RuAssetsWatch

MONITORING INITIATIVES TO CONFISCATE RUSSIAN ASSETS FOR THE RECOVERY OF UKRAINE

July 2023

In this release:

- **The EU took another step towards legislation on the introduction of criminal liability for violations and circumvention of sanctions. MEPs allowed the start of inter-institutional negotiations with the governments of the EU member states on the relevant directive. One of the initiatives of MEPs is that the assets confiscated under such criminal proceedings should be used for the reconstruction of Ukraine.**
- **Some of the partners are already taking measures to reduce the Russian presence in their economy – the Polish government appointed a temporary manager for the Russian oligarch Vyacheslav Kantor's property in Grupa Azoty. Poland will look for a partner who will buy about 20% of the frozen shares and pay compensation. The country's government believes this will ensure independence from Russian energy resources.**
- **In early July, the International Working Group on Russian Sanctions presented a new report aimed at limiting the access of the Russian military-industrial complex to Western technologies. The document contains convincing evidence of how critical missile components continue to get from Western countries to the Russian Federation, as well as recommendations on how to stop this process.**
- **The United States introduced new sanctions on a number of Russian enterprises working in the fields of the military-industrial complex, aerospace industry, quantum technologies and advanced computer technologies that the Russian Federation uses to support the defense industry, and more than a dozen scientific and research organizations, and also limited access to international financial system of a number of Russian banks.**

- **Canada's new sanctions target Russian private military companies and leaders of Russia's nuclear sector, as well as a number of individuals involved in the development, production and supply of Orlan-10 unmanned aerial vehicles.**
- **Japan expanded its ban on vehicle exports to Russia from August 9 to include used cars under G7 sanctions. Japanese cars are in high demand in the Russian Federation, and the extended ban could strike another economic blow.**
- **The Kyiv School of Economics (KSE) conducted a study on the impact of sanctions on the Russian economy. Conclusion: sanctions are working, but the breaking point regarding the impossibility of waging an aggressive war against Ukraine is not yet visible. Moreover, the economy of the Russian Federation is close to full recovery after the initial shock: Russia is diversifying its oil and gas supplies and establishing new sales markets.**
- **In its research, the Atlantic Council confirms that a key vulnerability in the application of sanctions on Russia is a gap in beneficial ownership information, also in the case of oil price cap.**
- **According to the KSE calculations, for the 18 months of war against Ukraine, only about 10% of Western companies left Russia. However, due to the exit of Western business, Russian oligarchs got the opportunity to buy assets at huge discounts or practically for free. It is not surprising that Putin's associates received the most attractive assets.**
- **Sense Bank (formerly Alfa Bank) became the property of the state, having passed the nationalization procedure, thereby increasing the government's share in the banking sector, which was already about 60%. At the same time, the National Bank of Ukraine received letters from the former owners (Mikhail Fridman and Pyotr Aven) stating their intention to appeal the decision to withdraw the bank from the market, which triggered the nationalization procedure.**
- **Ukraine was still unable to confiscate all the assets of the sanctioned Russian oligarch Oleg Deripaska – the Appeal Chamber of the High Anti-Corruption Court disagreed with the Ministry of Justice's evidence regarding the confiscation of Khustskyi and Zhezhelivskyi granite quarries.**

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1. Practical steps of the EU on confiscation of Russian assets and improvement of sanctions policy

Description of the situation

The European Union is close to finalizing laws on criminalizing sanctions evasion. The EU introduced sanctions against the Russian Federation and those who support it since the beginning of the annexation of Crimea in 2014. With the beginning of the Russian Federation's large-scale armed aggression against Ukraine, the EU has already introduced 11 packages of sanctions. However, according to the European Commission, the inconsistent application of EU sanctions undermined their effectiveness.

To lay the groundwork for unified criminal liability for EU sanctions violations, in July 2023, the European Parliament agreed to add sanctions violations to the list of "particularly serious crimes with a cross-border dimension" for which the EU can adopt minimum rules. The EU Council adopted this decision back in November 2022, and the European Commission put forward a proposal to harmonize the legislation in December 2022. Since then, the relevant draft directive has been under consideration by the European Parliament.

Finally, at the beginning of July 2023, the EP Committee on Civil Liberties, Justice and Home Affairs adopted a draft report with proposals on *the Directive of the European Parliament and of the Council on the definition of criminal offences and penalties for the violation of Union restrictive measures 2022/0398(COD)*.

As stated in the press release, EU sanctions may include, among other things, freezing funds and assets, travel bans, arms embargoes and economic restrictions. Under the proposed act, violations would include failing to freeze funds or comply with a travel ban as required by sanctions, or doing business with state-owned enterprises of sanctioned countries.

Sanctions circumvention will also be punished and will include practices such as concealing or transferring funds that should be frozen, concealing the true ownership of property, and failing to provide sufficient information. MEPs voted to specify the list of actions that are considered circumvention.

According to the proposal, violations and circumvention of sanctions should be punishable by imprisonment for a maximum term of up to five years and fines of up to ten million euros. When companies violate or circumvent sanctions, they should be excluded from public procurement. In the adopted text, MEPs set the maximum fine to be paid by companies at the level of up to 15% of the total annual turnover and added new aggravating circumstances, such as war crimes and obstruction of investigations.

MEPs also suggested adding two new clauses to Article 10 of the Directive:

- member states ensure that funds or economic resources subject to EU restrictive measures, in respect of which an identified person, organization or body, listed in Council Regulation (EU) No. 269/2014 and Council Regulation (EU) No. 833/2014, commits or participates in offences… should be frozen and confiscated in accordance with Articles 11-18a of the [Asset Recovery and Confiscation] Directive (*note: this Directive has not yet been adopted*).

- The European Commission issues guidance on the use of confiscated funds, proceeds and assets for compensation, restitution and compensation to States, particularly in times of aggressive war, as interests... are directly or indirectly affected by criminal activities covered by the provisions of this Directive and the [Asset Recovery and Confiscation] Directive.

In addition, MEPs proposed to supplement the directive with a new statement (declaration), in particular, they noted that the profit obtained by circumventing restrictive measures allows the continued use of assets. This undermines the objectives and effectiveness of these restrictive measures and therefore needs to be addressed. The income obtained as a result of sanctions violations should be subject to confiscation. If assets are confiscated in connection with Russia's war of aggression against Ukraine or related crimes, such assets or the proceeds received from them must be allocated to contributions to the reconstruction of Ukraine.

