

BUSINESS UPDATE | AUGUST 7, 2015

## United States Adds Russian Direct Investment Fund, Other Russian Financial Services Actors to Sectoral Sanctions List

*Certain Financing, Debt, and Equity Transactions Remain Prohibited; Action Relevant to U.S. Persons and Non-U.S. Persons (particularly Middle East- and Asia-based)*

### Sanctioned Status Made Explicit

On July 30, 2015, the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) made explicit the sanctioned status of certain entities operating in Russia's financial services sector by adding them to the Sectoral Sanctions Identifications List (SSIL). The SSIL identifies parties subject to U.S. Sanctions targeting specific sectors of the Russian economy (Sectoral Sanctions) within the framework of Ukraine/Russia-related sanctions adopted in response to events in Ukraine.<sup>1</sup> Currently Russia's financial services, defense, and energy sectors are targeted.

### Russian Direct Investment Fund, Other Vnesheconombank-linked Entities Listed

Among those added to the SSIL on July 30 are the Russian Direct Investment Fund (RDIF) and other entities identified by OFAC as being owned 50% or more by Russian state development bank Vnesheconombank (VEB). VEB itself was added to the SSIL on July 16, 2014, the same day on which OFAC first issued Directive 1, the relevant financial services sanctions implementing measure discussed in detail below ([generally](#) and [as applicable to the VEB-owned entities](#)).<sup>2</sup>

### Relevance to U.S. Persons and Non-U.S. Persons (Middle East and Asia-based)

U.S. Persons remain obligated to reject (and in the case of U.S. Financial Institutions, report to OFAC) transactions prohibited under Directive 1. As the U.S. Treasury Department's [July 30 statement](#) indicates, the July 30 action is expected to bolster compliance with Sectoral Sanctions and related Ukraine/Russia-related sanctions.

In recent years, the RDIF and some other Russian entities have turned away from the West, and to investors in the Middle East and Asia. In light of this, parties based in those regions (or elsewhere) that have current or planned business involving the RDIF, other VEB-owned entities, or entities owned directly or indirectly by them should acquaint themselves with relevant sanctions and take steps to assess any potential legal, commercial, or reputational risk that may flow. Some steps that may be taken to identify indirect risk are [outlined below](#).

### More Practical than Legal Significance; Entities Owned 50% or More by SSIL Entities are Similarly Sanctioned

The July 30 action is significant more for its likely practical impact, rather than its immediate legal meaning. This is so because the relevant VEB-owned entities, while not previously listed on the SSIL, have nevertheless been subject to Sectoral Sanctions since July 16, 2014.<sup>3</sup> The VEB's sanctioned status as of July 16, 2014 was imputed to its owned entities on the same day by operation of OFAC's "50% Rule," which attaches to entities owned 50% or more by one or more SSIL entities (*individually or in the aggregate*) the

*"Today's action is designed to counter attempts to circumvent . . . [U.S.] sanctions, to further align U.S. measures with those of our international partners, and to provide additional information to assist the private sector with sanctions measures."*

[-U.S. Dept. of the Treasury Statement](#)

July 30, 2015

sanctions status of their owner(s), *even if such owned entities are not separately listed on the SSIL.*

The 50% Rule significantly expands the potential scope of Sectoral Sanctions and corresponding compliance obligations. Effectively, the 50% Rule requires parties to determine, at every link in the ownership chain (vertically and horizontally), whether one or more SSIL entities (alone or in the aggregate) directly or indirectly owns 50% or more of a relevant entity. This can be particularly burdensome where corporate structures are complex and/or opaque.

### Not a Blocking Action

Importantly, Sectoral Sanctions measures are not “blocking” actions that would require U.S. Persons to block the property or interests in property of SSIL entities. OFAC has indicated that SSIL entities subject to Directive 1 will not be designated as Specially Designated Nationals.<sup>4</sup> However, given the fluidity of Ukraine/Russia-related events and sanctions measures in response, parties should not assume that OFAC’s current position cannot change or that Sectoral Sanctions measures will not be intensified.

### Continuing Prohibition of Certain Financing, Debt, and Equity Transactions and Financing and Services in Support of Same for VEB-owned Entities

The VEB-owned entities added to the SSIL on July 30 remain subject to Directive 1 (issued July 16, 2014 and tightened by amendment on September 12, 2014).<sup>5</sup> The relevant language of Directive 1 is [provided below](#), along with a detailed discussion of some of its key definitions (e.g., “new,” “equity,” “debt”) and mechanics.

