Litigation & Arbitration and Corporate Groups

# A New Era for UK and EU Sanctions Following Russia's Invasion of Ukraine: 2022 in Review and What 2023 May Bring

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## Contact


**Tom Canning,** Partner
+44 20.7615.3047
tcanning@milbank.com

**Andrea Hamilton,** Partner
+44 20.7615.3804
ahamilton@milbank.com

**Mark Padley,** Associate
+44 20.7615.3121
mpadley@milbank.com

**Ben King,** Associate
+44 20.7615.3025
bking1@milbank.com


2022 was an unprecedented year in the development of international financial and trade sanctions following Russia's invasion of Ukraine in February 2022. The sanctions imposed on Russia by the UK, EU, US, Japan, Switzerland and others represent the most severe sanctions ever imposed on a major economy. For the UK and EU in particular, the breadth and speed with which such sanctions have been imposed on Russia is without parallel – and both jurisdictions are still working through practical issues that have arisen concerning the interpretation and enforcement of the sanctions. At the same time, the enforcement powers of UK and EU regulatory authorities have been expanded and the capacity of regulators to deal with the implementation and enforcement of sanctions is beginning to increase to match their expanded role.

In this article we focus on the UK and EU Russia sanctions introduced in 2022 – providing an overview of those sanctions and then looking forward to the likely developments in 2023.[1]

**Overview and applicability of UK/EU Russia sanctions**

Since the invasion of Ukraine in February 2022, the UK and EU have adopted several waves of sanctions against Russia, building upon the sanctions originally imposed on Russia in 2014 in connection with its annexation of Crimea.[2] They have frozen the assets of numerous individuals and organisations, and severely curtailed the ability of UK/EU persons to do business in or with Russia through sanctions on trade, finance and services. The sanctions apply not only to activities carried out within the territory of the UK/EU, but also to the activities of UK/EU incorporated entities and UK/EU nationals wherever they are located in

[1] This Client Alert is a source of general information for clients and friends of Milbank LLP. Its content should not be construed as legal advice, and readers should not act upon the information in this Client Alert without consulting counsel.

[2] For the UK-Russia sanctions see The Russia (Sanctions) (EU Exit) Regulations 2019 (as amended) (the "**UK Russia Sanctions**"); for the EU-Russia sanctions see primarily Council Regulation (EU) No. 833/2014 (as amended) and Council Regulation (EU) No. 269/2014 (as amended) (the "**EU Russia Sanctions**").

the world.[3] UK sanctions also generally apply to British Overseas Territories and Crown Dependencies, such as Bermuda and the Cayman Islands.[4]

In the UK, financial sanctions are implemented and enforced by the Office of Financial Sanctions Implementation ("**OFSI**"), which is part of HM Treasury, and trade sanctions are the responsibility of the Department for International Trade ("**DIT**").[5] Both OFSI and DIT have issued a considerable body of guidance[6] on the interpretation of UK sanctions as well as licences permitting certain activities that would otherwise be in breach of sanctions (including for the daily living expenses of sanctioned persons).[7] In the EU, sanctions enforcement is the responsibility of the relevant competent authority in each EU Member State (which may also issue derogations from EU sanctions in limited circumstances),[8] and the European Commission has issued extensive guidance on the interpretation of EU sanctions.[9]

## Asset Freezes

Over 1200 individuals and entities were subject to an "asset freeze" by the UK/EU in 2022, including major Russian banks, key associates of President Putin and members of the Russian legislature.[10] In the UK alone, approximately £18 billion was reported as frozen under the UK Russia sanctions in 2022.[11] The effect of an "asset freeze" is to prevent UK/EU persons from dealing (directly or indirectly) in the funds or economic resources owned, held or controlled by designated persons as well as the making available of funds or economic resources to such persons. The restrictions also extend to entities that are owned (50% or more) or controlled by a designated person.[12]

This means that financial institutions and corporates, already accustomed to sanctions compliance, must undertake increasingly detailed analysis of the ownership structure of clients and counterparties to determine whether they are owned or controlled by a designated person. However, it is difficult to do this with certainty where the definition of "control," already widely defined, varies by jurisdiction and the analysis is inevitably very fact specific.[13] It may, therefore, be advisable to seek guidance from the relevant competent authority where there is doubt, if possible.[14]

## Sanctions on the financial services sector

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3 UK Russia Sanctions, Section 3; Council Regulation (EU) No. 833/2014 (as amended), Article 13 and Council Regulation (EU) No. 269/2014 (as amended), Article 17.

4 Article 21 of the Sanctions and Anti-Money Laundering Act 2018 and The Russia (Sanctions) (Overseas Territories) Order 2020.

5 The Export Control Joint Unit, which is part of DIT, is responsible for the majority of trade related sanctions.

6 See OFSI Guidance for the financial and investment restrictions in Russia (Sanctions) (EU Exit) Regulations 2019 and General guidance for financial sanctions under the Sanctions and Anti-Money Laundering Act 2018; see also Statutory guidance, Russia sanctions: guidance.

