Business Update | October 11, 2017 | Author: Hdeel Abdelhady

OFAC Further Tightens Russia Debt Prohibitions Pursuant to the Countering Russian Influence in Europe and Eurasia Act of 2017

As required by the Countering Russian Influence in Europe and Eurasia Act of 2017 (**CRIEEA**),[1] the U.S. Treasury Department's Office of Foreign Assets Control (OFAC) on September 29, 2017 amended and reissued OFAC Directive 1 (Directive 1).[2] As amended, Directive 1 continues to prohibit certain "new" debt, equity, and related transactions involving entities subject to U.S. Sectoral Sanctions targeting Russia's financial services sector. This Business Update discusses the background to and mechanics of Directive 1 as amended and reissued.

Ukraine/Russia-Related Sanctions

The United States has since March 6, 2014 maintained the Ukraine/Russia-Related sanctions program that, pursuant to successive Presidential Executive Orders and implementing measures, authorizes and imposes traditional and sectoral sanctions[3] on certain persons, sectors and activities in and related to the situation in Ukraine/Crimea.[4]

Sectoral Sanctions Targeting Specific Sectors of the Russian Economy

The U.S. Sectoral Sanctions framework, of which Directive 1 is a part, was authorized by Presidential Executive Order 13,662 of March 24, 2014, entitled "Blocking the Property of Additional Persons Contributing to the Situation in Ukraine."[5] EO 13662 authorizes the imposition of blocking and other sanctions measures against, among others, entities determined by the Secretary of the Treasury to be operating in target-worthy sectors of the Russian economy, "such as financial services, energy, metals and mining, engineering, and defense and related materiel."[6]

Sectoral Sanctions Identifications List and the "50% Rule"

Some Russian and related parties subject to Sectoral Sanctions are listed on the Sectoral Sanctions Identifications List (**SSIL**), which "***includes*** persons determined by OFAC to be operating in sectors of the Russian economy identified by the Secretary of the Treasury pursuant to Executive Order 13662."[7] Pursuant to OFAC's 50% Rule, entities that are ***not included*** on the SSIL but are owned 50% or more by one or more listed or unlisted SSIL entities are, like their sanctioned owner(s), subject to the prohibitions of Directive 1.[8]

CRIEEA Codified Obama Administration Sanctions Measures

CRIEEA became law on August 2, 2017. Among other measures, CRIEEA codified Russia/Ukraine-related Presidential Executive Orders issued by President Obama, including EO 13662.[9] As to Directive 1—issued on July 16, 2014 and first amended on September 12, 2014—CRIEEA required the Secretary of the Treasury to modify, by September 29, 2017, Directive 1 "to ensure that the directive prohibits the conduct by United States persons or persons within the United States of all transactions in, provision of financing for, and other dealings in new debt of longer than 14 days maturity or new equity of persons determined to be subject to the directive, their property, or their interests in property."[10]

The limitation on the permissible tenor of "new" debt to 14 days (from 30 days) is the thrust of the September 29, 2017 amendment of Directive 1. The 14-day debt maturity period applies to debt issued on or after November 28, 2017.[11]

Directive 1 Debt, Equity and Related Transactions Prohibitions

As amended and reissued on September 29, 2017, Directive 1 prohibits, within the United States or by U.S. Persons,[12] the transactions set forth in the table below, "except to the extent provided by law or unless licensed or otherwise authorized by [OFAC]." [13] To date, OFAC has issued two general licenses permitting otherwise prohibited transactions: those involving (1) derivatives linked to assets prohibited by Directive 1 (General License No. 1A) and (2) transactions with DenizBank A.S. and entities owned 50% or more by DenizBank A.S. (General License No. 3).[14] Presumably, OFAC will issue, on or before November 28, 2017, a general license authorizing transactions in derivative products linked to assets prohibited by Directive 1 as amended on September 29, 2017 (*i.e.*, linked to debt having a maturity period of longer than 14 days).