Both versions of Directive 1 prohibit the same long-term financing, long-term debt, and equity transactions, except that the allowable maturity period for “new” financing and debt is up to 30 days under amended Directive 1 and up to 90 days under original Directive 1. Because the relevant VEB-owned entities were subject to original Directive 1 as of July 16, 2014 and became subject to amended Directive 1 on September 12, 2014, the applicability of either Directive is based on a relevant transaction date. Thus, with respect to the VEB-owned entities, the following transactions are prohibited within the United States and by U.S. Persons:

- **“new” financing** to, or for the benefit of, the VEB-owned entities, where such financing has a maturity period of longer than 90 days (if provided between July 16, 2014 and September 11, 2014) or 30 days (if provided on or after September 12, 2014).
- transactions or dealings in **“new” debt** issued by, on behalf of, or for the benefit of VEB entities, where such debt has a maturity period of longer than 90 days (if issued between July 16, 2014 and September 11, 2014) or 30 days (if issued on or after September 12, 2014).
- transactions or dealings in **“new” equity** issued by, on behalf of, or for the benefit of VEB entities, if such equity was issued on or after July 16, 2014.

In addition, Directive 1 prohibits:

- **financing and services in support** of covered financing, debt, and equity transactions. For example, as discussed below, U.S. banks may continue to maintain correspondent accounts for the VEB-owned entities, so long as such accounts do not support prohibited financing, debt, or equity transactions.

Importantly, Directive 1 provides that **“[a]ll other activities” with SSIL entities “or involving their property or interests in property are permitted.”**

*“RDIF does not directly attract equity or debt financing but instead invests only its own funds together with co-investors. We have never attracted such direct financing and are not planning to do it in the future. Accordingly the sanctions do not affect RDIF investment activity in any way. Pursuant to RDIF constitutional documents the Fund is not allowed to acquire control in any company and therefore there is no impact on our portfolio companies as well.”*

**-RDIF STATEMENT**  
July 31, 2015

## Directive 1: Key Language, Definitions, Mechanics

### Key Language

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Directive 1 (as amended) provides in pertinent part that:

the following activities by a U.S. person or within the United States are prohibited, unless otherwise permitted by law or licensed or authorized by . . . [OFAC]: (1) all transactions in, provision of financing for, and other dealings in new debt of longer than 30 days maturity or new equity of persons determined to be subject to this Directive, their property, or their interests in property, and (2) all activities related to debt or equity issued before [September 12, 2014,] the date of . . . Directive 1 (as amended) that would have been prohibited by the prior version of this Directive [as amended] (emphasis added).<sup>6</sup>

The original version of Directive 1 prohibited the same transactions but allowed a maturity period of up to 90 days for new financing and debt; amended Directive 1 shortened the allowed maturity period to up to 30 days.

### Key Definitions

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- **United States Person.** “‘United States 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*” (emphasis added).<sup>7</sup>
- **Debt and Equity Defined Broadly.** *Debt includes* “bonds, loans, extensions of credit, loan guarantees, letters of credit, drafts, bankers acceptances, discount notes or bills, or commercial paper.”<sup>8</sup> *Equity includes* “stocks, share issuances, depository receipts, or any other evidence of title or ownership.”<sup>9</sup>
- **Debt and Equity “of” SSIL Entities.** According to OFAC, “the equity prohibitions of Directive 1 pertain to equity issued, directly or indirectly, by an SSIL entity on or after the sanctions effective date,” and not, for example, to “equity purchased or acquired by an SSI[L] Entity from a third party after the sanctions effective date.”<sup>10</sup> “Directive 1 does not prohibit U.S. persons from dealing with an SSIL entity as counterparty to transactions involving equity issued by a non-sanctioned party.”<sup>11</sup>
- **“New” Financing, Debt, or Equity; Sanctions Effective Date.** Financing, debt, or equity is “new” if extended, issued, or otherwise transacted in on or after the “sanctions effective date,” which is “the date a person is determined to be subject to the prohibition(s) of the relevant Directive.”<sup>12</sup>

For parties, like the VEB-owned entities, that were initially subject to a directive that was later amended, two sanctions effective dates are relevant to *transactions* involving such parties: (1) the date on which the party became a sanctioned entity (by its addition to the SSIL or its 50% or more ownership by one or more SSIL entities) and (2) the date that the relevant directive was amended.

