U.S. and allied sanctions cut off Russia from financial world

SPECIAL REPORT | The Ukraine Crisis

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In the run-up to the February 21 Russian invasion of Ukraine, the Biden Administration had promised “swift and severe” costs to Russia in the way of economic sanctions.

Once the invasion began, the President has taken a number of executive actions that have led to a slew of economic sanctions against a wide swath of the Russian economy, its leadership, and oligarchy. The White House has noted, “Over 30 countries representing well over half the world’s economy have announced sanctions that impose immediate and severe economic costs on Russia, cut off access to high-tech technology, sap its growth potential, and weaken its military for years to come.”

Executive Order 14065 prohibits new investment, trade, and financing between the United States and two regions of Ukraine that are the subject of Russian aggression, and authorized sanctions for violations of the prohibitions. The February 21, 2022, order found that “the Russian Federation’s purported recognition of the so-called Donetsk People’s Republic (DNR) or Luhansk People’s Republic (LNR) regions of Ukraine contradicts Russia’s commitments under the Minsk agreements and further threatens the peace, stability, sovereignty, and territorial integrity of Ukraine, and thereby constitutes an unusual and extraordinary threat to the national security and foreign policy of the United States.”

The Executive Order expands the scope of the national emergency declared in Executive Orders 13660, 13661, 13662, and 13685 which were issued in response to Russia’s 2014 annexation of the Crimea region of Ukraine; and Executive Order 13849, issued in September 2018, authorizing sanctions under the Countering America’s Adversaries Through Sanctions Act.

Executive Order 14065 also created the authority to impose sanctions on persons determined to “(1) operate or have operated since the date of the order in the Covered Regions; (2) to be or have been since the date of the order a leader, official, senior executive officer, or member of the board of directors of an entity operating in the Covered Regions; (3) to be owned or controlled by, or to have acted or purported to act for or on behalf of, directly or indirectly, any person whose property and interests in property are blocked pursuant to the order; or (4) to have materially assisted, sponsored, or provided financial, material, or technological support for, or goods or services to or in support of, any person whose property and interests in property are blocked pursuant to the order.”

Executive Order 14066, issued on March 8, 2022, banned the import of Russian oil, liquefied natural gas, and coal to the United States. The Executive Order also prohibits any United States person from financing or enabling foreign companies that are making investment to produce energy in Russia. It should be noted that although Russia accounts for just 2 percent of the world economy, it supplies 11 percent of global oil consumption and 17 percent of natural gas usage.

Finally, Executive Order 14068, dated March 11, 2022, prohibits:

- any new investment in any sector of the Russian Federation economy as may be determined by the Secretary of the Treasury, in consultation with the Secretary of State;
- exportation, reexportation, sale, or supply, directly or indirectly, from the United States, or by a United States person, wherever located, of U.S. dollar-denominated banknotes to the Government of the Russian Federation or any person located in the Russian Federation; and
- any approval, financing, facilitation, or guarantee by a United States person, wherever located, of a transaction by a foreign person where the transaction by that foreign person would be prohibited by this section if performed by a United States person or within the United States.

After each executive action, the Office of Foreign Assets Control (OFAC) has designated people and businesses to carry out the prohibitions and bans set forth in the Executive Orders.

DISMANTLING THE KREMLIN'S FINANCIAL NETWORK

The first action taken by OFAC was sanctioning "two major Russian state-owned financial institutions, imposing additional restrictions on Russian sovereign debt, and sanctioning five Kremlin-connected elites." The two financial institutions were the Corporation Bank for Development and Foreign Economic Affairs Vnesheconombank (VEB) and Promsvyazbank Public Joint Stock Company (PSB). Treasury Secretary Janet Yellen commented, "Today's actions, taken in coordination with our partners and allies, begin the process of dismantling the Kremlin's financial network and its ability to fund destabilizing activity in Ukraine and around the world. We continue to monitor Russia's actions and if it further invades Ukraine, the United States will swiftly impose expansive economic sanctions that will have a severe and lasting impact on Russia's economy."

The Treasury Department has issued six General Licenses—General License Number 17, General License Number 18, General License Number 19, General License Number 20, General License Number 21, and General License Number 22—to facilitate humanitarian and related activity in the regions, which allow for the export of food, medicine, and medical devices, and ensure personal remittances can remain flowing. Telecommunications, internet services, and mail services are also permitted to remain operational.

"UNPRECEDENTED AND EXPANSIVE" ECONOMIC SANCTIONS

The second round of OFAC sanctions targeted "the core infrastructure of the Russian financial system" as well as "80 percent of all banking assets in Russia." OFAC noted that these sanctions involved: Russia's two largest banks and almost 90 financial institution subsidiaries around the world; Russian elites and their family members; new prohibitions related to new debt and equity of major Russian state-owned enterprises and large privately-owned financial institutions; isolating Russia from international finance and commerce; and degrading the Kremlin's future ability to project power.

