Working Group Paper #4

Strengthening Financial Sanctions against the Russian Federation

The International Working Group on Russian Sanctions

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https://fsi.stanford.edu/working-group-sanctions

I. Executive Summary

The International Working Group on Russian Sanctions[1] aims to provide expertise and experience to governments and companies around the world by assisting with the formulation of sanctions proposals that will increase the cost to Russia of invading Ukraine and that will support democratic Ukraine in the defense of its territorial integrity and national sovereignty. Our working group is comprised of independent experts from many countries, but coordinates and consults with the Government of Ukraine and those governments imposing sanctions. This document is a follow-up to our first Action Plan and previous working papers on energy and individual sanctions, which have been informed by additional memos on our website.[2]

The importance of financial sanctions reflects Russia's dependency on the Western financial system, in particular on Western reserve currencies, as backing for the ruble, and on Western markets and banks, including to facilitate trade. We want to take advantage of this dependency. European, American, and Canadian governments already have imposed meaningful sanction on Russian financial institutions, but much more should be done. Every day that Putin's army remains in Ukraine is a day that sanctions against Russia should be increased.

Until Russian leader Vladimir Putin ends his war on and occupation of Ukraine, we propose to increase costs on the Russian economy by isolating Russian economic entities further from the core of the global financial system – the reserve currencies, key markets and leading banks and asset managers in the advanced economies. We also propose to use Western control over the core of the financial system, and the attractiveness of Western currencies, markets, banks and funds globally, to help regulate and police Russia's external trade, including with countries who remain on friendly terms with Russia, reducing the risk of sanction evasion. Economic policy towards Russia should build on the lessons learned from sanctions so far.

First, Russia's dependency on the dollar remains a vulnerability – as seen by the aggressive initial Russian policy reaction – but less acute than before. Russia has reduced exposure to Western finance with lower levels of foreign borrowing, exposure to foreign investors, and use of dollar deposits and lending domestically. During the war, this "fortress policy" led to further restrictions on changing rubles to foreign currency and transfers of foreign currency out of Russia (to prevent erosion of Russia's stock of foreign exchange.)

Second, the Russian economy will remain insulated from sanctions pressure until energy earnings fall. The Russian government is primarily financed by energy exports, which drive export earnings and budget revenues – and so far, high oil and gas prices have dominated the impact of sanctions, driving a wide trade surplus, stabilizing reserves and the ruble. This unfortunate windfall for the Russian government should change – and the impact of sanctions bite deeper – as Europe stops buying Russian oil and gas.

Third, the Russian government, Russian companies and individuals have sought to circumvent sanctions, with cross border flows migrating from sanctioned banks to unsanctioned

[1] All members of this working group participate in their private capacities, but we have consulted with numerous government officials, particularly with the Government of Ukraine. Similar to earlier papers, all signatories of this paper are non-governmental experts and do not represent the views of their institutional affiliations.
[2] Similar to other papers from this working group, our aim in this paper was not to produce a consensus document, but instead to provide a menu of possible additional measures to be considered by governments, multilateral institutions, and private actors. The implications of every sanction have not been thoroughly analyzed, and not every signatory of this paper agrees with every specific sanction or action proposed.

banks and working through "friendly" countries. The Russian government also has reacted with countermeasures, leveraging its control over food and energy supplies, including blocking Ukrainian food exports.

These factors imply that financial sanctions will work most effectively if implemented on a sustained and comprehensive basis, integrated with other policies. Accordingly, this paper proposes new actions at three levels:

1. **Immediate package of further sanctions**. Specifically, in the next wave of sanctions, including the European Union (EU)'s 7th sanctions package, we propose immediate full blocking sanctions on the top Russian-owned banks, many of which remain unsanctioned or only partially sanctioned; full blocking sanctions on other key market institutions in Russia, including the Russia stock exchange, the National Clearing Center, the National Settlement Depositary; personal sanctions on the financial leadership of the country; designation of Russia as a state sponsor of terrorism; and listing Russia on the Financial Action Task Force on money laundering (FATF) blacklist. To secure trade in energy and other unsanctioned goods, we propose issuing a special license to Gazprombank allowing a limited scope of transactions related to these trade flows and fully blocking all other transactions.

