

REVIEW OF SANCTIONS DEVELOPMENTS

THE IMPACT OF SANCTIONS ON SECTORS OF THE RUSSIAN ECONOMY

2019 – 2020



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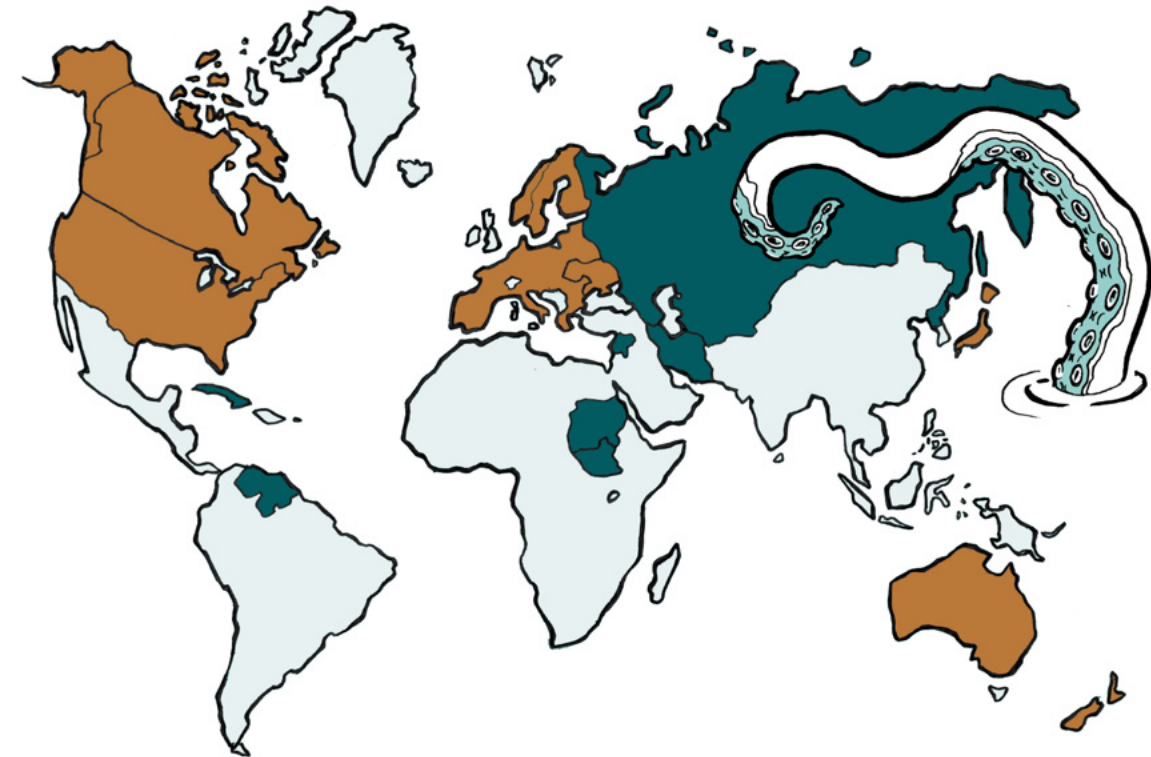




TABLE OF CONTENT

INTRODUCTION	1
THE IMPACT OF THE SANCTIONS DEVELOPMENTS ON DIFFERENT BUSINESSES	3
Energy, Oil, and Gas	3
Financial and Insurance Industries	9
The Defense Industry	14
Transportation Industry	17
Metallurgical Industry	20
Agriculture Industry	23
PROGNOSIS FOR THE DEVELOPMENT OF SANCTIONS AND RESTRICTIVE MEASURES	25
APPENDIX	27
Regulation and Statistics of the United States	27
Regulation and Statistics of the European Union	29
ABOUT US	31

INTRODUCTION



How did the sanctions-related events affect doing business in Russia? What areas of the economy were impacted most? What type of U.S. sanctions programs were implemented the most and thus transformed ways of doing business? What are the specifics of the EU sanctions? Is there any chance of improvement in the sanctions situation in 2020?

We conducted an analysis of economic, legal-political, and political events to assess the effect of sanctions for Russian and foreign companies that: (i) do business in Russia; and (ii) are active on the international stage and thus interact with the Russian counterparts, both at the international level (foreign trade) and in Russia itself (with producers and consumers of goods and services in Russia). The focus is concentrated on areas that are a customary part of the international economy: oil and gas, energy, transportation, the defense industry, the metallurgical industry, finance, insurance, and agriculture.

As sanctions are considered to have a global reach, this overview can be of interest to enterprises doing business in Russia or with Russia, as well as, more widely, to a business audience studying both the restrictions and the opportunities that come with them.

2019 started with the delisting of Oleg Deripaska's assets from an SDN list (Specially Designated Nationals and Blocked Persons List), and it brought a number of notable events, in particular in the sphere of sanctions-related investigations and precedent-setting cases. Sanctions enforcement proved an example of criminal liability for the breach of sanctions and demonstrated U.S. commitment to sectoral sanctions enforcement.

Along with the case law, this year can be marked by the long-awaited compliance framework documents and regulatory FAQs that help businesses in their compliance efforts. Risk management and compliance-building processes were a focus of these documents, and it is now clear what the regulatory expectations form these processes are.

Of all sanctions program, apart from Russia-related ones, Venezuela and Iran sanctions deserve the most attention. A business should consider these sanctions programs when managing its commercial and risk strategies.

It should be noted that some of the harsh prognoses did not come true. The Russian banking system was not stripped of SWIFT, and the U.S. Congress did not approve some of the sanctions-related bills, including DASKA (Defending American Security Against Kremlin Aggression Act), DETER (Defending Elections from Threats by Establishing Red-Lines Act), the Election Interference Acts, and others.

In Russia itself, sanctions law had its own development. For instance, courts issued rulings on the sanctions impact on arbitral clauses and provided details of restricted goods transit, elaborating on customs issues of Russia.

The impact of sanctions on business transformation is significant. For some, it is an incentive and a growth catalyzer, for others a way to stagnate. ■

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THE IMPACT OF THE SANCTIONS DEVELOPMENTS ON DIFFERENT BUSINESSES

ENERGY, OIL, AND GAS

General Overview

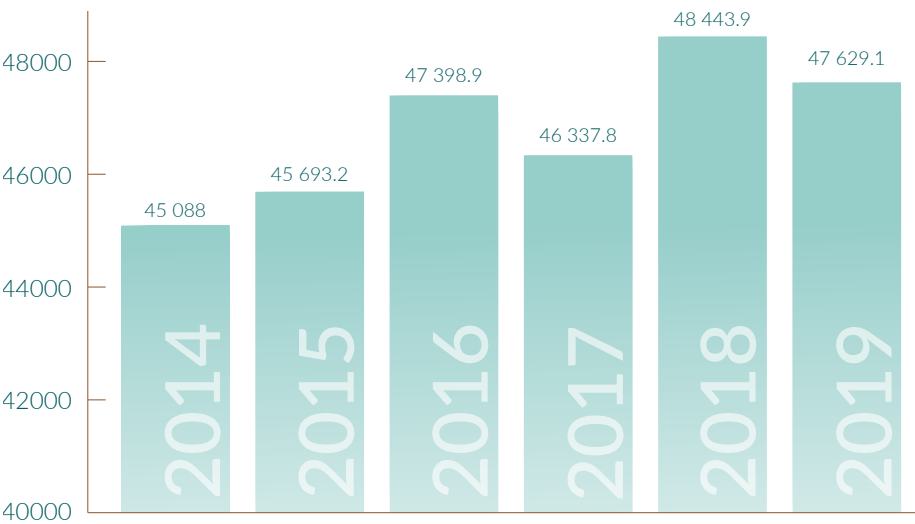
Targeted at the decrease of oil exploitation and oil exports, EU and U.S. sanctions failed to meet their objectives. The industry took advantage of the opportunities provided by the global economy in the recent 2-3 years and successfully implemented both traditional and outside-the-box scenarios. The main impact of sanctions, however, that the industry felt was due to: (1) the freeze on participation by, or withdrawal of, foreign partners from joint ventures; and (2) a lack of technologies.

According to Ministry of Energy of the Russian Federation, from August 2014 to December 2019, oil exploitation increased by 6.83% and reached 2,965,368.63 thousand tons. Exports of the crude oil from August 2014 to December 2019 reached 1,366,623.51 thousand tons and increased by 21.42%.

In 2019, Russian oil faced an increased demand because of the U.S. sanctions increase against Venezuela. Exploitation and exports of Russian oil are also affected by the U.S. sanctions against Iran. As an example of such increased demand, one can see more and more Russian oil in the U.S. market.