In addition, EU countries will be obliged to guarantee cooperation and coordination between various law enforcement and judicial authorities. Cooperation on criminal investigations of sanctions violations will also take place at the European level - between member states, the European Commission and EU agencies such as Europol or the European Public Prosecutor's Office.

The next step will be inter-institutional negotiations with the participation of the governments of EU member states. Once approved at the level of the entire European Parliament, this will be the position for negotiations on the final form of the directive.

Meanwhile, some of Ukraine's allied states are already taking certain measures to reduce the presence of Russians in their own economies. As noted by Money.pl, the Polish government appointed a temporary manager of Russian oligarch Vyacheslav Kantor's property in Grupa Azoty. Poland will look for a partner who will buy about 20% of Grupa Azoty's frozen shares and pay compensation. Such steps will ensure independence from Russian energy resources and limit the influence of Russian capital.

The appointment of a temporary manager involves: determination of the market value of purchased packages, determination of the entity/entities that will purchase shares, issuance of an administrative decision on acquisition, payment of compensation to a specific bank account (frozen funds), re-registration of securities.

As Waldemar Buda, Minister of Economic Development and Technology of Poland, noted: "Despite the fact that Kantor's shares are frozen, therefore the exercise of voting rights at shareholders' meetings and the payment of dividends are out of the question, we do not want this Russian to be associated in any way with the Polish, strategic company - the leader of the domestic fertilizer market and one of the key capital groups of the European mineral and chemical industry."

Analysis

The adoption of the directive on recognizing EU sanctions circumvention as a EU criminal offense is the first stage that will allow initiating the process of confiscation of Russian assets in favor of Ukraine as part of the relevant criminal proceedings.

In addition, the debate on the use of frozen Russian assets for the reconstruction of Ukraine has reached its peak. More and more experts and analysts point out that the European program for the recovery of Ukraine should be financed at the expense of Russian assets.

Barry Eichengreen, Professor of Economics at the University of California, presents his arguments in the article for *The Guardian* entitled Would handing frozen Russian assets to

Ukraine be better than reparations? In particular, he notes that the governments of the G7 countries have large debts and are faced with the need to allocate additional resources for national defense, the green transition and the aging of the population. There are already signs of fatigue from helping Ukraine.

These complaints are heard despite the fact that financial transfers from the US and the EU, amounting to about USD 3 billion a month, pale in comparison with the costs of reconstructing Ukraine (USD 411 billion according to a joint estimate of the government of Ukraine, the World Bank, UNDP, and the European Commission, published in March 2023). The bill continues to mount with each additional day of fighting.

G7 governments will not provide funding on this scale. To be sure, other countries and the multilateral financial institutions will contribute and foreign direct investment will flow in (though it is unlikely to be sufficient even if provided with war insurance). In these circumstances, frozen Russian central bank assets, plus interest, would go a long way toward filling the gap.

Eichengreen dismisses the most popular fears. He points out that only central banks whose governments commit the most egregious violations of international norms would be subject to such measures. The international role of the dollar will not be diminished, since there is no practical alternative: the Chinese yuan is much vaunted, and remains leagues behind as an international currency. Will confiscation of Russian assets be legal? Interpretation of existing law is best left to lawyers. But if legal provisions are all that stand in the way, then the laws in question should be changed.

On the other hand, Eichengreen points out that garnishing Russia's frozen assets would give the Kremlin a powerful propaganda tool with which to paint Russia as victim rather than aggressor. This would make it harder to negotiate a durable armistice and it would reduce the odds of a transition to a post-Putin government that respected Ukraine's territorial integrity and reestablished peaceful ties with the West. Offering to return the frozen funds if Russia adheres to its obligations under international law could have the opposite effect.

Martin Sandbu, the Financial Times's economics commentator, expressed an interesting opinion. He writes that the EU is pondering the conundrum of double accounting of Russian assets. In particular, in June, the President of the European Commission, Ursula von der Leyen, promised to propose a mechanism for using "income" from the frozen assets of the Central Bank of the Russian Federation "before the summer holidays". However, until now this promise has not been fulfilled because of the objections of lawyers and the European Central Bank.

In Brussels, the idea of using surplus profits of central depositories, which store investors' securities - mainly sovereign bonds of central banks - is most accepted. By far the largest is Euroclear – according to the Belgian government – which holds about EUR 180 billion (about two-thirds of all locked-up Russian reserves).

This is about two balances of funds: a deposit with Euroclear bank (a liability on the balance sheet) and the corresponding funds for payment to investors, which are kept by the depository institution itself in the assets of its balance sheet. The crucial thing is that juridically only the cash account of the Central Bank of the Russian Federation in Euroclear belongs to Moscow. The rest of the assets belong to Euroclear. Usually the cash is not accumulated: the investor takes it or reinvests it. But not in this case, because the assets are blocked by sanctions, and as a result, Euroclear almost tripled its normal balance.

Euroclear can earn up to 3.5% more if it places its monetary assets in eurozone central banks. In the first quarter of 2023, Euroclear received EUR 720 million in profit from EUR 88 billion of cash related to the Russian Federation (annual profit of 3.3%). As assets increase and cash accumulates, profits may stabilize at the level of EUR 7-8 billion per year.

But on the opposite side - the interest of Euroclear's shareholders, who are now benefiting from huge profits. Insurers, international banks and European public financial groups also benefit. In addition, the right to tax profits rests with national governments, in this case Belgium, not the EU.

As reported by Iryna Mudra, Deputy Minister of Justice of Ukraine, it is extremely important that the maximum number of assets that directly or indirectly belong to sanctioned persons, persons involved in armed aggression in Ukraine, in the commission of war crimes, those who sponsor the war in Ukraine and support it, were frozen, seazed and transferred to the compensation fund for damages and restoration of Ukraine.

Therefore, the EU faces serious challenges in finding legal solutions for the confiscation of Russian assets. Half-measures will not solve the issue of compensating Ukraine for the damages caused by Russian aggression, even in the short term. It is the confiscation of Russian state assets and then their transfer to Ukraine in a legal way that will allow to compensate such losses to a large extent.