2. **Completing the separation**. Over time, we propose full divestment from Russia by Western funds and companies, as well as bans to cut Russian enterprises and wealthy Russians off from wealth advisory, investment consulting, or fund management services, as well as from crypto-markets. We also propose full blocking sanctions on all Russia's banks and financial institutions, building on the next steps in the immediate package of further measures implemented by the sanctions coalition.

3. **Institutionalizing isolation**. We propose to put in a new framework for interactions with the Russian government and economic actors, using licensed institutions, enhanced supervision, and increased transparency, including:

    1. Tighter institutional framework to police financial transactions with Russia, including designation of a handful of dedicated financial institutions to transact with Russia. We envisage these dedicated financial institutions would transact with a single institution on the side of Russia, e.g., Gazprombank.

    2. Tighter and more centralized control and regulation over Russia's external trade with other countries (including countries "friendly" to Russia), to prevent Russian theft of technology and IP to circumvent sanctions, especially regarding dual-use goods and technologies and weapons. More comprehensive export controls should be applied to Russian entities.

    3. A new framework of transparency and information disclosure to strengthen public and market pressure on companies dealing with Russia, improve compliance, and provide strong grounds for the adoption of secondary sanctions.

II. Introduction

The Action Plan on Strengthening Sanctions against the Russian Federation outlined a comprehensive list of sanctions for many sectors and individuals, including the financial sector. This document aims to review the impact of the first wave of financial sanctions and propose additional measures to further increase the economic cost to Russia of Putin's war in Ukraine.

Financial sanctions have been a central part of the economic sanctions and countermeasures that have been imposed on Russia since the war began, with the general aim of imposing a cost on Russia and weakening its capacity to wage war. The importance of financial sanctions in this effort reflects Russia's dependency on the Western financial system, and in particular on Western reserve currencies, notably the dollar, as backing for the ruble, and on Western markets and banks for capital and payment services, including to facilitate trade. Financial sanctions have been applied broadly with measures targeting, among others: government agencies, such as the Central Bank of Russia; state-owned banks, including Sberbank; privately-owned banks, such as Alfabank; state-owned companies, such as Sovkomflot; and multiple individuals, both officials and those without an official position. The measures have varied from the general, such as full designation (SDN) forbidding Western institutions from dealing with the sanctioned institutions (absent special permission) to more specific actions, such as a ban on the use of the SWIFT payment system.

Financial sanctions have produced substantial impact on the Russian economy already. Russian citizens and businesses lost access to Visa, Mastercard, and other payment services. Russian institutions and sanctioned individuals lost access to global capital markets. Initially, domestic rates sharply increased, and the ruble fell sharply in value.

However, the impact of the initial wave of financial sanctions has not been decisive and did not cripple the Russian economy. After more than three months, the Russian financial system has recovered substantially from the initial impact of financial sanctions. In particular, high energy prices and the collapse in imports have produced a large Russian trade surplus, allowing Russian reserves to stabilize. The ruble is now trading above its pre-war range. The Central Bank of Russia has reversed its initial 10pp hike in the policy rate and has substantially eased the capital controls introduced at the start of the invasion. In addition, the effectiveness of some sanctions has weakened over time. In particular, the narrow scope of some sanctions, e.g., targeting only selected banks, provides opportunity for circumvention, as financial flows are diverted through alternative routes.

As with previous papers published by this working group, our proposals aim to stimulate thinking about how best to impose sanctions on Russia, focused on the paramount objective of helping to end Putin's invasion of and war in Ukraine, and at the same time supporting Ukraine's territorial integrity and sovereignty. While we all agree that more and better sanctions are needed, the group participants encompass a range of views, and not every signatory necessarily agrees with every sanction measure proposed in this paper.

III. Proposed Strategy

In this paper, we propose further financial sanctions to increase the cost to Russia's invasion of Ukraine, based on further targeting two key vulnerabilities.

First, Russia lacks a reserve currency and consequently is dependent on the dollar and other Western currencies to back the ruble. We propose measures to curb hard currency inflows and encourage outflows as part of a strategy to exploit this vulnerability. We recognize this weakness will only become a constraint when Russia's export earnings are curbed, which will require in particular full implementation of oil and gas sanctions.

