DORSEY
DORSEY + WHITNEY LLP

U.S. Treasury Ends Authorization for U.S. Banks to Handle Russian Bond Payments

by Lawrence Ward, Dave Townsend, and T. Augustine Lo

The U.S. Treasury Department has said that it is ending Russia's last option to pay its billions in sovereign debt owed to international investors. In response to Russian aggression in Ukraine, the Treasury Department's Office of Foreign Assets Control ("OFAC") had imposed expanded prohibitions against Russian financial institutions starting in late February 2022, which we previously reported here. Those prohibitions included banning funds transfers on behalf of the Russian Central Bank, National Wealth Fund, and Ministry of Finance on February 28, 2022 under Directive 4 of Executive Order 14024 (now codified under the Russian Harmful Activities Sanctions Regulations ("RuHSR"), 31 CFR Part 587), and other sanctions under EO 14024 against various Russian banks that prohibited dealings in their debts beginning on February 22 and 24. The Directive 4 prohibition immediately barred any U.S. financial institution from transferring U.S. Dollars required to service Russia's sovereign debt and the debts of certain Russian financial institutions on a regular basis.

However, OFAC had issued General License 9 ("GL 9") on February 24 to allow wind-down transactions for the debt and equity of certain sanctioned banks. On March 2, OFAC amended GL 9 by issuing GL 9A to enable U.S. financial institutions to handle Dollar-denominated Russian sovereign bond payments on a temporary basis. OFAC subsequently amended GL 9A two more times, issuing GL 9B on April 6 and GL 9C on April 7. On May 24, OFAC announced that it would not extend its temporary GL 9C authorization any further, and so that authorization would end at its stated expiration date of 12:01 a.m. Eastern Daylight Time on May 25, 2022 for all but two of the targeted Russian issuers. The expiration of GL 9C will likely lead to the first Russian defaults on its sovereign foreign debt since the Bolshevik Revolution toppled the Russian government that was in power in November 1917.

The expiration of the GL 9C authorization on May 25 prevents U.S. banks from transferring funds to service Russian sovereign debts on behalf of the Russian Central Bank, National Wealth Fund, and Ministry of Finance, as well as from processing payments owed on debt or equity issued by the following Russian issuers:

Related People

- Lawrence Ward
- Dave Townsend
- T. Augustine Lo

Related Capabilities

- Banking & Financial Institutions
- Financial Services Regulatory
- National Security Law
- International Arbitration & Litigation
- International Trade

- State Corporation Bank for Development and Foreign Economic Affairs (Vnesheconombank);
- Public Joint Stock Company Bank Financial Corporation Otkritie;
- Sovcombank Open Joint Stock Company;
- Public Joint Stock Company Sberbank of Russia;
- VTB Bank Public Joint Stock Company; or
- Any entity in which one or more of the above entities own, directly or indirectly, individually or in the aggregate, a 50 percent or greater interest.

However, the GL 9C authorization will remain in effect for a limited time for transactions with two other Russian financial institutions. GL 9C allows U.S. banks to continue processing U.S. Dollar payments for Joint Stock Company Alfa-Bank ("Alfa-Bank") or any entity in which Alfa-Bank owns, directly or indirectly, a 50 percent or greater interest, with regard to their debt or equity issued prior to April 6, 2022 through 12:01 a.m. Eastern Daylight Time on June 30, 2022. Similarly, such GL 9C authorization will also continue for Public Joint Stock Company Alrosa ("Alrosa"), or any entity in which Alrosa owns, directly or indirectly, a 50 percent or greater interest, with regard to their debt or equity issued prior to April 7, 2022 through 12:01 a.m. Eastern Daylight Time on July 1, 2022.

The May 24 OFAC announcement was not altogether unexpected since the Biden Administration had already earlier indicated that it was not going to extend this general license authorization. For example, at a G-7 finance ministers meeting held in Germany last week, U.S. Secretary of the Treasury Janet Yellen had pointedly said that the Treasury Department's temporary authorization was only "to allow a period of time for an orderly transition to take place, and for investors to be able to sell securities." She went on in her press conference comments to say, "The expectation was that [this authorization] was time-limited."

The Russian Government was also apparently expecting this latest U.S. move. In an effort to put off defaults on Russian debt as long as possible, the Russian Ministry of Finance made two advance bond payments on May 20 to try to get ahead of the impending OFAC deadline that would cut off this limited GL 9C access to U.S. banks.

Until now, given the RuHSR sanctions, the above-noted sanctioned Russian issuers had been relying on two major U.S. banks, JP Morgan Chase and Citigroup, to process the U.S. Dollar transfers required to pay international investors holding their Russian bonds. However, with the end of GL 9C, those U.S. banks can no longer serve as payment channels for those Russian issuers to meet those bond repayment obligations. Financial industry observers had noted that most institutional holders of Russian bonds have probably already used the temporary authorization period offered by GL 9C to offload their Russian holdings to avoid this imminent OFAC deadline and the cutoff of U.S. Dollar payments. However, there are probably still some investors in Russian debt who are either professionals specializing in distressed debt investments or who are committed to the inevitable litigation that will now probably play out in the coming years about which side was responsible for these bond defaults – that is, the Russian government because it chose to invade Ukraine or the U.S. government because it imposed the sanctions and thus created a *force majeure* event excusing the payments.

Such investors appear willing to play the odds that their holdings will still pay off at some future date when those likely conflicting legal claims are finally adjudicated or settled.

Russia next needs to make bond payments on June 23, and those Russian bonds, like most Russian debt, carry a 30-day grace period for non-payment before they can be declared in default. Accordingly, such Russian defaults would then be expected toward the end of July. Even if the actual occurrence of such defaults will not directly affect the outcome of the war in Ukraine, it will certainly erode global investor confidence in Russian sovereign debt and probably raise Russia's future borrowing costs, further damaging its economy and casting a dark shadow across that nation's economic future.

# # # # #