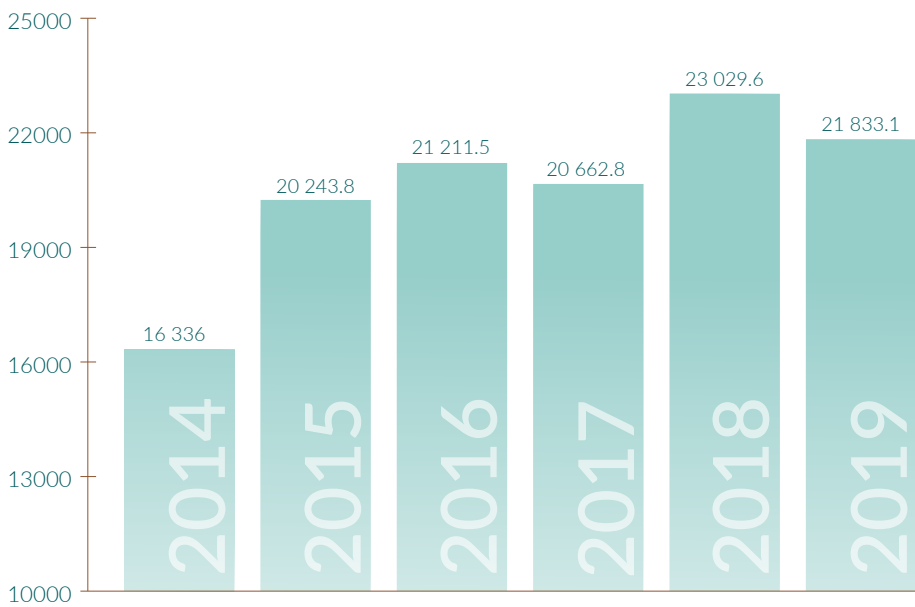
Despite the increase of several key indicators, the industry is still sensitive when it comes to sanctions.

Despite the increase of several key indicators, the industry is still sensitive when it comes to sanctions. It can be seen on many high-end fields and in projects, where the American and the European oilfield services companies, such as Schlumberger, Halliburton, and Baker Hughes, that are capable of technologically complex works in drilling, hydraulic fracturing, etc.



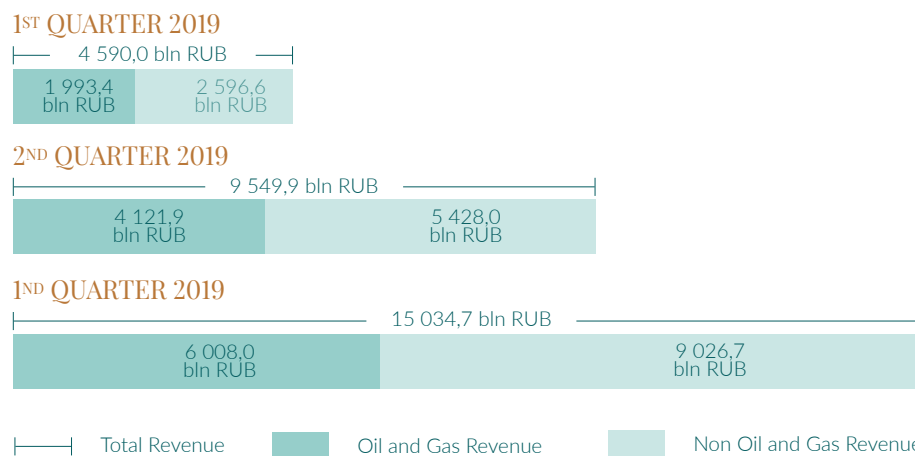
Oil exploitation in Russia

Total for the period: 2965368.63 thous.t.
Shift for the period: + 6.83%
Source: Ministry of Energy of the Russian Federation



Exports of oil from Russia

Total for the period: 1366623.51 thous.t.
Shift for the period: + 21.42%
Source: Ministry of Energy of the Russian Federation



Budget's oil and gas revenue

Summary of budgetary implementation in the Russian Federation
Source: Ministry of Finance of the Russian Federation

The industry fears the widening of technological sanctions more than anything else. Up to the half of 2030-2035 exploitation projects are under heavy sanctions risks.

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The industry is worried because of the difficulties the shelf projects are facing. Most of them are directly linked to the foreigners being a party to it and require the use of foreign equipment and components. Because of the foreign partner freeze in participation in, or their withdrawal from, joint ventures, Rosneft PJSC sent an application to Rosnedra (Russia's subsoil governance agency) asking to move more than 12 projects in the Sea of Okhotsk, Barents Sea, Pechora Sea, and the East Siberian Sea.

Foreign assistance accounts for more than half of the construction of the offshore Arctic platform "Pirazlomnaya." Hence, foreign components, mainly American ones, are crucial for its stable operation. This may be the reason for the Nikitin criminal case, a precedent-setting criminal case for the violation of sectoral sanctions. This situation is forcing the industry to show technological flexibility and stimulate import substitution, a policy by which the companies rely on the products made in their own country.

According to the Ministry of Energy of the Russian Federation, the "Rosneft" and "Transneft" oil companies are highly successful in their import substitution projects. Some of these projects cover essential hydraulic fracturing. The industry as a whole managed to successfully launch more than 100 import substitution projects.

Analysis of the Main Sanctions Developments in 2019

Delisting of the energy and metallurgical assets of Oleg Deripaska

In January 2019, the U.S. lifted sanctions against Russian companies En+ Group plc (En+), UC Rusal plc (Rusal), and JSC EuroSibEnergo (ESE), introduced on April 6, 2018. Prior to that, in December 2018, the U.S. Treasury notified the Congress of its intent to lift these sanctions, as it negotiated terms of Oleg Deripaska's withdrawal from companies' management and the reduction of his share in them. At the same time, En+ and Rusal introduced new boards of directors, while the Russian VTB Bank increased its share in the En+ Group up to 22.27%.

EuroSibEnergo is the largest privately held energy company in Russia.

Under its management, one can find hydro, thermal, and solar energy generational assets with a total capacity of 20 GW and 7% of the total electricity production in the country. Its shareholder is En+ Group.

The results have included:

- The company's delisting contributes not only to decreased perception of Oleg Deripaska's "business toxicity," but to the industry as a whole.
- Because the delisting of EuroSibEnergo, it is able to work with foreigners on terms that are more favorable.
- Funding opportunities for company's project are on the rise.
- As a positive sign of the delisting, one can consider the benefit of the increased compliance standards not only inside EuroSibEnergo, but also inside its beneficiary, the En+ Group.

Sanctions and the Nord Stream 2 Project

On December 20, 2019, President Donald Trump signed into law the National Defense Authorization Act for Fiscal Year 2020 (NDAA). Prior to signing, the Defense Authorization Act was amended by introduction of section 7503 - sanctions against the Nord Stream 2 and TurkStream pipeline projects.

- Sanctions came into force immediately and required that involved parties that have knowingly sold, leased, or provided vessels that are engaged in pipe laying at depths of 100 feet or more below sea level for the construction of Nord Stream 2 or TurkStream must ensure that such vessels immediately cease construction-related activity.
- Sanctions only delay the date of the project completion and are unable to stop it entirely.
- Though the Russian party to the project is capable of completing the project on its own, experts say that the remaining 50 to 70 km on the Baltic seabed are at depths of 10 to 25 meters, which means that the remaining construction activities are outside of the prohibited scope. Despite that, the main construction contractor, Allseas Group, refused to take any further part in the project.

ExxonMobil stood up for Sechin in the Federal Court and won

The U.S. oil company ExxonMobil entered into business relations with an SDN-person, Igor Sechin, in May 2014 and signed with him, while he was a head of "Rosneft," eight legal documents. For that, ExxonMobil received a significant monetary penalty. The oil giant did not agree with the penalty and successfully challenged it in an action against the U.S. Treasury in the United States District Court for the Northern District of Texas.

- ExxonMobil arguments covered a number of legal issues, with the main ones being: (1) a difference between the cooperation with an SDN in his individual and in his professional capacity; (2) a contention that the OFAC decision is capricious and arbitrary; and (3) that OFAC did not provide a proper Fair Notice.



- [In its ruling of December 31, 2019](#), the United States District Court for the Northern District of Texas did not elaborate whether the nature of business being done was in a professional or individual capacity. Instead it ruled that, due to the legal uncertainty and vagueness of the government agencies' position, the indefinite number of potential parties (the claimant included) did not and could not know that an activity is a prohibited one.
- Taking into consideration that Fair Notice provisions of the court's ruling are of a universal nature, this may affect OFAC cases not only under the Russian sanctions regime, but cases of arising from other sanctions programs as well.