2. Sanctions have not yet produced the expected effect, the Russian Federation is looking for new loopholes to circumvent them

Description of the situation

In early July, the International Working Group on Russian Sanctions, co-chaired by Andrii Yermak, Head of the Office of the President, and Michael McFaul, Director at the Freeman Spogli Institute for International Studies (FSI), presented a new report (No. 12) aimed at limiting the access of the Russian military-industrial complex to Western technologies.

This document contains compelling evidence of how Western elements continue to facilitate a full-scale Russian invasion and war against Ukraine. The Russian X-101 missile, which killed 11 people, including one child, in a five-story residential building in Kryvyi Rih on June 13 this year, contained 53 critical components obtained from democratic countries.

The report provides detailed recommendations on how to stop critical missile components from reaching Russia.

"We have transferred all the information contained in this report and all the evidence to our international partners, and now we expect decisive, quick and effective actions", Andrii Yermak said. According to him, it is important not only to significantly strengthen sanctions, but also to significantly improve the procedures and practices of applying existing restrictions. He emphasized that in the second half of 2022, Russia was able to restore and even exceed the pre-sanction level of imports of critical components for the production of various weapons.

An analysis of 1,057 foreign components of Russian military equipment produced by 155 companies demonstrates that Russia's military supply chain maintains access to critical Western technologies. The study found that the critical components found on the battlefield since April 2022 are found in a wide range of weapons, including missiles, armored vehicles, artillery, helicopters, electronic warfare devices, and more. In 2022, USD 2.9 billion of sale of critical components to Russia were accounted for by 155 companies, whose products were identified in Russian weapons. While the supply is almost entirely carried out through third countries.

Meanwhile, Ukraine's allies continue to introduce new sanctions regimes against Russian companies, oligarchs and those who help circumvent sanctions. Thus, the Office of Foreign Assets Control of the US Treasury Department (OFAC) announced new sanctions against a number of companies of the Russian military-industrial complex engaged in the production of ammunition and high-tech developments.

In particular, they are:

- Aleksin Chemical Plant (produces ammunition and weapons);

- Kazan State Gunpowder Plant (produces explosives, weapons, ammunition, small arms);

- Tambov Gunpowder Plant (one of the main Russian manufacturers of ammunition for artillery and small arms);

- Tula Ammunition Factory (produces ammunition for small arms).

Sanctions were also imposed on a number of intermediaries who helped supply dual-use products to the Russian Federation, in particular:

Amegino FZE (Amegino) – an engineering service company from the UAE that provides electronic components and related industry services (has sent to the Russian Federation dozens of batches of electronics, including integrated circuits);

MCI Trading DOO Beograd Palilula (MCI) – a Serbian company that acts as an intermediary in the supply of high-tech goods from manufacturers in Asia, Europe and the Middle East.

The US Department of the Treasury also imposed sanctions on a number of Russian companies working in the aerospace industry, quantum technologies and advanced computer technologies that the Russian Federation uses to support the defense industry, and more than a dozen research organizations, and also limited access to the international financial system for a number of Russian banks.

OFAC has also issued a document on voluntary notification of potential violations of US sanctions and export control laws. The agency explains that self-disclosure of potential violations can provide significant mitigation of civil or criminal liability, as well as alert to activities that may threaten the national security and foreign policy objectives of the United States.

New sanctions were also introduced by **Canada and Japan**. Thus, the press release of the Canadian Ministry of Foreign Affairs states that the new sanctions are aimed at Russian individuals and legal entities associated with private military companies and leaders of Russia's nuclear sector. The sanctions also target a number of individuals involved in the development, production and supply of Orlan-10 unmanned aerial vehicles.

In turn, Japan expanded its ban on vehicle exports to Russia from August 9 to include used cars under G7 sanctions. Kyodo News reports this. Japanese cars are in high demand in the Russian Federation, and the extended ban is likely to deal another blow to Moscow.

Japan has already banned shipments of premium cars worth more than 6 million yen ($43,000) to Russia starting in April 2022, and the latest measure will additionally cover new and used gasoline and diesel vehicles with an engine capacity of more than 1,900 cm^3, electric and hybrid vehicles, as well as tires for large vehicles.

In addition, despite the introduction of new sanctions, analysts and experts point out that the Russian Federation is finding resources and loopholes to bypass sanctions restrictions. The aggressor continued to export raw materials to other countries and import goods produced in Western countries.

Analysis

As The New York Times writes, despite tough statements, the new program of sanctions of Great Britain turned out to be shaky. Some oligarchs received concessions and generous exemptions. For example, the British government allowed Russian oligarchs to spend hundreds of thousands of dollars on benefits such as private chefs, drivers and housekeepers, despite their bank accounts being allegedly frozen. It refers to the owners of the Russian Alfa Group, Mikhail Fridman and Pyotr Aven.

