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INTERNATIONAL FINANCIAL SANCTIONS: HISTORY, RATIO AND THE SBERBANK STUDY CASE

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1. INTRODUCTION AND SCOPE OF THE PROJECT

In the intricate web of international relations, economic and financial sanctions emerge as powerful instruments shaping global dynamics. These measures, often deployed by states and international bodies, wield significant influence over the economic, political, and social landscapes of nations. The evolution and application of economic and financial sanctions underscore their multifaceted nature, serving as instruments of coercion, diplomacy, and power projection.

This examination seeks to unravel the intricate tissue of economic and financial sanctions, tracing their historical roots, exploring their diverse forms and functions, and analyzing their impact on targeted entities and broader geopolitical contexts. Critically, economic and financial strength has been used a proper tool of foreign affairs, both actively and passively, to pursue different goals in the field of international relations. And since no one is above the law, as the Americans told us, in the recent days it has been developed a proper theoretical and regulatory framework that defines how, when and where these

sanctions should be implemented. So, through an interdisciplinary view comprehensive of economics, political science, law, and international relations, this exploration aims to elucidate the complexities inherent in the use of sanctions as a tool of statecraft.[1] Writing a thesis on economic and financial sanctions is a timely and significant challenging pursuit that offers numerous benefits. It allows for a detailed examination of a critical international issue, contributes to various academic fields, and provides practical insights that can influence policy and decision-making. By focusing on the history, rationale, and current sanctions against Russia, I hope to provide a comprehensive and valuable analysis that can be relevant to today's global economic and political landscape with a focus on regulation of international financial markets.

[1] Geoff Berridge, Diplomacy, Theory and Practice, 2015

1.1 A first look at the theoretical framework

The origins of economic and financial sanctions can be traced back to ancient civilizations, where trade embargoes and economic restrictions were employed as mechanisms of exerting influence and control over adversaries. From the ancient times, historical records bear witness to the strategic deployment of economic measures to choke rival economies and weaken political adversaries.

In the modern era, the rise of nation-states and the evolution of international law provided a new framework for the imposition of sanctions. The Treaty of Westphalia in 1648 marked a pivotal moment in the codification of state sovereignty and the delineation of territorial boundaries, laying the groundwork for the use of economic measures as tools of statecraft. Throughout the 20th century, economic sanctions featured prominently in conflicts such as World War I, World War II, and the Cold War, reflecting their enduring relevance in international relations.

The 21st century witnessed a proliferation of sanctions regimes, with states and international bodies leveraging economic and financial measures to address a wide range of geopolitical challenges, including terrorism, nuclear proliferation, human rights abuses, and cyber threats. The evolution of sanctions reflects shifting geopolitical dynamics and emerging threats in an increasingly interconnected and interdependent world.

Economic and financial sanctions encompass a diverse array of measures designed to achieve specific policy objectives. Broadly classified, sanctions can be categorized into diplomatic, economic, and financial sanctions, each tailored to address distinct geopolitical challenges and strategic wills.

Diplomatic sanctions typically involve the severance or downgrading of diplomatic relations between states, often in response to obvious violations of international norms or acts of aggression. Economic sanctions, on the other hand, encompass a spectrum of measures ranging from trade restrictions and import/export bans to tariffs and quotas aimed at disrupting the flow of goods and services to targeted entities. Financial sanctions then, including asset freezes, capital controls, and restrictions on financial transactions, seek to undermine the economic viability and operational capacity of sanctioned entities. The mechanisms through which sanctions are implemented vary widely, reflecting the complex interplay of domestic legislation, international treaties, and multilateral agreements. While some sanctions are unilaterally imposed by individual states, others are enacted through international bodies such as the United Nations Security Council or regional organizations like the European Union.[2] The effectiveness of those sanctions holds on factors such as their scope, duration, enforcement mechanisms, and the degree of international consensus among participating actors meanwhile the deployment of economic and financial sanctions is driven by a spectrum of objectives, ranging from deterring aggression and promoting human rights to countering proliferation and combating terrorism. At its core, the rationale behind sanctions lies in their potential to alter the behavior of targeted entities by imposing economic costs and diplomatic isolation.

