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United States escalates sanctions and export controls in response to Russian invasion of Ukraine

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This updates the Biden administration's expansive imposition of economic sanctions and export controls targeting Russia through Monday, February 28.

The United States and its allies have continued to impose sweeping and unprecedented sanctions and export control restrictions in response to the Russian Federation's invasion of Ukraine. In a second tranche of sanctions and other measures first announced on February 24, 2022, the Biden administration imposed an expansive package of economic sanctions and export controls designed to "isolate Russia from the global financial system" and cut off Russian access to critical technology.[1] The Administration's strongest measures target the Russian banking system—prohibiting correspondent account services for Russia's largest bank, imposing full blocking orders on others, and banning U.S. dollar transactions with Russia's central bank—and limit the availability of a wide range of goods and components (including semiconductors and microchips) produced in the U.S. or based on U.S.-origin technology. Further measures prohibit dealing in new debt and equity of some of Russia's largest state-owned companies, impose blocking orders on Russia's sovereign wealth funds and individuals close to the Russian government, and sanction Belarus for its government's role in supporting the invasion. U.S. allies including the European Union, United Kingdom, Japan, Australia, and Canada imposed or committed to impose similar restrictions. These measures follow a first tranche of sanctions that the Biden administration imposed on February 23.[2]

Over the weekend and on February 28, the European Commission, France, Germany, Italy, the United Kingdom, Canada, Japan, and the United States announced their intention to take additional significant sanctions measures, including steps against the Russian Central Bank and ensuring that a number of major Russian banks (yet to be identified) will be disconnected from the Society for Worldwide Interbank Financial Telecommunication (SWIFT) messaging system.[3]

This update covers developments through February 28, 2022. As the U.S. and its allies continue to respond to the crisis in Ukraine, the situation will continue to rapidly develop.

Sanctions targeting Russia's banking sector and state-owned enterprises

The second tranche of sanctions announced by the Office of Foreign Assets Control (OFAC) on February 24 included a series of orders targeting Russia's largest banks pursuant to Executive Order 14024 (EO 14024).[4] Pursuant to Directive 2 under EO 14024 (Directive 2), OFAC targeted Russia's largest bank, Public Joint Stock Company Sberbank of Russia (Sberbank) with a ban on the provision of correspondent and payable through account services and processing of other transactions by U.S. financial institutions, which will take effect on March 26, 2022. These prohibitions will apply as well to entities that are 50 percent or more owned by Sberbank, and can be extended to other foreign financial institutions that are determined to be subject to Directive 2 by OFAC in the future. [5] OFAC also applied full blocking sanctions on Russia's second largest bank, VTB Bank Public Joint Stock Company (VTB) and a number of other large Russian banks, and added the Russian Direct Investment Fund (RDIF) and its management company to the SDN List on February 28. [6] These institutions are now (or in the case of Sberbank soon will be) effectively banned from the dollar economy globally, as no transactions on their behalf can be cleared through the U.S. financial system (which is generally a required step for interbank transfers of U.S. dollars, even between foreign banks). Institutions other than Sberbank have also had their assets subject to U.S. jurisdiction frozen. It is expected that the European Union, the United Kingdom, Japan, and other allies will also take measures targeting some or all of these banks.

OFAC followed those measures on February 28 with Directive 4 under EO 14024 (Directive 4), which targets Russia's Central Bank. Effective immediately, persons acting within U.S. jurisdiction are prohibited from performing any transaction "involving" the Central Bank of Russia, including transfers of assets to the Central Bank or foreign exchange transactions on its behalf. Directive 4 similarly prohibits transactions involving the National Wealth Fund of the Russian Federation and with the Russian Ministry of Finance. Despite the apparent broad scope and immediate effect of this prohibition, OFAC did not immediately issue any FAQs to provide guidance on its application and issued only one amendment to a prior general license in coordination with the publication of the directive. Accordingly, many key interpretive questions concerning Directive 4 remain open, including how it intersects with prior sanctions on Russian sovereign debt for which the Ministry of Finance is the obligor under Directive 1A and related general licenses.[7] OFAC signaled in its press release announcing the issuance of Directive 4 that additional guidance and general licenses would be forthcoming "as needed."

