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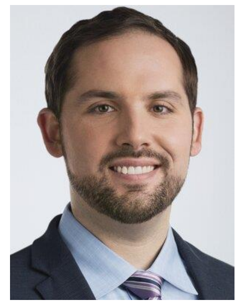
Combating Russia's Evolving Sanctions Evasion Efforts

By **Ian Herbert and Brad Dragoon** (March 8, 2023, 6:05 PM EST)



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On Feb. 24, the one-year anniversary of the Russian assault on Ukrainian sovereignty, the U.S. issued a fresh round of sanctions, targeting more than 100 individuals and entities, and placing further restrictions on the country's metals and mining sectors.[1]

Sanctions enforcement can sometimes feel like a game of cat and mouse. Starting with Russia's annexation of Crimea in 2014 and expanding sharply following Russia's invasion of Ukraine in February 2022, the U.S. and European Union have imposed increasingly encompassing economic restrictions on entire sectors of the Russian economy, along with bans on doing business with certain individuals in Russia's oligarch class and within President Vladimir Putin's inner circle.

Measures include bans on imports of advanced technology and luxury goods to Russia coupled with prohibitions on key Russia exports, including gold, crude oil and refined petroleum products.

Despite the multiple pain points created by these various sanctions programs, the Russian economy appears to have stabilized. To remain economically viable and continue its costly war in Ukraine, Russia has found new buyers and developed gray markets for its natural resources, including precious metals and energy.

In addition, a recent financial trend analysis from the U.S. Department of the Treasury's Financial Crimes Enforcement Network, or FinCEN, found that a number of members of the Russian oligarch class purchased high-value goods, including jewelry, art and real estate, outside of Russia in the lead up to the invasion, a practice that continues.[2]

The result has been constantly evolving frontiers for those seeking to combat Russian sanctions evasion.

Gold

Prior to the invasion of Ukraine in 2022, Russia was the second-largest producer of gold in the world, and according to Russia's finance ministry, had mined an estimated 314 tons of the precious metal the previous year.[3] Much of the gold exported by Russia ended up in markets in Europe and North America. The U.K. alone imported $15.2 billion worth of Russian gold in 2021.

Gold was not part of the original sanctions imposed in early 2022, but in June 2022, the U.K., U.S., Canada and Japan announced joint sanctions on Russian gold imports at the G7 summit.[4] The stated belief at the time was that:

> Given London's central role in the international gold trade and parallel U.S., Japanese and Canadian action, this measure will have global reach, shutting the commodity out of formal international markets.[5]

Though this ban on Russian gold represented a coordinated effort among some of the world's largest economies, those who described the move as largely symbolic appear to have been right.[6] In response to the sanctions, Russia rerouted its gold exports eastward, to precious metal-hungry markets in Asia, blunting the impact of the G7 ban.

Traditionally, gold producers in Russia sold their products through Russian financial institutions. However, sanctions on state-controlled banks such as VTB Bank PJSC and Bank Otkritie closed these channels. In response, some local producers have begun selling directly to buyers in the Middle East, South Asia and East Asia.[7]

In addition to tapping into alternative markets for gold, the Russian government has found that physical gold trading can be an effective way to evade import restrictions. As the country has been cut off from digital financial networks, such as the SWIFT financial messaging system, physical gold can be used to settle trade balances with countries that continue to sell to Russia.

While trading physical gold for imports can be a logistical headache, the movement of the metal cannot be tracked by existing sanctions enforcement mechanisms.[8] Following the G7 ban on Russian gold exports, Russia's central bank ceased reporting on its gold holdings, making gold flows out of the country impossible to track.

Compounding this opacity are reports from the World Gold Council that gold purchases by central banks quadrupled in the third quarter of 2022, and a substantial amount of purchased metal was from undisclosed buyers.[9] These reports confirm that despite attempts to stifle Russia's gold trade, the country's large reserves, production capacity and demand outside the West have kept the trade going and continue to facilitate Russian imports.

Oil

While sanctions aimed at Russia's precious metals industry are intended to place pressure on a tertiary aspect of the Russian economy, restrictions on the country's oil exports are designed to cripple the Russian war effort.

The sanctions, described in a Feb. 1 article in the Economist, as "the biggest package of energy sanctions ever imposed," include a complete ban on all Russian oil and gas imports into U.S.; a ban on Russian oil imports to the U.K.; an embargo on seaborne crude oil imports to the EU; an EU ban on refined products; and a price cap on Russian crude oil at $60 per barrel.[10]

The price cap, supported by the G7, EU and Australia, is noteworthy as it affects support services — such as commodities and customs brokering, financing and shipping insurance — for Russian crude oil shipments above the cap.