- **Property or Interests in Property, 50% Rule.** As discussed above, the prohibitions of Directive 1 apply to entities directly or indirectly owned 50% or more by one or more (in the aggregate) SSIL entities, even if such owned entities are not separately identified on the SSIL. Thus, Directive 1’s transactional prohibitions apply with respect to all 50% or more owned entities, as well as to the owned entities’ interests in property.

### Financing or Services in Support of New Financing, Debt, and Equity Prohibited

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- **Financing or Services in Support.** Within the United States or by U.S. persons (wherever located), “all financing in support of . . . [prohibited] new debt or new equity” is prohibited. Likewise, “any dealing in, including provision of services in support” of, new debt or new equity is prohibited.<sup>13</sup>

- **Correspondent Accounts, U.S. Dollar Clearing Permitted if Not Related to “New” Financing, Debt, or Equity.** OFAC has indicated that U.S. financial institutions may “continue to maintain correspondent accounts and process U.S. dollar-clearing transactions” for SSIL entities, “so long as those activities do not involve transacting in, providing financing for, or otherwise dealing in transaction types prohibited” by Directive 1.<sup>14</sup>

### **Creation of “New” Financing or Debt Under Pre-Existing Agreements**

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- **“Rollover” of Existing Debt Prohibited.** Directive 1’s prohibitions on “new” debt apply to the “rollover of existing debt, if such rollover results in the creation of new debt with a maturity of longer than 30 days (for persons subject to Directive[] 1.”).<sup>15</sup>
- **Negotiation of “New Debt” Under Existing Revolving Facilities or Term Loans Prohibited, But Adherence to Pre-Existing Commitments Permitted.** OFAC has stated that “[d]rawdowns and disbursements whose payment terms exceed the applicable authorized . . . [maturity period] are not prohibited if the terms of such drawdowns and disbursements . . . were contractually agreed to prior to the sanctions effective date and are not modified on or after the sanctions effective date.”<sup>16</sup>

### **Islamic “Debt” or “Equity”; Substance Over Form**

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Parties that have considered Islamic financing structures involving the RDIF other SSIL entities should assume that OFAC’s definitions of debt and equity would include Islamic transactions. In determining whether a transaction constitutes new debt or equity, OFAC appears to be interested in the substance, rather than the form, of transactions. For example, OFAC has indicated that “deferred purchase agreements extending payment terms of longer than 30 days . . . would constitute a prohibited extension of credit to an SSIL entity.” Moreover, “OFAC does not consider the inclusion of an interest rate to be a necessary condition for establishing whether a transaction represents new debt.”<sup>17</sup>

Applying a substance over form approach, Islamic transactions would likely fit within relevant definitions—*e.g.*, murabaha as credit/financing or sukuk as debt or equity (under different classification approaches and circumstances).

### **Sanctions Evasion, Conspiracy to Evade; Known Evasion Tactics**

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- **Liability for Evasion and Conspiracy.** The amended version of Directive 1 added language about liability for evasion and conspiracies to evade sanctions. Amended 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 prohibitions of . . . [Directive 1] . . . is prohibited.”
- **Known Evasion Tactics.** OFAC has identified, in various sanctions enforcement and guidance contexts, tactics that have been employed by parties to evade sanctions. Most recently, and in connection with Ukraine/Russia/Crimea non-sectoral sanctions, OFAC issued an advisory describing some known evasion tactics in financial transactions (*e.g.*, omissions of originator or beneficiary identifying information in SWIFT messages, an evasion method well-documented in sanctions enforcement settlements with banks) and international trade settings.<sup>18</sup> Parties should, in addition to conducting situationally appropriate due diligence, acquaint themselves with known evasion tactics to detect and avoid them.

### **U.S. Persons Must “Reject” Prohibited Transactions; U.S. Financial Institutions Must Report**

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- **U.S. Persons must reject prohibited transactions.** U.S. “financial institutions” subject to the reporting requirements of 31 C.F.R. § 501.604 must report to OFAC funds transfers that, if processed, would have violated or facilitated a violation of Directive 1’s prohibitions.<sup>19</sup> Recordkeeping and reporting protocols

designed to meet the requirements of § 501.604 should be tailored for and observed in connection with Directive 1.

## Non-U.S. Persons: Steps to Identify and Manage Indirect Risk

Non-U.S. Persons are not required to comply with the proscriptions of Directive 1. Nevertheless, they may encounter legal, commercial, or reputational risk in the context of current or planned business with or involving a sanctioned entity, whether listed on the SSIL (or another sanctions list) or sanctioned as a matter of law (such as under the 50% Rule).