Rosneft and the reality of sectoral sanctions

U.S.-based [Haverly System](#) provided services to Rosneft (a company subject to sectoral sanctions) and failed to get paid in 90 days time. To collect, the company followed Rosneft's instructions and became subject to an OFAC investigation.

OFAC determined that Haverly's behavior is a breach and violation of sectoral sanctions.

- To settle its liability, [Haverly Systems](#) agreed to pay USD 75,375.
- This case became indicative of the current enforcement climate, as it demonstrates that not only sectoral sanctions are real, but they are substantial.

Chinese contractor of the Yamal LNG Project took after Oleg Deripaska and hit the bull's eye

In September 2019, the U.S. Department of Treasury [designated two divisions of the Cosco company because it suspected the company to be involved in the transfer of the Iranian oil](#). One of these companies, Cosco Dalian, was a 50% owner of China LNG Shipping, which was, in turn, a co-owner of TC LNG, the owner and operator of the LNG Arc7 arctic tankers of Yamal LNG project. Though China LNG Shipping was not itself designated as an SDN, 50% of its shares was under the control of Cosco Dalian, and, thus, the company was considered as a "designated entity" under the 50% rule. Thus, TC LNG was designated as well.

- In the end, sanctions for [the tankers contractor of the Yamal LNG project were lifted under the same scenario](#) as with Oleg Deripaska's assets: The contractor's management company implemented a changed corporate structure and therefore freed its vessels from sanctions.
- Because of this practice, a business may use the same corporate restructuring methods when it wants to delist itself or its assets from sanctions.

The Turbine of Nikitin – the reality of the criminal liability because of a U.S. sanctions breach

[In the Nikitin case](#), a Russian citizen and his business partners allegedly attempted to acquire equipment necessary for deepwater oil and gas drilling. This equipment is subject to the U.S. sectoral sanctions, and the attempt to acquire it included an attempt to circumvent U.S. laws and defraud a producer of this equipment.

- As a result of coordinated efforts of the FBI, the Department of Justice, and other U.S. government bodies, Oleg Nikitin and his accomplices (a U.S. citizen and an Italian citizen) were arrested and indicted. The Department of Justice charged a federal crime, an attempt to circumvent U.S. sanctions. Nikitin and others are now facing of up to 20 years of prison time and up to USD 1 million in fines.
- The situation in the Nikitin case is rare, yet a highly indicative case of criminal prosecution under the sanctions. For many, it can be seen as the first U.S. criminal prosecution under the anti-Russian sanctions program.

Everybody keeps an eye on Venezuela

- The oil and gas industry has a high interest on any developments in U.S.-Venezuela sanctions relations. This can be seen in close, precise attention in the U.S. actions against Petróleos de Venezuela, Sociedad Anonima (PDVSA), the largest national oil and gas corporation. The Russian oil and gas industry is forced to consider reserve scenarios that would be arise if there would be more sectoral sanctions against the Russian oil and gas industry.
- The most significant U.S. actions against Venezuela include cases against PDVSA transportation contractors (more on that in the section of this report covering transportation industry), increased pressure on PDVSA joint ventures, and a tightening of export controls, which have resulted in restrictions against oilfield services equipment, as well as financial pressure on the country and its financial sector.



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FINANCIAL AND INSURANCE INDUSTRIES

General Overview

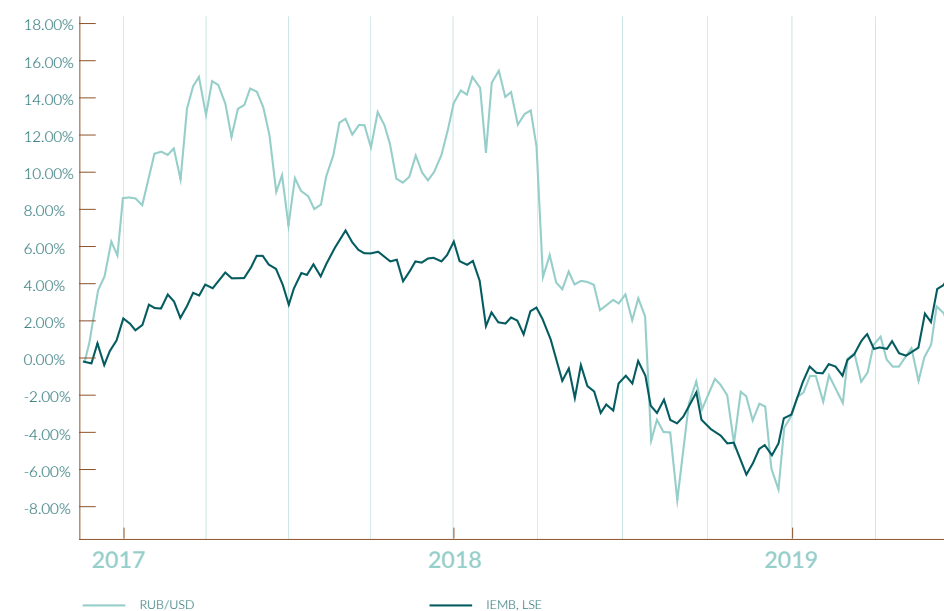
Financial and insurance industries felt the harsh impact of sanctions. The Central Bank of Russia and industry members undertook significant efforts to mitigate the harm; nevertheless, banks and insurance companies feel difficulties when working with capital markets, capital outflow, and deteriorations of the reinsurance market.

One of the most notable features that sanctions brought is its impact on the Russian currency.

Some time ago, some in the Central Bank of Russia claimed that the impact of sanctions on currency is significant and linked with a capital outflow. Yet now, the Central Bank considers this impact to be insignificant and estimated as only 0.5%.

The Central Bank claims that the sanctions impact on the banking industry has minimized, with many banks widening the use of the domestic financial systems. Nevertheless, the Central Bank says that for the banks that were specifically targeted by sanctions, the impact is still significant.

Another notable sign is the capital outflow ("Private Sector Financial Balance") which in 2018 hit USD 63 billion – a record since 2014.



Dynamics of the Russian Ruble toward the USD and the Developing Markets Currency Index

Source: the Central Bank of the Russian Federation, Reuters, Intercontinental Exchange Inc

In 2019, capital outflow dropped from the previous year to USD 26.7 billion.

The Russian insurance industry also suffered a significant sanctions hit. The reinsurance market, which is supposed to create additional financial stability, is most sensitive to the realities of sanctions. This sector is traditionally known for the participation of foreign companies.

Since sanctions were introduced and the socio-economic situation in the country deteriorated, foreign reinsurance tariffs increased from 40% to 150% as Russia became a high-risk country.

Moreover, foreign reinsurers started to withdraw from big strategic projects, especially from some that were being directly sanctioned and ones with sanctions "toxicity." There are precedents when companies refused to make insurance payments to insured parties before the sanctions were lifted.

In 2016, the market witnessed the emergence of the special state reinsurance company – RNPК (Russian National Reinsurance Company). Under Russian law, all insurance industry members should transfer 10% of all reinsurance volume to RNPК. For a sanctions-related project, however, this number is higher and hits 50%.

Analysis of the Main Sanctions Developments in 2019

Russia is still in SWIFT

The financial industry sees the fact that Russia was not banned from the use of the SWIFT system as a positive sign. The SWIFT disconnection scenario did not happen because of several political, economic, and technical reasons.

Firstly, when the U.S. used the same scenario against Iran, it was understood, that the U.S. businesses would not suffer consequences as severe as would happen if Russia should be disconnected from SWIFT.

Secondly, the if Russia would be disconnected from SWIFT, this would seriously hurt Russia's economic relations with the EU, a strategic ally of the United States and whose interests the U.S. takes into consideration.

Thirdly, Russia is a highly responsible SWIFT member and among the top 20 of its most active users worldwide.

Bankers focus on sectoral sanctions

As with the oil and gas industry, banks considered the Haverly Systems case to be significant. In it, the U.S. showed its determination to apply sectoral sanctions and warned that prohibited debt financing exceeding 90 days would not be tolerated.

Venezuela's crypto – a way to be designated as an SDN and to be banned from the international payment systems



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In [the Evrofinance Mosnarbank case](#), sanctions were imposed against a Moscow-based bank that is jointly owned by Russian and Venezuelan state-owned companies. The bank was designated because of its support of Venezuela's oil trade by PDVSA and its support of Petro cryptocurrency. Consequently, the Visa and Mastercard payment system denied the bank membership. Clients' cards were blocked.

- A few months after the incident, Gazprombank got rid of its share in the bank and transferred it without payment to Rosimushchestvo, thereby leaving a toxic asset behind.
- After the incident, Russian investors of Crypto, for the most part, lost their interest in this cryptocurrency.