Second, the Russian economy depends on the Western financial system for a range of services, including to raise finance, particularly longer-term finance, and to make payments. In this paper, we propose measures to exploit this dependency. In the near-term, this involves a wave of further substantial measures to reduce Russian access to Western finance. In the long term, we propose to put in place institutional arrangements which exploit this dependence both to cut Russia off further from the Western financial system, increasing the costs of accessing financial services, and to exercise greater control and oversight over Russia's trade, making it harder for Russia to circumvent sanctions.

IV. Key Takeaways from the Initial Round of Sanctions

Factors that have reduced the impact of sanctions on Russia:

1. The Russian economy has become more resilient and less dependent on the West since sanctions were first imposed in 2014. This is reflected in reduced levels of foreign borrowing, a more resilient domestic banking sector, and more diversified reserves. Moreover, the banking sector – which dominates the Russian financial sector – is largely state-owned, with limited foreign ownership. Conversely, these factors also limit any negative spillovers from banking system stress in Russia to the global financial system.
2. Aggressive policy response. The immediate policy response by the Russian authorities, notably the central bank, has been robust, with a rapid hike in rates and imposition of capital controls to manage the immediate situation and to provide liquidity to banks as needed, both in ruble and FX. As the reserve situation stabilized and the ruble strengthened, the Central Bank of Russia (CBR) has eased rates back below pre-war levels, and it has significantly eased capital controls.
3. Russia's strong external account is the key support. Russia's strong trade position at high oil and gas prices has been further strengthened in the short term by the collapse in imports, as a result of sanctions and the reaction to the war. The resulting strong FX inflow has been the key factor enabling the authorities to stabilize reserves and the ruble.
4. Using "friendly countries" to evade sanctions. We assess that Russia is likely to try and circumvent sanctions through "friendly countries", where Western scrutiny will be less,

and Russia typically has substantial leverage, including through its control of food and energy supplies. For instance, we note media reports of Uzbekistan, Armenia and Kyrgyzstan issuing Visa/Mastercard cards to Russians, Turkish hotels accepting MIR cards, and Dubai banks helping to repackage Russian assets.

Factors that have helped deepen the impact of sanctions:

1. Strong initial sanction action. The unexpected sanctioning of the CBR, which froze half of the CBR's foreign reserves, led to a dramatic initial fall in the RUB, and a sharp tightening of rates and regulations in response.
2. Russia is not impregnable. The strong Russian policy response is evidence that the Russian government is concerned about its vulnerability, particularly the lack of dollars to back the ruble and to settle its FX liabilities both domestically and externally. With half of the CBR reserves frozen, and a large proportion of the remainder in gold and yuan, which are hard to sell at scale for FX, freely convertible FX reserves under the effective control of the CBR are now enough to cover about 3 months of imports – a lot less than the headline cover of over 20 months' worth of import cover. Thus, if sanctions do now cut FX inflows sharply, the ruble and the Russian financial system might switch back from adequate to vulnerable rather rapidly.
3. Financial sanctions are having a major impact. Despite the headline rebound in the ruble and domestic bonds, and the easing of capital controls, financial sanctions are having a large impact, as they lead to higher rates and reduced availability of capital and payment services. Most forecasts expect a double-digit decline in growth and continued strong inflation, and see risks as tilted to the downside – with financial sanctions playing a central role in this outcome.

V. Proposed Approach for Future Financial Sanctions

Russia has significant vulnerabilities, which financial sanctions can exploit, as illustrated by the hike in rates and collapse in the ruble when sanctions were first imposed. At the same time, Russia has a high degree of resilience, underpinned by its strong trade position, as shown by its recovery from the impact of the initial round of sanctions.

We recognize that sanctions are not a magic bullet which will change Russia's behavior by themselves. However, we think that they can have an effect – reducing Russia's resilience and effectively targeting Russia's vulnerabilities – particularly when combined as a package. We propose a three-part approach to the next wave of sanctions:

1. **Comprehensive pressure on all fronts.** Incorporate additional sanctions in an "overload" strategy to put pressure on Russia on all fronts with multiple instruments - military, diplomatic and economic;
2. **Combined sanctions**. Amplify the impact of financial sanctions by enhanced sanctions on oil and gas to reduce Russia's export earnings, as set out in our recent paper on oil and gas sanctions, and more widespread individual sanctions, which will reduce Russian access to Western financial institutions, as set out in our recent paper on individual

sanctions. Generally, we support more sanctions quicker, since that will impose more of a cost on Russia and strengthen Ukraine's hand in negotiations.

