

Russian Sanctions – What has been the effect of sanctions on Russia?



The articles we will be discussing are:

“Sanctions Against Russia: How businesses linked to blacklisted oligarchs avoid western sanctions” from The Economist printed edition, 2/14/2015

“What’s Been the Effect of Western Sanctions on Russia?” from Frontline interview on 1/13/2015 with Andes Aslund

Points of Discussion:

What is the purpose of sanctions?

In what situations have sanctions been effective?

What countries have imposed sanctions? and which group have been most affected by sanctions?

When: Tuesday, April 7, 2015

Time: 5:15pm-7:00pm

Where: Humbrews

Sanctions against Russia

Fancy footwork

How businesses linked to blacklisted oligarchs avoid Western sanctions

Feb 14th 2015 | From the Print Edition: Business

AS THE West is loth to go to war against Russia over Ukraine, its main levers for persuading Vladimir Putin to back down are economic. And the principal economic tools at its disposal are sanctions, which have tightened incrementally since last March. Their importance as a policy was underlined this week, when European Union foreign ministers adopted new measures against 19 individuals and nine entities (implementation was delayed for a week to give diplomacy a chance).

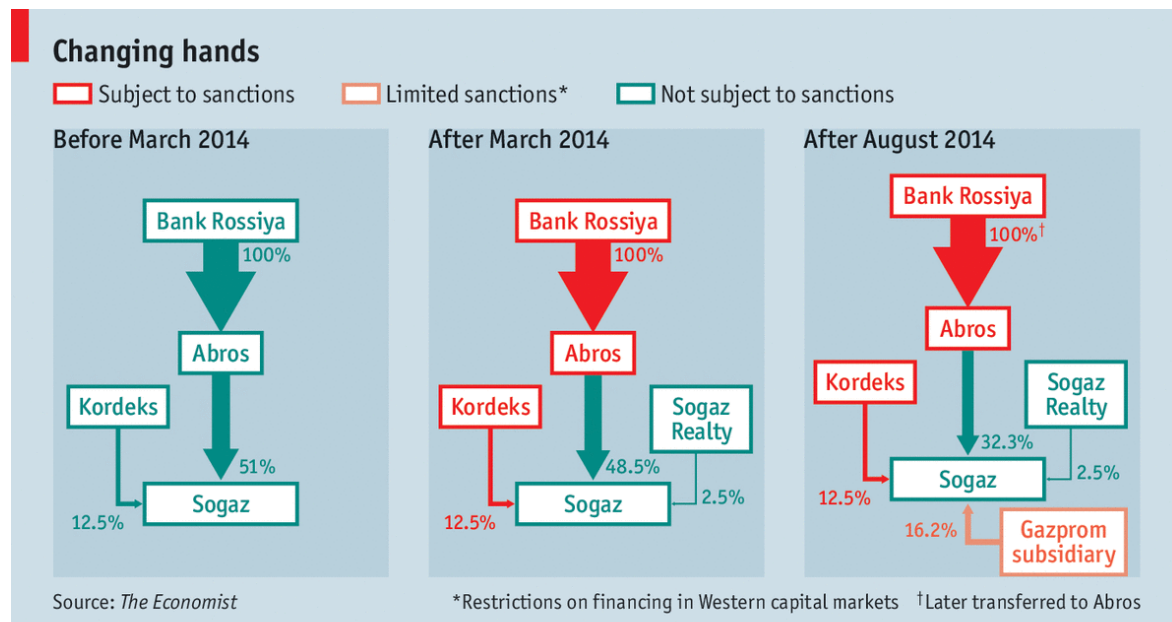
In several cases, however, companies that would have been subject to sanctions because of their links to “designated” Russian oligarchs have managed to wriggle free of the restrictions with well-timed transactions. These have had the effect of reducing the stakes held by parties subject to sanctions below thresholds that would trigger penalties against their businesses. “The blatant manner in which [some Russian entities] have avoided sanctions raises questions about the effectiveness of the existing system and the willingness of the West to enforce its own rules,” concludes an unpublished report by a corporate-investigations firm that has been seen by *The Economist*. It was compiled for one of the many Western companies that fret about whom they can or cannot do business with under the sanctions regime.