Sanctions against the sovereign debt and cooperation with international financial organizations

In August 2019, [the U.S. introduced the second round of sanctions against Russia because of the Scripal incident](#). According to the provisions on the application of the Chemical and Biological Weapons Control and Warfare Elimination Act of 1991, the U.S. limits the provision and prolongation of loans to Russia from the largest international financial organizations, such as the World Bank and the IMF. Moreover, the sanctions cover the primary placement of the Russian sovereign bonds.

- These measures were expected and did not impact the long-term perspectives of the debt situation in Russia. The country did not use the aid of the World Bank or the IMF for a while.
- Moreover, the ban on the purchase of the Russian sovereign debt covers its primary sales and allows the U.S. banks and corporations to acquire special Russian bonds on a secondary market.

Banks would not provide services if its client is under sanctions

Early 2020 marked the end of the proceeding in the Boris Rotenberg case. Mr. Rotenberg was suing four Scandinavian banks for their refusal to supply banking services to him: Handelsbanken, Nordea Bank, OP Group, and Danske Bank. Despite being a citizen of Finland, the banks refused to do payments for him, which was a reason for the case.

- In its judgment, Helsinki District Court ruled that Mr. Rotenberg failed to prove that he is a permanent resident of the European Economic Area, and, therefore, cannot receive banking services. The transactions themselves did not sufficiently meet the risk-management criteria and were in contradiction to both the banks' internal policies and the laws of Finland.
- On top of that, during the proceedings, at least one bank noted that it refused to provide services because the U.S. CAATSA law (Countering America's Adversaries Through Sanctions Act) had taken effect.

Adaptation of sanctions compliance and the realities of Russia

The financial industry noted the introduction of A Framework for [OFAC Compliance Commitments](#). Under the document, OFAC emphasizes key features and criteria for the successful operation of a sanctions risk system, as well as recommendations for its implementation.

- This document is very useful for businesses, especially for insurance and banking industries, as it provides an understanding of the regulator's intentions and predictability of regulatory action. Businesses may use the Framework as a basic guide when developing their policies on dealings with embargoes and restrictions.

International insurance pools – sanctions risks and the “Regulatory Straw”

The Russian insurance industry cooperates with international businesses by joint participation in international insurance pools (risk pools). That means that even if sanctions would one day apply to the insurance industry, there would be a differentiated approach towards each member of the sector.

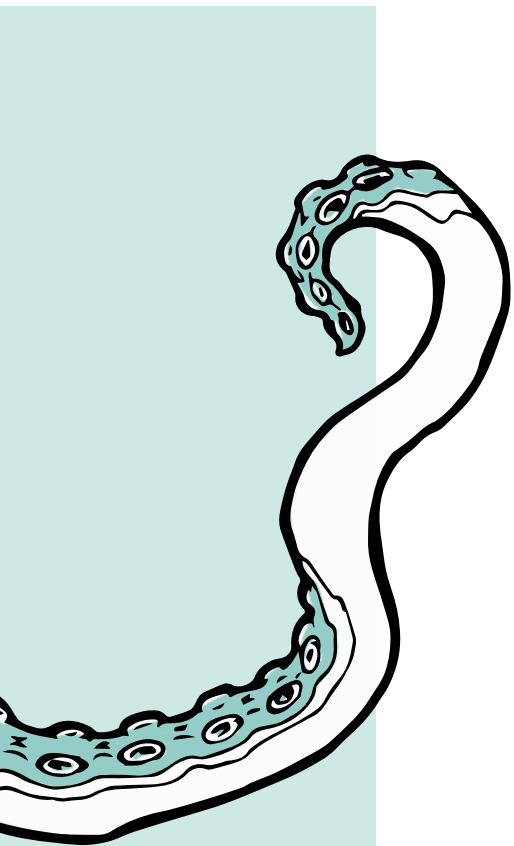
The industry kept an eye on [the Allianz](#) and [Chubb Limited](#) cases. Both of them involved the Cuba sanctions program. However, each has a significant feature and might be considered especially important for internal controls and risk management systems that can be used in Russia.

The company found out about a sanctions violation but did not take it seriously

In [the Allianz](#) case, the company failed to thoroughly track travel insurance policies for Cuba,. This failure eventually threatened the integrity of the Cuba sanctions program by attracting to the island tourists that would not visit it without an insurance policy.

- The regulator considered the use of the Canadian currency and interaction with the company's U.S. office to be a sufficient link to the U.S. jurisdiction.
- Certain actions of the insurance company's management might be considered notable, as it first did not think about a possible sanctions violation, and then, willfully ignored information about the violations.
- The management did not think about the operational functionality of its compliance system. It allowed to the company to work with Cuba by fronting policies via intermediaries. (“Fronting” insurance business involves an arrangement between two or more insurance companies to allow a company to issue indirectly a policy in a jurisdiction where it is not licensed).
- For Russian insurance companies, this may be a warning signal for the widening of internal controls and the functionality of risk management services, as well as for a review of its international strategies.

[A Framework for OFAC Compliance Commitments](#). Under the document, OFAC emphasizes key features and criteria for the successful operation of a sanctions risk system, as well as recommendations for its implementation. Businesses may use the Framework as a basic guide when developing their policies on dealings with embargoes and restrictions.



The company decided that sanctions clauses in some of its documents are not important

In the [Chubb Limited](#) (previously known as ACE Ltd) case, the company sold travel insurance policies for Cuba and also had a tight link with the jurisdiction of the United States. By being delusional towards lack of any sanctions clauses in its contractual base, the company demonstrated a denial of the existence of applicable U.S. sanctions, which it should have considered in its commercial activity.

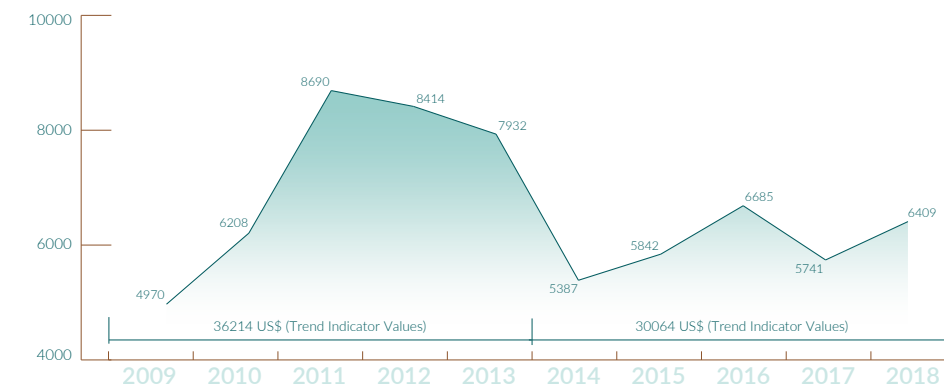
- The company believed that a rejection of sanctions clause was justified due to the blocking regulation of the EU, which guarantees protection to EU companies against American sanctions. (The Cuba travel insurance policies were distributed by the company's divisions in the EU.)
- During the violation at issue, the company did not take compliance seriously. However, later on it managed to: (1) provide compliance training of its employees; (2) hire a Global Financial Crime Risk Officer; (3) conduct a comprehensive risk assessment across the Europe, Eurasia, and Africa regions; and (4) develop a sanctions risk assessment methodology.
- This case might be a signal for Russian insurance companies to review their current risk management systems. ■

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THE DEFENSE INDUSTRY

General Overview

The defense industry is one of the most vulnerable when it comes to sanctions. The objective of sanctions is to deteriorate the efficiency to the defense industry inside Russia, as well as to install sanctions toxicity in the sector and jam its position on the international market. The impact can be seen in a decrease of the weaponry exports indicators and the break in the sensitive business connections with Ukraine.



Exports of the Weaponry from Russia
(2009-2018)

Source: SIPRI Stockholm International Peace
Research Institute
Date: 16 January 2020

Restrictions on the financing and import components significantly impact both the efficiency of the industry and the consumption structure. This interferes with the diversification of the industry's enterprises and plans to amend the structure of its production distribution, along with plans to provide enterprises with more economic freedom. Before the sanctions introduction most of the distribution was targeted on state and was a subject to the state defense contract.

One of the sanctions consequences for the industry was a break of economic ties of the defense industry enterprises with a sensitive industry partner – Ukraine. The Ukrainian components were in high demand in a number of sectors, such as the helicopter construction industry and sometimes were crucial for the projects to meet their deadlines.

The toxicity of the Russian defense industry is a direct consequence of sanctions against main industry enterprises with “Rostec,” “Almaz-Antey,” “Kalashnikov Concern,” “Uralvagonzavod,” “Rosoboronexport.” “United Aircraft Corporation,” “United Shipbuilding Corporation,” and many more. This toxicity interferes with Russian activity on the international weaponry market. At the same time, OFAC case law (e.g. [China's Equipment Development Department \(EDD\) case](#)) leads to the restrictions in the cooperation of Russia with its new and traditional partners in military-technical (defense) cooperation.

