1. I have been asked to submit evidence on the UK / EU sanctions regime in relation to Russia, including comparison to the U.S. sanctions regime.

2. I identify potential measures to strengthen the UK / EU sanctions regime in relation to Russia. I make no recommendation that the UK government should or should not take all or some of these measures, as any such recommendation would depend on UK foreign policy goals in relation to Russia, which are beyond the scope of this evidence.

General

3. UK sanctions in relation to Russia currently work through EU sanctions, which are also known as “restrictive measures”.

4. The EU imposed various Russia-related restrictive measures in 2014, first in relation to the illegal annexation of Crimea, and then in relation to destabilising activities in eastern Ukraine. These measures comprise:

   • Diplomatic measures.
   • Individual restrictive measures (asset freezes and travel restrictions).
   • Restrictions on economic relations with Crimea and Sevastopol.
   • Economic sanctions.
   • Restrictions on economic cooperation.¹

5. The economic sanctions (also referred to as “sectoral sanctions”) were instituted on 31 July 2014, in response to Russian activities in eastern Ukraine; they were strengthened in September 2014.²

6. The EU sectoral sanctions target five Russian banks, three energy companies, and three defence companies.

Comparison of EU and U.S. Russia-related sanctions regimes

7. This section compares aspects of the EU and U.S. sanctions regimes to identify areas in which the EU sanctions regime could be strengthened.

¹ All of these are summarised here: http://www.consilium.europa.eu/en/policies/sanctions/ukraine-crisis/
Specificity of Framing

8. Although they were defined more narrowly when first instituted in 2014, under the U.S. ‘Countering America's Adversaries Through Sanctions Act’ (CAATSA), passed on 2 August 2017, U.S. Russia-related sanctions have effectively become general sanctions against a range of Russian actions that are conflated together. This is in distinction to the EU sanctions, which are narrowly tied to specified areas of Russian state behaviour.

9. Hence CAATSA imposes general sanctions on Russia on the basis of several situations, activity in the Ukraine, Georgia, and a general hybrid threat identified in the following terms:

   The Government of the Russian Federation has sought to exert influence throughout Europe and Eurasia, including in the former states of the Soviet Union, by providing resources to political parties, think tanks, and civil society groups that sow distrust in democratic institutions and actors, promote xenophobic and illiberal views, and otherwise undermine European unity. The Government of the Russian Federation has also engaged in well-documented corruption practices as a means toward undermining and buying influence in European and Eurasian countries. (CAATSA §251).

10. By contrast, EU sanctions attach narrowly to Russian actions in the Crimea and eastern Ukraine, and are politically understood to be tied to Russian government compliance with the Minsk Agreements of 2014 and 2015.

11. While the EU does not follow this approach in all of its sanctions regimes, the notion that sanctions should be specific, and tied to reversing ongoing situations, rather than punishing past actions, is endorsed. This stands in contrast to an approach in which sanctions loosely defined as a catch-all regime risk becoming open-ended, which may entrench conflict rather than unwind it. That said, it is preferable that the action (e.g. compliance with the Minsk Agreements) that a sanctions regime is supposed to achieve should be defined politically, not entrenched in the legal text itself, to maintain political flexibility.

12. As regards the UK response to the Skripal affair, the difficulty with tying sanctions to future positive action, rather than past punishment, would be to identify an ongoing situation that any new sanctions would seek to reverse, rather than grouping together a catalogue of past Russian acts as part of a loose general threat. Were the UK to push for new EU sanctions in response to the Skripal affair as part of the wider Russian hybrid threat, the challenge would be to disaggregate the various elements of that hybrid threat, and the positive action required from the Russian state in relation to each of those elements.

13. Alternatively, the UK could push to develop deterrent EU sanctions, in which a specified sanction is advertised to come into force, for a given period of time, and / or limited by standard(s) other than a time period, were Russia to be found responsible for a specified proscribed action in the future.
Scope of Nexus

14. A key variable in the reach of a sanctions regime is its definition of those persons or entities who are potentially liable to be found in breach of it.