A striking example is Sogaz. Originally set up by Gazprom, an energy giant, the company provides insurance to Russian firms, including numerous ones on sanctions lists. The company reinsures its risks in Western markets. (It also sponsors Russia’s top football league.) Every member of the Sogaz board, including Alexey Miller, the boss of Gazprom, is affiliated with a sanctioned entity. Mr Putin’s nephew is a deputy chairman of Sogaz.

Until March 51% of Sogaz belonged to Bank Rossiya via a wholly owned subsidiary, called Abros. Rossiya is Russia’s 17th-largest bank, and its owners have links to Mr Putin. The remainder of the shares in Sogaz were divided between Gazprom, its subsidiaries and other figures close to the president. This included a stake held indirectly by Gennady Timchenko, a billionaire investor whom America assumes to be a member of Mr Putin’s inner circle (Mr Timchenko has denied this).

Rossiya was put on the sanctions list on March 20th 2014. Under the rules, Sogaz should have been too, as an entity that is 50%-or-more-owned by a sanctioned party. But Rossiya transferred a 2.5% stake to Sogaz Realty, a subsidiary of Sogaz, the week before the sanctions were imposed,

according to the insurer (see diagram). Investigators who have seen the paperwork note that the transaction was not filed with the Russian authorities until March 24th, after sanctions took effect. With Rossiya’s stake below 50%, Sogaz was able to produce comfort letters showing Western counterparties that it was not subject to sanctions. A note in Sogaz’s 2013 accounts, published in April 2014, mentions Rossiya losing control through a share transaction, but gives no reason for it. A Russian newspaper quoted a source at Sogaz as saying the share-rejigging was part of an “incentive programme for top management” that it had planned since late 2013 (before the Ukraine conflict erupted).



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The transaction let Sogaz avoid sanctions because of a gaping loophole: a firm controlled by several sanctioned entities was not itself subject to sanctions if none of them individually owned 50% of it. The Office of Foreign Assets Control (OFAC), the arm of the US Treasury that oversees sanctions, closed the loophole in August. Now, a firm is blacklisted if the stakes of sanctioned individuals add up to 50% or more. (The EU has a similar rule.)

Under these new rules, Sogaz should have been subject to sanctions because of its links to both Bank Rossiya and Kordeks, a 12.5% shareholder reportedly controlled by Mr Timchenko, whom America had blacklisted several months earlier. (Mr Timchenko declined to comment on this or any other details of his affairs.) However, in another exquisitely timed transaction, Rossiya cut its stake again—according to the paperwork, two days before the OFAC changes were announced—thus helping Sogaz avoid sanctions once more.

A document published by Sogaz in late August states that Abros, the Rossiya subsidiary, now held only 32.3% of Sogaz. It said the transaction had taken place on August 6th and had been registered on August 11th, just before the sanctions were expanded on August 13th. (The 16.2% stake was

offloaded to a subsidiary of Gazprom, the gas giant confirmed; Gazprom and its subsidiaries are not subject to full sanctions, but to looser ones, such as restrictions on financing in Western markets.) This meant that the total shareholdings in Sogaz of sanctioned parties had fallen to 44.8% (Abros 32.3%, Kordeks 12.5%), again bringing it below the threshold.

You belong to yourself

In another curious development, Rossiya later seems to have given away its remaining stake in Sogaz, by transferring ownership of Abros to Abros itself. The terms of the transaction are unknown. Russian media reported that in September, as part of a “restructuring”, it sold the stake to Abros’s management as part of a “motivation programme”. This explanation is odd, as Abros appears to have only one employee. As the investigators’ report puts it, Abros “appears to be only a shell company with nobody to incentivise”.

