

U.S. Treasury Department Clarifies Previous Prohibitions on New Investments in Russian Equities and on Export of Trust, Accounting and Management Consulting Services to Russia

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On June 6, 2022, the Office of Foreign Assets Control (“OFAC”) within the U.S. Department of the Treasury announced new Frequently Answered Questions (“FAQs”) that interpret several previous Executive Orders (“EOs”) issued by President Biden. One of those FAQs in particular effectively prohibits U.S. persons from making new purchases of any securities such as stocks or bonds issued by any Russian entity. On June 9, OFAC issued additional FAQs to clarify the scope of its recently announced prohibition against the provision of accounting, trust and corporate formation, and management consulting services to Russia. Both of these latest measures are part of the Biden Administration’s overall sanctions program to impose severe economic costs on Russia due to its invasion and ongoing war in Ukraine.

By way of context, earlier this year, President Biden had issued the following three Executive Orders (“EOs”) affecting U.S. person investments in Russia:¹

- EO 14066 of March 8, 2022, that had barred certain imports from Russia and new investments in the Russian energy sector;
- EO 14068 of March 11, 2022, that barred certain imports from and exports to Russia and authorized the U.S. Secretary of the Treasury in consultation with the U.S. Secretary of State to bar new investments in selected Russian economic sectors; and
- EO 14071 of April 6, 2022, that barred all new investments in Russia and authorized the U.S. Secretary of the Treasury in consultation with the U.S. Secretary of State to bar the export of selected services to Russia.

In its new or revised FAQs announced on June 6, OFAC referred to these three EOs collectively as “the respective E.O.s”. In particular, OFAC announced in its new FAQ 1054 the following interpretation of U.S. sanctions on Russia:

... the respective E.O.s prohibit U.S. persons from purchasing both new and existing debt and equity securities issued by an entity in the Russian Federation. However, the new investment prohibitions of the respective E.O.s do not prohibit U.S. persons from selling or divesting, or facilitating the sale or divestment of, debt or equity securities

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issued by an entity in the Russian Federation to a non-U.S. person (see FAQs 1049 and 1053). Please note that U.S. persons are not required to divest such securities and may continue to hold such previously acquired securities. Moreover, the conversion of depositary receipts to underlying local shares of non-sanctioned Russian issuers would not be considered a prohibited “new investment” in the Russian Federation under the respective E.O.s.

Significantly, this new June 6 guidance in FAQ 1054 clarifies the scope of the “new investment” prohibitions in the respective EOs to mean that U.S. persons generally cannot purchase Russian stocks or bonds on secondary markets. However, as FAQ 1054 states, even though U.S. persons may now not buy any such Russian securities, U.S. persons may still continue to hold such securities if purchased previously or to sell off or divest such Russian securities to a non-U.S. person buyer. (If a U.S. holder of such Russian securities were to try to sell such securities to another U.S. person, the latter would be deemed to be making an unlawful “new investment” in Russian securities contrary to FAQ 1054, so such sales can only be made to a non-U.S. person buyer.) Moreover, FAQ 1054 also says that U.S. persons may still invest in any U.S. mutual fund that owns Russian securities provided that the value of such fund’s previously acquired Russian holdings are less than the majority of the total value of the fund’s assets.

This latest OFAC move places yet more pressure upon U.S. funds to move out of holding any Russian securities, whether issued by government or private entities. By reducing the number of potential global investors in such Russian securities, especially given the outsized role of U.S. investors in global financial markets, this new OFAC measure is likely to further depress the value of all such Russian securities and thus to make them less attractive generally as investments.

Moreover, although FAQ 1054 continues to say that U.S. persons are not required to divest any previously acquired holdings of such Russian securities, there have been some calls by severe critics of the Russian invasion to compel total divestment. Whether the U.S. Government may eventually move toward that draconian position or not, OFAC’s steady progression of measures in recent months to limit U.S. person investments in such Russian securities may well suggest that U.S. funds should at least consider a gradual and orderly reduction of their Russian holdings. The probable alternative if such a future divestment were to be mandated would be hugely disadvantageous pricing because then every such U.S. fund would have to divest its Russian holdings all at the same time in such a compulsory sell-off.

In addition to the measures above, citing the authority of EO 14071, the U.S. Secretary of the Treasury had earlier announced on May 8, 2022 that U.S. persons may no longer provide accounting, trust and corporate formation, and management consulting services to Russia. OFAC had previously issued FAQs to define the services prohibited under that determination. However, on June 9, OFAC issued additional FAQs to clarify the scope of that prohibition.² These new FAQs show OFAC will apply the May 8 “services” prohibitions as follows:

- The prohibitions apply to services that ultimately benefit “persons in the Russian

Federation, individuals ordinarily resident in the Russian Federation, and entities incorporated or organized under the laws of the Russian Federation or any jurisdiction within the Russian Federation”;

- The prohibitions do not apply, however, if the ultimate beneficiary of the services is an entity established and located outside of Russia even if such a non-Russian entity is owned or controlled by a person in Russia;
- The prohibitions do not necessarily prevent U.S. persons from working as employees of Russian entities so long as they do not provide the specified prohibited services as employees;
- The prohibitions apply to any U.S. subsidiary of a Russian parent company so that such a U.S. subsidiary could not provide any of the prohibited services to its own parent entity;
- The prohibition against services for the formation of trusts and corporations draws no distinction between new and existing entities;
- The prohibition against management consulting services includes executive search and vetting services;
- The prohibitions generally prevent a U.S. person from serving as a voting trustee of any Russian entity;
- The prohibitions do not cover educational programs and services that teach accounting, trust or corporate formation, or management consulting topics;
- The prohibitions do not cover the provision of non-customized software that could be used for the prohibited services, including any technical support for such software, so long as the U.S. person does not provide tailored solutions for any software user in Russia; and
- The prohibition against accounting services includes any tax return preparation and filing.

Taken together, it is evident from these latest measures that OFAC continues to use all available American financial leverage on the Russian economy to exert pressure upon the Russian government to end its war in Ukraine. It is doubtful that any one economic sanction imposed by the United States will alter the behavior of the Russian government, but, sooner or later, the cumulative effect of these sanctions – especially when combined with many like measures imposed by other allied governments -- may create some reappraisal of the war in Moscow.

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[1] In addition, President Biden issued EO 14065 of February 21, 2022, to bar new investment in the self-proclaimed Donetsk People’s Republic (“DNR”) and Luhansk People’s Republic (“LNR”) regions of Ukraine, and importation of goods, technology or services from, or exportation to, those regions.

[2] <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/added/2022-06-09>.