GIBSON DUNN

January 4, 2024

OFAC Creates New Russia-Related Secondary Sanctions Risks for Foreign Financial Institutions; Expands Import Ban

Heightened compliance challenges for international banks as U.S. authorities continue to ramp up Russia-related trade controls and diligence expectations.

On December 22, 2023, the Biden Administration took further action to add significantly to its Russia-related sanctions by issuing a new Executive Order ("**EO**") 14114 that, among other things, now subjects foreign financial institutions ("**FFIs**")[1] to secondary sanctions risks when they conduct or facilitate certain Russia-related transactions, even unwittingly. These new regulations are noteworthy not simply because they create new secondary sanctions risks for foreign banks and other financial institutions, but also because they expose these financial institutions to such risks based on the facilitation of trade of certain enumerated goods, and do so under a standard of *strict liability*. These new measures build upon an already expansive suite of economic sanctions, export controls and other regulatory measures the United States has implemented that target the Russian Federation, and follow through on the United States' commitment to the G7 Leaders' Statement of December 6, 2023.[2]

As discussed in further detail below, these particular secondary sanctions risks will, in some novel ways, add to the already complex and nuanced compliance challenges facing financial institutions when it comes to Russia-related trade activity, and signal yet another move by U.S. regulatory authorities to ratchet up diligence expectations on banks and other financial institutions in the trade finance space.

Specifically, EO 14114 amends previous EOs 14024 and 14068, which authorize portions of the Russian sanctions regime (namely, the Russian Harmful Foreign Activities Sanctions Regulations ("**RHFASR**")).[3] The amendments to EO 14024 contain the new secondary sanctions provisions which aim to deter foreign banks from supporting certain Russia-related transactions and trade. The amendments to EO 14068 expand the current ban on importation into the United States of certain Russian-origin seafood, and set the stage for (but do not yet implement) similar expanded restrictions on other import-controlled goods such as diamonds.

Concurrent with the issuance of EO 14114, the Department of the Treasury's Office of Foreign Assets Control ("**OFAC**"): issued two new substantive Determinations; issued two general licenses ("**GLs**");[4] and published 12 new Russia-related FAQs and amended three existing FAQs (collectively with EO 14114, the "**New Regulations**").[5] OFAC also published a compliance advisory for foreign financial institutions on the new secondary sanctions regulations ("**Compliance Advisory**").

These measures are effective immediately, and we discuss the key elements and takeaways below.

New Secondary Sanctions Risks for Foreign Financial Institutions

Arguably the most significant impact of the New Regulations is the addition of 'traditional' financial institution-focused secondary sanctions[6] to the multitude of Russia sanctions that have been imposed in response to the war in Ukraine, which increases the overall sanctions risk for foreign financial institutions when engaging in certain Russia-related activities. Such secondary sanctions did not previously exist in the RHFASR program.[7]

Consistent with a number of previous U.S. government actions, this new executive order employs unprecedented provisions to continue to target Russia's military-industrial base and attempt to isolate it and degrade its ability to procure materiel necessary for Russia's war effort. Specifically, EO 14114 authorizes OFAC to impose secondary sanctions on foreign financial institutions that are deemed to have:

1. conducted or facilitated significant transactions for a certain class of persons sanctioned pursuant to EO 14024 (i.e., those persons designated as Specially Designated Nationals ("**SDNs**") for operating or having operated in Russia's technology, defense and related materiel, construction, aerospace or manufacturing sectors);[8] or

2. conducted or facilitated any significant transactions, or provided any service, involving Russia's military-industrial base, including the direct or indirect sale, supply or transfer to Russia of certain items specified by the New Regulations, such as certain machine tools, semiconductor manufacturing equipment, electronic test equipment, propellants and their precursors, lubricants and lubricant additives, bearings, advanced optical systems and navigation instruments (such items, "**Critical Items**").