7 OFSI is also able to issue general licences, such as 'wind down' licences that allow counterparties to extricate themselves from commercial relationships with a designated entity within a specified period of time. OFSI has issued over 33 Russia sanctions related general licences since February 2022. See OFSI Annual Review April 2021 to August 2022, (the "**OFSI 2022 Annual Review**"), page 4.

8 For example, for living or legal expenses or for the purposes of a wind down.

9 See Commission consolidated FAQs on the implementation of Council Regulation No 833/2014 and Council Regulation No 269/2014.

10 See OFSI 2022 Annual Review, page 7, UK consolidated list of designated persons and EU list of designated persons under the EU Russia Sanctions.

11 See OFSI 2022 Annual Review, page 7.

12 UK Russia Sanctions, Sections 7, 10-15; Council Regulation (EU) No. 269/2014 (as amended), Article 2; EU Best Practices for the effective implementation of restrictive measures, 4 May 2018, page 22.

13 For example, under the UK Russia Sanctions a designated person will be deemed to have control where "*it is reasonable, having regard to all the circumstances, to expect that [the designated person] would (if [it] chose to) be able, in most cases or in significant respects, by whatever means and whether directly or indirectly, to achieve the result that the affairs of [the entity] are conducted in accordance with [the designated person]'s wishes*" (UK Russia Sanctions, Section 7(4)); see also EU Best Practices guidance, page 22.

14 See, in particular, recommendations on page 12 of the UK NCA, NECC, jmlit and OFSI "Red ALERT Financial Sanctions Evasion Typologies: Russian Elites and Enablers".

In addition to targeting specific entities and individuals, both the UK and EU have targeted Russia's access to loans, investments and the financial markets more generally. These include (but are not limited to):

- Loans: Both the UK and EU have prohibited the provision of new loans or credit with a maturity of more than 30 days to the Government of Russia, its Central Bank and a number of large Russian banks and corporates.[15] The UK has gone further and prohibited any loans to persons "connected with Russia" (broadly speaking entities incorporated or domiciled in Russia) or entities owned by them.[16]
- Transferable securities: Both the UK and EU have prohibited dealings in transferable securities or money-market instruments of certain maturities issued by or on behalf of the Government of Russia, its Central Bank and a number of large Russian banks and corporates after 1 March and 9 March 2022, respectively.[17] As with loans, the UK has also prohibited dealings in transferable securities or money-market instruments issued by persons connected with Russia.
- Investments: The UK has prohibited investments in Russian businesses or land (as well as the provision of loans or the dealing in transferable securities issued for the purpose of such investments), with some exceptions.[18] The EU currently only prohibits investments in Russia's energy and mining sectors, although the financing of investments in Russia is also prohibited.[19]
- SWIFT bans: The EU, UK, Canada and US issued a joint statement in late February 2022, announcing that selected Russian banks would be removed from inter-bank financial messaging systems, such as SWIFT, severely curtailing their access to the financial payments system.[20]

**Sanctions on other services**

The UK and EU Russia Sanctions currently prohibit the direct or indirect provision of a range of services including accounting, business, IT and management consulting, engineering and public relations services to the Russian government or legal persons, entities or bodies established in Russia, subject to certain exceptions.[21] The EU Russia Sanctions go further, also prohibiting the provision of legal advisory services, with some exceptions.

**Trade sanctions**

The UK and EU have imposed trade-related sanctions across a number of sectors central to the Russian economy, which have also had a very substantial impact on non-Russian companies. These include, but are not limited to:

- Energy: Both the UK and EU have sought to restrict Russia's revenue from energy related products and to disrupt its oil, gas and coal industries. This has been particularly challenging given the EU's reliance on Russian gas, oil and, to a lesser extent, coal. However, both now generally prohibit:

    a. the import of Russian oil and coal and the provision of services and financing in relation to the same;[22]

15 UK Russia Sanctions, Section 17; Council Regulation (EU) No. 833/2014 (as amended), Article 5(6).
16 UK Russia Sanctions, Sections 17 and 19A(2). It is also worth noting that there are exceptions, including for subsidiaries of entities incorporated outside of Russia.
17 UK Russia Sanctions, Section 16; Council Regulation (EU) No. 833/2014 (as amended), Article 5(1)-(4) and Article 5a.
18 UK Russia Sanctions, Sections 16, 17 and 18B.
19 Council Regulation (EU) No. 833/2014 (as amended), Articles 3a and 2e.
20 See Joint Statement dated 26 February 2022 and Council Regulation (EU) No. 833/2014 (as amended), Article 5h.
21 UK Russia Sanctions, Section 54B-C; Council Regulation (EU) No. 833/2014 (as amended), Article 5n.
22 UK Russia Sanctions, Sections 46Z4-8; Council Regulation (EU) No. 833/2014 (as amended), Article 3m.

b. the maritime transport of certain Russian oil wherever it is to be delivered (along with related financial, insurance and brokering services), save where the price for that oil is at or below the $60 price cap; and[23]

c. the export to Russia of goods for use in its oil and gas industries and the provision of related services and financing.[24]