Sanctions Evasion, Conspiracy to Evade; Known Evasion Tactics

Naturally, Directive 1 provides that any transaction that "evades or avoids, has the purpose of evading or avoiding, causes a violation of, or attempts to violate any of the prohibitions contained in . . . [Directive 1] is prohibited . . . and . . . any conspiracy formed to violate any of the prohibitions in . . . [Directive 1] . . . [is prohibited].[15]

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For more information about Directive 1 or other OFAC-administered U.S. sanctions measures, or about MassPoint's related services, contact Hdeel Abdehady at habdelhady@masspointpllc.com. For a more detailed discussion of Directive 1's definitions and mechanics, see MassPoint's earlier OFAC Directive 1 Explainer.

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<table>
<tr><th colspan="3">OFAC DIRECTIVE 1 (AS AMENDED ON SEPTEMBER 29, 2017)</th></tr>
<tr><td>“New” Debt</td><td colspan="2">The key to determining if debt is prohibited (or allowable maturity periods) under Directive 1 is the date on which the debt was issued.</td></tr>
<tr><td>Period When the Debt Was Issued</td><td>Allowable Maturity Period</td><td>Examples of Compliance and Risk Allocation and Mitigation Measures to be Taken by Persons Obligated to Comply with Directive 1</td></tr>
<tr><td>On or after July 16, 2014 and before September 12, 2014</td><td>90 days or less</td><td rowspan="3">➲ Check the SSIL before and on the transaction execution date to determine if the relevant transaction parties are listed SSIL entities.
➲ Conduct due diligence to determine if the debt issuer/borrower/beneficiary of credit is owned 50% or more by one or more listed or non-listed SSIL or other sanctioned entities.
➲ Adopt contractual measures, such as Representations and Warranties, Covenants, and Default provisions that: (1) mitigate risk; (2) allocate risk to the debt (or equity) issuer, other borrower, or the direct or indirect recipient(s) or beneficiary(ies) of credit; and, (3) facilitate the clear and cost- and time-effective exit from a transaction. For example:
-Representations and Warranties that the debt issuer or other borrower (or equity issuer) is not an SSIL entity or owned 50% or more by an SSIL entity (and, of course, that all information provided as to ownership/group composition was at the relevant times true and correct and that notification of any change (or reasonably likely change) in ownership/group composition will be provided before or on the date of such change).
-Restrictions on the use of borrowed funds or credit extensions, such as prohibiting their use to acquire the debt of or extend credit to/for the benefit of an SSIL/sanctioned party or to provide financing in support of prohibited transactions.
- Indemnification terms providing for appropriate indemnification in the event of a Directive 1 or other applicable sanctions event constituting a breach of contractual terms.</td></tr>
<tr><td>On or after September 12, 2014 and before November 28, 2017</td><td>30 days or less</td></tr>
<tr><td>On or after November 28, 2017</td><td>14 days or less</td></tr>
<tr><td>New Equity</td><td colspan="2">The date on which equity is “new” (and thus prohibited if issued by an SSIL entity) is the date on which the equity issuer became an SSIL entity (by the entity’s listing on the SSIL or operation of the 50% Rule). The earliest date on which an entity could have become an SSIL entity subject to Directive 1’s prohibitions is July 16, 2014.</td></tr>
<tr><td>Financing for and other dealings in prohibited debt and equity.</td><td colspan="2">Directive 1 prohibits, within the United States and by U.S. Persons, the “the provision of financing for, and other dealings in” debt and equity transactions prohibited by Directive 1.</td></tr>
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NOTES

[1] Countering Russian Influence in Europe and Eurasia Act of 2017 (Title II of the Countering America's Adversaries Through Sanctions Act, Pub. No. 115-44, 131 Stat 886 (August 2, 2017)). Section 223(b) of the CRIEEA requires the Secretary of the Treasury to "modify" Directive 1 (as amended on September 12, 2014) "not later than 60 days after" August 2, 2017, the date of CRIEEA's enactment. September 29, 2017, the date of amended and reissued Directive 1, was the 60th day.