One primary objective of sanctions is usually to compel compliance with international norms and standards, thereby fostering stability and security within the international system. By imposing punitive measures on states or non-state

[2] Economic Sanctions in International Law and Practice, Masahiko Hasada, Routledge 2020

actors engaged in illicit activities or human rights abuses, sanctions serve as a means of signaling disapproval and eliciting behavioral change.

Moreover, sanctions are often employed as tools of conflict resolution and crisis management, offering policymakers a non-military means of addressing geopolitical tensions and averting armed conflict. In contexts where diplomatic negotiations falter or traditional forms of coercion prove ineffective, sanctions offer a middle ground between diplomacy and force, providing a mechanism for exerting pressure while preserving the prospect of dialogue and negotiation.

Additionally, economic and financial sanctions are utilized to protect national interests and promote economic prosperity by safeguarding domestic industries, mitigating security risks, and lowering the influence of hostile actors. Whether aimed at curbing nuclear proliferation in rogue states or countering cyber threats emanating from adversarial regimes, sanctions are instrumental in safeguarding the strategic interests of states and preserving global stability.

Despite their perceived efficacy and utility, economic and financial sanctions are not without challenges and limitations; one of the primary challenges lies in the potential for unintended consequences, whereby sanctions inadvertently harm civilian populations, exacerbate humanitarian crises, and undermine the very objectives they seek to achieve. The effectiveness of sanctions is then contingent upon a myriad of factors, including the resilience of targeted entities, the presence of alternative trading partners and the capacity for evasion and circumvention. In an increasingly globalized world characterized by interconnected supply chains and porous financial systems, the effectiveness of unilateral sanctions is often limited by the ability of sanctioned entities to adapt and navigate around imposed restrictions.

But the proliferation of sanctions enforced by multiple actors must take into account that , each player if pursuing divergent policy objectives, can lead to a fragmented and inconsistent sanctions regime, undermining efforts to achieve collective security and promote international cooperation. The lack of coordination and cooperation among sanctioning states poses challenges to enforcement, monitoring, and compliance, rendering sanctions less effective in achieving their intended goals.

Economic and financial sanctions therefore occupy a central role in contemporary international relations, shaping the behavior of states, non-state actors, and international institutions.

As we navigate the complexity of the modern world, understanding the nuances of economic and financial sanctions is essential for policymakers and citizens. By critically examining the objectives, mechanisms, and limitations of sanctions, we can better comprehend their impact on global affairs and explore avenues for fostering dialogue, cooperation, and conflict resolution in an increasingly interconnected and interdependent world.

1.2 Historical presentation of economics and financial sanctions: ratio and timeline

Financial and monetary sanctions have their origins in the earliest periods of human civilization. Societies have used economic measurements as tools of governance, diplomacy, and conflict resolution from antiquity to the present era. The development, justification, and ongoing significance of economic and financial sanctions in international relations may be understood by looking at its historical underpinnings.

Medieval and Renaissance times saw the rise of economic conflicts between European nations as well as the advent of mercantilism, as the first the emerging colonialism highlighted the strategic significance of economic dominance and exploitation even more. Trade barriers, tariffs, and monopolies were used by European colonial rulers to take resources out of colonies and keep economic superiority over native populations. A turning point in the development of state sovereignty and the creation of international law was the Treaty of Westphalia, signed in 1648. Cuius regio, eius religio ("whose realm, his religion") established the foundation for the employment of economic sanctions as an instrument of statecraft while also upholding the sovereignty of individual governments. During the Age of Enlightenment where provided theoretical underpinnings for the use of economic sanctions as acceptable tools of diplomacy and coercion. Economic sanctions were then increasingly utilized as tools of supremacy politics and geopolitical rivalry in the 19th and 20th centuries such as, established in the wake of the Napoleonic Wars, the Concert

of Europe used economic sanctions to protect the balance of power and the territorial integrity of the European states.