As a result of the space industry issues, Russia lost its space services leadership. According to the indicator of the rocket orbital launches, Russia lost the first place to China and is now on the second place.

Nevertheless, Russia still maintains its leading position on the global weaponry market. According to SIPRI, Russia is the world's second largest weaponry exporter.

The domestic market is painfully short of imported components and equipment. The import substitution system of the Russian defense industry is still unable to substitute foreign articles and forced to postpone a number of projects. It was even noted that the shipbuilding industry is forced to postpone the supply of vessels to the Russian navy.

At the center of attention is an issue of the economic efficiency of the defense industry enterprises. Often, the industry's enterprises are unprofitable or marginal, lacking stability with respect to financial indicators, and heavily dependent on state spending. On top of that, certain challenges to the industry arise, because in 2020 most of the rearmament programs for the Army and the Navy are due to be completed.

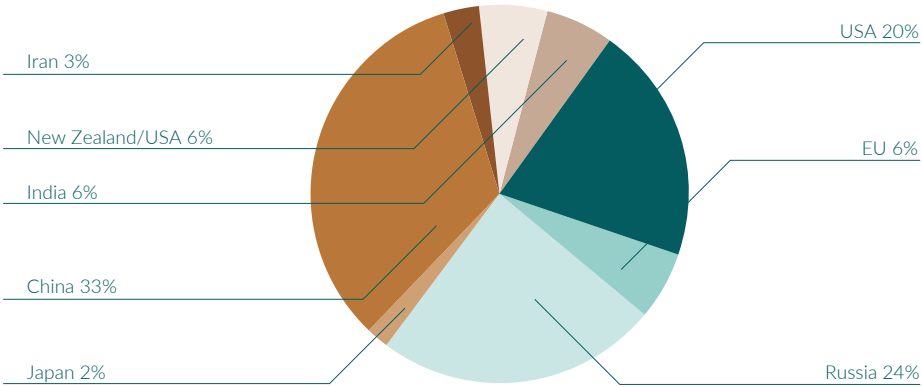
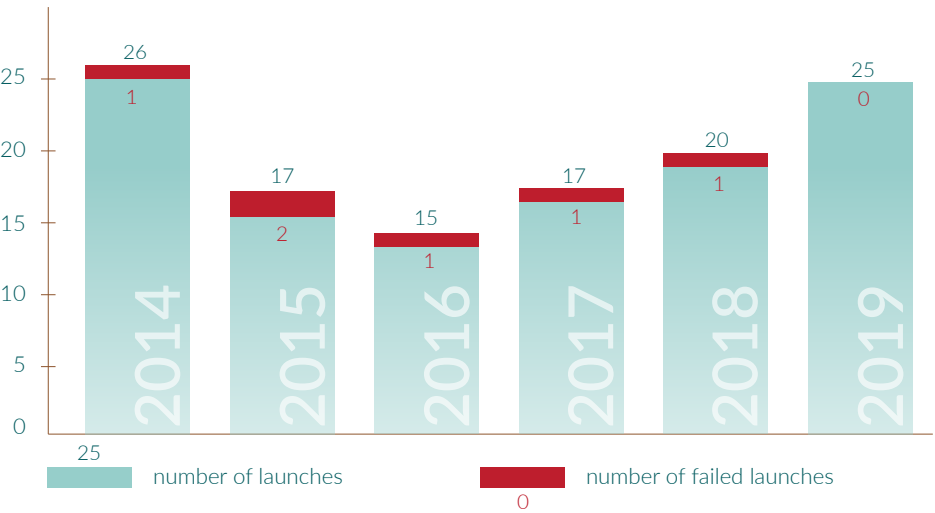
The space market could have been one of the locomotives for defense industry diversification. Rocket launches are in high demand worldwide for both telecommunications and space research and development purposes. If successfully managed, this could provide the Russian economy certain incentives for development.

Nevertheless, the industry: (1) failed to prove that it is profitable even to the special national insurance corporation; (2) is painfully short of imports of the foreign equipment and components (many of which are dual use items of U.S. origin) and for some articles that form up to 90% of the product; (3) must struggle with multi-billion corruption scandals and offenses worth of trillions.

In October 2019, experts noted that Russia significantly lost significant position in the space services market. However, by January 2020, Russia managed to take second place in terms of launches into orbit.

Launches of space missiles in Russia (2014 - 2019)

Source: Roscosmos



World leaders for orbit launches by country - 2019

Source: Space.skyrocket.de
Date: 13.01.2020

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Analysis of the Main Sanctions Developments in 2019

For Russia's defense industry, this year was notable because of the Kerch Strait incident. This case demonstrates two important industry-related issues: designation of defense industry persons onto the SDN-list with little to no relation to the incident and the designation of military suppliers.

SDN for persons with little to no relation to the incident

- Along with sectoral sanctions that make it difficult to finance or acquire foreign equipment and components, the concern of the industry is that SDN designations include designations for reasons that are not always related to the events that led to new designations.
- For instance, as part of the increased sanctions pressure on Russia's defense industry because of the Kerch Strait incident, and in addition to defense industry enterprises and an energy enterprise, the U.S. designated LLC SK Consol-Stroi LTD, one of the lead construction and development companies of the region. It is very active in the construction of residential and commercial real estate.

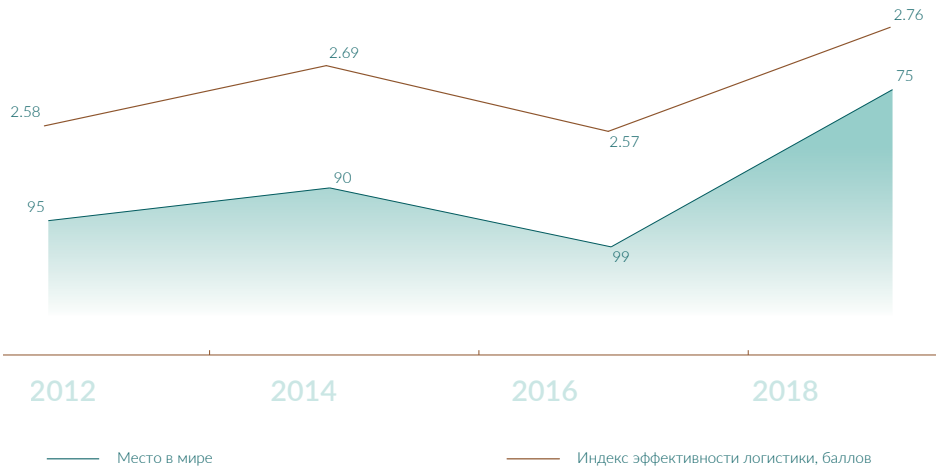
Supply of the military components is a way to be designated onto the SDN list

- The Kerch strait case demonstrates heightened risks for defense industry contractors.
- The supply of the components to the Russian Navy was one of the reasons AO Kontsern Okeanpribor was designated onto the SDN list.

TRANSPORTATION INDUSTRY

General Overview

At first, the transportation industry felt the harsh impact of the deterioration of the world sanctions situation. The drop in the number of carriages caused by the decrease in international trade, the consequent change of the structures, and the price increases, became challenges for the industry. Nevertheless, the “shock absorption” factors such as the intensification of the domestic ports use, a decrease in use of transit in ports of the Ukraine and the Baltic, an increase in the carriage of agricultural products, and some stabilization in the trade in imports after the currency situation improved in 2017 all can be considered as positive signs. Moreover, in 2019-2020, there are resolutions of the uncertainties around issues of the transit of embargoed food products through Russian territory, which is a solid, positive indicator for the industry.



Statistics Indicators of the Transportation Industry (2017-2018)

Source: World Bank Logistics Performance Index 2018

The Efficiency of the Russian Logistics, World Ranking (2012-2018) (2012 - 2018)

Source: World Bank Logistics Performance Index, Ministry of Transport of the Russian Federation, Rosstat, China Statistical Year Book 2018, Indian Railways Year Book 2017-18, Bureau of Transportation Statistics, EY Analysis

Length of the general use railway lines	3 rd in the world	86 000 km
Length of Automobile Roads	5 th in the world	1 529 000 km
The largest transshipment port of Russia by volume (Novorossiysk)	3 rd in Europe	155 mln of tons
The length of inland waterways	3 rd in the world	101 000 km

Analysis of the Main Sanctions Developments in 2019



Increased sanctions risks for the transportation contractors of the defense

Sanctions risks for Russia's transportation industry have become more and more tangible. This is especially relevant for the businesses that are active as military contractors.

