EU SANCTIONS RELATING TO UKRAINE AND RUSSIA:
PROHIBITION ON NEW LOANS AND CREDIT INTRODUCED BY
COUNCIL REGULATION (EU) NO. 960/2014 OF 8 SEPTEMBER 2014

1. Introduction

1.1 Under Council Regulation (EU) No. 833/2014 of 31 July 2014 ("Regulation 833"), the EU imposed a series of restrictive measures against Russia in response to the situation in Crimea and Sevastopol. With effect from 12 September 2014, Council Regulation (EU) No. 960/2014 of 8 September 2014 ("Regulation 960") expanded those restrictive measures by amending Regulation 833\(^1\) to include a prohibition on directly or indirectly making (or being part of any arrangement to make) new loans or credit with a maturity exceeding 30 days to certain entities. The prohibition applies in relation to new loans or credit made after 12 September 2014, subject to limited exceptions.

1.2 LMA Members have expressed an interest in the scope and interpretation of these restrictions. In sections 2 and 3 of this memorandum, we explain the provisions of Regulation 833 which impose restrictions on making new loans or credit, and identify some of the issues around the interpretation of these restrictions which have so far arisen. In section 4 of this memorandum, we briefly identify additional restrictions in Regulation 833 which may be relevant to Lenders.

1.3 The analysis in this memorandum is necessarily high-level. It is not an exhaustive list of the potential issues that may arise for Lenders. Nor is the analysis definitive. The relevant authorities were not consulted regarding the issues addressed and the analysis reflects the views of the authors rather than an official view. Many provisions of the EU's sanctions against Russia are capable of alternative interpretations and in the absence of specific guidance from the courts or from the relevant authorities, many uncertainties persist. This memorandum (and the information contained within it) is not legal advice, and must not be relied upon, whether as legal advice or otherwise. In all cases, the precise impact of the EU sanctions on any individual transaction will always be fact-specific, and the parties to a transaction must review the actual transaction documents and seek specific advice, including from the relevant authorities when necessary or appropriate.

1.4 Please see section 5 for further details of the permitted distribution of this memorandum.

2. The EU's prohibition on "new loans or credit"

2.1 Regulation 833 introduced (amongst other measures) a series of controls affecting the capital markets.\(^2\) With effect from 12 September 2014, Regulation 960 introduced a

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\(^1\) References to Regulation 833 in this memorandum are therefore to Regulation 833 as amended by Regulation 960.

\(^2\) In particular, Articles 5(1) and 5(2) of Regulation 833 impose restrictions relating to "transferable securities and money-market instruments" (as defined in Regulation 833) with a maturity exceeding 90 days (if issued after 1 August 2014 to 12 September 2014) or with a maturity exceeding 30 days (if issued after 12
new Article 5(3) into Regulation 833, which imposed a series of additional controls affecting the capital markets:

"It shall be prohibited to directly or indirectly make or be part of any arrangement to make new loans or credit with a maturity exceeding 30 days to any legal person, entity or body referred to in [the Appendix to this memorandum, together with: legal persons, entities and bodies established outside the EU whose proprietary rights are directly or indirectly owned for more than 50% by those entities; and legal persons, entities and bodies acting on behalf or at the direction of any of the aforementioned entities], after 12 September 2014 except for loans or credit that have a specific and documented objective to provide financing for non-prohibited imports or exports of goods and non-financial services between the Union and Russia or for loans that have a specific and documented objective to provide emergency funding to meet solvency and liquidity criteria for legal persons established in the Union, whose proprietary rights are owned for more than 50% by any entity referred to in Annex III [see the list in the Appendix to this memorandum]."

2.2 We use the term "Sanctioned Entity" in this memorandum to refer to an entity to whom the provision of new loans or credit is prohibited under Article 5(3) of Regulation 833.

2.3 For the purposes of interpreting Article 5(3), Regulation 833 does not define what is meant by the following crucial terms:

(a) "new loans or credit"; however, as examined in section 3 below, recital (6) of Regulation 960 indicates the intended scope of Article 5(3) and may be relevant for interpretational purposes;

(b) "directly or indirectly make";

(c) "be part of any arrangement to make"; and

(d) "with a maturity exceeding 30 days".