OFAC's FAQ 1151 provides guidance that Russia's "military-industrial base" includes the Russian technology, defense and related materiel, construction, aerospace and manufacturing sectors as well as individuals and entities that support the sale, supply or transfer of Critical Items. This definition lends itself to potentially a very broad interpretation, and the New Regulations, taken together, appear to capture: (i) significant transactions with persons designated as SDNs within the enumerated sectors; (ii) significant transactions and services involving sanctioned or unsanctioned persons operating in those sectors more broadly, including maintaining accounts, transferring funds or providing other financial services to such persons, either inside or outside Russia to support Russia's military-industrial base; and (iii) significant transactions with persons operating in any sector if the activity involves facilitating the sale, supply or transfer of Critical Items to Russia.[9]

FAQ 1151 applies the multi-factor test commonly used in other similar secondary sanctions provisions which provides wide interpretive latitude for OFAC to determine whether a transaction is "significant." OFAC will consider "(a) the size, number, and frequency of the transaction(s); (b) the nature of the transaction(s); (c) the level of awareness of management and whether the transactions are part of a pattern of conduct; (d) the nexus of the transaction(s) to persons sanctioned pursuant to E.O. 14024, or to persons operating in Russia's military-industrial base; (e) whether the transaction(s) involve deceptive practices; (f) the impact of the transaction(s) on U.S. national security objectives; and (g) such other relevant factors that OFAC deems relevant."[10]

Critically, these New Regulations do not require that the foreign financial institution "knowingly" engages in the significant transactions covered by the provisions. This departs from the language that OFAC more commonly uses when crafting thresholds needed for the imposition of secondary sanctions. It thus seemingly requires more stringent and forward-leaning diligence protocols for banks that may want to fully assess their potential secondary sanctions risks by identifying transactions which could be caught under these new provisions. OFAC's multi-factor "significance" test will still include a consideration of whether management teams at international financial institutions were aware that their institutions were processing targeted transactions. However, such awareness is only one factor to be considered, and assuming the test for "significance" is otherwise satisfied upon OFAC's review, the prospect of a resulting strict liability secondary sanctions risk no doubt will alter the diligence and risk calculus for financial institutions who may still be dealing in *legally permitted* Russia-related trade.

The new Determination which implements these secondary sanctions provision also contains a list of the items which constitute Critical Items.[11] The New Regulations do not qualify Critical Items by references to U.S. export control laws nor do they appear to require the items in question to be of U.S.-origin or have any other U.S. nexus. This is consistent in approach with other secondary sanctions, which by express purpose are geared to cover activity without a U.S. nexus. And along these lines, OFAC has also clarified that financial institutions that engage in any of the proscribed transactions in non-USD currencies are still subject to secondary sanctions risk.[12] The implications of this are that a foreign bank, for example, which processes a significant transaction denominated in a non-USD currency on behalf of a non-U.S. customer supplying a wholly foreign-produced "Critical Item" to Russia will face secondary sanctions risks.

Consequences of Engaging in Covered Conduct

Upon a determination by OFAC that a foreign financial institution has engaged in the conduct described in the amended 14024 secondary sanctions provisions, OFAC can prohibit the opening of, or prohibit or impose strict conditions on the maintenance of, correspondent accounts or payable-through accounts in the United States, or impose full blocking measures on the institution.

For any entities subject to full blocking sanctions pursuant to the amended EO 14024, all property and interests in property of that institution that are in the United States or in possession or control of U.S. persons will be required to be blocked and reported to OFAC. Any entities that are owned, directly or indirectly, 50% or more by one or more sanctioned entities, individually or in the aggregate, will also be subject to the blocking sanctions.

In relation to banks for which the opening or maintaining of a correspondent account or a payable-through account is prohibited pursuant to the amended 14024, U.S. financial institutions will be required to close any correspondent account or payable-through account maintained for or on behalf of such banks within 10 days of the imposition of sanctions.

The newly issued GL 84 provides a temporary general authorization to U.S. financial institutions to engage in certain limited transactions to close the account accordingly.