Another striking feature is that a tiny sliver of Abros is not management-owned. According to corporate records, a stake of 0.004% is held by a firm called Bolshoi Dom 9 (Big House 9), whose six shareholders (including its largest investor, Yuri Kovalchuk) all own stakes in Rossiya or are affiliated with the bank. Two of them are linked to Sogaz. This stake is very small but attracted the private investigators’ attention. Given the shareholders’ links, “the assumption must be that they continue to exert influence over Abros and, therefore, Sogaz,” they conclude. Neither Rossiya nor Sogaz responded to multiple e-mails seeking comment.

Abros was and remains on America’s sanctions list. So it is unclear why Rossiya, also under sanctions, would want to distance itself from its former subsidiary. It could be that Rossiya hoped that if Abros were no longer a majority-owned subsidiary of the bank, it would be taken off the list. But this has not happened.

Mr Timchenko is also a founder of Gunvor, a giant oil-trading firm, along with Torbjorn Tornqvist, a Swede. Until March 2014, 43.6% (and 50% of the voting rights) of Gunvor was owned by Fentex Properties, of which Mr Timchenko is the sole beneficial owner. An identical stake was held by Frefika Foundation, a vehicle owned by Mr Tornqvist. The remaining 12.8% was owned by a share plan for senior Gunvor employees, with no voting rights.

When Mr Timchenko was put on OFAC’s sanctions list on March 20th 2014, America alleged that Mr Putin had an undisclosed economic interest in Gunvor. The day before, Fentex Properties sold its stake in Gunvor to Mr Tornqvist, giving him 87.2% of the shares and 100% of the voting power. This allowed Gunvor to continue trading without restrictions.

Gunvor denies that Mr Putin is a beneficiary of Gunvor or its activities and says Mr Timchenko “has absolutely no ongoing involvement” in the firm. It agrees that the transaction’s purpose was “to de-risk the company from potential sanctions against Mr Timchenko”. But it says Messrs Timchenko and Tornqvist “had been in talks about a divestiture for a while prior to the actual sale”, in part

because of strategic differences. It says this process was speeded up after the first round of sanctions on March 6th. Gunvor insists it was a “fair-value sale” and—contrary to any suggestion that the stake was being parked temporarily with Mr Tornqvist—is “irrevocable”.

Another business linked to Mr Timchenko is the Hartwall Arena, a venue in Finland that has hosted concerts by the likes of Miley Cyrus and Aerosmith. Until last year it was jointly owned with two brothers who have long been friendly with Mr Putin, Arkady and Boris Rotenberg, with Mr Timchenko and the Rotenbergs each owning 50%. The Rotenbergs also had sanctions imposed on them on March 20th. Several big concerts were threatened with cancellation because of worries that the arena itself would be blacklisted.

At some point around the time of sanctions—it is unclear when exactly—the shareholding structure changed. According to Russian and Finnish media reports, Roman Rotenberg, a son of one of the brothers, acquired 100% of the vehicle through which they held their stake, as well as a small stake from the Timchenko-controlled outfit, bringing Mr Timchenko’s stake in the arena down to 49.5%. Since the son was not on the sanctions list, total ownership of the venue by sanctioned parties thus fell to 49.5%, meaning it could continue to be used for concerts by Western stars without repercussion. Roman Rotenberg told a Finnish newspaper that a deal for him to take control had been in the works since 2013, before the Ukraine conflict. *The Economist* sought comment from the Rotenbergs through SMP, a bank they co-own, but was unable to reach them.

Western lawyers say other Russian companies have concluded similarly well-timed transactions, the effect of which has been that they avoided sanctions. Two senior sanctions lawyers told us they have seen evidence of such transactions, though neither was willing to provide names. In several cases, says one, the European subsidiaries of Russian companies thought to be controlled by parties on sanctions lists suddenly appear to be only indirectly owned by them, thanks to the creation of a new corporate layer (ownership of which is hard or impossible to ascertain) to hold a majority stake in them. The timing of these share shuffles is “lucky”, says another lawyer. “I want to be with these guys at the blackjack table.”