The scope of the two exceptions in Article 5(3) is also subject to interpretation.

September 2014) by any of the following: (i) state-owned Russian banks, as listed in Annex III to Regulation 833; (ii) entities engaged in the conception, production, sales or export of military equipment and services, as listed in Annex V to Regulation 833; (iii) entities engaged in the sale or transportation of crude oil and petroleum products, as listed in Annex VI to Regulation 833; (iv) any legal person, entity or body established outside the EU whose proprietary rights are directly or indirectly owned for more than 50% by an entity in (i) to (iii) above; and (v) any legal person, entity or body acting on behalf or at the direction of an entity in (i) to (iv) above.

In the United Kingdom, offences relating to an infringement of the prohibitions in Article 5(3) are defined in The Ukraine (European Union Financial Sanctions) (No. 3) Regulations 2014 (S.I. 2014/2054) (as amended), Regulation 3B.
2.4 Regulation 960 also amended the prohibition on circumvention activities in Article 12 of Regulation 833. Article 12 of Regulation 833 now states:

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

3. **Commentary**

3.1 To date, neither the EU nor HM Treasury (as the competent authority in the UK) have issued guidance regarding the interpretation of the prohibition on "new loans or credit". As a result, considerable uncertainty exists as to how particular aspects of Article 5(3) should be interpreted. We examine below some of the issues which have arisen.

"New loans or credit"

3.2 Recital (6) to Regulation 960 states in relevant part that:

"Financial services other than those referred to in Article 5 of Regulation (EU) No 833/2014, such as deposit services, payment services, insurance services, loans from the institutions referred to in Article 5(1) and (2) of that Regulation and derivatives used for hedging purposes in the energy market are not covered by these restrictions. Loans are only to be considered new loans if they are drawn after 12 September 2014." (emphasis added)

3.3 The recital therefore indicates that **borrowing from** Sanctioned Entities is permissible.

3.4 The word "loan" is not defined in Regulation 833. However, the reference in recital (6) to Regulation 960 to loans being "drawn" suggests that the restriction is intended to apply to types of loan in connection with which drawings may be made by a Sanctioned Entity. At the very least, monetary loans are covered.

3.5 All types of term loans and revolving facilities would fall within the definition of "loan", and are prohibited by Article 5(3) if they are to be entered into with a Sanctioned Entity after 12 September 2014 (because, by definition, each loan could only be drawn for the first time after that date). We consider that the word "drawn" in this context should bear its ordinary meaning in connection with loan agreements, and would encompass the Sanctioned Entity receiving funds that it was contractually entitled to draw down under a loan agreement.

3.6 A key issue about which significant uncertainty remains is whether Article 5(3) permits a Sanctioned Entity to request (and a Lender to honour) further draw downs under a pre-existing facility, which was entered into between the Lender and the Sanctioned Entity on or before 12 September 2014. In relation to certain of the

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*In the United Kingdom, offences for infringement of Article 12 (in so far as the circumvention relates to the prohibitions in Article 5) are created by The Ukraine (European Union) Financial Sanctions (No. 3) Regulations 2014 (S.I. 2014/2054) (as amended), Regulation 4.*
restrictions imposed by Regulation 833 on the supply of particular goods, technologies and services to, or for use in, Russia (and the provision of related technical assistance, brokering services, financing and financial assistance), Regulation 833 expressly states that certain prohibitions are without prejudice to the execution of obligations arising from contracts or agreements that were concluded before the date upon which the relevant prohibition took effect.\(^5\) In contrast, Article 5 does not expressly refer to obligations arising under pre-existing contracts, and we therefore consider that, in circumstances where each draw down under a facility would result in a fresh advance of funds and would be regarded as a new loan, the better view is that draw downs made after 12 September 2014 are prohibited by Article 5(3).\(^6\)

3.7 In relation to revolving facilities (whether or not cashless) that have been extended to a Sanctioned Entity, one interpretation is that each rollover will not constitute a "new loan", because the funds have already been drawn by the Sanctioned Entity. However, we consider that the better view is that rollovers would constitute a "new loan" within the scope of Article 5(3). This includes cashless rollovers: in such rollovers, the Sanctioned Entity (as borrower) would submit a utilisation request and a new loan would be made available, albeit by way of a set-off against the existing obligation owed by the borrower.

