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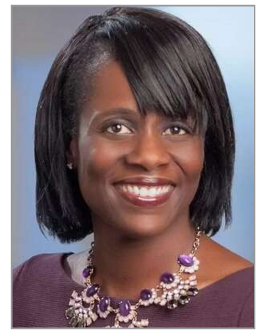
G7 Russia Restrictions May Further Complicate Compliance

By **Ama Adams, Emerson Siegle and Kurt Fowler** (May 22, 2023, 5:15 PM EDT)

On May 19, in coordination with similar announcements from other G7 countries, the **U.S. announced** new sanctions and export controls targeting Russia in response to the ongoing war in Ukraine.



Ama Adams

Coinciding with the start of the G7 summit in Japan, the new restrictions are aimed at further restricting Russian access to G7 economies, including through targeting non-Russian parties that assist Russia to circumvent existing restrictions.

Collectively, the new restrictions signal continued multilateral commitment to intensifying economic pressure on Russia and underscore the increasing compliance challenges for the companies that continue to pursue Russia-related opportunities.

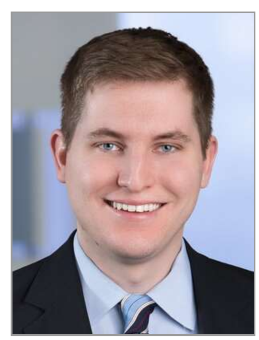
Emerson Siegle

New Controls

The new restrictions include both additional sanctions implemented by the U.S. Department of the Treasury's Office of Foreign Assets Control and new export restrictions implemented by the U.S. Department of Commerce's Bureau of Industry and Security as amendments to the Export Administration Regulations, or EAR.

The following new sanctions target Russia.

SDN Designations



Kurt Fowler

Since February 2022, OFAC has designated more than 2,500 Russian-related parties to the Specially Designated Nationals and Blocked Persons List. On May 19, OFAC designated to the SDN List an additional 22 individuals and 104 entities, based in over 20 jurisdictions. Notably, many of the new designations target parties outside of Russia, including parties based in Finland, India and the Netherlands.

These non-Russian parties were targeted for assisting Russia in evading and circumventing existing sanctions and export restrictions. The new sanctions designations also focus in part on targeting additional, major players in the Russian economy, including the Russian Foreign Intelligence Service, Russian defense suppliers, technology importers, educational institutions and energy firms.

In certain cases, OFAC issued general licenses allowing U.S. persons to engage in transactions ordinarily incident and necessary to wind down dealings with newly sanctioned parties for a limited period. For example, General License No. 68 authorizes through 12:01 a.m. Eastern Daylight Time on July 18 wind down transactions with certain newly designated Russian educational institutions.

Services Prohibitions

Executive Order No. 14071 prohibits, among other things, the provision from the U.S., or by a U.S. person, of specified services to the Russian Federation, including certain accounting, trust and corporate formation, management consulting, and quantum computing services.

On May 19, OFAC expanded this prohibition to include the provision of architecture and engineering services. Limited exemptions, including the provision of such services to Russian entities owned or controlled by U.S. firms, continue to be available.

Sector-Based Restrictions

Executive Order No. 14024 authorizes the secretary of the treasury, in consultation with other cabinet members, to impose blocking sanctions on any party determined to operate or have operated in designated sectors of the Russian economy.

On May 19, OFAC expanded the scope of designated sectors to include Russia's architecture, engineering, construction, manufacturing and transportation industries. As such, any party operating in those sectors of the economy risks sanctions.

Amendment to Directive 4

Pursuant to Directive 4 under Executive Order No. 14024, issued in February 2022, U.S. persons have been prohibited from engaging in "any transaction involving the Central Bank of the Russian Federation, the National Wealth Fund of the Russian Federation, or the Ministry of Finance of the Russian Federation, including any transfer of assets to such entities or any foreign exchange transaction for or on behalf of such entities," subject to narrow exceptions.

OFAC has now amended Directive 4 to include a reporting requirement, such that any U.S. person holding property of the foregoing Russian entities must submit a report to OFAC on or before June 18, and annually thereafter by June 30 of a given year.

In a corresponding press release, OFAC advised:

> This reporting requirement is designed to provide additional information and fidelity on the Russian sovereign assets immobilized in U.S. jurisdiction. It is consistent with a similar measure recently adopted by the European Union and implements the G7 Leaders' commitment today to take steps to fully map holdings of Russia's sovereign assets that will remain immobilized in G7 jurisdictions until Russia pays for the damage it has caused to Ukraine.[1]

The primary exception to Directive 4 has been pursuant to General License No. 13 and its successors, which have authorized payments to the Russian government necessary for the day-to-day business operations of entities in Russia subject to U.S. jurisdiction — e.g., taxes.

