AEB Association of European Businesses

AEB POSITION PAPER

"IMPACT OF NEW US SANCTIONS ON EUROPEAN BUSINESSES"

I. INTRODUCTION

On 6 April 2018, the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC), in consultation with the U.S. Department of State, designated seven Russian oligarchs and 12 companies they own or control, 17 senior Russian government officials, and a state-owned Russian weapons trading company and its subsidiary, a Russian bank (**update to the so-called "SDN List**").

Those actions are pursuant to the authority provided under **Executive Order (E.O.) 13661** and **E.O. 13662**, and codified by the Countering America's Adversaries Through Sanctions Act (**CAATSA**).

These actions follow the Department of the Treasury's issuance of the CAATSA Section 241 report in late January 2018 (so-called **"Kremlin report"**). In this report, U.S. Treasury identified the senior Russian government officials and oligarchs. The OFAC's latest action targets a number of the individuals listed in the Section 241 report, including those who "benefit from the Putin regime and play a key role in advancing Russia's malign activities".

The newly adopted measures block the property and interests in property of the targeted entities and individuals when it comes into the United States or the possession or control of a U.S. person. In addition, it prohibits virtually all dealings or transactions by U.S. persons with the targeted parties who are now on the OFAC's SDN List. The measures also apply to entities that are owned 50 percent or more by sanctioned persons, including the newly sanctioned parties. Non-U.S. persons may be impacted by the new sanctions through potential exposure to secondary sanctions for undertaking significant transactions with these parties.

By amending earlier legislation, Section 228 of CAATSA requires that asset-blocking sanctions be imposed against non-U.S. persons that knowingly "facilitate a significant transaction… for or on behalf of… any person subject to sanctions imposed by the United States with respect to the Russian Federation." This would include any of the newly added SDNs or parties owned 50 percent or more, individually or collectively, by SDNs.

In addition, the OFAC issued the following **two Ukraine-/Russia-related general licenses** in connection with these designations: **General License 12** "Authorising Certain Activities Necessary to Maintain or Wind down Operations or Existing Contracts"; **General License 13** "Authorising Certain Transactions Necessary to Divest or Transfer Debt, Equity, or other Holdings in Certain Blocked Persons".

II. GENERAL IMPACT

The sanctions introduced on 6 April 2018 were unexpected for European business. Previous SDN designations hit persons directly involved in Crimea, Donbass, as well as a handful of supporters of the current Russian government. Sectoral sanctions against state banks and state oil companies inflicted certain financial pain, but still permitted most operations. The April 6 US Treasury actions have inflicted

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significant harm on two major Russian industrial concerns and are perceived by the business community as a signal that no one is necessarily off limits anymore.

European companies doing business in or trading with Russia are extremely concerned by the consequences of these new US sanctions on their activities. The introduction of such measures creates a difficult and unpredictable business environment and may seriously damage European economic interests in relation to Russia.

On 16 April 2018, the AEB launched an online survey requesting its members to assess the impact of the new US sanctions on their businesses and industry. The preliminary results of the survey show that it is extremely difficult for many of the respondents to make estimates both in real and in monetary terms of the impact of the sanctions.

However, many companies mention the following consequences of the above-mentioned OFAC actions:

- Direct impact on the ruble exchange rate;
- Revenue losses (for some companies up to 20% of their annual revenue) and freezing of projects as a result of clients being SDNs;
- Difficulties handling payments from sanctioned banks to foreign banks; European banks may refuse transactions with Russian counterparts, and receiving payments from Russia on EU bank accounts has become problematic;
- Possibility of a radical change in business models;
- Legal uncertainty and increased costs for due diligence, screening and risk management;
- Threat of retaliatory measures from the Russian government.

III. SECTORAL IMPACT

BANKING SECTOR

There was no forewarning of the new sanctions package enacted on 6 April 2018. However, wisely encompass business unwinding provisions helping AEB member banks to close relationships with newly designated Russian SDNs. However, the OFAC General licenses 12 and 13 contain multiple legal uncertainties which create a number of difficulties for banks in terms of how they can be implemented without incurring unnecessary US regulatory risk and/or breach of Russian legislation. AEB banks are prudently implementing the new sanctions requirements.

The impact on the market so far has been limited due to the sufficient equity in the banking system and liquidity supply by domestic markets for debt refinancing. Fitch and Moody's issued moderate banking system and macroeconomic impact outlooks from the new sanctions not yet leading to credit ratings downward revisions. The direct negative impact of SDN designations on Bank credit portfolios is yet to be assessed after the expiration of business unwinding licenses granted by the OFAC.

The forced acceleration of payments under the sanctions will almost certainly create a domino set of defaults in both banks and suppliers. The timelines and scale of the business impact will very much depend on the severity of the direct losses for AEB banks and designated Russian entities as well as potential counter measures by Russian authorities which have not yet been announced.