3.8 Amendments to an existing facility which has been fully drawn would need to be considered on a case-by-case basis. Some amendments (for example, a change to a dispute resolution clause) would not present any issue under the sanctions, since they would not involve the making of "new loans or credit". However, other amendments

\(^5\) For example, see Articles 2a(3), 3a(2) and 4(2) of Regulation 833.

\(^6\) In the US, the Office of Foreign Assets Control ("OFAC") has issued the following guidance in relation to the prohibitions on transacting in, providing financing for, or otherwise dealing in new debt contained in its Sectoral Sanctions imposed under US Executive Order 13662 "Blocking Property of Additional Persons Contributing to the Situation in Ukraine" (March 20, 2014) and the Ukraine Related Sanctions Regulations, 31 C.F.R. Part 589. This guidance indicates that OFAC interprets "new debt" differently with respect to the similar prohibitions in the US Sectoral Sanctions, as regards obligations arising under facilities or arrangements pre-dating those sanctions.

"394. If a U.S. person entered into a revolving credit facility or long-term loan arrangement for a person determined to be subject to Directives 1, 2, or 3 prior to the sanctions effective date, what are the restrictions on drawdowns from that facility? Do all drawdowns and disbursements pursuant to the parent agreement need to carry repayment terms of 30 days or less (for persons subject to Directives 1 and 3) or 90 days or less (for persons subject to Directive 2)?

If a U.S. person entered into a long-term credit facility or loan agreement prior to the sanctions effective date, drawdowns and disbursements with repayment terms of 30 days or less (for persons subject to Directives 1 and 3) or 90 days or less (for persons subject to Directive 2) are permitted. Drawdowns and disbursements whose repayment terms exceed the applicable authorized tenor are not prohibited if the terms of such drawdowns and disbursements (including the length of the repayment period, the interest rate applied to the drawdown, and the maximum drawdown amount) were contractually agreed to prior to the sanctions effective date and are not modified on or after the sanctions effective date. U.S. persons may not deal in a drawdown or disbursement initiated after the sanctions effective date with a repayment term of longer than 30 days (for persons subject to Directives 1 and 3) or 90 days (for persons subject to Directive 2), if the terms of the drawdown or disbursement were negotiated on or after the sanctions effective date. Such a newly negotiated drawdown or disbursement would constitute a prohibited extension of credit. [9-12-2014]. (See: http://www.treasury.gov/resource-center/faqs/Sanctions/Pages/answers2.aspx#394).
to a facility (for example, to payment terms or interest rates) could, depending on the facts, more readily be construed as involving the making of "new loans or credit". We consider that an extension to an existing term facility (where the funds have already been drawn by the Sanctioned Entity) would constitute a "new loan" within the scope of Article 5(3).

3.9 The word "credit" is not defined in Regulation 833 but, given the use of the phrase "new loans or credit" may be presumed, in this context, to mean something other than loans. In its ordinary usage, "credit" would encompass an agreement between the Lender and the Sanctioned Entity, under which the latter would receive some form of value with an agreement to pay or reimburse the Lender at a date in the future. In the absence of a formal definition or published guidance on this point, we consider that "credit" should be construed broadly, to encompass all forms of credit (and not just cash and loans), including bank guarantees and letters of credit that are issued at the request of a Sanctioned Entity in favour of a third party, as well as deferred payment terms that are extended to a Sanctioned Entity. Lenders should be alert to circumstances in which any form of benefit is being provided to a Sanctioned Entity, and should consider if the provision of that benefit could be construed as a "credit" within the scope of Article 5(3).