- In the ongoing [Sovfracht case](#), the U.S. is trying to interfere in the supply of the jet fuel for Russia's forces in Syria by designated Sovfracht-affiliated entities and vessels. [The case is notable due to the primary use of the U.S. currency and U.S. financial instruments](#), which is a signal for the industry to leave USD-based operations behind when doing international transportation.

Sanctions is a ground for the annulment of the arbitration clause and interfere with the obligations for payment

- The Industry is keeping an eye on [the ongoing Instar Logistics case](#), in which the company was designated because it provided services to “Kalashnikov.” Sanctions heavily impacted the company's relations with its international partners.
- In 2019, the company participated in two important judicial proceedings. [In the first, the company proved the annulment of the arbitration clause because of the sanctions](#), while in the second, [still to be resolved](#), the company is trying to collect payments due for the services it provided and which its foreign party-consumer accepted but refused to pay. At the same time, it is presumed, that a foreign counterparty did not even try to obtain an OFAC license and resolve the matter.

“Sevastopol” issues in Singapore – inability to repair a vessel due to sanctions may lead to its loss

- The industry is keeping an eye on the ongoing Gudzon case. In it, OFAC designated two entities and six vessels, involved in oil products ship-to-ship trade for the needs of North Korea.
- Among those designated was a “Sevastopol” vessel, what had damage to its auxiliary engines and therefore was forced to stay in Singapore.
- As the vessel is considered “toxic,” neither the company nor the crew are unable to find a capable repairing contractor.
- Forced to idle, the vessel has an outstanding RUB 61 million debt and was arrested. [Singapore authorities were trying to acquire authorization for its sale.](#)
- The situation is instructive, as it clearly demonstrates a fear of secondary sanctions.



The end of abuses in the sphere of sanctioned products transit

2019 brought positive news for the transit businesses that use the Russian territory. The Ruling of the Supreme Court of the Russian Federation in favor of the Donetsk region entrepreneur Makovoz, in which the court allowed the transit of embargoed goods to Ukrainian territory, gives a clear, positive sign to both the business and the customs authorities that the times of the transit production being blocked to transit through Russia are at its end .

Everybody keeps an eye on Venezuela

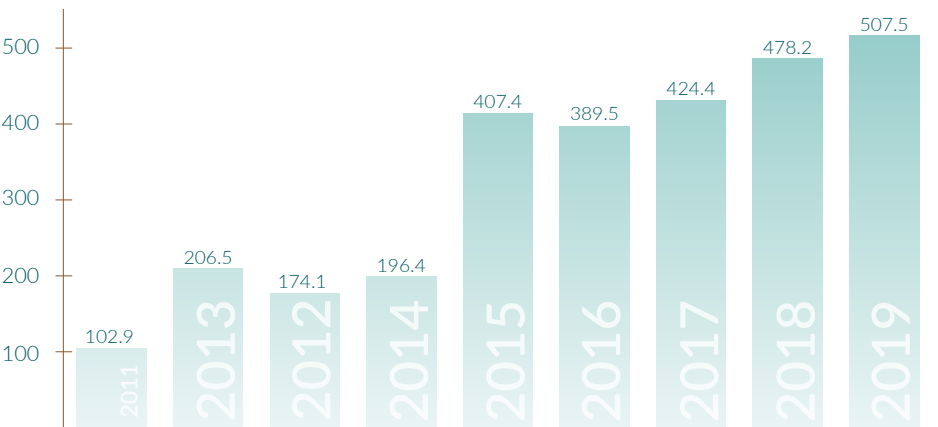
- As with the oil and gas industry, businesses are keeping an eye on Venezuela. PDVSA and its transportation contractors tried to implement different schemes to evade or circumvent sanctions. These included an attempt to use a complex scheme with international transportation contractors from Cuba, Liberia, Panama, Italy, and Cyprus.
- The cases were very indicative. In one of them, OFAC first designated a company onto an SDN-list and subsequently, probably when it received guarantees that the company would no longer deal with PDVSA, delisted the company. This is an example of the toxicity of the sea transportation operations with PDVSA.
- It might be the case that, should sanctions that cover Russia's transportation or oil and gas industries be widened, the regulator may take PDVSA-related experience into consideration. ■

METALLURGICAL INDUSTRY



General Overview

Russia's ferrous and non-ferrous metallurgy industries are extremely competitive in the world market. This makes the industry a target for sanctions.



Exports of Copper from Russia

Source: Federal Customs Service of the Russian Federation

1	Chile	5 832	28.5%
2	Peru	2 372	11.6%
3	China	1 742	8.5%
4	USA	1 333	6.5%
5	Australia	979	4.8%
6	Zambia	957	4.7%
7	Congo, D.R.	946	4.6%
8	Russia	763	3.7%
9	Canada	656	3.2%
10	Other countries	587	2.9%
Total		4 320	21.1%
		20 487	

World Mine Production of Cooper in the World (2018)

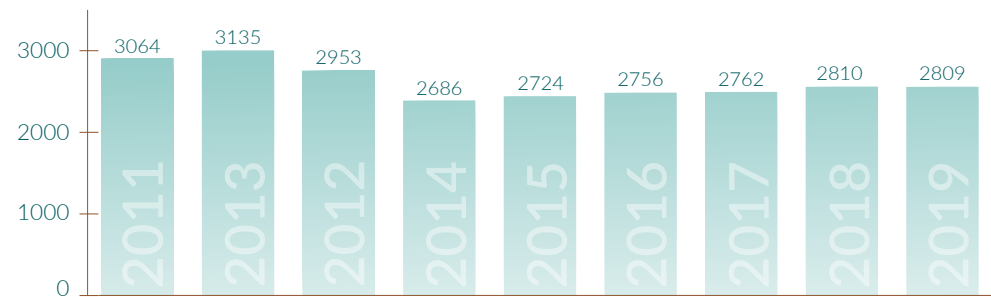
Source: Natural Resources Canada

When it comes to the non-ferrous metals, it is clear that sanctions against UC RUSAL were not coincidental, and its probable objective was a diminishment of the Russian producer's standing on the world market. As a result, it can be witnessed that an indicator of exported alumina dropped by 70% with its production level, however, remaining the same.

On top of that, En+ Group, a company that manages Oleg Deripaska's assets, has a significant share in the capital of the Nor Nickel company. After the introduction of sanctions against Oleg Deripaska, there were risks that Nor Nickel also would be designated.

Production of Alumina in Russia by the "RUSAL" company

Source: RUSAL



World production of Alumina by Country (2018)

Source: Natural Resources Canada

1	China	72,000	55.6%
2	Australia	19,000	14.7%
3	Brazil	7,900	6.1%
4	India	6,500	5.0%
5	Russia	2,800	2.2%
6	Jamaica	2,500	1.9%
7	Canada	1,600	1.2%
	Other countries	17,200	13.3%
	Total	129,500	

Apart from UC RUSAL and Nor Nickel, a significant share of Russia's non-ferrous metal market is held by the Ural Mining Metallurgical Company (UMMC) and the Russian Copper Company (RCC), which had the same fears.

The impact of the successful delisting of, and lifting of sanctions against, En+Group and UC RUSAL has substantial meaning for the metallurgy sector overall, as it has decreased the toxicity overall of Russia's non-ferrous sector. Prior to that, the industry lived in a constant fear of a deterioration of the sanctions situation.

With regards to ferrous metallurgy sector, sanctions are not a primary risk. Tube rolling entities, of course, were worried that there would be sanctions against Russia's gas pipelines, but they managed to meet all of their supply obligations before sanctions were introduced.

Though this question is not a subject of the research of this overview, the deepest concern of the industry is not sanctions; these are issues of tariffs and trade. A number of investigations across the globe are forcing the industry to amend its supply chain and business connections, however, as has been repeatedly demonstrated. NLMK, EVRAZ, MMK, Severstal, and Mechel had been seeing possible trade and tariffs risks as strategic issues for quite some time and successfully addressed these concerns. Nevertheless, trade restrictions can be significant and sometimes can reach a record-high increase as great as 756.93%.

Russia continues to support its metallurgical industry and uses diplomatic protection to do so. For instance, DSB WTO is now hearing the case DS554 ([United States – Certain Measures on Steel and Aluminium Products](#)). In it, Russia challenges trade measures introduced by the U.S. against Russian steel. The DSB decision is not expected before the autumn of 2020.

Analysis of the Main Sanctions Developments in 2019

An intense and highly productive year brings optimism for industry members in international business

- In 2019 the industry got a positive sign when the U.S. lifted sanctions against UC RUSAL – a key entity on the alumina market, controlled by Oleg Deripaska's structures.
- Moreover, a number of the Russian companies in the industry worked and continue to work with and in the United States. Many of them (such as NLMK subsidiaries in the U.S.) even managed to adapt to the U.S. administration's tariffs policy and reshape its supply chain, receiving components not from Russia but from U.S. free-trade partners: Brazil, Canada and Mexico.

