FINANCIAL MARKETS LAW COMMITTEE

ISSUES OF LEGAL UNCERTAINTY ARISING IN THE CONTEXT OF EU CONTRACT SANCTIONS

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FINANCIAL MARKETS LAW COMMITTEE[1]

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[1] The names of FMLC Members are given at the back of this paper. Given the involvement of HM Government and the regulatory authorities in the subject matter, Stephen Parker, Sonya Branch and Sean Martin took no part in the preparation and discussion of this paper.

[2] Note that Members act in a purely personal capacity. The names of the institutions that they ordinarily represent are given for information purposes only.

Table of Contents

1. EXECUTIVE SUMMARY AND INTRODUCTION[3]

Executive Summary

1.1 The role of the Financial Markets Law Committee (the "FMLC" or the "Committee") is to identify issues of legal uncertainty or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks and to consider how such issues should be addressed.

1.2 The aim of this paper is to identify issues of legal uncertainty which arise from Council Regulation (EU) No 833/2014 concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine (as amended by Council Regulations (EU) No 960/2014 and (EU) No 1290/2014) (the "Regulation"). The FMLC draws attention to issues of uncertainty relating to, in particular: (i) the prohibition relating to new loans or credit; (ii) the meaning and scope of related entities and the meaning of "on behalf or at the direction of" another; (iii) the scope of "transferable securities" and "money market instruments"; (iv) the impact on the derivatives market; (v) financing and financial assistance (vi) the rules on circumvention; and (vii) criminal and civil liability. The Articles of the Regulation which give rise to these legal uncertainties are referred to in an Annex to the paper.

Some of the issues addressed in this paper are particular to the Regulation. Others have broader resonance with respect to EU sanctions generally, as regards their impacts on the wholesale financial markets.

Introduction

1.3 Following Russia's failure to respond to demands formulated by the EU Council in its conclusions of June and July 2014, the EU Council adopted, on 31 July 2014, Regulation 833/2014, which introduced restrictions on access to the capital markets for certain Russian entities regarding specified issuances of transferable securities and money-market instruments. Regulation 833 was amended by Regulation 960, published on 12 September 2014, which introduced prohibitions relevant to the provision of loans and credit to certain Russian entities and by Regulation 1290, published on 4 December 2014.

1.4 The scope of the new measures extends beyond asset freezes, which have been implemented by previous measures (EU Council Regulations 208/2014 and 269/2014),

[3] This paper is written on the basis of the English version of the Regulation and does not take account of any nuances that may be suggested by other language versions of the Regulation.

to include capital markets and lending restrictions. The FMLC takes the view that the new measures give rise to significant legal uncertainties.

1.5 The issues of legal uncertainty arising from the Regulation are further exacerbated by the lack of systematic and uniform guidance concerning the Regulation's interpretation and application. On 16 December 2014, the European Commission published the Commission Guidance note on the implementation of certain provisions of Regulation (EU) No 833/2014 (the "Commission Guidance Note") in which it attempted to clarify some of the main areas of legal uncertainty arising from the Regulation. Although the Commission Guidance Note is helpful, it is a limited resource in that it only responds to specific questions that have been raised with the Commission and does not seek to address all areas of uncertainty. Further, the guidance provided by the European Commission is not binding for the European General Court, the Court of Justice of the European Union ("CJEU") and national courts which may reach a different interpretation of the rules. Moreover, because the Commission Guidance Note does not address all relevant issues of interpretation, there remains scope for differing interpretation of other provisions of the Regulation by the competent authorities of the Member States.

The European position may be contrasted with that in the United States. The United States' sectoral sanctions imposed under Executive Order 13662, Directives 1 – 4, commencing July 2014 preceded the similar sanctions imposed by Regulation 833. The policy objectives of the United States and Europe seemed broadly aligned. Many financial institutions are faced with the challenges of managing sanctions compliance risk arising under both US and EU laws. The US Treasury's Office of Foreign Assets Control ("OFAC") helpfully provided quite timely and detailed—although not comprehensive—guidance on the US sectoral sanctions in its Frequently Asked Questions and Answers. This minimised areas of uncertainty for institutions with respect to US sectoral sanctions—including issues concerning access to capital markets—but clearly it could not be assumed that guidance on US issues may reflect the EU's stance on similar questions of interpretation. The possible differences in US and EU approaches on similar issues—although not necessarily avoidable from either a legal or policy perspective—as a practical matter, exacerbate the uncertainties facing the market.

The FMLC observes that the broad nature of the restrictions imposed by the Regulation, combined with the lack of comprehensive and binding guidance, may give rise to unnecessary and costly legal actions, including judicial reviews and referrals to

the European General Court, as European entities and their advisors encounter difficulties in interpreting the restrictions. Indeed, in *OJSC Rosneft Oil Company v. Her Majesty's Treasury and Secretary of State for Business, Innovation & Skills and The Financial Conduct Authority* (the "*Rosneft* case") the Divisional Court of the Queen's Bench Division of the High Court of England and Wales recently referred a number of questions of interpretation concerning the Regulation to the CJEU, noting that:

> It is in our view a characteristic of these measures that terms are broadly defined and there may therefore be scope for multiple interpretations.[4]

In deciding to make a reference to the CJEU, one of the considerations was that,

> [W]e have views as to the merits of a number of the ... arguments, [but] we cannot be confident that the same conclusions would be arrived at by all courts across the EU and we are conscious that already there are differences of view on some key issues between the competent authorities of the different Member States.

1.6 Specifically, this paper addresses uncertainties relating to:

a. the prohibition relating to new loans or credit;

b. the meaning and scope of related entities and the meaning of "on behalf or at the direction of" another;

c. the scope of "transferable securities" and "money market instruments";

d. the impact on the derivatives market;

e. financing and financial assistance;

f. the rules on circumvention; and

g. criminal and civil liability.

The paragraphs below examine these uncertainties in greater detail.

[4] The Queen on the application of OJSC Rosneft Oil Company v. Her Majesty's Treasury and Secretary of State for Business, Innovation & Skills and The Financial Conduct Authority, Judgment of the Divisional Court dated 9 February 2015.

2. PROHIBITION RELATING TO NEW LOANS OR CREDIT

2.1 Article 5(3) of the Regulation imposes a new form of financial sanction, by prohibiting the making of new loans or credit to certain entities after 12 September 2014, if the loan or credit has a maturity of over 30 days. This prohibition has been drafted broadly, giving rise to uncertainty as to whether certain loans and credit fall within the scope of the prohibition.

2.2 When Article 5(3) was first introduced, the banking industry was faced with considerable uncertainty as to whether the prohibition applied only to loans or credit which were agreed and executed after 12 September 2014 or whether it also applied to loans or credit which were agreed or executed before 12 September 2014 but where the proceeds of the loan or credit were being advanced to the borrower after 12 September 2014. Although Recital 6 to the Regulation stated that "loans are only to be considered new loans if they are drawn after 12 September 2014", uncertainty nevertheless remained, particularly in the case of rollovers of revolving loans which were advanced before 12 September 2014 but rolled over after that date. This is discussed further in section 2.8 below.

2.3 Article 5(3) was amended by Regulation 1290, published on 4 December 2014. Regulation 1290 amended Recital 6 to remove the statement that loans are only to be considered new loans if they are drawn after 12 September 2014 and introduced a new Article 5(4).[5]

2.4 Although Article 5(4) provides some clarity with regard to the scope of "making new loans or credit", it does not resolve all issues of legal uncertainty in relation to loans or credit which were agreed before 12 September 2014. Following the introduction of Article 5(4), it is clear that further drawdowns or disbursements can be made under loans or credit agreed before 12 September 2014, provided that the conditions in Article 5(4) are met but there is some uncertainty as to the interpretation of the Article 5(4) conditions. In particular, whether parties can rely on Article 5(4) will depend on whether the "terms and conditions of such drawdown or disbursements" were agreed before 12 September 2014 and whether any modifications were made after that date. The final paragraph of Article 5(4) states that

> [t]he terms and conditions of drawdowns and disbursements referred to in point (a) include provisions concerning the length of the repayment period for each drawdown…

[5] For the text of Article 5(4), please refer to the Annex.

The use of the word "include" leaves open the possibility, however, that other types of term might be included.