3.10 The absence of guidance in relation to the meaning of "new loans or credit" has also created uncertainty over whether a deposit of funds which are placed with a Sanctioned Entity would fall within the scope of the prohibition in Article 5(3). Recital (6) to Regulation 960 states that "deposit services" are not intended to be prohibited by Article 5(3). However, this must be presumed to relate to deposit services provided to a Sanctioned Entity, rather than by a Sanctioned Entity.

3.11 A deposit is a chose in action. The relationship between the depositor and its bank is one of creditor and debtor, and the depositor is regarded as making a loan to its bank. However, the common usage of the words "loan" and "deposit" is different, and the nature of a deposit does not sit easily with the reference in recital (6) that a "loan" will only be regarded as a "new loan" if it is "drawn after 12 September 2014": a deposit is not "drawn" by a Sanctioned Entity with whom it is deposited. In light of this, we consider that the better view is that a deposit, which is made by a non-sanctioned depositor into a specific account held at a Sanctioned Entity should not automatically be regarded as falling within the scope of a "loan" for the purposes of Regulation 833. However, in light of the fact that a different interpretation is possible (and also bearing in mind the absence of a definition of "credit"), we consider that, until guidance is provided, depositors should exercise caution over the placing of deposits with Sanctioned Entities, since there is a risk that the competent authorities may consider deposits to be prohibited by Article 5(3). This is particularly the case where large deposits are to be held by a Sanctioned Entity on individually-negotiated terms and/or where a deposit is not being held in a specific account in the name of the depositor. In addition, Lenders should be alert to any situation where they are asked to consider placing deposits with Sanctioned Entities where, in ordinary practice, the Sanctioned Entity would have been expected to request a loan. Deposits that are placed to avoid the prohibitions on loans could fall foul of Article 12 of Regulation 833, which prohibits participating, knowingly and intentionally, in activities the object or effect of which is to circumvent the prohibitions in Article 5(3).
3.12 In relation to a deposit of commodities (for example, as security) that is placed with a Sanctioned Entity, we also consider that the better view is that such a deposit would not constitute in and of itself a new loan within the scope of Article 5(3), nor would it constitute a credit. It would be even more difficult to reconcile the nature of a deposit of commodities with the reference in recital (6) to a new loan comprising one that was "drawn after 12 September 2014". However, depositors should ensure that making such a deposit is not intended to have the object or effect of circumventing the prohibitions in Article 5(3), which would be contrary to Article 12.

"Directly or indirectly make or be part of any arrangement to make"

3.13 Article 5(3) prohibits persons and entities from directly or indirectly acting as lender or provider of credit to a Sanctioned Entity. The reference to "indirectly" in this context would, in our view, cover arrangements in which a person or entity lent funds (whether on their own, or with others) to a non-sanctioned entity or vehicle, knowing or having reasonable cause to suspect that the proceeds of the loan or the benefit of the credit were to be channelled or made available to a Sanctioned Entity.

3.14 The phrase "be[ing] part of any arrangement to make" is capable of being construed broadly to encompass a wide range of different activities which are linked to (or which support) lending or the making available of credit. In the absence of formal guidance, we consider it appropriate to adopt a broad interpretation that is consistent with the objective of Article 5(3), which is to prevent EU persons from being involved in activities that will result in loans or credit being made in favour of Sanctioned Entities. As a result, "part of any arrangement to make" could encompass the activities of different parties in connection with a lending transaction, such as: banks (e.g. when acting as arranger or agent; or when providing a credit approval for a loan to be advanced by an affiliated entity outside the EU); lawyers (e.g. in preparing contractual documentation); third parties providing security; and accountants (e.g. in carrying out due diligence).

"Maturity exceeding 30 days"

3.15 In most instances, it will be straightforward for a Lender to identify whether the maturity of a loan or credit exceeds 30 days.

3.16 Where an existing loan to a Sanctioned Entity has a maturity of less than 30 days, we consider that a subsequent extension to the maturity which results in it exceeding 30 days would be prohibited by Article 5(3) and/or Article 12.