Economic rivalry and territorial disputes were stoked by the advent of industrial capitalism and imperialism, which ultimately led to the start of World War I. The Allied and Central Powers' deployment of trade embargoes and economic blockades highlighted the crucial role that economic sanctions play in total warfare, so economic sanctions were codified as international peacekeeping and collective security measures during the interwar years.

But then Cold War era witnessed the ideological confrontation between the United States and the Soviet Union, characterized by proxy conflicts, espionage, and economic warfare and so the imposition of trade restrictions, financial sanctions, and diplomatic isolation became integral components of superpower competition and containment strategies. The Cuban Missile Crisis of 1962 epitomized the strategic use of economic sanctions as instruments of crisis management and deterrence. The United States in this case imposed a naval blockade and economic embargo against Cuba in response to Soviet missile deployments, escalating tensions and precipitating a diplomatic standoff.

The dissolution of the Soviet Union and the end of the Cold War heralded a new era of globalization and geopolitical realignment. From now economic sanctions emerged as preferred instruments of multilateral diplomacy and conflict resolution, employed by the United Nations Security Council and regional organizations to address humanitarian crises, human rights abuses, and weapons proliferation. Within the constantly evolving field of international relations, financial and economic sanctions have become important instruments of coercion, diplomacy, and statecraft. Sanctions are essential for influencing the conduct of governments and non-state actors in the twenty-first century, since

they may be used to promote human rights and prevent violence. Economic and financial sanctions, however, face new difficulties and dilemmas that put their effectiveness, legality, and influence on international security to the test as the globe grows more linked and dependent on one another. One of the primary challenges facing economic and financial sanctions is the risk of unintended consequences. Sanctions often inflict collateral damage on civilian populations, exacerbate humanitarian crises, and undermine the welfare of vulnerable communities. Moreover, the indiscriminate nature of sanctions measures can lead to unintended humanitarian suffering and exacerbate tensions between states, posing ethical and moral dilemmas for policymakers and practitioners. Sanctioned entities have become increasingly adept at evading and circumventing sanctions through illicit channels, underground networks, and informal economies. The proliferation of digital currencies, offshore havens, and alternative financing mechanisms has posed significant challenges to sanctions enforcement and compliance efforts. The cat-and-mouse game between sanctions enforcers and targeted entities underscores the adaptive nature of modern sanctions regimes and the need for innovative approaches to address evasion and circumvention tactics.

The proliferation of economic and financial sanctions by multiple actors, each pursuing divergent policy objectives, has led to a fragmented and inconsistent sanctions regime. The lack of coordination and cooperation among sanctioning states can undermine efforts to achieve collective security and promote international cooperation. Moreover, the extraterritorial application of sanctions by dominant powers has engendered tensions and disputes with allies and trading partners, raising questions about the legitimacy and enforceability of unilateral measures.

In the 21st century, economic and financial sanctions continue to shape international relations, confronting new challenges and dilemmas in an increasingly interconnected and interdependent world. The proliferation of non-state actors, transnational threats, and emerging technologies has reshaped the landscape of conflict and coercion, necessitating innovative approaches to sanctions design and implementation.

The advent of targeted sanctions regimes, including asset freezes, travel bans, and arms embargoes, reflects efforts to minimize collateral damage and mitigate humanitarian consequences.[3] However, the efficacy and legitimacy of targeted sanctions remain subject to debate, with critics raising concerns about due process, accountability, and unintended consequences.

A crucial thing that has to be kept in mind is that the rise of economic statecraft and the weaponization of finance have blurred the boundaries between economic policy and national security, challenging traditional norms of sovereignty and non-intervention. The extraterritorial application of sanctions by dominant powers, notably the United States, has engendered tensions and disputes with allies and trading partners, raising questions about the legitimacy and enforceability of unilateral measures. Financial sanctions are an essential part of modern diplomacy and conflict resolution tactics because they provide policymakers with a non-military way to influence the actions of targeted organizations and governments.