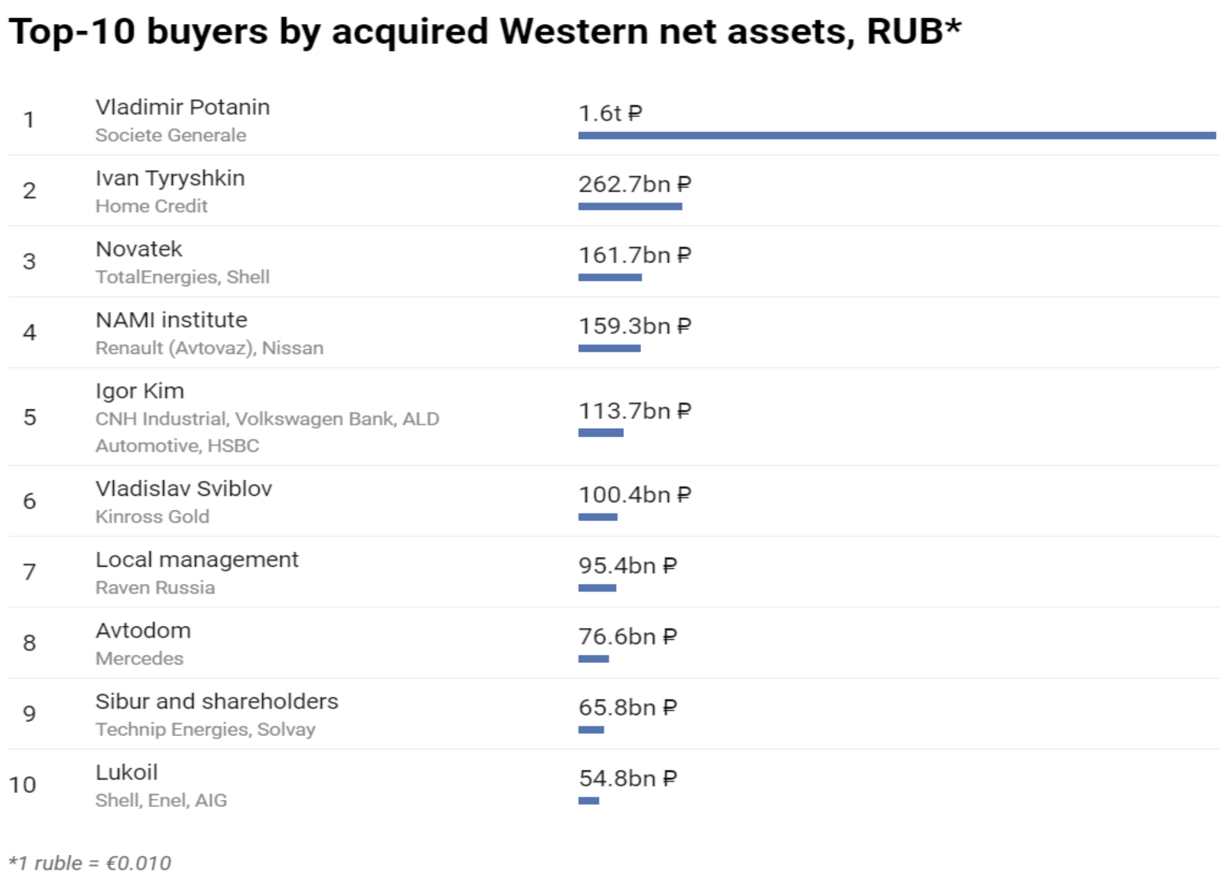
As the newspaper notes, the former business partners are among several Russians against whom sanctions were publicly imposed, but who secretly relaxed these restrictions. HM Treasury granted at least 82 licenses (permits) last year, and many more applications are pending.

In some cases, oligarchs were allowed to spend more than USD 1 million per year for residence. In other permits, officials have had to drop criminal investigations and lift sanctions after litigation.

At the same time, the reverse process is observed in the aggressor country – Russian businessmen purchased the assets of Western companies operating in the Russian Federation for the amount of EUR 35 billion for practically nothing. Novaya Gazeta Europe listed the entrepreneurs who benefited the most from the war in Ukraine and found out that more than 100 new big owners appeared in Russia after the start of the war. The assets of Western companies – bought, as a rule, for nothing – already brought them no less than 223 billion rubles of net profit last year. Businessmen close to the Kremlin, former top managers of companies and medium-sized entrepreneur are among the beneficiaries of the redistribution of Western property.

During the 18 months of war in Ukraine, only about 10% of Western companies left Russia, according to calculations by the Kyiv School of Economics (KSE). But thanks to the exit of Western business, Russians got the opportunity to buy large assets at huge discounts or practically for free. Foreigners who decided to leave the country at any cost are forced to carry out such transactions as a result of the rules established by the government of the Russian Federation – mandatory discounts and deductions to the budget.

Almost half of all assets sold by Western owners (1.6 trillion rubles) were bought by Vladimir Potanin, Russia's richest businessman. He acquired Rosbank, formerly a branch of the French Société Générale, and two insurance companies. The top 10 included buyers who acquired assets in the mining sector, manufacturing industry and financial institutions.



Source: Novaya Gazeta Europe, SPARK, open data

As the publication notes, the most profitable assets went to Novatek – a share of the French TotalEnergies in the Terneftegaz project and a share of Shell in the Sakhalin-2 project. The total net profit of Novatek from these projects in 2022 reached RUB 40 billion (EUR 400 million).

The largest shareholders of Novatek are the billionaires close to Putin, Leonid Mikhelson and Gennady Timchenko, as well as Total itself (19.4%), another 21% of the shares are listed on the stock exchange. After Terneftegaz deal, Total left the board of directors of Novatek. The management of Total claims that EU sanctions and Russian legislation do not allow the company to sell its stake in Novatek. In addition, the French company does not want to "enrich Russian investors" by complete divestment of assets.

The petrochemical company Sibur and its shareholders rank third in terms of profitability of purchases (RUB 31 billion, or EUR 310 million) and ninth in terms of net assets. Its largest owners are also Mikhelson (30.6%) and Timchenko (17%).

Therefore, Western companies faced challenges: either preserving business in Russia and thus indirectly financing the war in Ukraine, or huge losses from the sale of assets for nothing, or even the loss of the entire business. For example, McDonald's estimated its losses from exiting the Russian Federation at USD 1.2 billion, and Shell estimated the losses from exiting the Sakhalin-2 project at USD 1.6 billion.

Experts from the Kyiv School of Economics (KSE) conducted their own research and concluded that the sanctions are working, but the tipping point is not yet visible. Main theses:

1. *The economy of the Russian Federation is far from the breaking point*. Sanctions continue to affect the Russian economy, particularly external dynamics and budget revenues, but the country is not approaching a tipping point that would force it to end its aggressive war against Ukraine in the near future. Therefore, in the coming months, Ukraine's allies should significantly increase the pressure.

2. *Oil sanctions are having an effect, but more is needed*. International sanctions significantly affected Russia's exports and budget: export revenues in the first half of 2023 fell by a third (compared to the first and second half of 2022), and oil revenues fell by 23% compared to the second half of 2022 and by 46% compared to the same period last year. However, Russia continues to earn a lot of money from oil: USD 425 million per day in January-June.

3. *The external environment is increasingly complex*. In accordance with the decline in oil sales, the total export of goods from the Russian Federation fell by a third in the first half of 2023 (compared to the same period last year). Since imports are close to the pre-sanctions level, this means a sharp decline in the trade balance – USD 54.3 billion in the first half of 2023 against USD 179.8 billion a year earlier (-70%), and the current account surplus was USD 20.2 billion against USD 147.6 billion (-86%).

4. *The main macroeconomic factors cause the depreciation of the ruble*. At exchange rates of 90 rubles/dollar and 100 rubles/euro, the Russian currency has lost a significant share of its value since last fall – 39% against the dollar and 47% against the euro. A key factor is a significant decrease in foreign currency inflows due to a drop in exports. A weaker ruble increases the risk of inflation due to an increase in the cost of imported goods.