OFAC issued General License No. 13E, extending this authorization to 12:01 a.m. Eastern Daylight Time on Aug. 17. However, it is unclear whether OFAC will continue to renew this general license in perpetuity.

In addition, the general license and its predecessors do not authorize payments of the so-called exit tax for parties seeking to divest Russia-related operations, which OFAC guidance notes is not incident to day-to-day business operations.

The following new export controls target Russia.

Entity List Designations

On May 19, the BIS designated 69 Russian parties to the Entity List. In addition, the BIS also designated to the Entity List one Armenian party and one Kyrgyzstani party for engaging in conduct that prevented an end-use check, and that posed a risk of diversion to Russia. As a result, U.S. and non-U.S. persons alike must seek BIS authorization for exports, reexports and transfers — in-country — to the listed entities of all items subject to the EAR.

Furthermore, the BIS noted that all 69 Russian parties qualify as military end users, as defined in the

EAR, signaling the BIS' increasingly broad view of the scope of what qualifies as a "military end user" — both in Russia and, potentially, in other jurisdictions subject to comparable restrictions, such as China.

Furthermore, this determination also means the Russia/Belarus military end-user foreign direct product, or FDP, rule applies to exports to these parties. The Russia/Belarus FDP rule expands Entity List restrictions to certain items manufactured outside the U.S. that are derived from qualifying U.S. technology.

New Industry-Based Controls

In connection with the May 19 action, the BIS added 1,224 categories of industrial items, as identified by Harmonized Tariff Schedule, or HTS, code — covering a range of electronics, instruments and advanced fibers for the reinforcement of composite materials, including carbon fibers — to the relevant supplement of the EAR listing industrial goods that require a license for export to Russia, regardless of their control status.

The BIS also expanded a separate supplement to add certain chemicals to the list of items requiring a license. These actions dramatically increase the scope of products subject to controls, and emphasize that parties seeking to export goods subject to the EAR — including, inter alia, any U.S.-origin items — must assess both the export control classification number and HTS code of an item before proceeding.

Expansion of Russia/Belarus FDP Rule

The BIS also expanded the Russia/Belarus FDP Rule to apply to Crimea, ensuring that even certain items not manufactured in the U.S. are subject to the existing, broad export controls targeting Crimea.

Finally, the Department of the Treasury's Financial Crimes Enforcement Network and the BIS issued a supplemental alert, continuing to urge vigilance for potential efforts by Russia to evade export controls.

The supplemental alert, which follows a similar joint alert issued in June 2022, represents a second example of FinCEN and the BIS urging financial institutions to monitor for transactions that potentially violate export controls. Increased scrutiny of export-related considerations by banks could have a significant impact on the ability of companies to swiftly process financial transactions.

Takeaways

First and foremost, the new restrictions are a demonstration of sustained resolve by the U.S. and its allies to impede Russia's ability to execute its military strategy in Ukraine.

Second, the new restrictions signal that the U.S. has entered a new phase in its strategy to constrain Russia, focusing on imposing consequences on non-Russian parties and countries that indirectly support Russia's war effort through continued commercial engagement.

The U.S. government's focus on targeting those who circumvent its trade restrictions means that non-Russian entities may become an increasing enforcement target, and that even indirect Russia touchpoints can introduce compliance risk.

Third, while the new restrictions still do not technically constitute an embargo on Russia, they push sanctions and export controls ever closer to that designation.

For example, the combination of new military end user designations and significant new industry-based controls on over 1,000 new categories of noncontrolled products means that there is an increasingly exhaustive list of transactions where — either due to the end user, the item or both — exports to Russia are impermissible without a license, even if they do not involve an entity on a restricted party list or an item controlled under the EAR.

Finally, as the restrictions imposed by U.S. sanctions and export controls broaden, traditional compliance tools like restricted party screening solutions and export classification assessments are now a necessary, but not sufficient, component of an effective trade compliance program. The need for comprehensive compliance controls is particularly heightened for companies that do seek to continue to lawfully transact with Russia.

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Ropes & Gray partner Brendan Hanifin contributed to this article.

[1] Press Release, OFAC, With Over 300 Sanctions, U.S. Targets Russia's Circumvention and Evasion, Military-Industrial Supply Chains, and Future Energy Revenues (May 19, 2023), https://home.treasury.gov/news/press-releases/jy1494.