[2] Directive 1 (As Amended on September 29, 2017) Under Executive Order 13662 (herein "**Directive 1**").

[3] "Traditional" sanctions, for the purposes of this Business Update, are U.S. sanctions measures blocking persons and property and prohibiting certain "investment" by U.S. Persons; Sectoral Sanctions are non-blocking measures that target specific sectors of the Russian economy, including the financial services sector that is the subject of Directive 1 and this Business Update.

[4] Executive Orders: No. 13660, Blocking Property of Certain Persons Contributing to the Situation in Ukraine (March 6, 2014); No. 13661, Blocking Property of Additional Persons Contributing to the Situation in Ukraine (March 17, 2014); No. 13662, Blocking Property of Additional Persons Contributing to the Situation in Ukraine (March 20, 2014); NO. 13685, Blocking Property of Certain Persons and Prohibiting Certain Transactions with Respect to the Crimea Region of Ukraine (December 19, 2014) promulgated under the International Emergency Economic Powers Act (50 U.S.C. §§ 1701-1706) and National Emergencies Act (50 U.S.C. §§ 1601-1651) and implemented by administrative regulations issued by OFAC at 31 C.F.R. 589 (Ukraine-Related Sanctions Regulations). These and related materials are at http://www.treasury.gov/resource-center/sanctions/Programs/Pages/ukraine.aspx. *See also* Office of Foreign Assets Control, Ukraine/Russia-Related Sanctions Program (June 16, 2016) (providing an overview of the Ukraine/Russia-Related Sanctions Program).

[5] Executive Order 13,662 of March 24, 2014, Blocking the Property of Additional Persons Contributing to the Situation in Ukraine ("**EO 13662**"), is the principal legal basis for Sectoral Sanctions.

[6] *Id.* at 1(a) (also requiring the Secretary of the Treasury to make such determinations in consultation with the Secretary of State).

[7] OFAC, Sectoral Sanctions Identifications List, *at* https://www.treasury.gov/resource-center/sanctions/Programs/Pages/ukraine.aspx (emphasis added).

[8] *See, e.g.,* OFAC, Ukraine/Russia-related Sanctions (Sectoral Sanctions under Executive Order 13662) FAQs, No. 373 (The prohibitions of Directive 1 apply to SSIL listed parties, "their property, and their interests in property, which includes entities owned 50 percent or more by one or more persons identified as subject to. . . [Directive 1].")

[9] CRIEEA, Pub. L. 115-44 at § 222(a)-(c) (codifying six Presidential Executive Orders "as in effect on the day before the date of" CRIEEA's enactment and conditioning the termination or waiver of sanctions codified by CRIEEA on the provision by the President of notice or determination to "appropriate congressional committees" showing that termination or waiver is appropriate under CRIEEA.)

[10] *Id.* at § 223(b) (codified at 22 U.S.C. 9523).

[11] Directive 1.

[12] "The term United States person or U.S. person means any United States citizen, permanent resident alien, entity organized under the laws of the United States or any jurisdiction within the United States (including foreign branches), or any person in the United States." 31 C.F.R. § 589.312

[13] Directive 1.

[14] General License No. 1A of September 12, 2014, Authorizing Certain Transactions Related to Derivatives Prohibited by Directives 1,2, and 3 under Executive Order 13662 and General License No. 3 of October 6, 2014, Authorizing Transactions Involving Certain Entities Otherwise Prohibited by Directive 1 under Executive Order 13662. DenizBank is 99.85% owned by Sberbank of Russia. A general license or other exemption in favor of an entity owned 50% or more by more than one SSIL/sanctioned entity would not, it would seem, be as straightforward.

[15] Directive 1.