5. *Reduction of expenses leads to reduction of the budget deficit*. The deficit of the federal budget was significantly reduced – from RUB 3.4 trillion in January-April up to RUB 2.6 trillion in the first half of 2023. Oil and gas revenues are still lower (-47% compared to H1 2022), but other

revenues have increased and the authorities have managed to reduce spending. As a result, the deficit forecast for the whole of 2023 was reduced to ~5% of GDP.

6. *Russia's economy continues to recover. In fact, the economy is close to fully recovering from the initial shock of the sanctions* – in the first quarter of 2023, real GDP fell by only 1.8% compared to the previous year. While there are questions about the reliability of the Russian data, a variety of indicators, including high-frequency measures of activity and sentiment, paint a corresponding picture.

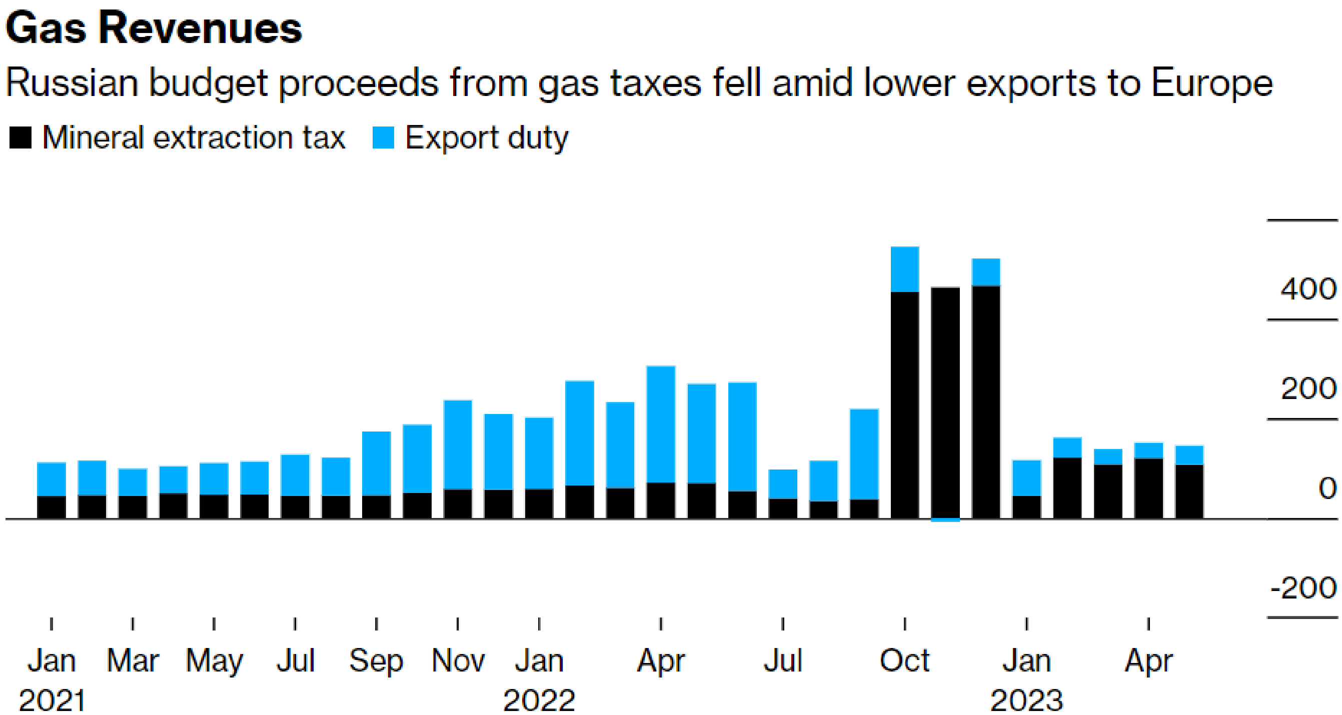
A Bloomberg study is an example of how the Russian Federation is looking for new ways to export oil and why, despite sanctions. As the newspaper notes, Russia is sending a rare cargo of crude oil through the Northern Sea Route to speed up deliveries to China. Primorsky Prospekt, Aframax tanker, loaded about 730,000 barrels of Urals oil at the Baltic port of Ust-Luga on July 11-12 and was heading north along the coast of Norway, with Zhizhao, China, as its destination. Using this route is expected to cut sailing times by two weeks, or about 30%, compared to the Mediterranean and Suez Canal route.

Eastbound shipping along the Northern Sea Route will be suspended for the winter from November 30. The previous shipment was sent last year, shortly before the route became impassable. At least two tankers passed in 2019. Rosatomflot and Russian oil companies are studying the possible redirection of crude oil supplies from Baltic ports through the Arctic. Meanwhile, Novatek, which operates LNG projects on Russia's Arctic coast, plans to begin year-round shipping to the east through the Northern Sea Route in early 2024.