- Aviation: In addition to banning Russian owned or operated aircraft from UK/EU airspace,[25] it is prohibited to export or otherwise make aircraft (and related products such as jet engines) available in Russia or for use in Russia.[26] The provision of financial and other services in relation to such activities is also prohibited and restrictions have also been introduced in relation to aviation fuel. In practice, this has meant that the leasing of aircraft for use in Russia is generally prohibited (along with related financing and insurance), with certain exceptions.[27]
- Other products: Other products deemed to be generating significant revenue for the Russian economy have also been subject to import bans and prohibitions on related services and financing. These include spirits, steel, wood and cements.[28]

## The outlook for 2023

With so many new Russia related sanctions introduced in 2022, it is perhaps inevitable that 2023 will see a slowing of the pace of new legislation. However, it is likely that some additional prohibitions will be introduced and that several new individuals will be subject to an asset freeze. The UK and EU are, however, likely to focus more on clarifying and enforcing the sanctions that have already been introduced.

In the UK, 2022 enforcement action by OFSI was very limited, with only one fine being issued under the UK Russia Sanctions since the February 2022 invasion of Ukraine.[29] However, this is likely to change markedly in 2023, with OFSI having received over 236 breach reports since February 2022 – all of which will need to be investigated and may result in monetary penalties or public censure. To this end, OFSI's 2022 Annual Report noted that it is "*significantly enhancing its ability to ensure effective enforcement. Over the coming year, OFSI will take on more, and more complex, enforcement cases to match its increased resourcing and capabilities. To do this, OFSI will take a risk-based approach and utilise new powers provided by the Economic Crime (Transparency and Enforcement) Act 2022*."[30] Those new powers:

- allow OFSI to impose monetary penalties for financial sanctions breaches on a strict liability basis (i.e., without the need to show that a person in breach of sanctions knew or had reasonable cause to suspect that they were acting in contravention of the relevant prohibitions);
- allow the publication of details of financial sanctions breaches even if no monetary penalty has been imposed; and
- broaden OFSI's existing power to share information with other government organisations.[31]

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[23] This prohibition was effective from 5 December 2022. See UK Russia Sanctions, Sections 46Z9A-D and General Licence – Oil Price Cap INT/2022/2469656; EU Council Decision (CFSP) 2022/2369.

[24] UK Russia Sanctions, Sections 22-29; Council Regulation (EU) No. 833/2014 (as amended), Article 3b.

[25] UK Russia Sanctions, Section 57J; Council Regulation (EU) No. 833/2014 (as amended), Article 3d.

[26] UK Russia Sanctions, Sections 22-29; Council Regulation (EU) No. 833/2014 (as amended), Article 3c.

[27] For example, the EU has clarified that scheduled flights into Russia by non-Russian airlines do not constitute the use of aircraft in Russia (see EU FAQ Guidance G2(23)) and the UK has issued a licence permitting such activity (General Trade Licence Russia Sanctions - Vessels).

[28] UK Russia Sanctions, Sections 46S-X; Council Regulation (EU) No. 833/2014 (as amended), Article 3i and Annex XXI.

[29] This was a £30,000 fine of a Hong Kong wine competition for dealing with a designated person in the period prior to February 2022.

[30] OFSI 2022 Annual Report, page 12.

[31] The Economic Crime (Transparency and Enforcement) Act 2022 (Commencement No. 2 and Saving Provision) Regulations 2022 amending the Policing and Crime Act 2017 and the Sanctions and Anti Money Laundering Act 2018.

These powers are likely to make it easier for OFSI to investigate suspected breaches and to impose fines where contraventions are identified.

Similarly, in the EU we expect that enforcement will be given greater attention in 2023. The position on enforcement in the EU, however, is more complex than in the UK as it is not the responsibility of the European Commission and instead is left to the competent authorities of each Member State. This leads to something of an "enforcement gap" where EU sanctions are developed at the EU level, but each Member State has a different competent authority, different judicial practices and, ultimately, different punishments. In recognition of this issue, the Council of the EU has recently adopted a Decision[32] to expand the list of "EU crimes" included in the Treaty on the Functioning of the EU to include the violation of restrictive sanctions measures. Following that decision, the European Commission has also presented a proposal setting out minimum rules on the definition of and penalties for the new crime.[33]

Finally, we expect that there will be an increased focus on preventing the circumvention of sanctions from taking place in third countries. For example, the EU has announced that it intends to appoint a new "sanctions envoy" to try to ensure full compliance with EU sanctions globally.[34]

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32 See European Council press release dated 28 November 2022.

33 See European Commission press release dated 2 December 2022.

34 https://www.ft.com/content/5c423057-61ee-4e64-ae7c-45e4daacfdc1

**Litigation & Arbitration Contacts**


London | 100 Liverpool Street, London EC2M 2AT

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|---|---|---|
| Tom Canning | tcanning@milbank.com | +44 20.7615.3047 |
| Andrea Hamilton | ahamilton@milbank.com | +44 20.7615.3804 |
| Mark Padley | mpadley@milbank.com | +44 20.7615.3121 |
| Ben King | bking1@milbank.com | +44 20.7615.3025 |


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