15. U.S. Russia-related sanctions regime work at two levels. Primary sanctions require the person or entity in breach of sanctions to have a nexus to the United States. This essentially includes all activity that touches U.S. persons or U.S. territory. The nexus is defined broadly to include U.S. dollar transactions that clear through the U.S. financial system, and non-U.S. entities who cause a U.S. entity to violate a primary sanction.

16. Secondary sanctions extend the range of persons who can be in breach of sanctions to non-U.S. entities with no U.S. nexus, which significantly amplifies the reach of the sanctions, and therefore their economic effect. However, their effect can be very legally disruptive, and potentially expose persons and companies to conflicting legal obligations, as well as arguably interfere in the internal affairs of other states.

17. CAATSA gives the executive authority to impose a range of secondary sanctions. However, the Trump administration has so far not done so.

18. EU sanctions do not include secondary sanctions, although they have some extra-territorial effect outside of the EU, for example on EU nationals or EU incorporated companies anywhere in the world.

19. This leaves a disparity between the wide reach of U.S. sanctions and the narrow reach of EU sanctions. One way in which this disparity manifests itself is in the way in which non-EU companies are not subject to the EU sanctions regime expect in respect of “any business done in whole or in part within the Union”, or if that business involves EU persons. This means that non-EU companies that operate in the EU can nonetheless avoid breaching EU sanctions if they deal with sanctioned entity in a way in which business is done outside of the EU, and does not involve EU persons. For example, Glencore is a Swiss company, but has a significant presence in the EU, and conducts various operations from London. Nonetheless, In December 2016, Glencore was able to be part of a consortium of investors that bought a 19.5% stake in Rosneft, an entity sanctioned under EU sectoral sanctions.

20. EU Russia-related sanctions could be tightened by changing the definition of the nexus to the EU to cover all business dealings, anywhere in the world, of non-EU companies that have a significant presence in the EU. The meaning of “significant presence”, would need to be specified to identify the desired level of nexus to the EU.

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**Prohibited Actions**

21. U.S. blocking sanctions are more impactful than U.S. or EU sectoral sanctions.

22. U.S. Russia-related sanctions fall into 3 categories: blocking sanctions against individuals or companies, who are placed on the U.S. Treasury Office of Foreign Asset Control (OFAC) “Specially Designated and Blocked Persons list” (SDN List); sectoral sanctions against specified entities operating in certain sectors of the Russian economy, who are placed on OFAC’s Sectoral Sanctions Identification List (SSI List); and a trade embargo against Crimea.

23. The U.S. and EU sectoral sanctions cover entities in: (a) the financial sector; (b) the energy sector; (c) the defense sector; and (d) some types of oil exploration and production. With regard to the first three sectors, the U.S. sanctions prohibit “transacting in, providing financing for, or otherwise dealing in new debt” of the sanctioned entities, with the exception of debt with short-term maturities (the exact time varies between each sector). Additionally, U.S. sanctions prohibit dealing in new equity issued by the sanctioned entities in the financial sector. EU sanctions prohibit dealing in new debt or equity in sectors (a)-(c), with the same exceptions for debt with short-term maturity.4

24. U.S. blocking sanctions are more impactful than either the U.S. or EU sectoral sanctions because they prohibit not only dealing in new debt or equity, but “transferring, paying, exporting, withdrawing, or otherwise dealing in the property or interests in property of entities or individuals”, which effectively covers most forms of business transaction.

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4 The EU sanctions regulation stipulates that: ‘It shall be prohibited to directly or indirectly purchase, sell, provide investment services for or assistance in the issuance of, or otherwise deal with transferable securities and money-market instruments with a maturity exceeding 90 days, issued after 1 August 2014 to 12 September 2014, or with a maturity exceeding 30 days, issued after 12 September 2014 by [the sanctioned entities in question]’. “Transferable securities” are defined as including shares, bonds or other forms of securitized debt, and any other securities giving the right to acquire or sell any such transferable securities.

25. Hence the extension of U.S. Russia-related sanctions on 6 April 2018 to 24 oligarchs and officials and 12 related companies caused a large market impact because these were additions to the SDN List, not the SSI List. The aluminium company Rusal for example lost ca. 50% of its value within a week of being sanctioned, as those subject to EU and U.S. sanctions could no longer buy Rusal’s aluminum, let alone its equity or debt.