ARCHITECTS OF RUSSIA'S WAR SANCTIONED

In addition, OFAC has imposed new sanctions on President of the Russian Federation Vladimir Putin and the Minister of Foreign Affairs, Sergei Lavrov, as well as Minister of Defense of the Russian Federation, Sergei Shoigu, and Chief of the General Staff of the Russian Armed Forces, First Deputy Minister of Defense, and General of the Army Valery Gerasimov. These sanctions build upon previous actions under Executive Order 14024 aimed at curbing Russia's "harmful foreign activities." In addition to Vladimir Putin, the latest sanctions also target his Minister of Foreign Affairs, Minister of Defense, and Chief of the General Staff of the Russian Armed Forces. The Treasury also separately sanctioned Russia's central bank. "We are united with our international allies and partners to ensure Russia pays a severe economic and diplomatic price for its further invasion of Ukraine," said Treasury Secretary Janet Yellen. "If necessary, we are prepared to impose further costs on Russia for its appalling behavior on the world stage."

RESTRICTING WAR FINANCING

With the issuance of Directive 4 under Executive Order 14024, United States persons are prohibited from engaging in transactions with the Central Bank of the Russian Federation, the National Wealth Fund of the Russian Federation, and the Ministry of Finance of the Russian Federation. This action effectively immobilizes any assets of the Central Bank of the Russian Federation held in the United States or by U.S. persons. OFAC also designated three entities critical to managing one of Russia's key sovereign wealth funds: Russian Direct Investment Fund (RDIF), its management company, and one of the managing company's subsidiaries, as well as RDIF's chief executive officer Kirill Aleksandrovich Dmitriev, a close ally of Putin.

OLIGARCHS SANCTIONED

OFAC's next round of sanctions specifically targeted Russian oligarchs, and their family members, who are believed to be providing direct and indirect support in order to fund Putin. OFAC also added 26 Russian individuals to the Specially Designated Nationals List. These individuals are believed to be aiding the Government of the Russian Federation promulgate disinformation and influence perceptions against Ukraine. The individuals and companies targeted are believed to be spreading propaganda through disinformation outlets and intelligence service affiliates by spreading false narratives that advance Russian strategic objectives to destabilize Ukraine and falsely justify the Kremlin's activities.

MORE PUTIN ENABLERS SANCTIONED

Finally, OFAC has sanctioned additional regime elites and business executives who are associates and facilitators of the Russian regime. These sanctions implement Executive Order 14068 which imposed new import and export restrictions on Russia. These latest sanctions included three immediate family members of President Putin's

spokesperson, Dmitriy Sergeevich Peskov; Russian tycoon and Kremlin insider Viktor Vekselberg; and the Management Board of the sanctioned VTB Bank. OFAC also designated 12 members of the Russian State Duma, including Vyacheslav Victorovich Volodin, who is also a permanent member of Russia's Security Council. Treasury Secretary Yellen noted that these actions "further isolates the severely damaged Russian economy by prohibiting trade in products that are key to the economic and financial interests of all Russian elites."

"DE-SWIFTING" RUSSIA

On February 26, the leaders of the European Commission, France, Germany, Italy, the United Kingdom, Canada, and the United States issued a joint statement that explained the further economic measures undertaken against Russia in response to its unprovoked attack on Ukraine. The leaders announced their commitment to ensuring that selected Russian banks are removed from the Society for Worldwide Interbank Financial Telecommunication (SWIFT) messaging system in order to disconnect them from the international financial system and harm their ability to operate globally.

SWIFT is a Belgium-based cooperative overseen by G-10 central banks and is incorporated under Belgian law and complies with regulatory obligation by disconnecting banks sanctioned by the European Union (EU) from the system. It is a message system for instructing the transfer of account-based money that verifies account holders' identities and records instruction details like the currency, amount and route.

Acting upon EU Council Regulation (EU) 2022/345, seven designated Russian banks, and their designated Russia-based subsidiaries, were disconnected from the SWIFT network on March 12. In addition, EU Council Regulation (EU) 2022/398 disconnected three Belarusian bank, and their designated Belarus-based subsidiaries, from the SWIFT network on March 20.

Although the Russian banks have been disconnected from SWIFT, there has been speculation as to whether these banks have other access to some other messaging system. In late January 2022, Alan Rappeport, an economic policy reporter for the *New York Times*, wrote at that time that "[t]he threat of being cut off from Swift might not be as dire as it was in the past." He noted that several countries including Russia have developed their own financial messaging systems that could allow Russian financial firms to maintain communications with the world. For example, SPFS, or System for Transfer of Financial Messages, is a Russian equivalent of the SWIFT financial transfer system, developed by the Central Bank of Russia.

Similarly, Christian Shepherd and Lily Kuo of the *Washington Post* wrote that Russian banks could access a Chinese alternative to SWIFT, the Cross-Border Interbank Payment System (CIPS) which "was launched in 2015 as a core plank of Beijing's efforts to internationalize the Chinese yuan and challenge the dollar's supremacy in global markets." A recent Economic Brief from the Federal Reserve Bank of Atlanta noted that there are currently around 340 banks in SPFS and 75 direct participants in CIPS, compared with more than 10,000 in SWIFT.

Shepherd and Kuo also noted that transactions using the messaging system would need to be made in Chinese yuan, which has drawbacks because of Beijing's strict capital controls that prevent large volumes of the currency leaving China. They added that Russian banks, using the CIPS system, would leave Chinese banks open to American sanctions. ■

Companies: Corporation Bank for Development and Foreign Economic Affairs Vnesheconombank; Promsvyazbank Public Joint Stock Company; Russian Direct Investment Fund

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