2.5 Whilst Article 5(4) addresses the question of whether further drawdowns or disbursements are permissible under loans or credit agreed before 12 September 2014, it leaves open the question of whether it is permissible to amend the terms of a loan or credit agreed before 12 September 2014 where the loan or credit has been drawn down in full. For example, if a loan was agreed on 1 January 2014 and the loan was drawn down in full by 1 June 2014, with repayment due by 31 December 2015, the loan will not fall within the scope of Article 5 paragraphs (3) and (4). There is no guidance at present on whether it is permissible to amend the terms of such loans or credit, whether to permit further loans under such facility or otherwise. It seems likely that Article 5(3) is not intended to capture a merely minor amendment to a pre-existing loan or credit; the position is more uncertain if the amendments are substantial or affect the key terms of the loan or credit, such as the amount of the loan or the timing and amount of the payments under the loan or credit—or to permit further advances. For example, it is unclear whether the grant of an extension of time for repayment under a pre-existing loan amounts to the grant of a "new" loan or credit prohibited under Article 5(3).[6] The FMLC would welcome further clarification as to when Article 5(4) applies.

The definition of terms "loan" and "credit"

2.6 The Regulation does not provide a definition of the terms "loan" and "credit" under Article 5(3). It remains unclear, therefore, what type of transactions might fall within their scope. The Commission Guidance Note has addressed a number of uncertainties, including whether, when goods or services are provided to a target of sectoral sanctions and the recipient is given more than 30 days to pay for such goods and services, these goods or services have been provided on "credit". The position taken in the Commission Guidance Note is that payment terms or permitting delayed payment for goods or services does not amount to giving a loan or credit, unless the payment terms are an attempt to circumvent the sanctions, for example because they are not in line with normal business practice or because the payment terms have been substantially extended since the imposition of the sanctions.[7] Although this guidance provides some

[6] The Commission Guidance Note states that the payment terms for loans or credit which were made before 12 September 2014 in relation to the export or import of non-prohibited goods or financial services between the EU and another state can be amended, but this guidance is of limited assistance because loans or credit relating to such trade are in any event exempt from the Article 5(3) prohibition on making new loans or credit.

[7] Commission Guidance, Question 19.

helpful clarity, the caveat is an area of uncertainty and there are other instances of opacity which remain in the context of Article 5(3).

2.7 The prohibitions in Article 5(3) relate to new loans or credits with a maturity exceeding 30 days. In most cases, it will be straightforward to conclude whether the maturity period brings the loan within the prohibitions in the Regulation. For example, short-term loans to sanctioned entities are not prohibited. The nature of facilities to sanctioned entities may need, however, to be considered in the context of the anti-circumvention provision in Article 12 of the Regulation. For instance, a series of short-term loans to a sanctioned entity may give rise to a concern that they have been structured in such a way so as to avoid a single longer term facility which would fall within Article 5(3). The parameters around this are unclear and market participants are unable to form a view of what is acceptable in this context. This feature also highlights the additional due diligence burden placed on institutions by the Regulation. Not only the features of a single facility, but also the overall portfolio of transactions with a sanctioned entity, may require scrutiny (but with no clear parameters) to ensure Article 12 is not invoked.

2.8 Prior to the publication of Regulation 1290/2014 in December 2014, uncertainty arose in relation to rollovers (whether cashless or not). These are technically new loans. The borrower submits a utilisation request, the existing loan is repaid and redrawn (by way of set off in the case of a cashless rollover). The introduction of Article 5(4) into the Regulation in December 2014 clarified that rollovers requested under facility agreements entered into before 12 September 2014 are exempt from the prohibition in Article 5(3) provided that there is compliance with the conditions in Article 5(4). The position in the intervening period between September and December 2014, however, had been unclear, leading to considerable uncertainty in the financial markets.

2.9 In the same context, it was also unclear whether a deposit might constitute a "loan" or "credit". The classic analysis of the relationship between a bank and its customer under English law is that of debtor and creditor: when a customer deposits funds with a bank, the bank borrows the funds and undertakes to repay them to the customer. This analysis suggests that making a deposit with a bank targeted by the sectoral sanctions would be caught by Article 5(3) (assuming that the deposit has a maturity of over 30 days). On the other hand, Recital 6 of the Regulation states that

> Financial services other than those referred to in Article 5…, such as deposit services, payment services, … are not covered by these restrictions.

This statement relates to the provision of financial services by EU entities to sanctioned entities, and therefore does not determine whether it is prohibited for an EU bank or other company to place a deposit for longer than 30 days with a bank targeted by the sectoral sanctions. The Commission Guidance Note clarifies that deposit services are not covered by Article 5(3), unless a (term) deposit is being used to circumvent the sanctions.[8] The Guidance is helpful but demonstrates that a strict legal analysis of the relationship between depositor and bank may not lead to an accurate understanding of the Regulation (or at least an understanding that reflects the Commission's views). The caveat that deposits will be prohibited if used as an arrangement to circumvent the sanctions also highlights the due diligence challenges that the Regulation places on EU parties, who should bear in mind the possibility that a deposit arrangement used in place of a loan could fall within the prohibition on new loans or credit.

2.10 Further, there are likely to be instances where it is unclear whether bank guarantees and letters of credit issued at the request of a sanctioned entity in favour of a third party, or any deferred payment terms extended to a sanctioned entity fall within the scope of Article 5(3). If a sanctioned entity referred to in Article 5 receives some form of value with an agreement to pay or reimburse the counterparty at a date in the future, then there must be a risk that the arrangement would be considered a provision of "credit" within Article 5(3).

2.11 A final practical issue arising under Article 5(3) concerns cases where an uncommitted facility relates to an underlying trade instrument. In such cases it is unclear whether a drawdown should be considered a loan with a

> specific and documented objective to provide financing for non-prohibited imports or exports of goods within the Union and Russia

as provided under Article 5(3). If this were clearly the case under the documented description in the trade instrument but was not actually mentioned in the facility itself (i.e. the purpose clause of the facility was silent) it is unclear whether enough has been done to bring the loan within the safe harbour provided in the article.

The FMLC would welcome clarification on the types of transactions that fall within the scope of the terms "loan" or "credit".

[8] Commission Guidance Note, Question 16.

Being part of an arrangement

2.12 Article 5(3) provides that "it shall be prohibited to directly or indirectly make or be part of any arrangement to make new loans or credit". The FMLC understands that "being part of any arrangement to make new loans or credit" would include, for example, a situation where Lender A makes a loan to Company B and Company B then lends the same amount to a target of the sectoral sanctions, and Lender A is aware that Company B intended to make this loan. Such a situation could also amount to Lender A indirectly making a loan to the target of the sectoral sanctions.

2.13 Being part of an arrangement to make a new loan or credit could, for example, include those involved in the administration of a loan (such as arrangers, agents, security trustees) as well as those institutions providing the funding for the loan/credit. It is not clear, however, whether the prohibition on "being part of any arrangement to make new loans or credit" is intended to cover activities which are less closely connected to the provision of a loan or credit. For instance, it is uncertain whether the following activities are caught under the prohibition of Article 5(3): (i) the issuance of an interest or currency swap linked to a loan provided by a non-EU third party to a sanctioned entity; (ii) payments processed by banks relating to new loans or the provision of other ancillary services such as foreign exchange services; (iii) the provision of back office services to a non-EU subsidiary which is making a loan to a target of the sectoral sanctions; (iv) the carrying out of due diligence by banks in preparation for a loan; and (v) the provision of advice or any type of involvement in the process of making new loans or credit by professional service providers such as law firms and accountants.

2.14 The Commission Guidance Note has provided clarity in relation to one of the issues identified above, namely whether processing payments amounts to "being part of any arrangement to make new loans or credit". The Commission's position is that the provision of payment or settlement services does not amount to "making" or "being part of any arrangement to make" new loans or credit.[9] There is no guidance, however, on the extent to which other services can be provided or on the extent of the due diligence banks are expected to undertake when screening payments to identify potential breaches of the sanctions. The FMLC would welcome guidance on these outstanding issues.

2.15 While it is assumed in line with general principles that EU banks are not required to ensure that their non-EU subsidiaries comply with Article 5(3), it seems possible that an

[9] Commission Guidance Note, Question 17.