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[3] The Economic Weapon,The Rise Of Sanctions As A Tool Of Modern War", Nicholas Mulder, Yale, University Press, 2022.

This section will highlights the main ideas and types of financial sanctions in contemporary international relations.

1.3 Economic and Financial sanctions de-facto

This section will highlights the main ideas and types of financial sanctions in contemporary international relations.

Freezing of Assets: The process of asset freezes, which entail the seizure and freezing of financial assets owned by sanctioned people, organizations, or governments, is examined in this section.

Transaction Bans: limitations on financial transactions involving sanctioned parties forbid banks, financial institutions, and other organizations from doing business with specific people or organizations.

Capital Controls: cash controls include measures like capital repatriation obligations, prohibitions on cross-border investments, and limits on foreign exchange transactions that are intended to regulate the flow of cash across national borders.

Moreover, we must evaluate another important characteristic about sanctions which is how they are enforced, by one state alone or more of them so, Coordination and Collaboration in Multilateral vs. Unilateral Sanctions

Sanctions on a Multilateral basis are coordinated efforts by several governments or international organizations to impose sanctions on specific entities or regimes are known as multilateral sanctions meanwhile by Unilateral Sanctions on the other hand we mean the ones that are applied unilaterally and those that are carried out by a single state or organization without the support or assistance of other nations.

The mechanisms of enforcement for these actions are relevant and can be mostly divided into: Accountability, Compliance, and Monitoring.

- Monitoring: Information about sanctioned firms, transactions, and activities is gathered, analyzed, and disseminated as part of monitoring measures. how international organizations, regulatory bodies, and financial intelligence units monitor sanctions compliance and identify unlawful activity.
- Compliance: To guarantee adherence to punishments, rules, and prohibitions, compliance measures comprise the creation of legislative frameworks, regulatory standards, and enforcement procedures. And the difficulties in complying with sanctions such developments in technology, regulatory complexity, and jurisdiction.
- Accountability: mechanisms that are designed to make governments, international actors, and sanctioned entities answerable for breaking sanctions agreements. The function of international tribunals, sanctions committees, and accountability mechanisms in upholding sanctions, encouraging transparency, and discouraging unlawful activity

A century ago, economic sanctions as we know them today were formed. Organized material pressure arose at the close of World War I as an innovative response to the age-old issue of how to avert conflict without using armed force. The League of Nations would utilize what the winners referred to as their "economic weapon" to persuade states that were heading in the wrong direction. Following the terrible devastation caused by the Great War, international organizations embraced economic warfare tactics and repositioned them as a countermeasure against actual warfare. Sanctions were certain to become "a

permanent part of the machinery of organized mankind" before the end of the WW1. From a twenty-first-century perspective, they have undoubtedly become permanent, but not without significant changes. It forces us to think about how economic pressure does and does not shape political outcomes, suggesting a key distinction between the effects and the efficacy of sanctions in global history. The history of interwar sanctions offers valuable insights into the disparities and interconnections between effectiveness and consequences indeed observers of the interwar period often interpreted the visible and alarming repercussions of blockades on Central Europe as evidence of the crucial role of this policy in the Allies' triumph in World War I. The effects were conflated with effectiveness without probing the intricate relationships between them. This conflation served political purposes by instilling confidence in the League's capacity to maintain peace through its formidable economic tool. Nonetheless, effects were not necessarily indicative of effectiveness. One of the most perplexing aspects of sanctions is that, regardless of their technical intricacies, their outcomes are never solely determined by economic factors. Proponents of interwar sanctions presumed that state actions were influenced by public opinion and the material self-interest of both populations and elites.[4]

[4] The Economic Weapon,The Rise of Sanctions as a Tool of Modern War", Nicholas Mulder, Yale, University press, 2022.