Though it was reported in January that Russian oil exports fell by 40% year over year in 2022, the country appears to have blunted the direct impact of the energy sanctions.[11] Similar to gold exports, Russian crude has been rerouted from traditional markets in Europe to feed demand elsewhere at steep discounts — primarily to buyers in India and China.

Additionally, a parallel market for support services has developed, with refiners, shipping firms, financiers and insurers based in China, India and the United Arab Emirates moving to fill the gap left by the departure of intermediaries in the West, according to media reports.

Russia itself is also working to evade the price cap by reportedly establishing a shadow fleet of 200 to 300 ships acquired in 2022 and in anticipation of sanctions.[12] According to recent statements made by U.S. Deputy Treasury Secretary Wally Adeyemo:

> Russia is working to get around the price cap through shadowy intermediaries [and] has been formed to divert billions in funds from the invasion to pay for insurance, shipping, and other services to support its oil trade.[13]

Similar to financing mechanisms, Russian and Chinese firms have stepped in to provide cargo and vessel insurance in replacement of several maritime insurance companies, primarily based in the U.K.[14] Certain shipping sources have even reported that some tanker companies are willing to load Russian oil and oil products without insurance cover.[15]

Real Estate

Western-led sanctions are not only intended to squeeze the Russian state, but also target prominent individuals — members of Russia's ultra-wealthy oligarch class and Putin's inner circle. Since Russia's annexation of Crimea in 2014, hundreds of Russian nationals and Ukrainian separatists have been sanctioned by the U.S., EU, U.K., Canada, Japan and Australia.

The designation of Russian nationals has proliferated since February 2022, with hundreds of additional politicians, military leaders and businesspeople being added to sanctions lists, including the list of specially designated nationals maintained by the the Treasury's Office of Foreign Assets Control.

Similar to the evasion tactics employed by the Russian state for the gold and oil industries, enterprising oligarchs are finding innovative ways to preserve their wealth outside of Russia. One notable route to this wealth preservation and sanctions evasion has been investment in commercial real estate.

In January, FinCEN issued an alert warning that sanctioned Russian elites and oligarchs could shelter assets in the U.S. through investments in commercial real estate.[16]

FinCEN warns that the commercial real estate market is vulnerable to exploitation due to "highly complex financing methods and opaque ownership structures," which can allow sanctioned parties to conceal the movement of illicit funds.

Vehicles such as trusts and shell companies are commonly used in commercial real estate transactions. These entities can be domiciled in offshore jurisdictions or within the U.S., in states where corporate disclosure mandates are limited. Ownership of these types of entities, designed solely to execute transactions, can be concealed through the use of registered agents, corporate fiduciaries, and other intermediaries.

Though financial institutions must conduct customer due diligence, FinCEN cautions financial institutions that ownership by a sanctioned individual may sit in a pooled investment below the 25% or even 10% ownership interest required for screening in certain risk-based approaches.

There has yet to be a major scheme uncovered involving the use of commercial real estate investments by designated nationals in Russia to evade sanctions since the start of the 2022 invasion of Ukraine; however, the techniques used in structuring these transactions could be appealing to oligarchs looking to preserve wealth outside the blockaded Russian economy.

Conclusion

The war in Ukraine has entered its second year. Coinciding with ongoing conflict will be the continued implementation of sanctions to choke the Russian economy and restructure the activities of high-profile Russian nationals. As Russia finds ways to maintain its economy, other nations will continue to use their combined economic power to harm the war effort.

Over the past year, we have seen this game play out in the precious metals, energy and commercial real estate markets. Undoubtedly, Russia and its oligarch class will continue their attempts elude sanctions, and regulators from the U.S. and allied nations will search for ways to beat them back.

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[2] https://www.fincen.gov/sites/default/files/2022-12/Financial%20Trend%20Analysis_Russian%20Oligarchs%20FTA%20_Final.pdf.

[3] Saptarshi Ray, "What's Happening to Russian Gold?" Al-Jazeera, July 19, 2022.

[4] https://www.gov.uk/government/news/uk-sanctions-russian-gold-exports.

[5] Id.

[6] "Factbox: Western Ban on Russian Gold Imports is Largely Symbolic," Reuters, June 27, 2022.

[7] "Russia Seeks New Ways to Sell its $20-Billion-a-Year Gold Output," Mining.com, April 1, 2022.

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[13] https://home.treasury.gov/news/press-releases/jy1286.

[14] Sameer Mohindru, "Update: Shipping: Russian Oil Flow to Asia May Not Slow on Insurance Glitch," Platts Commodity News, November 7, 2022.

[15] Ibid.

[16] https://www.fincen.gov/sites/default/files/shared/FinCEN%20Alert%20Real%20Estate%20FINAL%20508_1-25-23%20FINAL%20FINAL.pdf