EU bank may not be permitted to exercise credit approval powers in respect of loans made by the non-EU subsidiary or provide capital to the non-EU subsidiary where the non-EU subsidiary wishes to make a loan to a sectoral sanctions target. There is also a question, to what extent EU nationals employed by non-EU banks to which the Regulation does not apply, could individually be caught by this or other restrictions. The FMLC would welcome guidance on the types of activities which this part of the Article 5(3) prohibition is intended to cover.

3. RELATED ENTITIES

3.1 Pursuant to Article 5 paragraphs (1) and (2) of the Regulation, EU entities are prohibited from directly or indirectly purchasing, selling, providing investment services for or assistance in the issuance of, or otherwise dealing with defined transferable securities and money-market instruments issued (amongst others) by (a) a legal person, entity or body established outside the Union whose proprietary rights are owned "for more than 50%" by an entity listed in Annexes III, V and VI to the Regulation or (b) a legal person, entity or body acting on behalf or at the direction of an entity listed in the same Annexes. These provisions are also relevant to determining the application of the prohibition in Article 5(3) that relates to new loans or credit. The FMLC takes the view that the precise application of this rule is not clear as set out in the paragraphs below.

Aggregation

3.2 In particular, it remains unclear whether proprietary rights owned by two or more different sanctioned entities should be aggregated. The Regulation does not specify whether the scenario where an entity is owned 50% or more by two or more sanctioned entities falls within the scope of Article 5 paragraphs (1) and (2). For example, two entities listed in Annex III of the Regulation could each own 26% of an entity, resulting in a 52% aggregate holding. Sanctioned entities for the purposes of Article 5 of the Regulation are also referred to in Annexes V and VI. It is unclear whether the ownership rights held by two or more entities from separate Annexes of the Regulation should also be aggregated (e.g. two entities from separates Annexes could each hold 26% of an entity).

3.3 As in relation to other aspects of the Regulation, the uncertainty here is in contrast with the clarity that has been provided by OFAC. OFAC's guidance states that, where two or more Specially Designated Nationals ("SDNs") and Sectoral Sanctions

Identifications ("SSIs") together own in excess of 50% of an entity, that entity is considered designated or subject to sectoral sanctions. The EU has not yet indicated whether it takes the same approach. The FMLC would welcome clarification on this issue.

Chain of ownership

3.4 A further issue of legal uncertainty arising from Article 5 paragraphs (1) and (2) is whether the "chain of ownership" contemplated in this article could be broken where shareholdings are held through intermediary companies and, in particular, where an intermediary company is an EU person. Consider the following example:

> Russian Company A owns 60% of French Company B, which in turn owns 100% of Algerian Company C. Russian Company A would be considered to "own" 50% or more of Algerian Company C by virtue of its shareholding. In this case, it remains unclear whether the fact that French Company B (an intermediary company) is an EU person means that Algerian Company C would no longer fall within the scope of the rules.

3.5 OFAC has issued guidance in relation to indirect holdings, which provides that

> "Indirectly" refers to one or more blocked persons' ownership of shares of an entity through another entity or entities that are 50 percent or more owned in the aggregate by the blocked person(s).

Under the US guidance, in the event that Blocked Person X owns 50 percent of Entity A, and Entity A owns 50 percent of Entity B, then Entity B is considered to be caught under the restrictive measures. Blocked Person X's 50 percent ownership of Entity A makes Entity A a blocked person, while Entity A's 50 percent ownership of Entity B in turn makes Entity B a blocked person.

The FMLC would be grateful if the EU could provide guidance on how it intends to interpret the term "owned for more than 50%" in Article 5 paragraphs (1), (2) and (3).

Meaning of "on behalf or at the direction of" another

3.6 The FMLC observes that the EU has not provided guidance on the factors that should be taken into consideration when determining whether a person or entity is acting "on behalf or at the direction of" another. In particular, it is not clear the extent to which

this rule interacts with existing EU guidance on the meaning of control and ownership in the context of financial restrictive measures.[10]

3.7 The EU has issued guidance on determining whether an entity is "controlled" by another entity. Although this guidance serves a different purpose, it is not clear if matters that would indicate "control" in the contexts discussed in that guidance should also be used to determine whether an entity is acting "on behalf or at the direction of" an entity falling under Article 5. The "control" analysis applies to a continuing state; whereas "on behalf or at the direction of" could imply a transaction-specific analysis. Examples of possible overlap include the following: (i) the designated entity (Entity A) has a dominant influence over the other entity (Entity B), whether this is by means of formal or informal agreement; (ii) Entity B shares officers and directors with Entity A; (iii) Entity B operates in the same industry/business as Entity A, with a similar customer base; and (iv) Entity B appears to operate as a front for Entity A.

3.8 Establishing whether an entity is acting on behalf of or at the direction of another entity entails considerable difficulty. In practice, the parties may not record the *de facto* relationship in writing or may take steps to conceal the true drivers behind the transaction. The fact that companies share officers and directors may be indicative, but will by no means be determinative of whether, on a particular occasion, one entity is acting on behalf or at the direction of another. The FMLC would welcome guidance on the indicia parties are intended to consider in order to establish whether one entity is acting "on behalf or at the direction of" another.

Meaning of "indirect assistance"

3.9 The term "indirect assistance" under Article 5 paragraphs (1) and (2) appears to cover any type of assistance offered to a sanctioned entity regarding the issuance of transferable securities and money-market instruments and it is unclear what types of activities fall within the scope of this term.

3.10 The FMLC understands that the assistance will be linked to the underlying nature of the transaction. What remains unclear, however, is how closely the assistance should be linked to the underlying transaction in order to fall within the prohibition of Article 5 paragraphs (1) and (2). For instance, it is not clear whether assistance with restructuring an entity in Annexes III, V or VI which has the ancillary benefit of enhancing its ability to issue transferable securities and money-market instruments in

[10] "Restrictive measures (Sanctions)—Update of the EU Best Practices for the effective implementation of restrictive measures", 7383/15 REV 1, 24 March 2015 (the "2015 Update").

future, is caught by the prohibition. Moreover, it is unclear whether the provision of employer's liability insurance and/or reinsurance to an entity listed in Annexes III, V or VI which covers those responsible for issuing transferable securities and money-market instruments might constitute indirect assistance of the prohibited activity. Another issue that remains uncertain is whether the provision of professional services such as accounting and legal services falls within the scope of the term "indirect assistance". The Committee would welcome clarification on the types of assistance this provision is intended to cover.

4. THE SCOPE OF "TRANSFERABLE SECURITIES" AND "MONEY MARKET INSTRUMENTS"

4.1 The Regulation imposes a ban on buying or selling (directly or indirectly) and generally providing investment services for, assisting in the issuance of and dealing with transferable securities and money-market instruments with a maturity exceeding 30 days, issued after 12 September 2014, by certain sanctioned credit or other institutions (as specified in the Regulation).

4.2 The definition of "transferable securities" for the purposes of the Regulation is as follows:

> "transferable securities" means the following classes of securities which are negotiable on the capital market, with the exception of instruments of payment:
>
> (i) shares in companies and other securities equivalent to shares in companies, partnerships or other entities, and depositary receipts in respect of shares,
>
> (ii) bonds or other forms of securitised debt, including depositary receipts in respect of such securities,
>
> (iii) any other securities giving the right to acquire or sell any such transferable securities.[11]

4.3 This definition is substantially the same as the definition of "transferable securities" in Article 4(18) Directive 2004/39/EC ("MiFID") and limits the classes of securities captured by the Regulation to those listed. There is, however, ambiguity as to the

[11] Article 1 of the Regulation.

meaning of "negotiable on the capital market". For example, if a subsidiary of a sanctioned entity issues some shares which the purchaser agrees not to sell without the issuer's consent, it remains unclear whether these securities are negotiable on the capital markets. It is also unclear whether these securities become negotiable when the issuer provides the consent for their sale. Similar uncertainty arises when bonds are issued with selling restrictions "not negotiable on the capital markets". The FMLC would welcome clarification on this and general guidance as to whether the definition is intended to operate in the same way, and have the same coverage, as the definition of "transferable securities" under MiFID.