With this in mind, non-U.S. Persons should—as appropriate for their type (*e.g.*, privately or publicly held, state-owned, status as a fiduciary), risk profile, and the nature and duration of relevant investments or other stakes—take steps to identify and manage any indirect risk, including by determining whether:

- any existing or planned (co-)investments, projects, or partnerships are or may become subject to Sectoral Sanctions by operation of the 50% Rule discussed above.
- current or prospective counterparties, joint investors, or other relevant parties are sanctioned entities.
- contingency plans should be made, in the event that U.S. Persons providing or expected to provide, participate in, or facilitate (*e.g.*, through the provision of financing or services) prohibited financing, debt, and/or equity, are required to exit transactions or choose to do so to avoid compliance burdens or potential legal, reputational, or other risk. Non-U.S. Persons may also opt out of business involving sanctioned entities, to generally avoid risk.
- business with entities over which a sanctioned entity exercises control (without a 50% or greater ownership interest) poses non-compliance or other regulatory risk (outside of the U.S. sanctions framework) that may outweigh (presently or prospectively) expected benefits.
- current or future positions (*e.g.*, at the point of a planned sale, listing, exit) in investments or projects undertaken with or involving sanctioned entities may be altered, diminished, or exposed to previously uncalculated risk.
- under existing or expected contracts, a sanctioned entity’s status has triggered or may trigger termination, assignment, change of control, or other contract clauses.
- investment or other business with a sanctioned entity triggers internal reporting requirements (*e.g.*, to the board, a risk committee, investors) or external reporting or disclosure requirements in other jurisdictions.

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**CONTACT**

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## NOTES

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<sup>1</sup> Sectoral Sanctions pursuant to Executive Order No. 13662 of March 24, 2014, Blocking Property of Additional Persons Contributing to the Situation in Ukraine (authorizing the targeting of certain sectors of the Russian economy “such as financial services, energy, metals and mining, engineering, and defense and related materiel.”) *Id.* at 1(a)(i).

<sup>2</sup> Additional VEB-owned entities added to the SSIL on July 30 can be viewed at OFAC’s [website](#). Interested parties should note that entities owned by Rosneft (OJSC Rosneft Oil Company) were also added to the SSIL on July 30, 2015. Rosneft is subject to Sectoral Sanctions measures ([Directive 2](#) (as amended) and [Directive 4](#)) that target the Russian energy sector.

<sup>3</sup> *See, e.g.*, July 30 Treasury Release (reiterating that the entities added to the SSIL on July 30 “were already subject as a matter of law to the same financing restrictions as their parent entities per OFAC’s 50 percent rule guidance.”); OFAC, Ukraine/Russia-related Sanctions (Sectoral Sanctions under Executive Order 13662) FAQs, No. 373, at [http://www.treasury.gov/resource-center/faqs/Sanctions/Pages/faq\\_other.aspx#ukraine](http://www.treasury.gov/resource-center/faqs/Sanctions/Pages/faq_other.aspx#ukraine) (Sectoral Sanctions FAQs”).

<sup>4</sup> No. 370, Sectoral Sanctions FAQs.

<sup>5</sup> OFAC [Directive 1 \(as amended\)](#) Under Executive Order 13662, September 12, 2014; OFAC [Directive 1 Pursuant to EO 13662](#), July 16, 2014.

<sup>6</sup> [Directive 1](#) (amended) and [Directive 1 \(original\)](#).

<sup>7</sup> Executive Order No. 13662. *See also* 31 C.F.R. § 589.312.

<sup>8</sup> No. 371, Sectoral Sanctions FAQs.

<sup>9</sup> *Id.*

<sup>10</sup> No. 404, Sectoral Sanctions FAQs.

<sup>11</sup> *Id.*

<sup>12</sup> No. 370, “Sectoral Sanctions FAQs.

<sup>13</sup> *Id.*

<sup>14</sup> *Id.*

<sup>15</sup> No. 371, Sectoral Sanctions FAQs.

<sup>16</sup> No. 394, Sectoral Sanctions FAQs.

<sup>17</sup> No. 410, Sectoral Sanctions FAQs.

<sup>18</sup> OFAC Crimea Sanctions Advisory, [Obfuscation of Critical Information in Financial and Trade Transactions Involving the Crimea Region of Ukraine](#), July 30, 2015.

<sup>19</sup> Reports by U.S. financial institutions on rejected funds transfers, 31 C.F.R. § 501.604.