ACAMS

RAPID RESPONSE BRIEF

POSSIBLE IMPACT OF RUSSIA SANCTIONS AND DIVESTMENT

This rapid response brief examines the implications of financial sanctions on Russia, introduced by the EU, the non-European members of the G7, and other countries, on International Swaps and Derivatives Association (ISDA) related portfolios.

How does this relate to the Ukraine crisis?

The spotlight on Russian divestment will continue to grow as financial and trade sanctions pile up. The financial sector should be accustomed to unexpected events, however, when events happen like the invasion of Ukraine, financial markets inevitably whipsaw accordingly. Across the board, we can see dislocation in energy prices, natural gas and petroleum, and the movement of base and precious metals, other commodities, and wheat prices. We would expect to see a similar impact in the derivative markets.

Context

Due to the strict liability on sanctions, all three lines of defense should discuss the developing implications of sanctions on the organization. Sanctions cover new investments, the export or sale of goods, services, technology, financing, facilitation, and guarantees. As financial institutions adapt to the new environment, particular markets will encounter problems with close-out, novations, or possibly declaring default on parties, as sanctions on individuals or legal entities bite.

1. **Financial markets**
   Clearinghouses manage most derivative contracts. However, many ISDA products are not covered by client clearing and can expect possible pricing problems, liquidity issues, and potentially higher margin rates on bilateral portfolios, as the contagion ripples through the commodity and derivative markets.

2. **Pricing and sanction termination events**
   In 2019, ISDA foresaw potential challenges with the expanding use of targeted economic sanctions and the need to incorporate sanction termination events into documentation. Given market dislocation, financial firms are looking at their available options. Risk managers and compliance officers need to be mindful of two scenarios: (a) continuing business but acquiring proper licenses, or (b) closing contracts because of pricing or valuations, an early termination event, or risk issues.

   Example one: firms should take proper care to adhere to sanctions requirements, including blocking accounts from new and re-occurring activity. In some cases, it may entail acquiring a license from the proper authorities, sometimes in multiple jurisdictions, to facilitate operational, lifecycle events, or valuation processes. Furthermore, additional due diligence is required when a financial institution has collateralized ISDA Master Agreements with a sanctioned party.

   Example two: after consideration, organizations may want to divest, transfer, or settle obligations. Financial institutions should be aware of contractual set-off provisions, additional termination events, and notification provisions. There is a tendency for traders to close contracts that are to the trader's advantage when price transparency evaporates. Instead, risk managers should insist on polling market participants when pricing sources become unavailable.

3. **Liquidity and collateral**
   New limitations or restrictions placed on collateralized ISDA may disguise unintended considerations. In example one, the mark-to-market and liquidity issues may prompt margin calls, especially when prices become meaningless as cash and derivative markets diverge. Compliance officers need to recognize that margin calls may require a license. Additionally, the variation margin requested by the collateral management team may be impacted by rising volatility and greater counterparty risk. Moreover, compliance staff may need to review client margin calls and inspect internal processes. As a result, expect that liquidity in various assets, derivative contracts, or loans will deteriorate.

Communication is key. Financial institutions should have procedures for managing liquidity and collateral calls on blocked accounts, especially when unanticipated volatility grows.

Considerations for Compliance

Below, we have listed five areas that compliance officers need to be alert to concerning the widening impact of sanctions.

- As financial institutions apply sanctions, they may need to request licenses from OFAC/OFSI beyond the mandated term (for example – five days) because of operational, lifecycle events, or valuation processes. In addition, sanctioned entities may need a more extended wind-down period, noting size and volume could be significant factors.

- Financial hedges or rising counterparty risk may materialize as sanctions are applied, or accounts are frozen. It may not be immediately apparent to all market participants that a Russian financial institution or customer has an issue. As the ramification of the SWIFT delisting cascade, Western financial institutions may materialize losses.

- SWIFT messages around re-occurring payments on sanctioned Russian entities and individuals may need review. When reviewing, filter by the BIC/ SWIFT code, and be mindful of dividend and interest payments or custody and asset management relationships.

  Example:

Bank Otkritie	RUDLRUMMXXX
Novikombank	CNOVRUMMXXX
Promsvyazbank	PRMSRUMMXXX
Rossiya Bank	ROSYRU2PXXX
Sovcombank	SOMRRUMMXXX
Vnesheconombank (VEB)	BFEARUMMXXX
VTB Bank	VTBRRUMMXXX

- Some organizations may want to self-sanction, withdraw, or stop payments because of the growing complexity of sanctions and the liability of doing business with Russian individuals and entities. Self-sanction carries the risk of being targeted by the Russian government. Companies with sizeable interest in Russia may need to seek a considered response, including the impact of the physical seizure of assets.

- At the moment, sanctions are being updated daily. Sanctions personnel should be consulted regularly by trading and investment staff. The best practice standard is to perform sanctions updates during morning calls but, recognizing many organizations are decentralized, oral and written communication may be necessary. Organizations will not want to adversely close out a customer position if sanctions have changed, or if an OFAC/OFSI waiver could have been sought.

Conclusion

Compliance and operational staff supporting business lines must be diligent in executing US, UK, and European sanctions. This is not the time to fail – as it may put organizations, boards, senior management, and critical personnel under the microscope of regulators.

We recognize that the largest financial institutions will have additional resources allocated to handle the surge of activity. However, smaller institutions may encounter questions in the application, operational issues, or lack the clarity larger firms possess, more materially depending on individuals to manage high risk activities during times of crisis.

Author

William Scott Grob, Director of Research & Analysis

March 10, 2022

(edited March 21, 2022)

About ACAMS

ACAMS is the largest international membership organization dedicated to providing opportunities for anti-financial crime (AFC) education, best practices, and peer-to-peer networking to AFC professionals globally. With over 90,000 members across 180 jurisdictions, ACAMS is committed to the mission of ending financial crime through the provision of anti-money laundering/counterterrorism-financing and sanctions knowledge-sharing, thought leadership, risk-mitigation services, ESG initiatives, and platforms for public-private dialogue. The association's CAMS certification is the gold-standard qualification for AFC professionals, while the CGSS certification is its premier specialist qualification for sanctions professionals. ACAMS' 60 Chapters globally further amplify the association's mission through training and networking initiatives. Visit acams.org for more information.

© 2022 ACAMS. All Rights Reserved V21032022