3. **Big new wave of financial sanctions.** Impose full blocking sanctions on the top 30 Russian-owned banks (state and private), the main domestic exchange (MOEX), the National Clearing Center, and the National Settlement Depositary; impose personal sanctions on the financial leadership of the country; and designate Russia as a sponsor of state terrorism and put it on the FATF blacklist.

Beyond this, given the prospect of an extended period of confrontation with Russia, we propose that Ukraine's allies design and start to put in place the institutional arrangements to police Russia's isolation from the advanced economies and to allow effective control and regulation over Russia's external trade with other countries to mitigate Russian action to circumvent sanctions. In support of this, we propose a new framework of transparency and information disclosure which would strengthen public and market pressure on companies dealing with Russia and would improve compliance.

VI. The Key Objectives of Financial Sanctions

The general aim of sanctions is to impose costs on Russia until it ends the war in Ukraine. We propose that financial sanctions should be particularly focused on two areas where the Russian economy and financial system are dependent upon the Western financial system, which creates vulnerabilities that sanctions can exploit.

Measures to curb inflows and encourage outflows, alongside measures to reduce oil and gas earnings

A key focus of financial sanctions should be Russia's lack of a reserve currency and consequent dependence on Western reserve currencies, particularly the dollar, to underpin the ruble and to ensure monetary and financial stability. This dependence has been amplified by the use of the dollar for borrowing and saving inside Russia[3]. Russia's high starting point of reserves and very strong trade balance so far this year with high export earnings from oil and gas as imports collapsed, has partially shielded the Russian economy. Even so, the impact of the first wave of sanctions, notably the sanctioning of the Russian central bank, has been significant.

Looking ahead, we propose further sanctions with the aim of encouraging outflows and discouraging inflows, which will erode Russia's holdings of dollars and put enhanced pressure on the currency and the economy. Here, sanctions that reduce Russia's export earnings from the sale of oil and gas may be the most important, as proposed in our paper on energy sanctions. However, we believe that a range of other financial sanctions could further encourage outflows and reduce inflows:

[3] As of now deposits are ~20% in FX, which is lower than Russia's historically high levels, but still significant.

Encouraging outflows:

1. **Western institutions in Russia.** There is ongoing pressure on Western institutions to exit the Russian market fully, and to divest their physical and financial Russian assets. In terms of direct investors, this campaign has had many successes to date (e.g., McDonalds, Société Générale, Renault),[4] but there remain institutions that have not yet committed to divestment (e.g., Auchan, Leroy Merlin). Many more have not yet completed the divestment they have announced (e.g., bp, Siemens, Raiffeisen). In terms of financial investments, at first sight there is little more to do, given the comprehensive ban on non-resident securities trading in Russia. However, in practice, many Western institutions have not yet divested their holdings of Russian ruble or securities. While we recognize direct investors may require more time for an orderly exit, we do not see the same justification for delay in the case of portfolio investors. We propose Western funds and companies should be required to complete their divestment of remaining ruble holdings and Russian securities from their portfolios, and to close any remaining accounts at Russian banks, with a deadline for divestments and recognition of their losses in Russia, absent special permission from their regulator.
2. **Russian institutions and individuals in Russia**. Here, we favor in principle a somewhat permissive attitude in the short term towards capital outflows from Russia, provided that full information about the origin of funds can be given and the transfer is not from a person subject to sanctions. In practice, outflows from Russia were quite constrained by Russian capital controls, but from early June the CBR has eased these restrictions and now allows Russian residents to transfer abroad up to $150k per month. Still, there are more restrictions on inflows, including enhanced checks for sanctions and the EU's limit of 100k euro on deposits by Russian residents or nationals in an EU bank – but with no limits on deposits by EU nationals or on transfers to EU nationals. For now, these rules leave substantial scope for outflows. And since Russia's financial system will be increasingly isolated if the war continues – with capital controls likely to return – this window of opportunity to transfer abroad should support a "closing down sale" effect, to take funds out of Russia while it is still possible.