Compliance Advisory for Foreign Financial Institutions and Enhanced Controls Considerations

As discussed above, the New Regulations create additional due diligence and risk considerations for foreign banks when engaging in Russia-related transactions. Such banks weighing these new secondary sanctions risks may want to evaluate Russia-related transactions for connections to Russia's military-industrial base or to trade in Critical Items. This may involve additional due diligence on customers and the nature of items involved in such transactions. To assist in this complex task, OFAC issued a Compliance Advisory to provide guidance to foreign financial institutions on mitigating these risks under EO 14114, including practical guidance on how to identify sanctions risks and implement corresponding controls. In addition to the activities described in FAQ 1148 which could expose a foreign financial institution to secondary sanctions risk (discussed above), the Compliance Advisory also notes that helping companies or individuals *evade* U.S. sanctions on Russia's military-industrial base is activity that could on its own expose a foreign financial institution to such risk under the new provisions. According to the advisory, such activity could include:

- "offering to set up alternative or non-transparent payment mechanisms;
- changing or removing customer names or other relevant information from payment fields;
- obfuscating the true purpose of or parties involved in payments; or
- otherwise taking steps to hide the ultimate purpose of transactions to evade sanctions."

The Compliance Advisory advises institutions seeking to mitigate these new secondary sanctions risks to implement controls commensurate with their specific risk and current exposure to Russia's military-industrial base and its supporters, and suggests a few examples of such controls.[13] It also refers to OFAC's "Framework for OFAC Compliance Commitments" and previous agency alerts focused on Russia sanctions and export control evasion risks for further guidance on risk-based sanctions compliance controls, and suggests a few best practices, including working sanctions risks and information into traditional anti-money laundering controls.[14]

Appropriately tailoring and incorporating these suggested controls and best practices into an existing compliance framework operationally may require new, and increasingly sophisticated and nuanced risk assessments and control reviews given the unique issues presented by these New Regulations.

We also note that this Compliance Advisory builds upon a series of previous advisories issued by U.S. regulators addressing Russia-connected sanctions and export controls evasion risks, and in our view is thematically consistent with this previously published guidance, highlighting the cohesiveness of the United States' whole-of-government approach to Russia. The Treasury Department's Financial Crimes Enforcement Network ("FinCEN") and the Commerce Department's Bureau of Industry and Security ("BIS"), for example, have published three joint notices—on June 28, 2022, on May 19, 2023, and on November 6, 2023 —that urge financial institutions to employ risk-based controls to detect criminal activity and/or attempts to evade

U.S. sanctions and export controls (and particularly those targeting Russia).[15] As with OFAC's Compliance Advisory, the FinCEN-BIS joint notices contain specific guidance on transaction due diligence, including lists of compliance "red flags" and best practices, and financial institutions will want to familiarize themselves with these advisories in context as well.

Expanding the EO 14068 Import Bans

EO 14114 also expands the existing import restrictions in EO 14068 on Russian-origin seafood, to prohibit the importation into the United States of Russian-origin salmon, cod, pollock and crab[16] that was produced wholly or in part in Russia or harvested in Russian waters or by Russia-flagged vessels. This prohibition extends to such seafood that has been incorporated or substantially transformed into another product outside of Russia. While continued prohibitions despite a "substantial transformation" is very rare in OFAC regulations (to our knowledge it is only present in the Cuba sanctions program), newly issued GL 83 authorizes, until February 20, 2024, all transactions incident and necessary to the importation into the United States of seafood derivative products, pursuant to written contracts or agreements entered into prior to December 22, 2023. OFAC FAQ 1154 notes that the Agency intends to issue (but has not yet implemented) a similar Determination related to the importation of certain Russian diamonds processed in third countries.

Lastly, the New Regulations also clarify the import treatment of certain Russian-origin gold. Since June 28, 2022, pursuant to a Determination made under EO 14068, importation into the United States of Russian-origin gold has been prohibited. OFAC's revised FAQ 1070 and a revised Determination clarify, however, that this prohibition does not extend to Russian-origin gold located outside Russia prior to June 28, 2022.

Conclusions and Key Takeaways

While financial institution-focused secondary sanctions provisions are certainly not new, as discussed above we see some noteworthy implications of these particular secondary sanctions provisions imposed under the New Regulations.