Even if an entity is a military contractor, global sanctions risks are minimal if it is truly international

- Most of the industry members are in tight cooperation with each other and the state when it comes to state defense contracts. Nevertheless, the depth of sanctions risks is proportional to the specific integration of the entity into a global supply chain.
- The most important sector member, VSMPO–AVISMA, has the deepest integration into the global aerospace supply chain and is considered the world's largest producer of titanium and titanium products. Among its clients and partners are U.S.-based [Boeing](#) and [Pratt & Whitney](#), the [European Airbus Group](#), as well the [British Rolls-Royce](#).
- Among the corporation's Russian clients is [the United Aircraft Corporation](#), a key entity for the production of the military planes It has certain sanctions toxicity due to its tight connection with Rostec.
- Despite the tight connection with sanctioned entities, the introduction of sanctions against VSMPO-AVISMA is clearly not in the interest of the U.S. and the European aerospace industries. ■

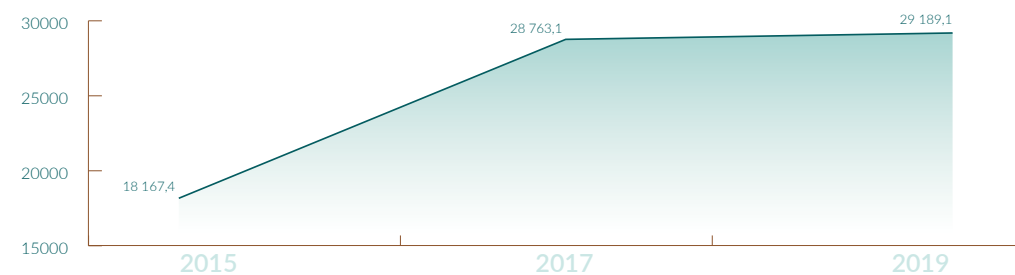
AGRICULTURE INDUSTRY

Agriculture Industry

General Overview

International sanctions had a positive impact on a number of agriculture industry sectors.

Because of the Russian countermeasures (food embargo), there were improvements and an increase in the export-oriented industry sector. The industry achieved improvements in a number of self-sufficiency and food security issues. The domestic market witnessed an increase in the profitability indicators of agricultural organizations for some non-traditional products. At the same time, the part of the food market held by the EU was quickly overtaken by companies from the Latin America. At the same time, the industry's successes relied on the foreign equipment, technologies, and materials.



Exports of the Russian Wheat

Source: Federal Customs Service

1	Russia	43 965 629
2	Canada	22 839 875
3	USA	22 498 998
4	France	18 943 618
5	Australia	12 514 528
6	Ukraine	16 373 389
7	Argentina	11 724 765
8	Romania	5 842 705
	World	188 573 780

Global Wheat Exports (2018)

Source: trademap.org

There has been a significant increase in the exports of agricultural products. At the end of 2019, exports were estimated in the range of USD 24-25 billion, which is 20% higher than in the 2018. Export articles mainly include crop products (e.g., wheat and maslin), fish, and sunflower oil. Imports include citrus fruits, alcohol, fruits, cheeses, and cottage cheese.

The Ministry of Agriculture of the Russian Federation considers that one of the key factors in the increase has been Russia's countermeasures, i.e., the food embargo. It is noted, that that companies from Latin America, Asia and the neighboring Belarus took over the EU's position some time after embargo.

The change in the global situation greatly contributed to the development of the new Doctrine of Food Security, in which the main criterion is sufficiency of the country's supply of its main food products. The new doctrine has new indicators such as "vegetables and melons" with a threshold value of 90%, "fruits and berries" with a threshold value of 60%, and also "seeds" with a threshold value of 75%.

At the same time, it is noted, that a production of agricultural products inside the country increased by 20%. Currently, Russia produces 99% of the its requirements for consumable wheat, 93% of meat, and 95% of sugar.

At the same time, the industry relies on the state aid. Experts say that the source structure of one agricultural ruble consists of 60% from the state and 40% from the private sector. It is noted that once the state leaves a project in the industry, the private sector follows.

For a number of projects, success is impossible without the aid of foreign suppliers of equipment, materials, and technical components. The share of the foreign products in this segment is sometimes more than 50%.

Analysis of the Main Sanctions Developments in 2019

Permitted transited of embargoed goods cause concerns in the industry

2019 marked an important step in the issue of the transit of the embargoed production. This was made possible due to the ruling of the Supreme Court of the Russian Federation in the case of Donetsk Oblast entrepreneur Makovoz, in which the court allowed a transit of goods, barred by the countermeasures of Russia, to Ukraine. The case involved the transit of frozen pork lard from the Netherlands, which was prohibited by the food embargo for sale in the territory of the Russian Federation.

- The Industry had certain concerns due to the possible abuse of the court decision by unfairly competing businesses.
- On the other hand, it is noted that the Federal Customs Services continues to fiercely fight breaches of food embargo.

PROGNOSIS FOR THE DEVELOPMENT OF SANCTIONS AND RESTRICTIVE MEASURES

At the end of the fifth year of sanctions against Russia, it can be said that Russian businesses had lived through the initial shock of the sectoral sanctions and has managed to survive, and sometimes even develop itself, in new realities. The foreign policy situation and domestic political processes in the countries that initiated sanctions suggest that sanctions will remain for many years, if not for decades.

Despite the disappointing forecasts of some experts in 2018, Russia in 2019 did not experience harsh scenarios. "Sanctions from Hell" and "The Most Painful Measures Ever Taken by the U.S" did not happen. That said, among threats that did not see the light of the day, one can see:

- DASKA (Defending American Security from Kremlin Aggression Act) – an act that called for the introduction of somewhat severe sanctions against Russian banks, energy companies, sovereign debt, and certain persons
- DETER (Defending Elections from Threats by Establishing Red-Lines Act) – an act that called for complex sanctions against the Russian banks (including prohibitions of corresponding relations with U.S. banks), energy companies, the defense industry, and sovereign debt
- Some of the harshest sanctions as part of the second stage of the implementation of the Chemical and Biological Weapons Control and Warfare Elimination Act

However, some positive results in 2019 year must not lead one to the conclusion that a balance with sanctions initiators has been discovered. A number of factors may violate the existing balance. Among them: Syria and developments in neighboring countries, the U.S. Presidential elections in November 2020, and the southeastern Ukraine conflict.

Even if the EU catches a wind favorable to Russia, it is unlikely to reach the U.S., and further deteriorations are expected.

EU sanctions are linked to Russia's implementation of the Minsk Agreements and the progress in this realm may start a positive scenario. Relations with the new government of Ukraine also provide some hope. From a technical standpoint, lifting of the EU sanctions would be relatively easy to accomplish; it would be sufficient to prevent their prolongation. However, even if Minsk process would be positive, the EU would experience influence from two

sides: from its traditional trade partner, Russia; and from its traditional strategic ally, the United States.

On the bureaucratic level, the EU adopted a more pragmatic sanctions approach. In order to boost the efficiency of its implementation, part of the Unit FPI.5 in charge of the sanctions administration was transferred from the Service for Foreign Policy Instruments to the Directorate General on Financial Stability, Financial Services and Capital Markets Union (FISMA).

This would not lead to the change of strategy in the sanctions field; it's still an area under the High Representative of the Union for Foreign Affairs and Security Policy. However, it would definitely contribute to sanctions becoming more technical. There would be an increase in the monitoring for sanctions breaches, while investigations and imposition of penalties would now be under a procedure.

Another consideration is the prospects for some of the U.S. sanctions to be lifted; or, in other words, the lack of such prospects. The domestic political situation in the United States does not give confidence about any loosening of sanctions. Due to the results of the elections in 2018, the Congress is now highly influenced by the Democrats, who control the U.S. House of Representatives and have what fairly could be called an aggressive approach towards Russia. As a result, the role of Congress in creating sanctions is on the rise, in sharp confrontation with the Executive Branch of the U.S. Federal Government. Foreign policy perspectives between the two countries are also not the best, due to well-known reasons.

Mainly due to the domestic policy turmoils and struggle, the U.S. authorities might be unable to maintain the traditional sanctions pressure. It is possible that procedural, not political, factors might begin to take the driver's seat for U.S. sanctions policies, with sanctions-related activities would shifting from Congress and the White House to law enforcement agencies and institutions in the U.S. Federal Government. It is notable, that an active role in the enforcement of the Russian sanctions is currently demonstrated by the Department of Justice and the FBI (Oleg Nikitin case). There are also some Russia-related cyber cases (Yakubets case against an alleged Russian hacker) that could lead to the further strengthening of OFAC.