Discouraging/freezing inflows:

1. **Export controls on payments to Russian entities.** We favor comprehensive reporting of all payments, at a minimum, and would favor a maximal policy of depositing all such payments into an escrow account until the invasion is over. Pending such a full regime, we see two particular areas for enhanced scrutiny: a) enhanced controls on transactions that divert from the previous pattern and have the impact of supporting additional inflows into Russia, such as the reported surge in Russian crude purchases by Lukoil refineries in Italy; b) transactions between related parties, including transfer pricing and related-party loans that can be used to evade taxes and sanctions.
2. **Special license for cross-border banking.** We favor a special licensing regime for banks working with Russian entities, and Russian banks working with Western institutions, restricted to a limited number of banks and for a limited range of activities. This control would provide options for more offensive action, e.g., allowing funds to be paid into an

[4] https://som.yale.edu/story/2022/over-1000-companies-have-curtailed-operations-russia-some-remain

account, to settle a debt, but then freezing the funds in that account by preventing transfer or conversion into cash or another currency.

Box 1: Offensive Options – Turning the Tables on Gazprombank

Gazprombank is playing a central role in Russia as it handles gas trade, and according to recent reports, is also involved in the direct financing of the war in Ukraine.

We could deny Russia access to energy export receipts by turning the table on Gazprombank. On March 5th, President Putin issued decree 95 that allows Russian residents to repay their debt to non-residents by paying in rubles into dedicated "C" accounts set up with the National Settlement Depository. The money in those accounts is not available for withdrawal or conversion into hard currency, but the debtor's obligations are considered extinguished under Russian law. In an analogous scheme, Gazprombank itself should effectively be turned into such a "C" account (essentially an escrow account) by adding it to the SDN list and issuing a general license to allow correspondent banks to only *credit* USD accounts held at Gazprombank (accepting SWIFT order MT103 or equivalents with Gazprombank listed as the beneficiary's bank but not as payee's bank). This move is unlikely to constitute a breach of contract on the part of European customers and would be consistent with Russia's own treatment of its financial obligations. Gazprom and Rosneft would likely then demand payments be made into foreign accounts at subsidiaries, but those accounts could also be immobilized by adding the subsidiaries to the SDN list, with an exemption to allow them to continue receiving payments.

3. **Prohibit use of rubles in trade.** Explicitly prohibiting the use of rubles in trade reduces opportunities for Russia to evade the sanctions regime (particularly around escrow accounts). Contracts, where buyers' payments obligations are only considered to be fulfilled upon successful payment of or currency conversion into rubles, should be deemed void.

Measures to a) impose a cost by further cutting the Russian financial system off from the Western financial system, and b) use the Western financial system to control and regulate Russia's external trade, including with "friendly" countries

The second key Russian vulnerability that financial sanctions can exploit is Russia's lack of deep and sophisticated financial markets and consequent dependence on Western capital markets and financial institutions and services. In contrast to the dependence on the dollar, this vulnerability is unlikely to trigger a short-term crisis and will largely have longer-term effects. In particular, we see scope to isolate Russia further from the core of the global financial system – the reserve currencies, key markets and leading banks and asset managers in the advanced economies – imposing a cost as Russia faces reduced access to capital and other financial services, as well as to use Western control over the core of the financial system, and the attractiveness of Western currencies, markets, banks and funds globally, to help regulate and police Russia's external trade, including with countries who remain on friendly terms with Russia, reducing the risk of sanction evasion.

To deepen Russia's financial isolation, we propose the following measures:

1. Further progress towards the objective of full SDN sanctions on all of Russia's banks, i.e., a full ban with only targeted and limited exemptions for specific, tightly defined purposes, e.g., for the banks licensed to conduct specific foreign trade operations. Specifically, the next wave of sanctions should include full SDN sanctions on the top 30 Russian-owned banks, both state and private, with similar sanctions extended to their subsidiaries.
2. Set an upper limit to any SWIFT transfer out of Russia without the special permission of the sanctioning authority.
3. Impose personal sanctions on the Board and executive team (Upravlenie) at the key large Russian banks already sanctioned, such as Sberbank, VTB, VEB, Promsvyazbank, and on the key officials in Russian finance, including in particular at the Central Bank and Ministry of Finance.
4. Impose full blocking sanctions on MOEX[5], the main Russian domestic financial exchange, which will further disrupt the domestic use of dollars and raise the cost of capital for Russia. Sanction international securities of Russian companies, which will: prohibit additional emissions; prohibit IPOs; and exclude them from indices. Impose full blocking sanctions on the National Settlement Depositary (in the spirit of the 6th package of the EU), an institution which enables operations with bonds and stocks.
5. Impose restrictions on Western insurance companies working in Russia, and sanction the leading Russian insurance companies, thus increasing the cost of transactions.
6. Demand rapid exit of all Western financial institutions (e.g., Raiffeisen), and companies providing financial sector IT-solutions and cloud services that continue to operate in Russia (Thales, Cisco, etc.).[6] [7]
7. Prohibit Western asset managers, related service providers, and individuals from supplying investment consulting, fund management, or wealth advisory services to Russian or Belarusian clients (including but not limited to services associated with portfolios of "traditional" and "alternative" assets such as stocks, bonds, real estate, commodities, hedge funds, private equity, and venture capital)[8].
8. Hold revenues accruing under patents and IP licenses for Russia-based beneficiaries in an escrow account, until the end of the war.
9. Ban trading against the ruble on crypto exchanges, including ruble-stablecoins. Wallet companies should ban openings and transactions in Russia. Russia-based, Russia-backed,

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[5] This will likely accelerate the exit of foreign corporates as it would make their treasury management function very challenging.

[6] Russian banks are currently critically dependent on technology supplied by Western companies. For example, the Russian payment system MIR (which offset the negative effects of Visa and Mastercard's exit from the Russian market) is based on the architecture of the Belgian company OpenWay. In addition, most Russian banks use solutions from Thales, store the source code of their applications on Gitlab, use telecommunications equipment from Cisco, work with Oracle databases, use virtualization from VMware, etc.

[7] We suggest establishing a mechanism with regard to the online licenses, which will oblige a provider to revoke the license if there are reasonable grounds to believe that the license has been used in Russia or by any Russian legal entity. The use of classic licenses should be brought under the control of the supplier and the language tightened to close legal loopholes which might allow ongoing Russian use of the license.

[8] Some types of fund management services, such as those provided by general partners of semi-liquid hedge funds and illiquid private equity and venture capital funds, should be allowed to have reasonable transition periods, providing that the fund managers fully report all holdings that they manage on behalf of Russia-based or Belarus-based individuals and institutions to the sanctioning authorities (including details of the ultimate beneficiaries).

or other crypto-mining companies subsidized by Russian energy resources should be banned.

10. Extend the freeze on Russian official assets by imposing full sanctions on other Russian official bodies with control over FX abroad, including the Russian Ministry of Finance, the Social Insurance Fund, the presidential administration, and any funds managed by security or military agencies. These assets should remain frozen with a view to their possible seizure to finance Ukraine reconstruction.
11. Designate the Russian Federation as a Sponsor of State Terrorism, expel Russia from the FATF, and place Russia on the FATF's blacklist, thereby forcing partner banks to reconsider cooperation with the Russian financial system.

To support this new regime, we propose enhanced transparency and information disclosure:

1. Obligate legal entities and organizations to disclose information regarding existing business relations with Russian/Belarusian enterprises and their subsidiaries inside and outside of Russia and Belarus, including the key parameters of such business relations. Such disclosure could involve a mandatory U.S. Securities and Exchange Commission (SEC) filing, and it should name the Russian (or Belarusian) counterpart, share the value and nature of the transaction or business relationship, and detail the description of the goods and services involved. Disclosed information should be provided in a standardized way to the public in order to increase reputational damage for businesses who maintain ties with Russia.
2. Specifically require Western asset managers to report all holdings that they manage on behalf of Russia-based or Belarus-based individuals and institutions to the sanctioning authorities, including details of the ultimate beneficiary of the funds. Consider standardized public disclosure of each firm's aggregated number of Russia- or Belarus-based clients and the related assets under management (or capital commitments) in order to increase reputational damage for firms who continue to manage assets for such clients.
3. Specifically require all crypto exchanges to be able to identify any payments made to a Russia-based beneficiary, and to secure permission from the regulator for any payment into Russia – or series of linked payments – of a material size[9].
4. Ensure specific disclosure of the nationality of a company's ultimate beneficiary as part of standard company incorporation and reporting processes. Require companies to report when this individual holds a Russian or Belarusian passport.
5. Accelerate the creation of a global public register of beneficial ownership.