For one, by disincentivizing foreign financial institutions from processing transactions related to trade in Critical Items, even when the items would not be controlled for supply to Russia under existing U.S. export control laws, EO 14114 appears to create an extraterritorial U.S. export control-like regime, but through the use of secondary sanctions risks. This likely will create enhanced compliance considerations and challenges for financial institutions. Financial institutions, including foreign financial institutions, are already subject to a certain degree of compliance obligations under U.S. export controls when it comes to *knowingly* facilitating prohibited trade in items subject to U.S. export controls.[17] However, these entities have now become subject to an additional *strict liability* secondary sanctions risk when dealing with certain items not subject to the EAR (i.e., Critical Items), when they may be destined for Russia. As noted above, the consequences of secondary sanctions exposure can be much more severe than the consequences of violating U.S. export controls laws (i.e., full financial blocking measures are available under a sanctions action). Accordingly, the New Regulations will likely necessitate many foreign financial institutions reexamining their risk appetite and related controls when it comes to trade finance and other trade-related activity involving Russia.

This compliance challenge is compounded by two additional factors. First, the list of Critical Items is not tethered to U.S. export control classifications. This presents significant due diligence challenges and creates a degree of uncertainty as to the full scope of items that could fall within the list of Critical Items compared to those items subject to U.S. export controls. Second, as noted above, there are material differences in the culpable mental state standards required for compliance by financial intermediaries with U.S. export controls and the secondary sanctions risks under OFAC's New Regulations (i.e., a "knowledge" standard under General Prohibition 10 of U.S. export controls versus this new strict liability risk under EO 14024). These two factors likely will create significant added challenges for any institution looking to implement a nuanced compliance and controls framework.

As with all secondary sanctions, banks ought to apply appropriate controls designed to identify and triage transactions for possible secondary sanctions risk, in line with their individual internal risk appetite and risk profile. However, with the more stringent *strict liability* standard doing away with any need for intent, mitigating secondary sanctions risks under the New Regulations may require more nuanced controls – and hence more resources – in order to apply an appropriately risk-tailored program. It is possible that, in turn, this may result in increased compliance and operational risks. Conversely, in an effort to simply avoid such increased risks and costs, banks may end up erring on the side of overcompliance.

---

[1] A term defined broadly to include "any foreign entity that is engaged in the business of accepting deposits; making, granting, transferring, holding, or brokering loans or credits; purchasing or selling foreign exchange, securities, futures or options; or procuring purchasers and sellers thereof, as principal or agent. It includes depository institutions; banks; savings banks; money services businesses; operators of credit card systems; trust companies; insurance companies; securities brokers and dealers; futures and options brokers and dealers; forward contract and foreign exchange merchants; securities and commodities exchanges; clearing corporations; investment companies; employee benefit plans; dealers in precious metals, stones, or jewels; and holding companies, affiliates, or subsidiaries of any of the foregoing." EO 14024 11(f), as amended by EO 14114.

[2] Available here.

[3] 31 C.F.R. Part 587.

[4] For the sake of completeness we note that OFAC issued on the same day a third GL 85, providing a temporary wind down license for certain transactions involving Expobank Joint Stock Company, which was sanctioned pursuant to WO 14024 on December 12, 2023.

[5] *See* OFAC Press Release, "Issuance of new Russia-related Executive Order and related Determinations; Issuance of Russia-related General Licenses and Frequently Asked Questions; Publication of Russia-related Compliance Advisory," Dec. 22, 2023, available at https://ofac.treasury.gov/recent-actions/20231222.

[6] Note that we do not consider EO 14024 provisions authorizing SDN designations for persons providing 'material support' to other SDNs to be 'traditional' secondary sanctions for a variety of analytical, structural, practical and historical usage reasons.

[7] None of the executive orders authorizing the provisions of the RHFASR included secondary sanctions, nor did the secondary sanctions provisions of the Countering America's Adversaries Through Sanctions Act ("CAATSA"), which amended The Support for the Sovereignty, Integrity, Democracy, and Economic Stability of Ukraine Act of 2014 and the Ukraine Freedom Support Act, apply to the executive orders authorizing the various components of the RHFASR. For reference, *see* the language of Sections 226 and 228 of CAATSA; the Ukraine-/Russia-Related Sanctions Regulations, 31. C.F.R. Part 589, Note 2 to § 589.209(c) and Note 2 to § 589.201; and related OFAC FAQs 541 and 547 (both of which were last amended over one year after the issuance of EO 14024).

