



Ukraine Crisis and new Russia Sanctions

This briefing paper summarises the recent package of sanctions measures put in place by the European Union, UK and US against Russia and occupied territories in Ukraine. We include our point of view on some of the practical challenges faced by firms in applying the new measures, and add to the debate on whether sanctions really work.

New Sanctions Obligations

Following the Russian invasion of Ukraine on 21 February 2022, the EU, UK and US together with other States, imposed an initial package of sanctions against Russia and the occupied territories in Ukraine. The measures have been broadly viewed as insufficient to deter Russia, sparking widespread international criticism from the press, public and some politicians.

On 23 February 2022, the EU Council agreed on a further tranche of measures in response to Russia's decision to recognise the non-government controlled areas of Donetsk and Luhansk Oblasts in Ukraine as independent entities, and the ensuing decision to send Russian troops into these areas.

The agreed measures included:

- targeted sanctions against the 351 members of the Russian State Duma (the lower house of the Federal Assembly of Russia) and 27 individuals;
- restrictions on economic relations with the non-government controlled areas of Donetsk and Luhansk Oblasts;
- restrictions on Russia's access to the EU's capital and financial markets and services.

On 24 February, EU leaders met at a special summit convened following Russia's escalating aggression against Ukraine. They agreed on further sanctions against Russia that target:

- the financial sector
- the energy and transport sectors
- dual-use goods
- export control and export financing
- visa policy

- additional sanctions against named Russian individuals
- new listing criteria.

On 25 February, the EU decided to freeze the assets of Vladimir Putin, President of the Russian Federation, and Sergey Lavrov, Minister of Foreign Affairs. In addition, the EU has imposed restrictive measures on members of the National Security Council of the Russian Federation and on the remaining members of the Russian State Duma who supported Russia's immediate recognition of the self-proclaimed Donetsk and Luhansk "republics".

The Council has also agreed on a further package of individual and economic measures to respond to the unprovoked and unjustified military aggression carried out by the Russian Federation against Ukraine. These sanctions cover the finance, energy, transport and technology sectors, as well as visa policy.

FIs will need to consider the following new and incremental sanctions measures that have been implemented by the EU, US and UK:

- Occupied territories are considered prohibited countries by financial institutions under their jurisdiction risk index with application of blocks and mitigating controls;
- US sanctions against NordStream 2 will require updates to Customer Name Screening and Transaction Filtering systems and controls, with application of asset freezing, blocks and mitigating controls;
- EU and US sanctions against certain Russian individuals and entities will require FIs to update screening lists as part of Customer Name Screening and Transaction Filtering systems and controls;
- EU and US sanctions against the Russian Sovereign Funds means no new lending to Russia (including Central Bank and National Wealth Fund), and no primary and secondary market equity/debt transactions;
- EU, US and UK sanctions against certain Russian FIs will require asset freezing and blocking controls; capital market sanctions extend to also cover cash settling derivatives (referencing to targeted securities only).

FIs should also be closely monitoring the safety concerns of staff members in Russian subsidiaries in response to the implementation of these measures. This has been reinforced over the weekend by France and the US requesting workers to leave Russia.

What are the challenges for Financial Institutions?

The dynamic and evolving nature of these new packages presents a significant challenge to FIs in regards to:

- **Significant time and resource pressure** on sanctions and compliance teams to assess the impact of the new measures and update applicable policies, procedures and guidance in compressed timescales, alongside ensuring systems and controls are updated, including effectively screening against the new sanction lists. This has been exacerbated by their incremental nature, with new measures being revealed almost daily last week;
- Navigating and effectively **addressing conflicting sanctions obligations** and guidance from the EU, UK, US and other jurisdictions;
- **Reviewing transactions, counterparty and third-party relationships** to assess and determine any direct or indirect touchpoints to Separatist Regions or designated parties;
- **Taking commercial decisions** about onboarding new clients and executing new transactions, which may include putting a temporary block on new business;
- Undertaking **potential 'de-risking' activity** with exiting clients or unwinding bond holdings, trades or transactions, and understanding the potential commercial impact;
- Ensuring no payments are processed on behalf of designated FIs and **ensuring preventative controls** are in place;
- **Asset freezing** and ensuring that reporting obligations are met with the relevant regulatory bodies within the required timeframes;

- Funds with exposure to Russia may see **significant redemption requests** which could result in funds triggering clauses to prevent further redemptions;
- Safety concerns for staff members of EU/US bank subsidiaries in Russia.