4.4 Prior to the issuance of the Commission Guidance Note, it was unclear whether securities lending agreements or repurchase agreements fell within the scope of the Regulation. A typical repurchase agreement involves two simultaneous transactions: (i) one party agrees to sell securities to another on an agreed date for an agreed sum; and (ii) the seller agrees to repurchase equivalent securities from the buyer on an agreed (future) date for an agreed sum. In economic terms, a repurchase agreement can be viewed as a secured loan made by the buyer of the securities (who is advancing funds) to the seller (who repays the buyer by repurchasing the securities) although from a legal perspective these types of agreements are drafted so that they would not be characterised in this way. The difference between a properly drafted repurchase agreement and a secured loan is that, in a repurchase agreement, the title to the securities is transferred by the seller to the buyer and so a sale takes place.

4.5 The Commission Guidance Note states that entering into a repurchase agreement or securities lending agreement with a sanctioned entity is not permissible, even if the securities used as collateral do not fall within the scope of Article 5 paragraphs (1) and (2) (i.e. because the securities were issued by a non-sanctioned entity). The Commission's position is that:

> Repurchase agreements or securities lending agreements are instruments which are normally dealt with on the money market and, therefore, money market instruments as defined in Article 1 [of the Regulation]. EU persons are therefore prohibited from entering into repurchase agreements or securities lending agreements with an entity covered by Article 5(1) between 1 August 2014 to 12 September 2014 with a maturity exceeding 90 days or after 12 September 2014 with a maturity exceeding 30 days, and by

> an entity covered by Article 5(2) after 12 September 12 with a maturity exceeding 30 days.[12]

4.6 Although this has provided guidance to the financial markets, the FMLC is concerned that it may create uncertainty by expanding the definition of "money market instruments" in a way which does not appear to be envisaged by Article 1. The definition of "money market instruments" in Article 1 is

> those classes of instruments which are normally dealt in on the money market, such as treasury bills, certificates of deposit and commercial papers and excluding instruments of payment.

4.7 This definition is identical to the definition of "money market instrument" in MiFID. Repurchase agreements and securities lending agreements are not regulated as any sort of MiFID instruments and do not fall naturally within this definition.[13] Accordingly, by stating that they fall within the definition, the Commission Guidance Note is contrary to established market understanding and practice as to the legal intent and effect of repurchase agreements and securities lending agreements and may give rise to uncertainty in the markets. This tension between the Commission Guidance Note and existing market practice, and resulting uncertainty, is also exacerbated by the fact that the Commission Guidance Note is expressly not legally binding, but only reflective of the Commission's understanding.

4.8 Further, by interpreting the Regulation as prohibiting repurchase agreements whether the sanctioned entity is the purchaser or the seller, the Commission Guidance Note goes beyond the Regulation which only prohibits arrangements where the sanctioned entity is the borrower or the issuer (i.e. not where the sanctioned entity is the lender). It is also inconsistent with the approach in the Commission Guidance Note to derivative contracts between an EU entity and sanctioned entity as set out in section 5 below.

5. IMPACT ON THE DERIVATIVES MARKET

5.1 The Regulation does not expressly target the derivatives market. The basic restriction in Article 5 paragraphs (1) and (2) is expressed to apply to dealings in "transferable

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12 Commission Guidance Note, Question 25.

13 They are regulated separately: there is a proposed EU Regulation on Securities Financing Transactions (COM(2014) 40 final; 2014/0017 (COD), the final compromise text of which was published on 26 June 2015. Once it has been translated and finalised in all languages, it will be submitted to the EU Parliament for approval at first reading and to the Council for adoption. See the FMLC's letter on this proposed regulation dated 15 February 2015: Letter to the European Commission on a Proposed Regulation on Reporting and Transparency of Securities Financing Transactions.

securities" and certain "money market instruments", as defined in Article 1. These are well known defined terms in the context of MiFID. A wide range of derivatives are regulated under MiFID. Some warrants, options and futures giving rights to acquire transferable securities may constitute "transferable securities" in a MiFID context, as may certain securitised cash settled derivatives including some futures, options, swaps and contracts for difference. However, over-the-counter ("OTC") derivatives under an ISDA master agreement (a significant part of the derivatives market) are not "transferable securities" for MiFID purposes.[14]

5.2 Prior to the publication of the Commission Guidance Note, there was uncertainty as to which derivatives would be caught by the definition of "transferable securities" and whether the same approach would be taken as under MiFID. As originally defined under Article 1 of Regulation 833/2014, the term "transferable securities" was intended to include those classes of securities which are negotiable on the capital market such as shares, bonds and

> any other securities giving the right to acquire or sell any such transferable securities *or giving rise to a cash settlement*. (emphasis added)

Regulation 960/2014 amended this definition by deleting the sentence "or giving rise to a cash settlement". Question 21 of the Commission Guidance then provides that any derivative *giving the right to acquire or sell* a transferable security or money market instrument to which Article 5 applies is itself caught by Article 5. In other words, any derivative contract whose underlying asset is a security or money market instrument (of the relevant maturity specified in Article 5) issued by a sanctioned entity and whose terms permit or require physical settlement is prohibited under Article 5.

5.3 Question 21 and the amendment to Regulation 960/2014 collectively make it clear that the identity of the issuer of the underlying asset and physical settlement are key: regardless of the derivative counterparty and regardless of the execution venue (exchange or OTC), if the derivative contract gives either party the right to "physically" buy or sell the underlying asset (where it is a transferable security or money market instrument issued by a sanctioned entity of the relevant maturity), it is prohibited under Article 5. Accordingly, any derivative contract (regardless of counterparty or execution venue) that provides for no possibility of physical delivery of underlying sanctioned assets (i.e. purely cash settled transactions) is clearly outside the scope of Article 5.

[14] FCA PERG 13.4 https://fshandbook.info/FS/html/FCA/PERG/13/4.

5.4 As mentioned in section 4.5 above, the Commission Guidance Note in Question 25 provides that any repurchase agreement or securities lending agreement (with the requisite maturity) is prohibited if the counterparty is a sanctioned entity. It is irrelevant whether the underlying assets provided as collateral fall within Article 5, paragraphs (1) and (2).

5.5 This approach is inconsistent with the approach taken in Question 21 to derivatives: Question 21 provides that derivative contracts can be entered into with sanctioned entities, provided that the underlying assets do not fall within Article 5 and there is not physical settlement. If the same approach had been applied to securities lending agreements and repurchase agreements, such agreements would be allowed if they did not involve collateral falling within Article 5.

5.6 There does not appear to be any rationale for the difference in approach to derivatives and repurchase agreements and securities lending agreements. Also, combinations of OTC derivative trades that Question 21 provides are permitted could be used to produce identical economic effects as repurchase agreements that Question 25 provides are prohibited. This anomalous approach risks giving rise to uncertainty and the FMLC would therefore be grateful if the Commission could clarify the position with respect to repurchasing agreements and securities lending agreements.

5.7 Finally, the FMLC notes that, following the introduction in the US of a provision analogous to Article 5, paragraphs (1) and (2), the OFAC issued a general license authorising US persons to enter into derivative contracts, the value of which is derived from underlying assets that would otherwise be caught under the sectoral sanctions. As outlined above, the EU has not adopted this approach with respect to derivatives. The amendment to the Regulation referred to in paragraph 5.2 above and the Commission Guidance Note have attempted to clarify the application of Article 5, paragraphs (1) and (2) to derivatives, however, as set out above, the approach is not systematic which risks uncertainty as to the precise impact of the rules on the derivatives market. The FMLC would therefore be grateful if the Commission could provide further guidance or revisions to the Regulation in order to apply a more consistent approach to derivatives and the application of Article 5, paragraphs (1) and (2) to them, thereby eradicating any remaining issues of legal uncertainty.

6. FINANCING AND FINANCIAL ASSISTANCE

6.1 Under Article 3 of the Regulation the sale, supply, transfer or export of certain items suited to specified categories of oil exploration and production projects, as listed in Annex II of the Regulation, whether or not originating in the Union, to or for use in Russia (including its Exclusive Economic Zone and Continental Shelf) requires a prior authorisation from a Member State competent authority.

6.2 Similar prohibitions, as set out in Articles 2 and 2a of the Regulation, relate to the sale, supply, transfer or export of dual-use goods and technology, whether or not originating in the Union, to or for use in Russia.

The meaning of "financial assistance"

6.3 Under Article 4 of the Regulation, financing or financial assistance related to restricted items referred to in Articles 2, 2a and 3 or related to the sale, supply, transfer or export of items listed in the Common Military List (see Article 4 paragraph 1(a) and (b))—or for the provision of related technical assistance—requires prior authorisation from a competent authority within the EU.