Although OFAC provided several general licenses[8] that authorize, among other things, a 30-day wind-down period for certain transactions involving sanctioned banks, including VTB, Otkritie, and Sovcombank (and the sanctions against Sberbank have a delayed effective date), many of these licenses are heavily conditioned.[9] General License 11, for example provides a wind-down period for transactions ordinarily incident and necessary to exit pre-existing operations, contracts, or agreements, to collect or make payments on loans, or to close a correspondent account, but any funds collected from closing those accounts or otherwise owed to a blocked party must be transferred into a blocked account, and no blocked assets may be released (even in connection with a wind-down). OFAC has also explicitly stated that "business as usual" activities such as funds transfers and securities transactions not directly related to contract termination are not permitted during the wind-down period and must stop immediately.[10] OFAC also issued General License 8 (subsequently amended as General License 8A), authorizing transactions "related to energy" with a number of sanctioned Russian banks, including the Central Bank of Russia; however, those transactions must be conducted through the accounts of non-sanctioned third-country banks.[11]

OFAC also extended restrictions on dealings by U.S. persons in issuances of new equity and new debt with a tenor of 14 days or longer to a range of additional state-owned and private banks in Russia pursuant to Directive 3 under EO 14024.[12] These restrictions, which take effect on March 26, 2022, apply to some of Russia's largest state-owned companies, including Gazprom, the world's largest natural gas company, Sovcomflot, a major shipper, Russian Railways, and Rostelcom, Russia's largest telecommunications company, as well as entities that are 50 percent or more owned by these companies.

Export controls on technology and components

In addition to targeting the Russian financial system, the Biden administration imposed new export controls to "cut off Russia's access to cutting edge technology critical technology and subcomponents."[13] The export controls target not only goods made in the United States, but also goods made in third countries using U.S.-origin technology or software, greatly increasing their reach and impact (similar to export controls targeting Huawei imposed in 2020).

These controls were implemented through a new rule issued by the U.S. Department of Commerce, Bureau of Industry and Security (BIS), which became effective February 24, 2022.[14] The new rule has multiple prongs:

— Expanded export licensing requirements applicable to many categories of dual-use goods, software, or technology to any Russian recipient.
— Expansion of the "foreign direct product rule" to prohibit the delivery to Russia of goods or components made outside the United States using dual-use U.S.-origin technology or software in the same categories.
— Expansion of export controls to Russian military end users and military end uses to cover all U.S.-origin goods, other than uncontrolled food and medicine.
— Expansion of the "foreign direct product" rule to prohibit the delivery to military end users or for military end uses of goods or components made with any controlled U.S.-origin technology or software.

As the Huawei experience demonstrates, the "foreign direct product" rule has a wide-ranging impact, particularly on semiconductors and other electronics (many of which are manufactured with U.S.-origin technology or software, even outside the United States).

All items listed in categories 3-9 of the Commerce Control List (CCL), the list of dual-use goods controlled under the Export Administration Regulations now require a license from BIS for export or reexport to Russia, unless certain limited license exceptions apply. This significantly expands controls on shipment of dual-use goods to any user in Russia (or to third countries for incorporation into goods destined for Russia), including many less-sensitive goods that were previously not the subject of controls. Items affected by this change include microelectronics, telecommunications items, sensors, navigation equipment, avionics, marine equipment, and aircraft components, among other things. Applications for licenses for these newly controlled items will be subject to a general policy of denial, with limited categories of exports eligible for case-by-case review.

The new Russia-specific "Foreign Direct Product Rule" (FDP Rule) imposes licensing requirements for items that are foreign-made direct products of U.S. software or technology listed in the same categories of the CCL, or produced with plants or key manufacturing equipment that are the product of such U.S.-origin software and technology. The FDP Rule applies to items that are destined for Russia or will be incorporated into or used in the production or development of items destined for export to Russia.[15]

With respect to military end uses and military end users, the controls are even stricter. All U.S.-origin items must be licensed for export or reexport for these purposes, other than uncontrolled food and medicine. The FDP Rule for Russian military end users is similarly expansive, covering the products of U.S.-origin software or technology under all categories of the CCL. While a number of military end users have been specifically identified (and are now found on BIS's Entity List, given the broad licensing requirement on almost all exports), the list of military end users identified on the Entity List is not exclusive. Exports of U.S.-origin goods, or goods subject to the FDP Rule, are restricted if destined for any "military end use"[16] or, even more broadly, "military end-user"[17] in Russia.

Both versions of the FDP Rule applicable to Russia exclude exports, reexports, or in-country transfers of items from partner countries that have committed to apply substantially similar export controls to Russia.[18]

Additional individual designations

Of symbolic importance, if not economic significance, the United States continues to designate individuals associated with the Russian government for blocking sanctions, now including President Vladimir Putin and Foreign Minister Sergei Lavrov. It is likely that additional targeted designations of significant Russian political, military, and economic actors will be announced in the coming days and weeks (a number of additional persons were designated by the European Union today), and the U.S. and its European allies have committed to establish a transatlantic task force that will ensure the effective implementation of financial sanctions by identifying and freezing the assets of sanctioned individuals and companies that exist in their respective jurisdictions, and to identify additional sanctions targets.