26. The EU individual restrictive measures are similar in ambit to the U.S. blocking sanctions, and prevent most forms of business dealing with the sanctioned person (or any companies of which they own 50% or more).

27. However, while the EU individual restrictive measures have thus far been confined to people directly related to Russian activity in the Ukraine or Crimea, the U.S. SDN List appears to target those thought to be close to President Putin.
This suggests that these two sanctions regimes envisage different mechanisms to achieve a change of behavior in the Russian state, the EU individual sanctions regime directly pressuring persons associated with the Russian behavior at stake, while the U.S. SDN list seeks to change the behavior of the Russian government by targeting persons associated with the Putin regime, regardless of the connection to the Russian behavior at stake.

28. That said, both the EU and US sectoral sanctions appear to envisage the same mechanism, which is to put pressure on sectors of the Russian economy that will in turn put political pressure on the Kremlin, but which so far as possible do not hurt the Russian people.

29. **A way to make EU sanctions more impactful would be to extend the scope of the individual restrictive measures to cover people closer to President Putin, and their companies. This would follow the mechanism envisaged in the U.S. SDN List.**

30. **Alternatively, the prohibited actions in the EU sectoral sanctions could be amplified to a level equivalent to the U.S. blocking sanctions.** Of course, the economic impact of such a move would also be more disruptive to European and global markets, and this would need to be taken into consideration.

**Options to sanction Russian sovereign debt**

31. The Russian state itself is not formally sanctioned under either the U.S. or EU sanctions regime, and can issue sovereign debt in U.S. and EU capital markets. This is a fundamental weakness in both sanction regimes, which can be fixed by sanctioning Russian sovereign debt, or through lesser steps to frustrate the Russian state from accessing U.S. and EU capital markets.

32. The nature of the weakness is as follows. The EU and US sectoral sanctions aim to essentially cut off the sanctioned entities from EU and US capital markets, and thus severely restrict their access to borrow in hardcurrency. The idea is that this in turn makes it hard for the sanctioned entities to service their hard-currency debt, as well as to engage in new projects that require financing in hard-currency. However, the sanctioned companies have continued to be able to access hard-currency through the Russian state, which has supported them via intermediary Russian banks.\(^4\) This is in part possible because the Russian state has continued to borrow in hard-currency in EU and US capital markets, which offsets its need to tap into its own foreign currency reserves.\(^5\)

33. Note that on 21 March 2018, in the week following the announcement of the UK expulsions of Russian diplomats following the Skripal incident, Russia issued $4 billion worth of eurodollar bonds (i.e. U.S. dollar bonds sold outside of U.S.

\(^4\) These intermediary banks include: Bank Otkritie; B&N Bank; Promsvyaz Bank; Credit Bank of Moscow. These banks supported the dollar financing needs of sanctioned entities from 2014 onwards, and were themselves supported by the Russian Central Bank.

\(^5\) See Annex 1 for more detail on the economic mechanisms by which the Russian state has dealt with the US and EU sanctions regime.
jurisdiction). While Russia had announced in late 2017 that it planned new eurodollar bond issuance in 2018, the exact timing was likely designed as a show of strength by the Kremlin. First, it showed that Russia could borrow without difficulties in western capital markets, even at the height of the Skripal affair. And second, it was announced by VTBCapital that half of the debt was bought by investors in the UK (which does not necessarily mean by British citizens or British companies).

34. The U.S. Treasury decided not to sanction Russian sovereign debt in a January 2018 report on what actions it planned to take under CAASTA. However, following the Skripal attack, on 6 April the ‘Stand with the UK Against Russia Violations Act’ was introduced to the U.S. Congress that would sanction Russian sovereign debt if passed.

35. On the EU side, directly to sanction Russian sovereign debt would be the most far-reaching measure available, as it would touch all entities with a nexus to the EU. It would also likely prove political difficult.

36. However, below this are two steps that are less far-reaching, and thus less escalatory, and perhaps politically easier to accomplish.

37. First, the EU sanctions could be extended to prohibit the purchase of any bond the issue of which has been organized by a book-runner which is itself a sanctioned entity. This would avoid sanctioning Russian sovereign debt directly, but makes it harder for Russia to issue it.