6.4 The Regulation does not provide, however, a definition of the term "financing" or "financial assistance". In the text of the Regulation, the term "financial assistance" is stated to include, in particular:

> grants, loans and export credit insurance, for any sale, supply, transfer or export…or for any provision of related technical assistance.

6.5 The Department for Business Innovation & Skills (the "BIS") of Her Majesty's Government (UK) published answers to Frequently Asked Questions (the "BIS FAQs") in August 2014, which were amended in two further guidance notes dated 30 September 2014 and 5 December 2014. The BIS FAQs explain that

> it understands the term in its broadest sense, i.e. involvement in any financial transaction which promotes, enables or facilitates the prohibited or restricted trade transaction to which it relates.

This seems a reasonable description of what would be deemed to be "financial assistance" and one which, on a plain English reading, would capture a variety of instruments which would support a transaction, such as loans, guarantees, and, potentially, (re)insurance.

6.6 The BIS FAQs briefly address the question of whether "financial assistance" includes the provision or brokering of (re)insurance in respect of the transport of prohibited or restricted goods. The BIS FAQs note that

> the prohibition on the provision of financing and financial assistance related to the supply of items on the EU Common Military List specifically refers to "insurance and re-insurance". […] There is no reference to "insurance or re-insurance" in the corresponding measures relating to provision of financial assistance for supply of dual-use items or Annex II technologies. As a result we consider that these other measures do not include insurance or re-insurance.

The answers given by BIS do not specify, however, whether the views set out above are ones that are shared across the EU.

6.7 In the *Rosneft* case, the Court considered evidence provided by a BIS official concerning the meaning of the expression "financing or financial assistance", including that there are differences of views amongst competent authorities in the Member States. The Court noted

> the importance of a common interpretation being applied to key terms found in the relevant sanctions legislation. It is in our view a characteristic of these measures that terms are broadly defined and there may therefore be scope for multiple interpretations. Whilst the specific example given…focused upon the expression "financing or financial assistance", in our view the ambiguities do not rest there but extend to a number of other important expressions found elsewhere within the legislation.

A reference to the CJEU was considered important in order to provide the domestic authorities of Member States with a definitive interpretation of provisions of the Regulation; not only to ensure consistency between the States but to ensure a level playing field for all businesses operating within the EU.

6.8 The FMLC observes that, since EU sanctions legislation refers frequently to "financial assistance", the term might usefully be defined more clearly. The reference in the *Rosneft* case is limited to the narrow issue of whether the expression "financial assistance" includes processing of payments. This will not, for example, resolve the issue of whether, for example (re)insurance would as a general rule be deemed a form of "financial assistance". Clearly the question of whether (re)insurance is intended to

fall within the term is of significant legal and practical importance for the financial market.

Financial assistance and correspondent banking

6.9 In Question 2 of the Commission Guidance Note, which relates to the way banks are expected to comply with the prohibition on providing financial assistance under Article 4 for the goods and technology that are subject to a ban, the European Commission provides

> Banks acting on behalf or to the benefit of their client should exercise due diligence on payments carried out by their customer and oppose to any payment made in breach of the Regulation. As regards banks acting as correspondent banks, they should oppose to payments when information on such a breach is available.

6.10 In this regard financial institutions face considerable uncertainty as to: (i) how much information they must seek; and (ii) to whom they need to look for their customer due diligence. The cause of the difficulty is that correspondent banks ("correspondents") providing cross-border products and services for overseas banks ("respondents"), typically on an agency basis, often have little or no knowledge of parties and beneficiaries to a payment transaction beyond their customer.

6.11 The first sentence of Question 2 of the Commission Guidance Note states

> Banks acting on behalf or to the benefit of their client should exercise due diligence on payments carried out by their customer and oppose to any payment made in breach of the Regulation.

It is unclear whether this could be construed as meaning that correspondents should conduct due diligence in relation to payments carried out by parties other than their customer. Banks providing correspondent banking services often participate in "downstream" correspondent clearing arrangements in which a correspondent (Correspondent B) is a recipient of correspondent banking services from another correspondent (Correspondent A) and itself provides correspondent banking services to its customers in the same currency as the account it maintains with Correspondent A.

6.12 A literal interpretation of the guidance, which would accord with most correspondents' current practice, is that Correspondent A must look at its own customer (Correspondent B) for its customer due diligence but not its customer's customers, further down the

payment chain. In practice, it is often difficult—if not impossible—for Correspondent A to determine the identity of persons beyond its customer, particularly where there is no privity of contract. Not looking beyond its own customer, however, Correspondent A could unintentionally become party to arrangements to finance dual-use goods with a sanctioned customer of Correspondent B in breach of Article 4 of the Regulation, particularly if Correspondent B is not subject to the Regulation. The FMLC takes the view that there is currently ambiguity as to how far correspondents must look along a chain of payments and, in particular, whether they are expected to look beyond their own customer. The FMLC would welcome further clarification on this issue.

6.13 The issue with regard to the amount of information correspondents must seek for their customer due diligence arises from the second sentence of Question 2 of the Guidance, which states

> As regards banks acting as correspondent banks, they should oppose to payments when information on such a breach is available.

The meaning of "available" is unclear, as the guidance does not explain what is covered by this term. "Available" could be interpreted to indicate that correspondent banks should examine whether the underlying contract of the payment instruction relates to a prohibited good or technology under Article 4 of the Regulation. The FMLC would welcome further clarification on the term "available".

Grandfathering provisions

6.14 Competent authorities may grant an authorisation to undertake otherwise prohibited activity in defined circumstances under the Regulation. Some authorisations, such as those under Article 2, are contingent on the transaction in question constituting the execution of contracts concluded before 1 August 2014 or ancillary contracts necessary for the execution of such contracts. No such grandfathering provision extends to activity otherwise prohibited by Article 5 of the Regulation. Unless specifically contemplated by the Regulation, no possibility of authorisation exists.

It has been noted in particular that Article 5(4) of the Regulation seeks to clarify the circumstances in which drawdowns and disbursements pursuant to agreements to provide loans or credit made prior to 12 September 2014 may be made; but there is no blanket carve-out from the prohibition on new loans and credit in Article 5(3) for the execution or completion of agreements concluded prior to 12 September 2014. It

would be helpful for sanctions regulations to make clear their intended impact on pre-existing contractual arrangements either by exempting performance of obligations arising from contracts or agreements executed prior to the relevant regulation coming into effect; or providing a grace period during which contracts could be wound down in an orderly fashion; or expressly clarifying that the intention is to interrupt existing contractual relationships. In the last case, it would be helpful for there to be guidance, as to whether specific steps are expected to terminate relationships proactively, or simply to preclude active performance of obligations that would be contrary to the sanctions. It is understood that regulations imposing freezing measures override all incompatible contractual arrangements, and it is assumed other measures such as the Regulation would have the same effect.[15]

6.15 Contracting parties increasingly seek to include sanctions clauses in their arrangements to try and anticipate the contractual consequences of a future imposition of sanctions. While this might mitigate the uncertainty that might otherwise arise under agreements following the imposition of sanctions, such clauses (which are often widely drafted) can potentially disrupt the natural operation of the market, for example by requiring agreements to be prematurely terminated and loans to be immediately repaid. To avoid necessitating resort to contractual provisions, a more certain approach would be to have clearer guidance or blanket carve-outs to avoid the scope for uncertainty as to the status of contracts concluded prior to the imposition of sanctions.

7. CIRCUMVENTION

7.1 Article 12 of the Regulation, in common with other EU sanctions, prohibits participation "knowingly and intentionally, in activities the object or effect of which is to circumvent" other prohibitions within the Regulation. There is little existing guidance on the types of activity that may constitute circumvention, but it may include "activities which, under cover of a formal appearance which enables them to avoid the constituent elements of an infringement ... nonetheless has the object or effect ... of frustrating the relevant prohibition", while the mental element may be satisfied where a person is involved in activities, aware that participation may have the object or effect of frustrating sanctions and accepting that possibility.[16] Given the existing uncertainties concerning the scope of application of the express prohibitions in the Regulation—

[15] See footnote 20, below; and the Judgment in Mollendorf, C-117/06, EU:C:2007:596.