What are the challenges in enforcing sanctions?

Sanctions are designed to deter war and target nefarious regimes to influence a change in policy and behavior. As it stands, the current sanctions have gathered criticism, with the initial response from the UK government deemed by some to be a 'pea shooter' approach to the crisis.

At the heart of UK sanctions is identifying entities or assets that are "owned or controlled directly or indirectly" by specific individuals. This relates to holding directly or indirectly 50% of the shares or voting rights in the entity, or holding a direct or indirect right to appoint or remove a majority of the board of directors. Such individuals, taking all circumstances into consideration, are deemed to have a controlling influence on the entity (which can be open to interpretation). OFAC's '50 Percent Rule' adopts a similar approach.


Beyond the targeted, financial, trade and sectoral sanctions on Russian state owned enterprises, companies and banks, applying these measures to Putin, Sergey Lavrov, other Russian officials and oligarchs, is ultimately contingent on identifying where they have a controlling stake or influence. This presents multiple challenges to firms because these individuals have deliberately sought to shield their ownership and control to mitigate the risk of sanctions and obscure (in some cases) where they are holding their ill-gotten gains. Some practical challenges that FIs face include:

- **Truly understanding the beneficial owner of the entity.** Russian officials or oligarchs typically act through third parties that they control, known as proxies or fronts. Proxies typically have no formal or known association with sanctioned individuals and therefore standard sanctions controls such as Customer Name Screening and typical Customer Due Diligence are ineffective. It is widely reported that some oligarchs are, in effect, proxies for Putin.
- **Beneficial ownership can also be obscured through the use of newly registered companies**, such as Scottish Limited Partnerships (SLPs) set up through the UK's Companies House, or companies registered in "secrecy jurisdictions". SLPs have gained notoriety for their relatively low reporting requirements and ability to be controlled by corporate partners, which can be based in secrecy jurisdictions such as the Seychelles and Belize. Their use was found to be at the centre of the "Russian Laundromat", a money-laundering scheme that moved more than \$20 billion out of Russia between 2010 and 2014 through global banks. A significant amount of these funds is suspected to be from the Russian treasury and state contracts.
- **The proposal to accelerate the Economic Crime Bill** by the UK Government through Parliament will introduce a register of overseas entities highlighting the ultimate owners of overseas companies that control property and land in the UK. It will also include measures to strengthen the system of "Unexplained Wealth Orders" which can be used to determine the source of wealth of individuals and apply for a forfeiture order if the person cannot prove it was gained legitimately. However, the Bill will apply additional pressure on FIs to comply with the new requirements once adopted.

Do sanctions really work?

Some of the new measures will evidently impact Russia, but the question is whether they will have the desired effect in stopping the war. Based on the measures implemented so far, our view is that there will be a critical delay between imposing these changes and the full impact being felt by Russia. Russia is already subject to numerous sanctions since its 2014 support of separatists in Donbas. It has not given Crimea back to Ukraine or left the Donbas in peace, which therefore raises a question around the impact of sanctions.

However, Western leaders agreed on Saturday 26 February to impose more financial sanctions on Russia for its invasion of Ukraine, including removing "selected Russian banks" from the SWIFT international payments system and excluding the Russian Central Bank from international operations. This undoubtedly will have a material impact, preventing the country from using its estimated \$630bn international dollar reserves with significant repercussions for the Russian economy. At the time of writing this paper the US dollar rose as much as 40%



against the rouble – the move being reported as the largest one-day slump in Russian currency's modern history. However, proceeding with the new sanctions also puts companies and financial institutions who are dealing with Russian counterparties in terms of trade, debt and payment exposure at risk, notwithstanding scope for Russia to circumvent the blocks by exploiting trade, financial agreements and informal payment channels with other non-NATO countries such as China and India.

History has proven that sanctions can also have deep and devastating unintended consequences beyond the initial targets. The human costs as evidenced in Iraq, North Korea and Iran demonstrate the humanitarian impact sanctions can trigger on the wider population of the target country. Iraq relied on imports for two-thirds of its food supply. In 1990, when a financial and trade embargo was imposed after the invasion of Kuwait, prices of basic commodities rose 1,000 percent between 1990 and 1995. This resulted in a 150 percent increase in the infant mortality rate and at least 670,000 children under-five died in poverty.