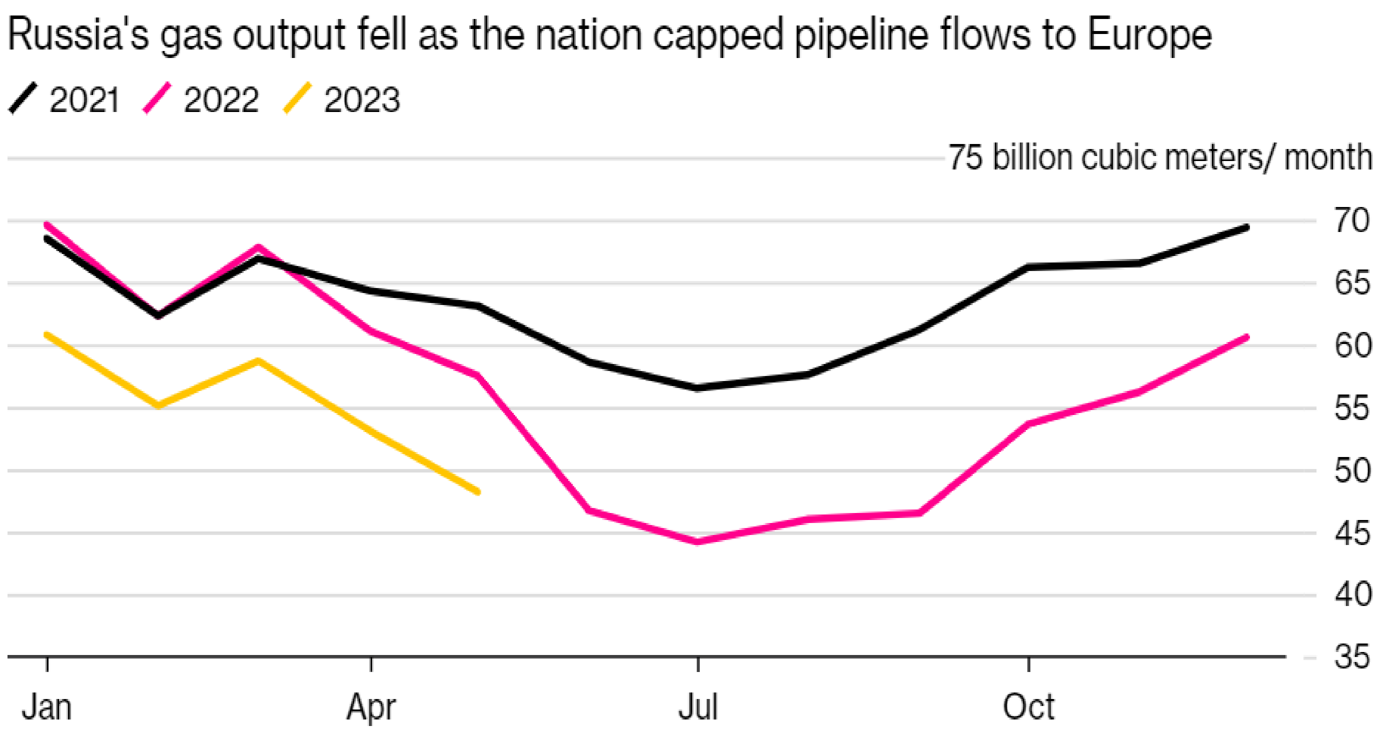
Another Bloomberg study shows how the Russian gas sector is looking for new sales markets. The war cut Russia off from Europe, its biggest market (two-thirds of gas exports, including LNG). In 2021, Russia pumped about 150 bcm of gas through pipelines to Europe — more than enough to meet the combined annual consumption of Germany, France, and Austria.

Now, even with efforts to find new sales markets, Russia has no customers for about 90 bcm of pipeline gas, which has increased the pressure on its economy. A drop in gas prices of more than 50% this year has further reduced earnings. Gas production fell by more than 13% in the first five months of the year compared to the same period in 2022. Most of this decline is accounted for by Gazprom, which exported pipeline gas. If it weren't for Novatek, Russia's largest LNG producer, which kept its production at the previous level, and Rosneft, which provided additional supplies to the domestic market, the decline would have been even more severe.

A mild winter helped Europe to overcome a deep energy crisis, but it was not so easy for Moscow to replace the European market. Gas revenues fell by almost 45% in the period from January to May compared to the same period in 2022 – to RUB 710 billion (USD 8.3 billion), according to the Ministry of Finance of the Russian Federation.



Source: Bloomberg, Ministry of Finance of the Russian Federation



Source: Bloomberg, industry data

Note: Production does not include flared volumes and technical losses of gas

The tougher the sanctions, the more creative a country usually becomes in terms of figuring out how to overcome them. This situation accelerated Russia's "pivot" to China, which, however, will require the construction of new gas pipelines that will complement the Power of Siberia branch, which began operating in December 2019. Shipments to China are a fraction of what they were to Europe before the war, but they have grown and are expected to rise by 42% this year to 22 bcm before rising to 38 bcm in 2025.

Some countries, such as the UK and the Baltic states, have completely banned imports of Russian gas, including LNG, while other governments have urged companies to reduce dependence. But the full embargo on Russian gas has not yet been imposed. However, the speed with which Western European markets have adapted to the reduction in Russian pipeline gas volumes has hit Gazprom particularly hard. Production fell by 20% in 2022 to 412.6 bcm, the lowest in at least 15 years. And net income fell by more than 41% to RUB 1.23 trillion.

Supply diversification options – a Turkish trading hub, new markets in Central Asia and additional pipelines to China – require significant political effort, leaving Russia with limited options in the short term for what to do with "excess" gas. Nevertheless, Russian LNG exports are booming, accounting for 12% of Western Europe's total LNG imports this year. France, Belgium and Spain imported record volumes from Russia in 2022, to which European officials are beginning to pay close attention. The Netherlands and Spain are taking steps to ban LNG imports from Russia, but the region as a whole is unlikely to stop buying from the Russian Federation in the near future.

Russia wants to triple LNG production by the end of the decade, and it could use spare pipeline capacity after falling flows to Europe to meet the goal. Novatek wants to connect the proposed Murmansk LNG plant to Gazprom's gas network, which would allow the company to liquefy gas that was previously transported via pipelines to Europe.

The *Ekonomichna Pravda* published an analytical article by Bohdan Miroshnichenko titled How the West will Lose Economic Sanctions to Russia, the main message of which is that instead of introducing tougher sanctions after the events of 2014, Western companies helped the Russian Federation master gas liquefaction technologies and bring production to a new level.

In particular, the analyst notes that Western countries fought so hard against the oil dictators in Iraq, Iran, Libya and Venezuela that they did not notice the biggest among them right under their very noses. The USA, Britain and the EU not only bought Russian oil and gas for decades, but also built pipelines, displaced other importers in favor of the Kremlin, and helped the latter to master extraction and transportation technologies.