To regulate and control Russia's trade more effectively, we propose setting up a new institutional framework to police economic and financial transactions with Russia:

1. Establish, perhaps under the aegis of the G7 and building on the existing arrangements for coordinating sanctions, a dedicated committee of the sanctioning powers to manage trade and economic relations with Russia, in particular by developing, coordinating and enforcing sanctions.

[9] Requiring crypto exchanges to ban operations with Russians may be difficult, given weak regulation of crypto. However, this requirement – to ensure no transactions are conducted with Russian entities – could be enforced as part of a move to establish greater regulation of crypto exchanges.

2. Establish a network of officials to enforce the sanctions regime, including officials at the major Western central banks to track Russian trade and financial flows, officials at the major financial regulators to track declarations of business ties with Russia, and a network of officials at embassies in the key "friendly countries" which Russia may seek to use as a cover to circumvent sanctions, including such countries as UAE, Saudi Arabia, Pakistan, Turkey, Armenia and Kazakhstan, to mitigate Russia's efforts to circumvent sanctions.
3. Appoint a single financial institution, or a single institution for each major economy, to finance trade with Russia on the Western side, and require Russia to appoint a single institution on its side – perhaps Gazprombank given its privileged role in foreign trade, though it could equally be another bank e.g., VEB – to be the sole institution involved in financing Russia's foreign trade with the advanced economies on its side. Require all trade-related financial transactions to be handled by the licensed entities, with these entities only allowed to provide a "whitelist" of trade-related financial services, and not other financial services, e.g., longer-duration lending or FX services. Having a small number of specialized entities engaged in this trade on each side will make it easier to enforce rules, create a centralized database, and monitor compliance.
4. To reflect the enhanced risks and regulations associated with doing business with Russia, we propose higher collateral and capital requirements for banks licensed to finance trade with Russia.
5. Require a full inventory of all Russian ownership in Western financial systems and industries, and review whether current Russian ownership is compatible with national security. Impose a system of controls over these assets, including to prevent technology and IP theft, and to review any proposed transfer of a material size to Russia.
6. Require that all cross-border transfers into a Western account or fund report if the funds had a Russian origin, in which case special permission will be required, as well as confirmation that the funds are not controlled by a sanctioned person.

There is some tension between the objectives of encouraging outflows, isolating Russia from the Western financial system, and using its dependence to help police the sanctions regime.

First, eroding Russia's stock of dollars and triggering a crisis for a currency underpinned by Western reserve currencies favors encouraging outflows from Russia, while imposing a cost on Russia by reducing its access to Western financial markets and services implies blocking outflows from Russia. On balance, we propose to leave scope for capital outflows from Russia for some time, subject to a regime of enhanced disclosure. Nonetheless, a sharp increase in the number of personal sanctions should make access to the Western banking system more costly for individual Russians. The endpoint, if Russia does not end its war in Ukraine, will be a high level of isolation from the Western banking system. We suggest regular monitoring, dynamically shifting to tighter controls as capital outflows decline.

Second, isolating Russia from the Western financial system, which implies preventing Russian entities from accessing Western financial markets, institutions, and services, is in some tension with using Russian access to the financial system – including use of dollar and euro accounts in third countries – to allow enhanced control and regulation of the trade and sanctions regime. Here, we see the tension as simpler. We see advanced economies such as the United States, EU, United Kingdom (UK), and Japan as largely ceasing to trade with Russia, except for

a limited role for some commodities, but the West using its leverage over the global financial system to monitor and control Russian trade with other countries, especially non-sanctioning "friendly" countries, where there is an enhanced risk of Russian attempts to circumvent sanctions.

We believe many of these measures – including SDN sanctions on the top 30 Russian-owned banks, state or private, MOEX, the National Clearing Center, and the National Settlement Depositary, with a carveout for energy and other unsanctioned trade-related transactions at Gazprombank, and personal sanctions on finance officials – can be implemented immediately, including in the EU's 7th package of sanctions and the next round of U.S. sanctions. Looking ahead, to allow for an orderly transition, we would propose requiring Western banks to exit Russia by the end of the year, and all trade with Russia from January 2023 onwards should be conducted exclusively by licensed banks. We would also propose a date, e.g., December 2022, by which time Western asset managers should have offboarded all existing Russia-based or Belarus-based clients[10].