3.17 Lenders may contemplate a series of loans to a Sanctioned Entity, each with a maturity of 30 days or less, and with a requirement that the Sanctioned Entity repays the amounts drawn down before any new loan is extended. In these circumstances, whilst we consider that it is arguable that each individual advance should be treated as a separate loan of up to 30 days’ duration (rather than as one arrangement of a longer duration), Lenders will need to be mindful of the prohibition on circumvention activity under Article 12. Entering into a series of loans may be considered a circumvention activity if the objective is to secure continued funding to the Sanctioned Entity that exceeds 30 days. Whilst the question of whether such an arrangement will in any particular case be contrary to Article 12 will be fact-
dependent, a key issue is likely to be whether, in form and in substance, each advance is a genuine and justifiable short-term advance, rather than one that is regarded by either of the parties as being part of a longer term arrangement. We consider that the likelihood of a breach of Article 12 would be significantly higher where, for example, advances from a Lender are structured as a series of short term loans, but are recorded in the records of the Lender or the Sanctioned Entity as a longer term facility; or where there is a commitment from a Lender that a loan will be automatically renewed.\(^7\)

"Specific and documented objective"

3.18 The exceptions in Article 5(3) permit: (i) new loans or credit that have a specific and documented objective to provide financing for non-prohibited imports or exports of goods and non-financial services between the EU and Russia; and (ii) new loans that have a specific and documented objective to provide emergency funding to meet solvency and liquidity criteria for legal persons established in the EU (whose proprietary rights are owned for more than 50% by a bank listed in Annex III to Regulation 833).

3.19 Lenders will need to establish that the objective of a contemplated loan or credit to a Sanctioned Entity is one that is permitted under Article 5(3). In addition, Lenders will also need to consider how to meet the requirement that the loan or credit should have a "specific and documented objective", which Regulation 833 does not elaborate upon. We consider that there is no specific form of words which is required in this regard.

\(^{7}\) In the US, OFAC has issued the following guidance in relation to the prohibitions on transacting in, providing financing for, or otherwise dealing in new debt contained in its Sectoral Sanctions imposed under US Executive Order 13662 "Blocking Property of Additional Persons Contributing to the Situation in Ukraine" (March 20, 2014) and the Ukraine Related Sanctions Regulations, 31 C.F.R. Part 589. Although this guidance has no interpretive value for the purposes of the EU sanctions, given the broad convergence of policy objectives between the EU and the US sanctions, we consider that it is nevertheless helpful to have reference to this guidance and to follow the logic of the analysis, as this may assist in seeking to interpret Article 5(3) to the extent that the wording of Article 5(3) does not suggest a different interpretation.

"409. If a person determined to be subject to Directives 1, 2, or 3 makes successive draws under a short-term facility created after the sanctions effective date (e.g., it borrows $100 million with a 15-day maturity, then at the end of the 15 days, the debt "rolls over"), does the facility become prohibited if the SSI borrower makes successive short-term borrowings that cumulatively add up to more than 30 days (for persons subject to Directives 1 or 3) or 90 days (for persons subject to Directive 2)?

Two conditions must be met for short-term facilities created after the sanctions effective date to be permissible. As long as (1) each individual disbursement has a maturity of 30 or 90 days or less (depending on the applicable Directive) and the disbursement is paid back in full before the next disbursement and (2) the lender is not contractually required to roll over the balance for a cumulative period of longer than 30 or 90 days (depending on the applicable Directive) at the borrower's request (i.e., it has the option to refuse the request for a new short-term loan and terminate the facility), the loan is not prohibited, even though the same borrower may obtain a series of short-term loans from the same lender over a cumulative period exceeding 30 or 90 days (depending on the applicable Directive). U.S. persons may not deal in a drawdown or disbursement initiated after the sanctions effective date with a repayment term of longer than the applicable authorized tenor if the terms of the drawdown or disbursement are negotiated or re-negotiated on or after the sanctions effective date. Such a newly negotiated drawdown or disbursement would constitute a prohibited extension of credit. [9-12-2014]" (See: http://www.treasury.gov/resource-center/faqs/Sanctions/Pages/answers2.aspx#409).
but the loan or credit (as applicable) should specify in clear and unambiguous terms what its purpose is, so as to make it clearly referable to one of the exceptions. Such a statement should be included in the principal contractual documentation for the loan or credit (for example, in a tightly-drafted “purpose” clause in a loan agreement) as opposed to, for example, being placed in a side letter or equivalent. In addition, Lenders should consider the inclusion of covenants regarding the use of funds in the loan agreement.