[16] Case C-72/11, *Generalbundesanwalt beim Budesgerichtshof v Afrasiabi,* 21 December 2011.

particularly in the contexts of structuring or restructuring transactions—the circumvention provision entails considerable difficulty in terms of its application.

The effect of Article 12 on the "trade finance exception"

7.2 The FMLC observes that considerable legal uncertainty arises from the interaction of Article 12 with the "trade finance exception" as set out in Article 5(3). Article 12 prohibits any activity having the object or effect of circumventing the sanctions in the Regulation, including by using the trade finance exception to fund entities, to which it is otherwise prohibited to provide new loans or credit.

7.3 The "trade finance exception" allows the provision of loans and credit to sanctioned entities where the loans or credit have a specific and documented purpose to provide financing for non-prohibited imports or exports of goods and non-financial services between the EU and any third State (including Russia). The FMLC takes the view that Article 5(3) read in conjunction with Article 12 allows the provision of trade loans or credit to sanctioned entities, so long as those do not "fund" that entity. In light of this, it is not clear what types of loan and credit are intended to fall within the Article 5 exception. The FMLC would welcome guidance on the circumstances in which the trade finance exemption may be used.

8. CRIMINAL AND CIVIL LIABILITY ISSUES

8.1 The FMLC has observed that the lack of clarity in both the objectives and wording of the Regulation create legal uncertainty for the financial markets. This can have a chilling effect given the potential criminal and civil liability for institutions that infringe the relevant sanctions. In a situation in which criminal liability may arise, institutions may be expected to adopt a particularly cautious approach to interpretation of the relevant prohibitions. This may insulate them from potential criminal penalties but there appears not to be equivalent protection available to meet all potential civil claims; if, for example, they are alleged to have acted in breach of contract by failing to perform relevant obligations on the basis of an interpretation of the sanctions that was made in good faith but that ultimately proves to have been mistaken.

Potential criminal and civil liability

8.2 Article 8 of the Regulation provides

> Member States shall lay down the rules on penalties applicable to infringements of the provisions of this Regulation and shall take all measures necessary to ensure that they are implemented. The penalties provided for must be effective, proportionate and dissuasive.

This is a standard provision in EU sanctions regulations.[17]

8.3 Article 10 of the Regulation provides

> Actions by natural or legal persons, entities or bodies shall not give rise to liability of any kind on their part, if they did not know, and had no reasonable cause to suspect, that their actions would infringe the measures set out in this Regulation.

This clause (the "EU non-liability clause") is another standard provision in EU sanctions regulations.[18]

8.4 Although Article 10 is a standard formula, the scope of its application is not entirely clear. In particular, it is unclear whether the article is intended only to protect EU persons from liability pursuant to the rules on penalties that have been laid down by the Member States; or whether it is intended to protect an EU person who has infringed sanctions from civil liability if it acted without knowing or having reasonable cause to suspect that its actions would infringe the imposed sanctions.

8.5 Given the reference to "liability of any kind" in Article 10 of the Regulation, the Committee understands that this provision could exclude civil liability in any case in which a person acted without knowing or having reasonable cause to suspect that its actions would infringe the measure set out in the Regulation. This approach would, however, create further uncertainty. In particular, it would result in a position whereby an EU person who had infringed sanctions may have a defence to a contractual claim for breach of contract if s/he acted without knowledge or suspicion, as defined; but a

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17 The Council of the European Union has issued guidelines which address a number of general issues and present standard wording and common definitions that may be used in legal instruments implementing sanctions. The latest version of the Guidelines is "Guidelines on implementation and evaluation of restrictive measures (sanctions) in the framework of the EU Common Foreign and Security Policy", ("EU Guidelines"), Council of the European Union, 11205/12 of 15 June 2012.

18 EU Guidelines, page 39. In the EU Guidelines, this is the second limb of a two-part non-liability clause. The first part is the "good faith clause" discussed below.

person who refused to perform the contract so as to comply with sanctions would have no defence to a claim for breach of contract—at least in cases where its belief that it may commit an infringement of sanctions by performing the contract is mistaken.

8.6 It is not clear whether the failure of the Regulation to deal with a situation of this kind was intentional, or possibly an oversight. By contrast, Council Regulations (EU) No. 208/2014 and 269/2014 which impose an asset freeze and related restrictions in relation to listed persons and entities, include the following provision:

> 1. The freezing of funds and economic resources or the refusal to make funds or economic resources available, carried out in good faith on the basis that such action is in accordance with this Regulation, shall not give rise to liability of any kind on the part of the natural or legal person or entity or body implementing it, or its directors or employees, unless it is proved that the funds and economic resources were frozen or withheld as a result of negligence.
>
> 2. Actions by natural or legal persons, entities or bodies shall not give rise to any liability of any kind on their part if they did not know, and had no reasonable cause to suspect, that their actions would infringe the measures set out in this Regulation.

8.7 This combination of the non-liability clause with the good faith clause reflects a standard formula for EU asset freeze regulations.[19] While the good faith clause would, in its entirety, be inapposite within the Regulation, as discussed above, the inclusion of the non-liability clause alone could expose EU persons to civil liability risk. The FMLC recommends that consideration be given to whether the good faith clause could be adapted in order to provide protection to private parties, in relation to their actions or omissions based on their understanding of the requirements of the Regulation. The FMLC acknowledges, however, that careful consideration should be given to this issue to the extent it could potentially involve a reallocation of risk between contractual counterparties.

8.8 A similar issue arises in the context of Article 11,[20] which provides some protection for EU persons facing civil liability. Article 11 is based on a standard "no claims" clause

[19] EU Guidelines at page 39.

[20] For the text of Article 11, please refer to Annex.

developed by the EU and is similar in its nature to the non-liability provision discussed above.

8.9 The EU Guidelines do not offer a definition of "claim" in this context. Although Council Regulation (EU) No. 269/2014 includes a similar protective provision in Article 11, supported by a definition of "claim" in Article 1(a), Regulation 833 does not contain a similar definition of "claim". The FMLC considers that this may be an oversight.

8.10 In any event, Article 11 of the Regulation is intended to provide EU persons with a defence to certain civil claims arising from a person's failure to perform a contract. Article 11 does not, however, provide a defence to all claims or to all parties. For example, the article requires the relevant contractual performance to have been affected, directly or indirectly, by the measures imposed by the Regulation. If a party only believed, however reasonably, that its performance had been so affected but the court held to the contrary, then Article 11 would not *prima facie* apply. Moreover, any defence to a claim applies only to claims made by the limited categories of persons listed in Article 11. There is no specific protection where, for example, a financial institution declines to proceed with or complete a transaction on the basis of its interpretation of sanctions requirements, thus giving rise to the possibility of a claim on the part of a non-sanctioned counterparty thereby affected. Although this may be the more appropriate allocation of "interpretation" risk, the Committee would welcome some analysis of how the existing language of Article 11 may operate in respect of those who have been affected by the introduction of the Regulation but are not intended targets thereof.

8.11 It is also unclear whether and how Article 11 provides a defence to litigation. Article 11(1) provides that no claims defined therein "shall be satisfied". In particular, it is not clear how that term is intended to operate in the context of court proceedings, taking account of Article 11(3) which provides that the article is

> without prejudice to the right of persons, entities and bodies [listed in the Article as being those whose claims may not be satisfied] to judicial review of the legality of the non-performance of contractual obligations in accordance with this Regulation.

Given that there is very little express European guidance concerning the effect of sanctions regulations on contracts the FMLC would welcome guidance on the interpretation of this article.[21]

8.12 As noted in the introduction, Regulation 1290/2014 and the Commission Guidance Note, which were both published in December 2014, clarified certain issues of legal uncertainty arising from Regulation 833/2014 (as amended by Regulation 960/2014). The Regulation did nothing, however, to address the position of EU entities which may have acted in the intervening period on the basis of good faith and interpretations of the provisions which were not in line with the clarifications or the guidance provided in December. Regulation 1290/2014 does not offer protection designed to address the situation of entities which declined to perform contractual obligations on the basis of their interpretations during that period where those interpretations differed from clarifications made in Regulation 1290/2014.