OFAC declined to comment on these specific cases or on whether it might broaden its sanctions so that businesses subject to this sort of share transfer remain blacklisted. It did say that it encourages Western firms to watch out for purported changes in ownership, in which someone subject to sanctions sells shares in a “sham” transaction—for instance, at below market value or in a temporary arrangement. Even in scenarios where a bona fide transfer brings sanctioned parties’ combined stakes to below 50%, OFAC says it would continue to urge Western counterparties to exercise caution, as “such entities may be controlled—even if not owned” by blacklisted parties, for instance through nominees.

Feeling the pain

Some lawyers think OFAC will not be too concerned about cases like that of Sogaz because it is not those firms but their owners who are the main targets. Even if some of their businesses dodge sanctions, the oligarchs who have had to loosen their grip on them are still feeling pain. “The sanctions are broadly working,” says Jeremy Zucker of Dechert, a law firm. What matters more to OFAC than the timing of the divestments is that they are genuine transactions, not window-dressing—so that the blacklisted are forced to sell assets they would rather keep.

Moreover, even if a holding manages to avoid blacklisting, it might still suffer if Western firms give it a wide berth, anticipating a further tightening of the sanctions. Indeed, much as they insist their rules are clear, Western governments design them with a degree of ambiguity, so as to encourage Western firms to play safe and shun any company that might conceivably be connected with targeted people.

But this approach increases uncertainty for Western companies that do business (or are considering transactions) with such firms. Faced with this, many have felt obliged to hire investigators like those who looked into Sogaz’s affairs. This is costly, and even seasoned sleuths are often unable to give firm assurances about ownership and control, given Russian business’s widespread use of offshore jurisdictions, points out Judith Lee of Gibson Dunn, another law firm.

The broader worry is that such cases make it look as if sanctions are too easy to dodge, undermining their credibility at a time when the West wants to appear strong. By letting Russian-linked firms sidestep them through well-timed share transfers, the West may be weakening one of the most powerful tools it has in its dealings with Russia.

What's Been the Effect of Western Sanctions on Russia?

Frontline-January 13, 2015, 9:50 pm ET by Priyanka Boghani

When Russia annexed Crimea from Ukraine last March, the United States and European Union responded with an economic weapon — sanctions.

The first few rounds, applied in March and April of 2014, targeted Russian and Crimean officials, as well as businessmen seen to have close ties to President Vladimir Putin — his “inner circle” — with travel bans and asset freezes.

Since then, the West has steadily expanded its sanctions against Russian entities, targeting major businesses and parts of Russia’s financial, energy and military industries.

FRONTLINE talked to Anders Åslund, senior fellow at the Peterson Institute for International Economics, on Jan. 8, 2015 about the effects and consequences of Western sanctions on the Russian economy. Åslund served as an economic adviser to the Russian and Ukrainian governments in the 1990s.

Which round of sanctions do you think really had an effect on the Russian economy? How would you measure that?

The sanctions the U.S. imposed came in two big chunks. The first concerned Crimea, and they were only personal sanctions for Crimean and Russian leaders involved in the Crimean drama.

Then, the important sanctions were imposed on July 16, which are called sectoral sanctions.

We can see that no money has been going into Russia after July. No financial institutions dared to provide Russia with any financing more than a month after that. And that we know from talking to banks. ...

The point is that the [July] financial sanctions have worked out as far more severe in their effect than anyone seems to have believed.

Would sanctions alone have damaged Russia's economy without the current plunging oil prices?

There are three major causes for Russia's economic troubles. The first cause is the corruption and bad economic policies that Putin pursues, which on their own would lead to stagnation, or at most 1 percent growth.

The second element is the falling oil prices. The oil prices have now fallen so much that Russia's total export revenues this year will be two-thirds of what they have been before. That means that Russia will have to cut its imports by half. This is a big blow.