[8] *See* OFAC FAQ 1126 for definitions of each of these sectors.

[9] *See* OFAC FAQ 1148.

[10] OFAC FAQ 1151.

[11] Determination Pursuant to Section 11(a)(ii) of E.O. 14024, as amended by E.O. of December 22, 2023 (Effective December 22, 2023).

[12] OFAC FAQ 1152.

[13] Examples form the Compliance Advisory include:

- "Reviewing an institution's customer base to determine exposure to the following:
    - Any customers involved in the specified sectors of the Russian economy or who conduct business with designated persons in the specified sectors.
    - Any customers that may be involved in the sale, supply, or transfer of the specified items to Russia or to jurisdictions previously identified as posing a high risk of Russian sanctions evasion.
- Communicating compliance expectations to customers, including informing them that they may not use their accounts to do business with designated persons operating in the specified sectors or conduct any activity involving Russia's military-industrial base. This may also include sharing the list of the specified items with customers, especially customers engaged in import-export activity, manufacturing, or any other relevant business lines.
- Sending questionnaires to customers known to deal in or export specified items to better understand their counterparties.
- Taking appropriate mitigation measures for any customers or counterparties engaged in high risk activity or who fail to respond to requests for information regarding activity of concern. These measures include restricting accounts, limiting the type of permissible

activity, exiting relationships, and placing customers or counterparties on internal "do not onboard" or "do not process" watchlists.

- On a risk-basis, obtaining attestations from customers that they do not operate in the specified sectors, engage in any sales or transfers of the specified items to Russia, or otherwise conduct any transactions involving Russia's military-industrial base.

- Incorporating risks related to Russia's military-industrial base into sanctions risk assessments and customer risk rating criteria. This includes updating jurisdictional risk assessments as appropriate.

- Implementing enhanced trade finance controls related to the specified items, including monitoring information collected as part of documentary trade.

- Using open-source information and past transactional activity to inform due diligence and to conduct proactive investigations into possible sanctions and export control evasion."

[14] Best practices from the Compliance Advisory include:

- "Training staff on sanctions risks and common red flags. This includes not only compliance personnel but also front-line staff, senior management, and business lines (e.g., underwriters, relationship managers). It is especially important to train staff that while it is appropriate for customers to ask for guidance on how to comply with bank policies and sanctions, any request for assistance in evading sanctions should be treated as a serious red flag and result in appropriate mitigation measures.

- Ensuring any identified risks or issues are escalated quickly to the proper level (e.g., senior risk committee) and promoting a "culture of compliance."

- Communicating clearly and frequently with U.S. and other correspondent banks on their due diligence expectations and requests for information.

- Incorporating information and typologies from relevant FinCEN and OFAC alerts and advisories into automated and manual anti-money laundering controls. Of particular concern for Russian sanction evasion are:

    - Customers conducting business with newly formed Russian companies or newly formed companies in third-party countries known to be potential transshipment points for exports to Russia.

    - Companies or counterparties supposedly involved in production or import-export of sophisticated items with no business history or little-to-no web presence.

    - Customers or counterparties using unusual or atypical payment terms and methods, such as large cash payments, frequent or last-minute changes to end-users or payees, or routing payments through third countries not otherwise involved in the transaction."

[15] *See* FinCEN & BIS Joint Alert, FinCEN and the U.S. Department of Commerce's Bureau of Industry and Security Urge Increased Vigilance for Potential Russian and Belarusian Export Control Evasion Attempts, June 28, 2022, available at https://www.fincen.gov/sites/default/files/2022-06/FinCEN%20and%20Bis%20Joint%20Alert%20FINAL.pdf; FinCEN & BIS Joint Alert, Supplemental Alert: FinCEN and the U.S. Department of Commerce's Bureau of Industry and Security Urge Continued Vigilance for Potential Russian Export Control Evasion Attempts, May 19, 2023, available here; FinCEN & BIS Joint Alert, FinCEN and the U.S. Department of Commerce's Bureau of Industry and Security Announce New Reporting Key Term and Highlight Red Flags Relating to Global Evasion of U.S. Export Controls, Nov. 6, 2023, available here.