9. PROPOSED SOLUTIONS

9.1 The FMLC suggests that efforts should be made to articulate the intended scope and impact of sanctions regulations affecting contracts more clearly in the future and further consideration should be given to introducing more comprehensive harmonised guidance in relation to the Regulation at the European level. Whilst the Commission Guidance Note was welcomed, given the broad nature of the restrictions, there is merit in further and systematic guidance being issued. Where it is not intended that particular types of transaction should be covered by the Regulation but they may be construed as falling within the terms of broadly worded prohibitions, the Committee suggests that either further specific exemptions could be drafted into the Regulation, or the Commission's view of the issue expressed in any guidance. Although there is no provision for the Commission to issue general licenses of the type commonly used by the OFAC, this would be one possible tool that the EU might consider, short of amendments to the Regulation. The FMLC encourages the Commission to consult widely with representatives of the financial services sector and their representative trade organisations, to seek to tailor future sanctions measures in accordance with market practice and understanding of instruments and terminologies.

[21] EU guidance with respect to the effects of an asset freeze confirms that: "Once in force, the Regulations imposing freezing measures override all incompatible contractual arrangements." See paragraph 33 of the 2015 Update.

9.2 One of the main challenges concerning implementation of EU sanctions is the consistent application of relevant measures throughout the Member States, including competent authorities interpreting regulations in the same way and adopting consistent approaches to the issuance of authorisations. Achieving uniformity of application is necessary for there to be a level playing field for EU businesses, regardless of place of establishment. This goal could be facilitated by the establishment of a centralised EU authority—perhaps within the Commission itself—responsible for the issuance of licenses/authorisations and the provision of answers to specific questions raised by market participants in relation to the interpretation of the rules. The OFAC of the US Department of the Treasury performs a similar role by issuing general licenses and providing guidance on the interpretation of US sanctions.

9.3 Finally, the FMLC recommends the adoption of a clear presumption of non-applicability of sanctions regulations to pre-existing contractual obligations unless specifically stated to the contrary, and the introduction of further protective measures for private parties acting in good faith and non-negligently in seeking to comply with EU restrictive measures.

10. CONCLUSION

This paper has identified and, where appropriate, suggested potential solutions or improvements to, issues of legal uncertainty affecting the wholesale financial markets arising from Council Regulation (EU) No 833/2014 concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine (as amended by Council Regulations (EU) No 960/2014 and (EU) No 1290/2014). The FMLC has drawn attention to issues of uncertainty relating to, in particular: (i) the prohibition relating to new loans or credit; (ii) the meaning and scope of related entities and the meaning of "on behalf or at the direction of" another; (iii) the scope of "transferable securities" and "money market instruments"; (iv) the impact on the derivatives market; (v) financing and financial assistance; and (vi) criminal and civil liability. These matters raise considerable uncertainty within the market and impose an increasingly challenging compliance burden on financial institutions. To address these uncertainties, the paper sets out a number of proposed solutions which include, among other things that (i) a centralised EU authority responsible for the issuance of licenses and the interpretation of the rules should be established; (ii) further guidance is provided with regards to certain provisions; and (iii) there be a stated presumption that sanctions measures do

not prohibit the performance of obligations arising from contracts or agreements that pre-date the sanctions.

ANNEX

Relevant Articles of the Regulation

Article 2

1. It shall be prohibited to sell, supply, transfer or export, directly or indirectly, dual-use goods and technology, whether or not originating in the Union, to any natural or legal person, entity or body in Russia or for use in Russia, if those items are or may be intended, in their entirety or in part, for military use or for a military end-user.

Where the end-user is the Russian military, any dual-use goods and technology procured by it shall be deemed to be for military use.

2. When deciding on requests for authorisations in accordance with Council Regulation (EC) No 428/2009, the competent authorities shall not grant an authorisation for exports to any natural or legal person, entity or body in Russia or for use in Russia, if they have reasonable grounds to believe that the end-user might be a military end-user or that the goods might have a military end-use.

The competent authorities may, however, grant an authorisation where the export concerns the execution of an obligation arising from a contract concluded before 1 August 2014, or ancillary contracts necessary for the execution of such a contract.

Article 2a

1. It shall be prohibited to sell, supply, transfer or export, directly or indirectly, dual-use goods and technology as included in Annex I to Regulation (EC) No 428/2009, whether or not originating in the Union, to natural or legal persons, entities or bodies in Russia as listed in Annex IV to this Regulation.

2. It shall be prohibited:

(a) to provide technical assistance, brokering services or other services related to goods and technology set out in paragraph 1 and to the provision, manufacture, maintenance and use of these goods and technology, directly or indirectly to any person, entity or body in Russia, as listed in Annex IV;

(b) to provide financing or financial assistance related to goods and technology referred to in paragraph 1, including in particular grants, loans and export credit insurance, for any sale, supply, transfer or export of these goods and technology, or for the provision

of related technical assistance, brokering services or other services, directly or indirectly to any person, entity or body in in Russia, as listed in Annex IV.

3. The prohibitions in paragraphs 1 and 2 shall be without prejudice to the execution of contracts concluded before 12 September 2014, or ancillary contracts necessary for the execution of such contracts, and to the provision of assistance necessary for the maintenance and safety of existing capabilities within the EU.

4. The prohibitions in paragraphs 1 and 2 shall not apply to the sale, supply, transfer or export of dual use goods and technology intended for the aeronautics and space industry, or the related provision of technical and financial assistance, for non military use and for a non military end user, as well as for maintenance and safety of existing civil nuclear capabilities within the EU, for non military use and for a non military end user.

Article 3

1. A prior authorisation shall be required for the sale, supply, transfer or export, directly or indirectly, of items as listed in Annex II, whether or not originating in the Union, to any natural or legal person, entity or body in Russia, including its Exclusive Economic Zone and Continental Shelf or in any other State, if such items are for use in Russia, including its Exclusive Economic Zone and Continental Shelf.

2. For all sales, supplies, transfers or exports for which an authorisation is required under this Article, such authorisation shall be granted by the competent authorities of the Member State where the exporter is established and shall be in accordance with the detailed rules laid down in Article 11 of Regulation (EC) No 428/2009. The authorisation shall be valid throughout the Union.

3. Annex II shall include certain items suited to the following categories of exploration and production projects in Russia, including its Exclusive Economic Zone and Continental Shelf:

(a) oil exploration and production in waters deeper than 150 metres;

(b) oil exploration and production in the offshore area north of the Arctic Circle; or

(c) projects that have the potential to produce oil from resources located in shale formations by way of hydraulic fracturing; it does not apply to exploration and production through shale formations to locate or extract oil from non-shale reservoirs.

4. Exporters shall supply the competent authorities with all relevant information required for their application for an export authorisation.

5. The competent authorities shall not grant any authorisation for any sale, supply, transfer or export of the items included in Annex II, if they have reasonable grounds to determine that the sale, supply, transfer or export of the items are destined for any of the categories of exploration and production projects referred to in paragraph 3.

The competent authorities may, however, grant an authorisation where the sale, supply, transfer or export concerns the execution of an obligation arising from a contract concluded before 1 August 2014, or ancillary contracts necessary for the execution of such a contract.

The competent authorities may also grant an authorisation where the sale, supply, transfer or export of the items is necessary for the urgent prevention or mitigation of an event likely to have a serious and significant impact on human health and safety or the environment. In duly justified cases of emergency, the sale, supply, transfer or export may proceed without prior authorisation, provided that the exporter notifies the competent authority within five working days after the sale, supply, transfer or export has taken place, providing detail about the relevant justification for the sale, supply, transfer or export without prior authorisation.

6. Under the conditions set out in paragraph 5, the competent authorities may annul, suspend, modify or revoke an export authorisation which they have granted.

7. Where a competent authority refuses to grant an authorisation, or annuls, suspends, substantially limits or revokes an authorisation in accordance with paragraphs 5 or 6, the Member State concerned shall notify the other Member States and the Commission thereof and share the relevant information with them, while complying with the provisions concerning the confidentiality of such information in Council Regulation (EC) No 515/97.

8. Before a Member State grants an authorisation in accordance with paragraph 5 for a transaction which is essentially identical to a transaction which is the subject of a still valid denial issued by another Member State or by other Member States under paragraphs 6 and 7, it shall first consult the Member State or States which issued the denial. If, following such consultations, the Member State concerned decides to grant an authorisation, it shall inform the other Member States and the Commission thereof, providing all relevant information to explain the decision.