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, Joined by Allies and Partners, the United States Imposes Devastating Costs on Russia (Feb. 24, 2022), https://www.whitehouse.gov/briefing-room/statements-releases/2022/02/24/fact-sheet-joined-by-allies-and-partners-the-united-states-imposes-devastating-costs-on-russia/.

[2] The first tranche of sanctions included, among other things, (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); (iii) blocking sanctions on five individuals linked to the Russian government; and (iv) sanctioned Nord Stream 2 AG, the company that owns and operates the Nord Stream 2 gas pipeline between Russia and Europe.

[3] Joint Statement on Further Restrictive Economic Measures (February 26, 2022), https://ec.europa.eu/commission/presscorner/detail/en/statement_22_1423.

[4] 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. Exec. Order No. 14024 (2021).

[5] *See* Directive 2. The prohibitions with respect to other foreign financial institutions determined to be subject to the Directive take effect 30 days after the date in which that determination is made.

[6] The other financial institutions most recently added to the SDN List include Public Joint Stock Company Bank Financial Corporation Otkritie (Otkritie), Open Joint Stock Company Sovcombank (Sovcombank), and Joint Stock Commercial Bank Novikombank (Novikombank); as noted, VEB and PSB were designated as SDNs in the first tranche.

[7] Directive 1A is discussed in our February 23 client update on the first tranche of U.S. sanctions. To the extent that the Ministry of Finance is the issuer of and obligor on Russian sovereign bonds, including those in the secondary market, the Directive 4 prohibition on transactions with the Ministry calls into question whether U.S. persons can process or receive interest payments on Ministry-issued debt or whether such payments would have to be rejected. Given prior guidance and general licenses permitting secondary market trading in Russian sovereign debt, this may be an issue subject to clarification or resolution in future guidance from the U.S. Treasury.

[8] The general licenses include Russian-related General License No. 5 (Official Business of Certain International Organizations and Entities); Russian-related General License No. 6 (Transactions Related to the Exportation or Reexportation of Agricultural Commodities, Medicine, Medical Devices, Replacement Parts and Components, or Software Updates, or the Coronavirus Disease 2019 Pandemic); Russian-related General License No. 7 (Authorizing Overflight Payments, Emergency Landings, and Air Ambulance Services); Russian-related General License No. 8 and General License 8A (Authorizing Transactions Related to Energy);

Russian-related General License No. 9 (Authorizing Transactions Related to Dealings in Certain Debt or Equity); Russian-related General License No. 10 (Authorizing Certain Transactions Related to Derivative Contracts); Russian-related General License No. 11 (Authorizing the Wind Down of Transactions Involving Certain Blocked Persons); and Russian-related General License No. 12 (Authorizing U.S. Persons to Reject Certain Transactions).

[9] OFAC provides guidance in Frequently Asked Questions relating to the scope and applicability of the general licenses.

[10] OFAC, Frequently Asked Question No. 975 (Feb. 24, 2022), https://home.treasury.gov/policy-issues/financial-sanctions/faqs/975.

[11] See Russian-related General License No. 8 and Russian-related General License No. 8A (Authorizing Transactions Related to Energy).

[12] These banks are Alfa-Bank and Credit Bank of Moscow. Russian Agricultural Bank, Sberbank, and Gazprombank were also listed under Directive 3 but were already subject to similar prohibitions under the sectoral sanctions imposed pursuant to Directive 1 under Executive Order 13662.

[13] *See* White House, Joined by Allies and Partners, the United States Imposes Devastating Costs on Russia, *supra* note 1.

[14] The new rule will be published in the Federal Register on March 3, 2022.

[15] The rule excludes, however, foreign-produced items that are classified as EAR99, which includes many consumer goods.

[16] "Military end use" is defined in 15 C.F.R. § 744.21(f) as "[i]ncorporation into a military item described on the U.S. Munitions List (USML) (22 CFR part 121, International Traffic in Arms Regulations); incorporation into items classified under Export Control Classification Numbers (ECCNs) ending in "A018" or under "600 series" ECCNs; or any item that supports or contributes to the operation, installation, maintenance, repair, overhaul, refurbishing, "development," or "production," of military items described on the USML, or items classified under ECCNs ending in "A018" or under "600 series" ECCNs."

[17] "Military end user" is defined in 15 C.F.R. § 744.21(g) as "the national armed services (army, navy, marine, air force, or coast guard), as well as the national guard and national police, government intelligence or reconnaissance organizations, or any person or entity whose actions or functions are intended to support 'military end uses' as defined in paragraph (f) of this section." This definition is both broad and vague in scope.

[18] The specific countries to which this exclusion applies are Australia, Austria, Belgium, Bulgaria, Canada, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Japan, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, New Zealand, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the United Kingdom.