38. The background to this is that since mid-2016, when the Russian state returned to international capital markets for the first time since the 2014 sanctions, no western banks would act as book runners (i.e. the main organizers) of new Russian sovereign debt issuance. Hence Russia has had to rely on its own banks to do that.

39. The result is that while a sanctioned bank like VTB-Bank is not allowed to access EU capital markets in its own right (subject to the exception for short-term debt), it can still manage the issuance of Russian sovereign debt in EU capital markets. This was the case in the 21 March 2018 issuance, given that VTB-Capital is part of VTB-Bank.

40. Second, EU sanctions could prohibit EU clearing houses from making available new issuances of Russian sovereign debt. This would also avoid sanctioning Russian sovereign debt directly, but makes it hard to trade on the secondary market, and therefore more illiquid, which would inhibit many western firms from buying it at all.

41. The background to this is that when Russia returned to international capital markets in 2016, there was initially serious reluctance amongst investors to buy the new Russian eurobond, as it was not available on the two major clearing

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7 Stand with the UK Against Russia Violations Act, Draft Bill H.R., 6 April 2018.
houses for sovereign bonds in the EU (Euroclear, based in Brussels; and Clearstream, based in London).

42. This was because western investors anticipated the clearing houses’ fear of getting burnt by sanctions (noting that Clearstream had been fined $152 million by the U.S. Treasury in 2014 for breaching U.S. sanctions on Iran).

43. However, Euroclear made the Russian sovereign bond available in July 2016. That removed the final obstacle to Russia issuing sovereign debt in EU capital markets post the 2014 sanctions, and it has been able to find EU investors for its eurobonds regularly since then.

44. Finally, note that the 21 March 2018 Russian eurobond had a very unusual “alternative currency payment event” clause that allowed the bondholder to have payments on the bond settled in euros, sterling, or Swiss francs if dollar payment was not available. This clause was likely added with the risk of further sanctions in mind, to encourage the repatriation of money by oligarchs who might in future find themselves subject to sanctions that prevented them from dealing in U.S. dollars. The purpose of the bond in repatriating money held by Russians abroad was expressly advertised as such by the head of VTB Bank, and President Putin himself.

OFSI Investigations

45. EU sanctions would be strengthened if the UK’s enforcement agency, the Office of Financial Sanctions Investigations, made public its investigations into sanctions compliance, or at least provided a gist.

46. Sanctions are matters of national security and therefore public interest, compliance with which should be subject to the standards of transparency that enable public scrutiny. If the way a given entity has complied with a sanctions regime by potentially finding a loophole therein is not made public, it is hard for those loopholes to be publically scrutinised and fixed.

Procedure

47. Any new EU sanctions must be agreed unanimously at the EU Council level, as do changes to existing sanctions regimes. While it may be politically difficult, the UK could look to amend the existing EU sectoral sanctions regime, which has to be renewed every six months following the review of the Minsk Agreement at the European Council, and so far, always have been. The latest renewal, following the EU Council meeting in December 2017, extends the sectoral sanctions to 31 July 2018.

Legal Basis of Sanctions

48. The legal basis of the UK / EU Russia-related sanctions regime in EU law are articles 21 and 30 of the Treaty on the European Union, and
regulations issued under article 215 of the Treaty on the Functioning of the European Union. Their legal basis in UK law is the European Communities Act 1972.

49. The Sanctions and Anti-Money Laundering Bill will, if passed, provide the UK government with a new legal basis to impose economic and financial sanctions after Brexit. How UK sanctions will interact with EU sanctions post-Brexit remains unsettled. While there is a possibility that the UK would choose to continue to align with EU sanctions, there is also a possibility that the UK could craft certain sanctions autonomously from the EU in relation to the same area of foreign policy. However, the UK’s ability to craft sanctions autonomously might be restricted by areas of EU law that continued to apply, especially as regards free movement of goods and trade barriers.

50. EU wide economic sanctions are plainly more effective than UK only sanctions. In line with the December 2017 House of Lords Report, it is recommended that the UK develop a mechanism to influence EU sanctions-making and integration with UK sanctions after Brexit.

April 2018

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