VII. Mitigation Strategy

We propose several measures to mitigate any negative impact on Western financial systems from a sanctions strategy that targets Russia's dependence on Western reserve currencies and on the Western financial system.

There is a clear asymmetry between Russia, a user of Western reserve currencies and financial services who lacks an alternative provider, and the providers of reserve currencies and financial services, for whom Russia is a relatively small market. So, the effect on the sanctioning countries will be much more modest than the impact on Russia. Nonetheless, there is scope for these financial sanctions that target Russia's dependence on the dollar and on Western finance to have undesirable side effects on the sanctioning countries. In this section, we consider some of the key potential negative impacts and mitigations:

Undermining the dollar. Over time, there is a risk that imposing sanctions on the use of dollars in some countries e.g., Iran and Russia – may drive diversification away from Western reserve currencies, notably the dollar, and to other reserve currencies. However, we contend that demand for reserve currencies over time has tended to be driven by other factors – notably, the strength of the economy issuing the currency and the network effect of which currencies are most widely used. Moreover, shifts in reserve currency shares have historically been very gradual. Finally, we note that the initial "risk-off" reaction in the global market and at the street level in Russia to Russia's invasion has been to buy dollars – a reaction which we think highlights the credibility problem any alternative to the dollar will struggle to overcome. Still, we think the most important action to maintain demand for dollars is for the central banks of the

[10] For "traditional" liquid assets such as portfolios of stocks, bonds, and other traded securities, this long time period should not be necessary. Even for most "hedge funds", there could be a much shorter transition period. Special licensing for an extended wind-down period could be used for semi-liquid hedge funds and illiquid partnerships such as private equity and venture capital, assuming full disclosures were made in a timely fashion (including details on ultimate beneficial owners).

reserve currencies to ensure monetary stability, maintain the value of their currencies, and reinforce that sanctions will only be deployed against rogue states, who pose a clear and present threat to international order.

Direct economic impact. In aggregate, the Western financial exposure to Russia, which is the highest in Europe, appears manageable. For instance, a recent European Banking Authority report, stated that "exposures to Russia and Ukraine are small (0.3% of total assets)… As a result, first round impacts from the Russian invasion of Ukraine on the EU/EEA banking sector are expected to be manageable." Swiss exposure to Russian risk looks similar, at around 0.3% of banking system assets, although asset manager funds from Russia are more substantial, likely in the low single digits, according to the chair of the Swiss Bankers Association Marcel Rohner.

Outside of Europe, direct credit exposure to Russia looks even more limited. For instance, American banks' direct exposure to Russia represents around 0.01% of the US's $17 trillion banking assets, while the direct loan exposure to Russia of all three Japanese megabanks MUFG Bank, Mizuho Bank, and Sumitomo Mitsui Banking Corp. is only about 0.06% of their combined total assets.

Nonetheless, even if total exposure is limited, individual banks or funds may have concentrated exposure to Russian debt, banks, and companies that create problems with the potential to spread. To help manage such pockets of distress in an orderly way, we propose that Western central banks, especially the ECB, consider providing targeted support for divestment from Russian assets, including an option to offload exposures to Russia before further sanctions are introduced to limit the risk of contagion.

Diversion of activity into the offshore. The third major risk that we can identify is that pushing Russian institutions and individuals out of the "mainstream" financial system of transactions might expand the hidden, less regulated or dark parts of the financial system – such as "friendly countries", offshore jurisdictions, and crypto exchanges – which provide loopholes to Russian entities to avoid sanctions. In many cases, offshore centers appear to be complying with sanctions with, for instance, reports of Jersey, the Cayman Islands, and Bermuda freezing Russian assets. However, we think that further action may be required in relation to Dubai, which appears to have become a center for Russians evading sanctions since the invasion. Here, we would propose that Ukraine's allies consider if Dubai or the UAE, already on the FATF grey list, should be placed on the FATF black list, and what actions would be required to avoid this action, which could cut Dubai/UAE off from the Western financial system.

We see our proposals for setting up new institutional arrangements for managing relations with a hostile Russia – including new institutional arrangements for coordinating and enforcing sanctions policy, backed by a network of officials, a special licensing regime for banks who continue to finance trade with Russia, as well as enhanced disclosure for all banks and asset managers on Russia-origin funds and Russian clients – as helpful to mitigate this risk.

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