[16] *See* OFAC FAQ 1157, which defines salmon, cod, pollock and crab to include articles defined at the specified Harmonized Tariff Schedule of the United States (HTSUS) subheadings.

[17] *See* 15 C.F.R. § 736.2(b)(10) ("**General Prohibition 10**").

The following Gibson Dunn lawyers prepared this alert: Adam M. Smith, David Wolber, Stephenie Gosnell Handler, Chris Timura, Dharak Bhavsar, and Audi Syarief.

Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding these issues. For additional information about how we may assist you, please contact the Gibson Dunn lawyer with whom you usually work, the authors, or the following leaders and members of the firm's International Trade practice group:

United States
Ronald Kirk – Co-Chair, Dallas (+1 214.698.3295, rkirk@gibsondunn.com)
Adam M. Smith – Co-Chair, Washington, D.C. (+1 202.887.3547, asmith@gibsondunn.com)
Stephenie Gosnell Handler – Washington, D.C. (+1 202.955.8510, shandler@gibsondunn.com)
David P. Burns – Washington, D.C. (+1 202.887.3786, dburns@gibsondunn.com)
Nicola T. Hanna – Los Angeles (+1 213.229.7269, nhanna@gibsondunn.com)
Marcellus A. McRae – Los Angeles (+1 213.229.7675, mmcrae@gibsondunn.com)
Courtney M. Brown – Washington, D.C. (+1 202.955.8685, cmbrown@gibsondunn.com)
Christopher T. Timura – Washington, D.C. (+1 202.887.3690, ctimura@gibsondunn.com)
Hayley Lawrence – Washington, D.C. (+1 202.777.9523, hlawrence@gibsondunn.com)
Annie Motto – New York (+1 212.351.3803, amotto@gibsondunn.com)
Chris R. Mullen – Washington, D.C. (+1 202.955.8250, cmullen@gibsondunn.com)
Sarah L. Pongrace – New York (+1 212.351.3972, spongrace@gibsondunn.com)
Anna Searcey – Washington, D.C. (+1 202.887.3655, asearcey@gibsondunn.com)
Samantha Sewall – Washington, D.C. (+1 202.887.3509, ssewall@gibsondunn.com)
Audi K. Syarief – Washington, D.C. (+1 202.955.8266, asyarief@gibsondunn.com)
Scott R. Toussaint – Washington, D.C. (+1 202.887.3588, stoussaint@gibsondunn.com)
Claire Yi – New York (+1 212.351.2603, cyi@gibsondunn.com)
Shuo (Josh) Zhang – Washington, D.C. (+1 202.955.8270, szhang@gibsondunn.com)

Asia
Kelly Austin – Hong Kong/Denver (+1 303.298.5980, kaustin@gibsondunn.com)
David A. Wolber – Hong Kong (+852 2214 3764, dwolber@gibsondunn.com)
Fang Xue – Beijing (+86 10 6502 8687, fxue@gibsondunn.com)
Qi Yue – Beijing (+86 10 6502 8534, qyue@gibsondunn.com)
Dharak Bhavsar – Hong Kong (+852 2214 3755, dbhavsar@gibsondunn.com)
Felicia Chen – Hong Kong (+852 2214 3728, fchen@gibsondunn.com)
Arnold Pun – Hong Kong (+852 2214 3838, apun@gibsondunn.com)

Europe
Attila Borsos – Brussels (+32 2 554 72 10, aborsos@gibsondunn.com)
Susy Bullock – London (+44 20 7071 4283, sbullock@gibsondunn.com)
Patrick Doris – London (+44 207 071 4276, pdoris@gibsondunn.com)
Sacha Harber-Kelly – London (+44 20 7071 4205, sharber-kelly@gibsondunn.com)
Michelle M. Kirschner – London (+44 20 7071 4212, mkirschner@gibsondunn.com)
Penny Madden KC – London (+44 20 7071 4226, pmadden@gibsondunn.com)
Benno Schwarz – Munich (+49 89 189 33 110, bschwarz@gibsondunn.com)
Nikita Malevanny – Munich (+49 89 189 33 160, nmalevanny@gibsondunn.com)
Irene Polieri – London (+44 20 7071 4199, ipolieri@gibsondunn.com)