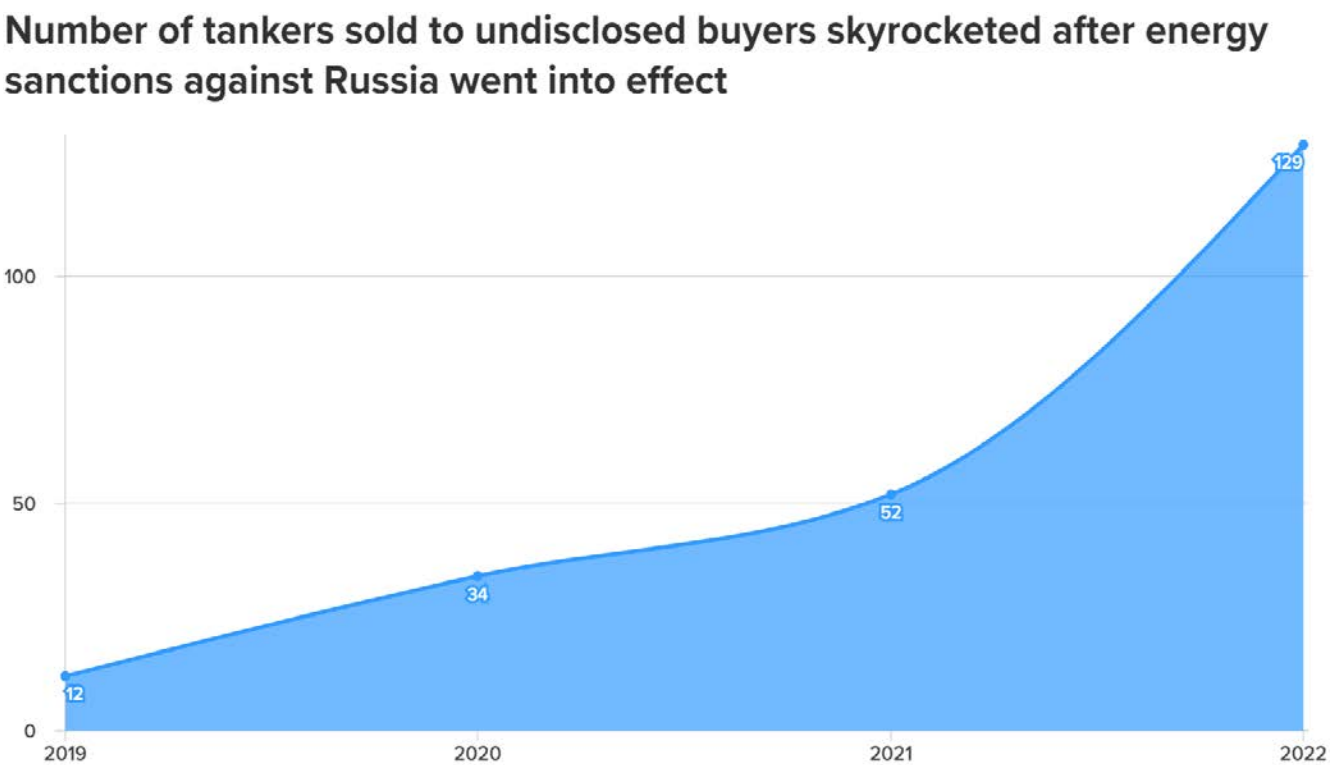
In his opinion, the oil embargo and price restrictions introduced against the Russian Federation do not work in full force, and natural gas is generally outside the sanctions. As a result, **Russia retains its main source of income, and energy sanctions have no effect on the Kremlin's desire to end the war**.

Atlantic Council experts also conducted their study on evasion of global sanctions, one of the main conclusions of which is that the key vulnerability in the application of sanctions against Russia is a gap in beneficial ownership information, including in the case of oil price restrictions.

As analysts note, the lack of knowledge about the beneficiaries played a key role in preventing the implementation of the maximum prices for Russian oil. The effectiveness of the price cap strategy depends on the access of Russian oil exporters and importers to services such as oil tanker insurance, which is provided by companies mainly from the G7 countries (90% of the market). In response, Moscow created a "shadow fleet" of oil tankers, the real owners of which are unknown. In February 2023, it had about six hundred vessels.

Why is the "shadow fleet" so dangerous? It includes tankers previously used to supply Iranian and Venezuelan oil, as well as European tankers sold to owners in the Middle East and Asia since the start of Russia's invasion of Ukraine. Tankers operate without Western insurance and do not meet safety standards. Most of them belong to offshore companies based in countries such as Panama, the Marshall Islands and Liberia. A third of the tankers in the "shadow fleet" are more than 15 years old (the service life after which the vessel is decommissioned), which creates increased risks of oil spills and environmental disasters. The average age of the "shadow fleet" is 12 years.

Last year, the number of undisclosed tanker buyers more than doubled compared to 2021. The buyers of most of the vessels were located outside the G7 countries or the European Union. In particular, the London company Gibson Shipbrokers estimates that about a hundred tankers were sold to companies outside the G7. The undisclosed buyers of the ships were most likely shell companies or individuals acting on behalf of the Russian beneficial owners of the "shadow fleet."



Sources: Bloomberg News, VesselsValue

Implementing the FATF's recommendations to provide competent authorities with information about the true owners of companies can make life difficult for those who evade sanctions and those who launder money to facilitate transactions for Russian sanctioned companies. **A broader exchange of information about Russia's illegal financial activities and the shell companies involved in it will help close this gap in the application of sanctions**.

3. Ukraine's initiatives to improve the procedure for confiscation of assets of persons subject to sanctions

Description of the situation

The President Volodymyr Zelenskyi signed the Law On Amendments to Certain Legislative Acts of Ukraine on the Application of Sanctions (draft No. 8392), which provides for the creation of the State Register of Sanctions. The Verkhovna Rada adopted the law at a meeting on July 13.

In particular, it is provided for that information about all individuals and legal entities against whom sanctions have been imposed will become public. The register will be maintained by the NSDC Apparatus in Ukrainian and English.