Article 3a

1. It shall be prohibited to provide, directly or indirectly, associated services necessary for the following categories of exploration and production projects in Russia, including its Exclusive Economic Zone and Continental Shelf:

(a) oil exploration and production in waters deeper than 150 metres;

(b) oil exploration and production in the offshore area north of the Arctic Circle; or

(c) projects that have the potential to produce oil from resources located in shale formations by way of hydraulic fracturing; it does not apply to exploration and production through shale formations to locate or extract oil from non-shale reservoirs.

For the purpose of this paragraph, associated services shall mean:

(i) drilling;

(ii) well testing;

(iii) logging and completion services;

(iv) supply of specialised floating vessels.

2. The prohibitions in paragraph 1 shall be without prejudice to the execution of an obligation arising from a contract or a framework agreement concluded before 12 September 2014 or ancillary contracts necessary for the execution of such a contract.

3. The prohibitions in paragraph 1 shall not apply where the services in question are necessary for the urgent prevention or mitigation of an event likely to have a serious and significant impact on human health and safety or the environment.

The service provider shall notify the competent authority within five working days of any activity undertaken pursuant to this paragraph, providing detail about the relevant justification for the sale, supply, transfer or export.

Article 4

1. It shall be prohibited:

(a) to provide, directly or indirectly, technical assistance related to the goods and technology listed in the Common Military List, or related to the provision, manufacture, maintenance and use of goods included in that list, to any natural or legal person, entity or body in Russia or for use in Russia;

(b) to provide, directly or indirectly, financing or financial assistance related to the goods and technology listed in the Common Military List, including in particular grants, loans and export credit insurance or guarantee, as well as insurance and reinsurance for any sale, supply, transfer or export of such items, or for any provision of related technical assistance, to any natural or legal person, entity or body in Russia or for use in Russia;

(c) to provide, directly or indirectly, technical assistance or brokering services related to dual-use goods and technology, or related to the provision, manufacture, maintenance and use of such goods or technology, to any natural or legal person, entity or body in Russia or for use in Russia, if the items are or may be intended, in their entirety or in part, for military use or for a military end-user;

(d) to provide, directly or indirectly, financing or financial assistance related to the dual-use goods and technology, including in particular grants, loans and export credit insurance, for any sale, supply, transfer or export of such items, or for any provision of related technical assistance to any natural or legal person, entity or body in Russia or for use in Russia, if the items are or may be intended, in their entirety or in part, for military use or for a military end-user.

2. The prohibitions in paragraph 1 shall be without prejudice to the execution of contracts concluded before 1 August 2014, or ancillary contracts necessary for the execution of such contracts, and to the provision of assistance necessary for the maintenance and safety of existing capabilities within the EU.

3. The provision of the following shall be subject to an authorisation from the competent authority concerned:

(a) technical assistance or brokering services related to items listed in Annex II and to the provision, manufacture, maintenance and use of those items, directly or indirectly, to any natural or legal person, entity or body in Russia, including its Exclusive Economic Zone and Continental Shelf or, if such assistance concerns items for use in Russia, including its Exclusive Economic Zone and Continental Shelf, to any person, entity or body in any other State;

(b) financing or financial assistance related to items referred to in Annex II, including in particular grants, loans and export credit insurance, for any sale, supply, transfer or export of those items, or for any provision of related technical assistance, directly or indirectly, to any natural or legal person, entity or body in Russia, including its Exclusive Economic Zone and Continental Shelf or, if such assistance concerns items

for use in Russia, including its Exclusive Economic Zone and Continental Shelf, to any person, entity or body in any other State.

In duly justified cases of emergency referred to in Article 3(5), the provision of services referred to in this paragraph may proceed without prior authorisation, on condition that the provider notifies the competent authority within five working days after the provision of services.

4. Where authorisations are requested pursuant to paragraph 2 of this Article, Article 3, and in particular paragraphs 2 and 5 thereof, shall apply mutatis mutandis.

Article 5

1. It shall be prohibited to directly or indirectly purchase, sell, provide investment services for or assistance in the issuance of, or otherwise deal with transferable securities and money-market instruments with a maturity exceeding 90 days, issued after 1 August 2014 to 12 September 2014, or with a maturity exceeding 30 days, issued after 12 September 2014 by:

(a) a major credit institution, or other major institution having an explicit mandate to promote competitiveness of the Russian economy, its diversification and encouragement of investment, established in Russia with over 50 % public ownership or control as of 1 August 2014, as listed in Annex III; or

(b) a legal person, entity or body established outside the Union whose proprietary rights are directly or indirectly owned for more than 50 % by an entity listed in Annex III; or

(c) a legal person, entity or body acting on behalf or at the direction of an entity referred to in point (b) of this paragraph or listed in Annex III.

2. It shall be prohibited to directly or indirectly purchase, sell, provide investment services for or assistance in the issuance of, or otherwise deal with transferable securities and money-market instruments with a maturity exceeding 30 days, issued after 12 September 2014 by:

(a) a legal person, entity or body established in Russia predominantly engaged and with major activities in the conception, production, sales or export of military equipment or services, as listed in Annex V, except legal persons, entities or bodies active in the space or the nuclear energy sectors;

(b) a legal person, entity or body established in Russia, which are publicly controlled or with over 50 % public ownership and having estimated total assets of over 1 trillion

Russian Roubles and whose estimated revenues originate for at least 50 % from the sale or transportation of crude oil or petroleum products, as listed in Annex VI;

(c) a legal person, entity or body established outside the Union whose proprietary rights are directly or indirectly owned for more than 50 % by an entity listed in point (a) or (b) of this paragraph; or

(d) a legal person, entity or body acting on behalf or at the direction of an entity referred to in point (a), (b) or (c) of this paragraph.

3. It shall be prohibited to directly or indirectly make or be part of any arrangement to make new loans or credit with a maturity exceeding 30 days to any legal person, entity or body referred to in paragraph 1 or 2, after 12 September 2014.

The prohibition shall not apply to:

(a) loans or credit that have a specific and documented objective to provide financing for non-prohibited imports or exports of goods and non-financial services between the Union and any third State, including the expenditure for goods and services from another third State that is necessary for executing the export or import contracts; or

(b) loans that have a specific and documented objective to provide emergency funding to meet solvency and liquidity criteria for legal persons established in the Union, whose proprietary rights are owned for more than 50 % by any entity referred to in Annex III.

4. The prohibition in paragraph 3 shall not apply to drawdown or disbursements made under a contract concluded before 12 September 2014 provided that the following conditions are met:

(a) all the terms and conditions of such drawdown or disbursements: (i) were agreed before 12 September 2014; and (ii) have not been modified on or after that date; and

(b) before 12 September 2014 a contractual maturity date has been fixed for the repayment in full of all funds made available and for the cancellation of all the commitments, rights and obligations under the contract. The terms and conditions of drawdowns and disbursements referred to in point (a) include provisions concerning the length of the repayment period for each drawdown or disbursement, the interest rate applied or the interest rate calculation method, and the maximum amount.

Article 11

1. No claims in connection with any contract or transaction the performance of which has been affected, directly or indirectly, in whole or in part, by the measures imposed under the Regulation, including claims for indemnity or other claim of this type, such as a claim for compensation or a claim under a guarantee, notably a claim for extension or payment of a bond, guarantee or indemnity, particularly a financial guarantee or financial indemnity, of whatever form, shall be satisfied, if they are made by:

(a) entities referred to in points (b) or (c);

(b) any other Russian person, entity or body;

(c) any person, entity or body acting through or on behalf of one of the persons, entities or bodies referred to in points (a) or (b) of this paragraph.

2. In any proceedings for the enforcement of a claim, the onus of proving that satisfying the claim is not prohibited by paragraph 1 shall be on the person seeking the enforcement of that claim.

3. This Article is without prejudice to the right of the persons, entities and bodies referred to in paragraph 1 to judicial review of the legality of the non-performance of contractual obligations in accordance with this Regulation.

Article 12

It shall be prohibited to participate, knowingly and intentionally, in activities the object or effect of which is to circumvent the prohibitions referred to in Articles 2, 2a, 3a, 4 or 5, including by acting as a substitute for the entities referred to in Article 5, or by using the exceptions in Article 5(3) to fund entities referred to in Article 5.

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