3.20 The prohibition on circumvention in Article 12 of Regulation 833 includes a reference to "using the exceptions in Article 5(3) to fund entities referred to in Article 5". We construe this reference as relating to the possible provision of emergency funding to an EU subsidiary of an entity referred to in Annex III of Regulation 833 (see the list in the Appendix) where that funding would be used to fund a Sanctioned Entity, rather than to fund the EU subsidiary.

4. Other restrictions on lending introduced by Regulation 833

4.1 Regulation 833 introduced new restrictions on the provision of financing or financial assistance (which expressly includes loans) in connection with certain restricted trade activity relating to Russia, unless a prior authorisation has been obtained in connection with the provision of that financing or financial assistance. Those restrictions are beyond the scope of this memorandum.

5. Distribution of this memorandum

5.1 This memorandum is addressed to the LMA and has been prepared for the purposes of assisting the LMA in providing LMA Members with a summary of the restrictions introduced by Regulation 960. The LMA may release a copy of this memorandum to its Members and/or publish a copy of this memorandum in the LMA Members-only section of the LMA’s website, in each case, for the purposes of information only but it should be noted that: (a) the provisions of paragraph 1.3 above applies to LMA Members and any other persons to whom this memorandum may be disclosed; (b) we assume no duty or liability whatsoever (whether in negligence or otherwise) to any

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8 Regulation 833: (1) prohibits the provision, directly or indirectly, of financing or financial assistance related to the goods and technology listed in the Common Military List (including grants, loans and export credit insurance or guarantee, insurance and reinsurance) for any sale, supply, transfer or export of such items, or for any provision of related technical assistance, to any natural or legal person or entity in Russia or for use in Russia (Article 4(1)(b)); (2) prohibits the provision, directly or indirectly, of financing or financial assistance relating to dual-use goods and technology (including grants, loans and export credit insurance) for any sale, supply, transfer or export of such items, or for any provision of related technical assistance, to any natural or legal person, entity or body in Russia or for use in Russia, if the items are or may be intended, in their entirety or in part, for military use or a military end-user (Article 4(1)(d)); (3) requires prior authorisation for the provision of financing or financial assistance related to technologies in Annex II of Regulation 833 (including grants, loans and export credit insurance) for any sale, supply, transfer or export of those items, or for any provision of related technical assistance, directly or indirectly to any natural or legal person, entity or body in Russia or, if such assistance concerns technologies for use in Russia, to any person, entity or body in any other country (Article 4(3)(b)); (4) prohibits the provision of financing or financial assistance related to dual-use goods and technology (including grants, loans and export credit insurance), for any sale, supply, transfer or export of those goods and technology, or for the provision of related technical assistance, brokering services or other services, directly or indirectly to any person, entity or body in Russia who is listed in Annex IV to Regulation 833 (Article 2a(2)(b)).
LMA Member or any other person; (c) we have no intention of updating this memorandum and subsequent judicial, legislative, regulatory and interpretive developments may cause us to change our views and/or render our analysis obsolete; and (d) no LMA Member nor any other person to whom this memorandum may be disclosed may in any circumstance release a copy of this memorandum to any person outside its organisation without our prior written consent.

Clifford Chance LLP
21 October 2014
APPENDIX

Annex III to Regulation 833
Sberbank
VTB Bank
Gazprombank
Vnesheconombank (VEB)
Rosselkhozbank

Annex V to Regulation 833
OPK Oboronprom
United Aircraft Corporation
Uralvagonzavod

Annex VI to Regulation 833
Rosneft
Transneft
Gazprom Neft