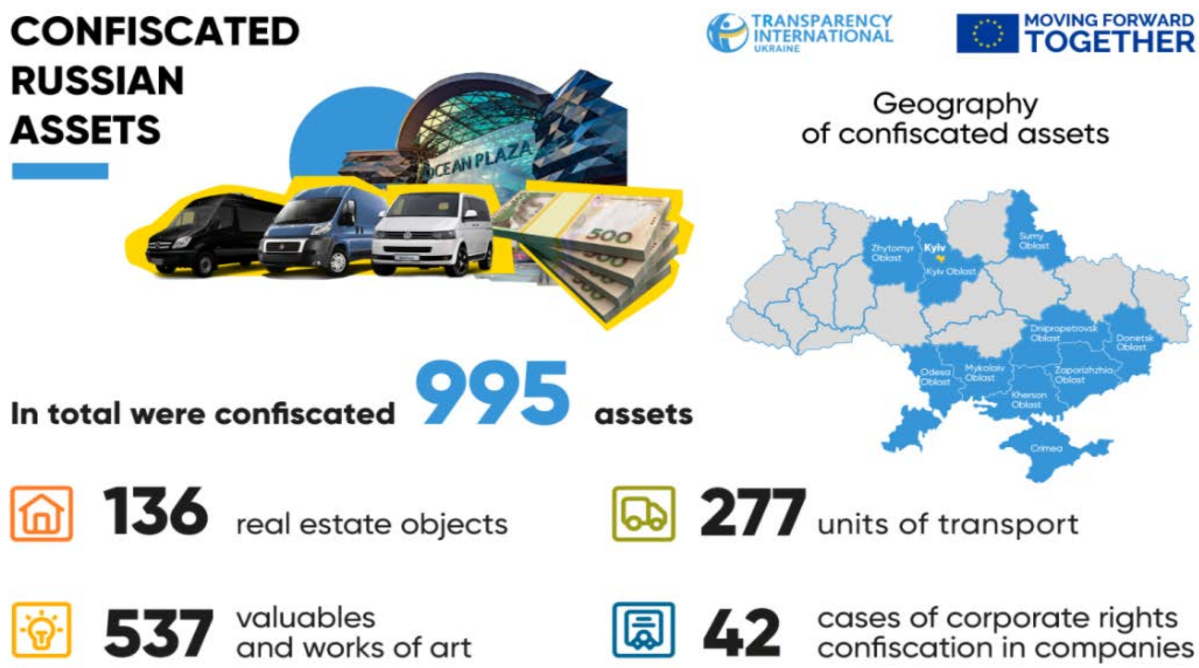
The register will contain:

- grounds for applying, changing or canceling sanctions;
- a list of sanctions that were introduced or canceled;
- a list of sanctioned persons and information for their identification: for a company, organization – name, location, state of registration, registration (identification) number/tax number; for a person – name, date of birth, registration number of the taxpayer's registration card or identification number, citizenship and other data.

The registry is expected to be operational in 6 months. Its introduction will allow effective monitoring of all sanction restrictions, as the only source of information on the imposed sanctions today is the War&Sanctions portal of the NACP.

At the same time, Transparency International Ukraine team together with Ukrainska Pravda presented a special How to Confiscate Russian Assets in Ukraine platform. This platform provides information on confiscation processes of Kremlin henchmen and properties that have already been confiscated: real estate, assets, corporate rights, cars, etc. (in the form of interactive maps, cards and slides).

As of July, USD 85,000 and over UAH 77 million of monetary assets, 136 real estate items, 278 vehicles, corporate rights and shares of 39 enterprises and 3 banks, as well as 537 valuables and works of art were confiscated in Ukraine. Data on seized Russian assets are structured by former owners, regions and confiscation mechanism.



Source: Transparency International Ukraine

At the same time, Sense Bank (formerly Alfa Bank) passed into state ownership, having passed the nationalization procedure. The state began to prepare for the nationalization of this bank as early as the end of 2022: in particular, in October, the law on the withdrawal of systemically important banks from the market during martial law in the event of insolvency entered into force. But expectations that the bank would gradually lose liquidity did not come true.

To implement the intentions, in May, the Verkhovna Rada adopted a special Law On Amendments to Certain Legislative Acts of Ukraine on Improving the Procedure for Withdrawing a Bank from the Market in Martial Law Conditions. We remind that this law provides for the procedure of withdrawing banks owned by sanctioned persons from the market, in such a way that the termination of their participation in the state banking system does not harm the interests of bank clients and their depositors.

Analysis

As Forbes writes, while the new management of Sense Bank is studying the situation, another challenge has appeared – the NBU has already received letters from the ex-owners (Mikhail Fridman and Pyotr Aven) with a statement of intentions to appeal the decision to withdraw the bank from the market, which launched the procedure of nationalization. A separate potential lawsuit may relate to USD 400 million liability that a bank-related company from Cyprus owes to customers of the former Alfa Bank under its corporate bonds. Legally, the bank itself has no relation to these securities, but it still risks a lawsuit, since the bonds were sold among customers who were part of A-Club VIP-category, that is, in outlets of Alfa Bank.

The share of the state in the banking sector will increase even more due to the nationalization of Sense Bank. As for now, it already reaches almost 60%, the state is the owner of the largest systemic banks – Privatbank, Oshchadbank, Ukreximbank and Ukrgasbank. This situation is not positive for the banking market, since the state is not considered an effective owner in a competitive market. In addition, a state-owned bank must fulfill certain social obligations, even when it is fully independent. In addition to the factor of the ongoing war, the sale of Sense Bank to private hands may also be hindered by lawsuits from the former owners.

Another bank, the shares of which were charged to state revenue on March 13, 2023 in accordance with the decision of the Appeal Chamber of the High Anti-Corruption Court, has not yet been nationalized. We are talking about the assets of the sanctioned Russian Yevgeny Giner – 89% of the shares of the First Investment Bank (operating under the PINbank brand).

And although the financial institution, as it turns out, was still owned by a Russian as of July, the expert group at the interdepartmental working group on sanctions policy as early as March 31, based on the decision of the High Anti-Corruption Court, considered the possibility of transferring PINbank shares to the authorized capital of Ukrposhta. The NBU opposes this transfer and is inclined to liquidate PINbank.

In connection with this situation, the question arises about the effectiveness of the management of confiscated assets (if these are working businesses and not passive assets). After all, **the purpose of confiscation is not to destroy or close the business that previously belonged to the sanctioned persons, but to keep it working with maximum benefit for the state of Ukraine**.

The state was also never able to confiscate all the assets of the sanctioned Russian oligarch Oleg Deripaska – the Appeal Chamber of the High Anti-Corruption Court disagreed with the Ministry of Justice’s evidence regarding the confiscation of the Khustskyi and Zhezhelivskyi granite quarries (more details here).

Having studied the scheme of acquiring control over these assets, the court decided that the evidence collected by the Ministry of Justice was insufficient, and satisfied the claim of third parties (Ukrainian businessmen who consider themselves the owners of these assets).

It should be noted that not all of the panel of judges of the Appeal Chamber of the High Anti-Corruption Court supported this position. There was a separate position of one of the judges, in which it is stated that the scheme of execution of the contracts for sale and purchase of shares of PrJSC Zhezhelivskyi Quarry and PrJSC Khustskyi Quarry with the Cyprus-based company Samsta Limited in October 2021 is a way of circumventing sanctions.