In 2020, the FBI and OFAC may finish a number of the investigations they started a while ago, and which are complex from both economic and technical standpoints. Areas for the investigation may cover banking, insurance, energy, dual-use items, as well as the supply and delivery of the equipment and components for the key Russian oil and gas and transportation projects. ■



APPENDIX

REGULATION AND STATISTICS OF THE UNITED STATES

Laws and Statutes:

- Trading with the Enemy Act (TWEA 1917)
- National Emergencies Act (NEA 1976)
- International Emergency Economic Powers Act (IEEPA 1977)
- Chemical and Biological Weapons Control and Warfare Elimination Act (CBWCWEA 1991)
- Countering America's Adversaries Through Sanctions Act (CATSAA 2017)
- Section 7503 of The National Defense Authorization Act (NDAA 2019-2020)
- Export Administration Act (1979)
- Foreign Assistance Act (1961)
- Export Administration Act (1979)

Executive Orders:

- Executive Order No. 13660 Blocking Property of Certain Persons Contributing to the Situation in Ukraine
- Executive Order No. 13660 Blocking Property of Certain Persons Contributing to the Situation in Ukraine
- Executive Order No. 13661 Blocking Property of Additional Persons Contributing to the Situation in Ukraine.
- Executive Order No. 13662 Blocking Property of Additional Persons Contributing to the Situation in Ukraine
- Executive Order No. 13685 Blocking Property of Certain Persons and Prohibiting Certain Transactions With Respect to the Crimea Region of Ukraine.

- Executive Order No. 13849 Authorizing the Implementation of Certain Sanctions Set Forth in the Countering America's Adversaries Through Sanctions Act
- Executive Order No 13883 Administration of Proliferation Sanctions and Amendment of Executive Order 12851

Notes:

For purposes of the above-mentioned regulation implementation, [the U.S. has special Directives](#).

Sanctions can be classified as sectoral, personal, and sanctions that interfere with foreign trade.

For matters of interpretation, OFAC issues official ["FAQs"](#) and in some cases, it regulates affairs via [General Licenses](#) that along with official FAQs provide guidance towards certain commercial actions.

There is also an opportunity to receive a [Specific License](#), for the authorization of certain action that would otherwise would be prohibited.

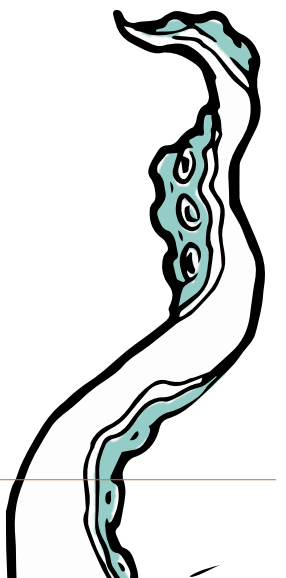
[The SDN list](#), which includes persons who are blocked due to the sanctions, is freely available.

When one settles a sanctions violation or breaches secondary sanctions, information on the settlement can be made public and be seen on the [official page of Civil Penalties and Enforcement Information](#).

The most important document for the business is [A Framework for OFAC Compliance Commitments](#), as it sets key basics for the successful functioning of an efficient compliance program that OFAC expects.

The U.S. Department of Commerce is charged with the administration of issues relating to foreign trade and export controls, with its [Bureau of Industry and Security](#) being charged with certain licensing activities.

Criminal prosecution for a breach of sanctions and exports controls is conducted by the Department of Justice with its [National Security Division](#), with investigative support by national regional divisions and offices of the FBI. ■



Statistics:

According to the official page of OFAC's Civil Penalties and Enforcement Information, [the Federal Budget received USD 1,289,027,059 as a result of OFAC's activity.](#)

To compare, [in 2018, the indicator was only USD 71,510,561.](#) The result in the previous five years that was closest to the collections in 2019 was [2014, in which penalties totaled USD 1,205,225,807.](#)

REGULATION AND STATISTICS OF THE EUROPEAN UNION

EU Regulation:

EU Regulation provides for personal and sectoral sanctions, as well as sanction related to certain foreign trade issues.

Council Decision 2014/145/CFSP of 17 March 2014 and Council Regulation (EU) No 269/2014 of 17 March 2014

Personal sanctions against Russian nationals because of Ukraine events.

Council Decision № 2014/ 386/CFSP and Council Regulation (EU) No № 692/2014 of 23 June 2014

Trade ban on imports from Crimea and Sevastopol

Council Decision № 2014/ 933/CFSP and Council Regulation 1351/2014

Widening of the sanctions application for Crimea and Sevastopol

Council Decision № 2014/ 512/CFSP and Council Regulation № 833/2014 of 31 July 2014

Sectoral sanctions

Council Decision № 2014/ 872/CFSP and Council Regulation № 833/2014 of 31 July 2014

Amendments to the sectoral sanctions

Council Decision № 2019/416/CFSP

Restrictions because of the Kerch Strait incident

Notes:

Economic restrictions include:

1. Restrictions against Sevastopol and Crimea

- An import ban on goods from Crimea and Sevastopol
- Restrictions on trade and investment related to certain economic sectors and infrastructure projects
- A prohibition to supply tourism services in Crimea or Sevastopol
- An export ban for certain goods and technologies

2. Sectoral restrictions

- Access to EU primary and secondary capital markets for certain Russian banks and companies is limited.
- Export and import bans on the trade in arms is imposed.
- Established an export ban for dual-use goods for military use or military end-users in Russia
- Russian access to certain sensitive technologies and services that can be used for oil production and exploration is curtailed.
- EU's international development institutions – European Bank for Reconstruction and Development (EBRD) and European Investment Bank (EIB) – suspended their activities in and with Russia.
- The administration and coordination of sanctions in the EU is conducted by the Unit FPI.5. part of which in 2020 [transferred from the Service for Foreign Policy instrument to the to the Directorate General on Financial Stability, Financial Services and Capital Markets Union \(FISMA\).](#)
- Criminal prosecution for the breach of sanctions and export controls is conducted within a member-state.

Statistics:

Currently, EU restrictions cover [170 persons and 44 entities.](#) Among them are powerful and influential politicians and businesspersons, military personnel, public officials, and big corporations.

EU restrictions are extended until the mid-2020. ■



ART DE LEX

ABOUT US

ART DE LEX law firm provides a full specter of legal services to businesses, public organizations and individuals. We provide truly global services by crafting the best solutions to help our clients in navigating complex legal issues.

We are proud to note our key features: responsibility for the results, individual approach and confidentiality.

All of our Partners and Head of Practices are highly recognized professionals with a proven track record in their respective areas of expertise. As such, our expertise and business-oriented approach were recognized and recommended by the lead Russian and International legal rankings.

ABOUT THE PRACTICE

International economic sanctions pressure intensifies regularly. It comes along with new risks for international transactions and foreign investments. Sanctions risks directly affect every global transaction and hence need to be considered when drafting and implementing a business strategy.

ART DE LEX law firm provides services in the realm of international economic compliance. Created in 2014, for almost six years the practice consults international companies, Russian businesses and investors on these pressing issues.

The solutions of the practice meet industries' expectations and perfectly match best practices of banking, insurance and energy sectors – industries of the heightened sanctions pressure and risks.

SERVICES

- Complex sanctions compliance solutions for international transactions
- Structuring of international operations with sanctioned or potentially sanctioned elements
- Analytical support for work with sanctions regime, including delisting issues
- Sanctions screening
- Sanctions-related dispute resolution services
- Support on sanctions issues for the interaction with financial organizations

SOME OF THE PRACTICE'S PROJECTS

1. Represented "Transcapitalbank" (44% of which, at the time, were held by the EBRD and the World Bank structures) in a precedent-setting case, in which courts discovered an approach to deal with payment order in the USD if sanctions are involved.
2. Represented the lead Korean entity in the realms of oil refining, petrochemistry and construction in a joint venture project with his Russian counterpart – a specialized entity with key expertise in construction and design of oil and gas refineries.
3. Consulted a key, the full-cycle construction company in its complex oil and gas infrastructure projects on issues of (1) Kaliningrad region special economic zone peculiarities, (2) sanctions issues as part of the LNG regasification terminal on the Baltic (part of Kaliningrad energy zone).
4. Provided complex consulting expertise to one of Russia's largest insurance companies on matters of legal support of its international operations and issues of its sanctions compliance program.
5. Represented a client in a case, where its counterpart contractual performance was linked to the existence and use of the licenses issued by the U.S. Treasury.
6. Central Bank's opinion is confirmed by the comparison graph of RUB/USD currencies toward IEMB (LSE) that reflects "currency changes" of other countries with emerging markets. As demonstrated by the graph, starting with 2017, RUB as a whole "pursued" emerging markets currencies. ■



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