Although sanctions played a part in forcing Iran to the Nuclear Deal in 2015 and was regarded as a success, a report published by Iran's Ministry of Labor highlighted how roughly one third of Iranians lived below the poverty line (with an income of around 25 million rials a month, equivalent to \$200 at the time). According to the Labor Ministry's report, poverty increased by 38 percent across the period, mainly due to high inflation and rising prices of food and housing.

Beyond longer term impacts on the economy, sanctions have been responsible for triggering humanitarian crises, including the displacement of refugees. These unintended social consequences are often not considered, and the sharp end of the sanctions miss the intended targets who have significant economic resources at their disposal. Therefore it is imperative to push ahead with blocking select Russian banks from SWIFT and the Russian Central Bank from international operations to hopefully drive a constructive response from Putin. This was reinforced by Putin's order to his defence chiefs over the weekend to put the country's "deterrence forces" on high alert, accusing Western countries of taking "unfriendly" steps against his country, no doubt triggered by the SWIFT announcement, wider sanctions and arms support by NATO countries.


Lastly, due to the globalised nature of the world we live in, when sanctions lead to closure of one market, targeted nations shift their economic focus to other markets and trading partners. When the US or the EU impose sanctions it is seen as an opportunity by other economies such as China, India and South Korea. For example, China has been the dominant economic ally of Myanmar since sanctions were imposed in the 1980s. China has also continued to have sizable economic ties with heavily-sanctioned North Korea. Therefore, there is a significant risk that Russia may circumvent the measures and augment existing trade or financial relationships – or build new ones.

Conclusion

Despite the perception that some sanctions can be limited in terms of their impact, the new SWIFT and Russian Central Bank sanctions, coupled with existing measures, will undoubtedly hurt Russia as evidenced by the devaluation of the rouble and doubling of the interest rate to 20%. It is clear that by doubling down on the sanctions measures, NATO countries have created a situation where Putin and Russia will feel an immediate impact and bite. This is preferable to a prolonged and drawn out situation that does not create an immediate impetus for Putin to change his course of direction, or where the sanctions have a long term economic impact on the Russian economy and people as outlined earlier. However, given the dynamic nature and unintended consequences of sanctions, it is important that the EU, UK and US monitor the situation carefully and adjust as appropriate, depending on whether Russia falls into line.

At Plenitude our primary objective is to ensure our clients are meeting their Financial Crime Compliance obligations effectively and efficiently, which includes sanctions obligations. However, the current Ukraine crisis has brought into sharp focus the challenges that FIs face (at an organisational and staff level) implementing the new measures, against a backdrop of navigating an already complex set of sanctions regimes globally.

In writing this paper, we spoke to multiple clients at a broad range of financial institutions who have been under unprecedented pressure to assess and implement the new measures. They told us they are driven by the requirement to ensure their respective firms meet their regulatory obligations, but also contribute to the worldwide effort to support Ukraine and hopefully change the path of Russia.



Amongst all of this, we would like to extend our heartfelt support and solidarity to the people of Ukraine, and hope that the efforts of the wider industry and unwavering support from Financial Crime Compliance professionals influence the outcome of the current crisis.

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Plenitude are Financial Crime, Risk and Compliance specialists, offering advisory, transformation services and innovative cloud-based RegTech subscription products. We help our clients meet their regulatory obligations and reduce their financial crime risk exposure by providing deep subject matter expertise, advisory and transformation services. Our RegTech subscription products which are used by leading financial institutions, offer clients enhanced insight into the vast array of FCC laws, regulations, guidance and risk indicators globally.

Plenitude has extensive experience of assisting financial institutions with assessing and improving their sanctions programs, systems and controls; and have a proven suite of assets and deliverables to accelerate the delivery of our engagements and support industry wide benchmarking.

Our consultants come from a variety of backgrounds and disciplines across consulting, in-house financial crime compliance, regulators, government and law enforcement. As experts in financial crime compliance, we fully understand the financial crime compliance challenge, and have the expertise and skills to design and implement effective programmes or initiatives.

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