ENERGY SECTOR

The energy sector is deeply concerned about the US expanded sanctions targeting a number of Russian entities and individuals in the energy sector. The AEB Energy Committee is analysing the impact of the new US sanctions on high-profile Russian companies and businessmen. The new expanded sanction list increases uncertainty in the Russian business environment and can also affect the interests of European energy companies either operating in Russia or working with Russian partners abroad.

INTERNATIONAL LAW FIRMS

The new sanctions affect law firms and the consulting industry in general. AEB members include a large number of international law firms acting in Russia and consulting both foreign and Russian clients. The new sanctions not only urge law firms to refrain from providing services to certain companies and individuals, but may also negatively impact relations with Russian clients in general.

Also, recent counter-sanctions initiatives of the Russian Government is a matter of concern for international law firms. In particular, Russian lawmakers propose restrictions on the provision of consulting, audit, and legal services by entities under the jurisdiction of the US or other foreign states in certain areas.

IT TELECOM SECTOR

In response to the US sanctions, the counter-sanctions proposed by the Russian State Duma are aimed at US and European IT & Telecom companies and aim to further limit their presence in the Russian public sector. This will be certain to limit the opportunity for European companies to participate in Russian state-run programmes such as the so-called "Digital Economy".

The prospect of harsher sanctions hit the Russian rouble, with it falling against every major currency. So it will impact European companies that import hardware and software to Russia.

The lower level of business cooperation between companies under US sanctions and European companies will lead to an overall drop in business, which will have an impact on the purchase volumes of hardware and software from European companies.

PRODUCTION SECTOR

The impact on production of the US expanded sanctions can be very noticeable. This is the first time when the sanctions are massively aimed at the private business. The impact of the sanctions can be harmful for many European companies which developed their production sites in Russia during the last 15 years. The new sanction affect and can damage the global supply chains, high complexity of which does not let reconfigure them quickly. The consequences of the sanctions, initially aimed at certain individuals, will affect regular workers at the production sites and endanger the jobs not only in the Russian regions, but, because of the global supply chains, in many European countries. As a result, the business of the European companies can be downsized, investments done can be lost, future projects can be suspended. Moreover, after downsizing footprint in Russia it would be hard to regain previous market share and position on this market, due to high competition and a lot of players.

IV. RUSSIAN COUNTER-MEASURES

The first draft law on counter measures has been submitted to the State Duma with the 1st reading scheduled on 15 May 2018.

The draft law purports to "protect the interests and safety of the Russian Federation, rights and freedoms of the citizens of the Russian Federation" by introducing certain measures envisaged by that draft law which aim to prevent the "illegal and hostile actions of the US and/or other foreign states". "Foreign states" denotes countries that have taken the decision to join the US and introduce economic sanctions against specific sectors of the economy of the Russian Federation, Russian legal persons and/or individuals, or support such a decision; the measures may be introduced by the Government of the Russian Federation following the decision of the President of the Russian Federation.

The draft provides for the possibility of introducing the following measures:

- Prohibition or restriction on the import into Russia of the following goods originating from the US and/or other foreign countries: agricultural products, raw materials and food products, alcohol and tobacco products and medicines originating from the US and/or other foreign states, except for cases where such products and preparations do not have any counterparts produced in Russia; any other goods based on the list to be drawn up by the Government of the Russian Federation;
- Visa bans for persons to be listed by the Ministry of Foreign Affairs of Russia;
- Termination or suspension of international cooperation with US and/or other foreign states, including entities that are more than 25% directly or indirectly owned by entities under the jurisdiction of the US and/or other foreign states in the following sectors: nuclear power, rocket engine production, aircraft production;

- Prohibition or restriction of access to public procurement for technological equipment and software originating from the US and/or other foreign states;
- Prohibition or restriction on the provision of consulting, audit and legal services by entities under the jurisdiction of the US and/or other foreign states (including entities that are more than 25% owned by entities under the jurisdiction of the US and/or other foreign states) for state and municipal needs, as well as with respect to certain types of entities (yet to be determined).

The Russian counter-measures are subject to change during the legislative process.

V. CONCLUSION

Although the actual impact of the new US sanctions on European businesses is difficult to measure, they are harming the business environment by creating legal and economic uncertainty for European companies operating in and with Russia. The message for European investors and business partners working in Russia is clear: they need to do deeper due-diligence on the people and entities they work with to make sure that current and future contracts do not fall under the U.S. sanctions.

The Association of European Businesses calls on the EU authorities and its members-states to protect European investors' interests in relation to Russia and prevent them from US retaliatory measures by waiving the US restrictions on European businesses. The AEB urges the European Commission and European Council to find a political solution which would prevent further deterioration of international relations, global trade and foreign direct investments.