This is then reinforced by the financial sanctions, so that Russia cannot mitigate this blow by borrowing money. By ordinary standards, Russia is perfectly credit-worthy with a public debt that is only 10 percent of GDP. But if you don't have access to financial markets, then it doesn't matter how credit-worthy you are, because you're not credit-worthy so-to-say.

[Editor's Note: On Jan. 9, Fitch Ratings cut Russia's credit rating to BBB-, one step above junk.]

What has been the impact on the Russian public so far?

The big impact is that the prices of buckwheat have increased as much as 70 percent. Basic food stuff has increased sharply. We're seeing consumer panic in Russia because of the falling exchange rate. And the falling exchange rate is mainly because of the oil prices, but it's also the financial sanctions. People are fearful of the situation and we're seeing that the exchange rate is jumping up and down. It's moving either way every so often by 5 percent in a day. The worst we've seen is it has gone down by 10 percent in a day.

There's fundamental financial instability in Russia now, and this will have a big impact on the banking system. We've so far seen one medium-sized bank going under and two of the big state banks have needed recapitalization. We will see more of that.

And this of course will hit the GDP. My guess is we'll see a decline in the order of 10 percent this year.

One of the initial rounds of sanctions targeted members of Putin's so-called inner circle, including Gennady Timchenko [founder of commodity trading company Gunvor], Igor Sechin [chairman of Rosneft, Russia's leading petroleum company], Arkady and Boris Rotenberg [magnates with majority stakes in construction firm Stroygazmontazh, and banks SMP and Investcapitalbank] and others. Were these sanctions largely symbolic, or did they do some real damage?

I think they've done real damage. These people... many of them are billionaires. They're used to living in grand style, and now they are not allowed to travel to Europe and the U.S.

It's particularly [the fact] that they're not allowed to go to Europe that hurts them.

[Gennady Timchenko] lives in Geneva. What I hear is that he moved back to Moscow because it became so impossible. Another of them — Boris Rotenberg — lives in Finland. Both Timchenko and Rotenberg are actually Finnish citizens.

A recent Bloomberg investigation found that companies linked to Timchenko and Arkady Rotenberg actually received more state contracts after being sanctioned. Does that mean the strategy of targeting Putin's "inner circle" has in some way backfired?

Putin indeed has given Timchenko and Rotenberg more contracts through Gazprom. It now looks as if Putin is making the same mistake as [deposed President] Viktor Yanukovich did in Ukraine, giving ever more to his friends and very little to the others. Putin has been very good previously at distributing widely, but now he has tightened it so that it only goes to his close friends, and that is not likely to be popular.

And what do you think that could lead to, in terms of sentiment?

The elite [who aren't part of his inner circle] are utterly alienated from Putin now. I don't think they will rise in any way against Putin, but they will take money out of the country as fast as they can, so it will further destabilize the country.

The question is what will happen in the big industrial cities outside the most wealthy cities — Moscow and St. Petersburg. It would be surprising if we don't see some social unrest down the road, because these are big blows to ordinary people.

Are further sanctions possible? What would next steps look like?

My view is that the sanctions are so severe that it's simply not necessary to reinforce them further. It's also easier to keep the Western front together. The U.S. has, in this case, been very careful to keep a united front with the whole of the European Union. The administration has thought that it's more important to keep unity with the E.U. than impose even more severe sanctions. I think that policy has borne fruit now.

Have sanctions been seen as a success from the U.S. government's perspective?

I would think that one could strongly argue that, because what's happened is that Russia cannot get international financing from any source. Russian international reserves declined last year by \$135 billion. We haven't gotten the final number, but that's the order. There has been a huge outflow of reserves from Russia. And of course, the Russian economy is now in a serious financial crisis, which is, to a considerable extent, caused by the financial sanctions.

Are Russians trying to get around the sanctions? Is that even possible?

They clearly are trying to get around it. They've been trying to get money from China. But it's very striking that the Chinese are not providing financing for Russia, because like everyone else they're afraid of the American financial regulators. ...