apr. 21, 2022).

[26] U.S. Department of the Treasury, General License No. 13 (Mar. 2, 2022), available at: https://home.treasury.gov/system/files/126/russia_gl13.pdf.