2. MODERN DAY FINANCIAL AND ECONOMIC SANCTIONS TOWARDS RUSSIA

2.1 Mechanisms enforced to weaken Russian economy

Theoretically, sanctions imposed on Russia following its invasion of Ukraine can undermine its financial and economic stability through several interconnected mechanisms and the most crucial notion of this statement is whether Russia's economic and financial imbalance toward the Far East, caused by friction with the West, will ensure its economic and political growth and status. That is, in my opinion, the key question posed by the West, as well as the primary aim of sanctions. Force Russia and its supporters to be absolutely certain that continuing the invasion of Ukraine is worth the danger of complete political and economic isolation from the free market.

By restricting access to international financial markets, sanctions target to reduce Russia's ability to borrow and raise capital, limiting liquidity and hindering investment in crucial sectors as well as targeting major Russian banks and isolating them from the global financial system disrupts "theoretically" international transactions, diminishing foreign investment and trade while raising domestic borrowing costs. Sanctions that impose technology embargoes then, particularly in the energy and defense sectors, stifle technological advancement by preventing access to essential high-tech goods. This technological stagnation will theoreticcaly impedes Russia's ability to maintain and develop its industrial capabilities, affecting long-term economic growth. Additionally, sanctions on influential individuals, such as oligarchs and political figures, consequently, create internal pressure on the government. These elites

often have significant economic interests abroad and the disruption of their wealth and influence can lead them to push for policy changes.

The aim is to slow down and make more rigid their domestic economy by both hitting their export revenues, especially from critical commodities like oil and gas and limiting the state's ability to fund public services and military expenditures. The withdrawal of foreign companies from Russia then decreases market competition and innovation, resulting in a less dynamic domestic economy. Currency devaluation, triggered by sanctions and reduced investor confidence, leads to inflation, eroding consumer purchasing power and further destabilizing the economy. Regarding the part of reducing their ability to raise capital, the deterrence of foreign direct investment due to the uncertain economic environment created by sanctions deprives Russia of the essential capital, the technology transfer, and the managerial expertise needed for economic development.[5] So freezing Russian assets held abroad constrains the government's financial flexibility, exacerbating economic crises by limiting the ability to stabilize the economy during downturns.

Finally, the economic hardships resulting from sanctions can weaken public support for the government. As economic conditions deteriorate, citizens may demand political change or policy shifts, potentially leading to concessions or alterations in aggressive foreign policies.

These mechanisms collectively illustrate how sanctions can theoretically weaken Russia's financial and economic fabric, exerting significant pressure on both the economy and the political regime.

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[5] Treasury, https://home.treasury.gov/news/press-releases/jy0608

Now exploring the forms and mechanisms of economic and financial sanctions unveils the intricate ways in which states and international bodies wield economic power to achieve political and strategic objectives. From trade restrictions to financial penalties, these sanctions encompass a wide array of measures tailored to address diverse geopolitical challenges.[6] 70% of assets of the Russian banking system are under sanctions. Around €20 billion of assets of more than 1 500 sanctioned persons and entities have been frozen. The invasion of Ukraine was a shock to the world and many Russians, even though the Kremlin had been openly expressing dissatisfaction with the European security order for some time. It was clear that the Russian regime was becoming more authoritarian and increasing its military capabilities, with doctrines and policy documents indicating Russia's intention to reclaim its status as a global power. It has often been said that Russia cannot be assessed by Western standards, yet this mistake is frequently repeated. Understanding the exact Russian logic in this case is challenging. [7] Nevertheless, the West quickly and unanimously condemned Russia’s illegal actions in Ukraine, responding with sanctions, a common 21st-century foreign policy tool used to signal disapproval of international law violations.. In July 2014, both the US and the EU significantly increased pressure by imposing economic sanctions on Russia, restricting the ability of listed banks and companies to raise credit in EU and US capital markets. Additionally, the EU and the US imposed sector-specific sanctions prohibiting the export of arms, dual-use goods, and advanced equipment for oil

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[6] European Council, https://www.consilium.europa.eu/en/infographics/impact-sanctions-russian-economy

[7] European Commission, https://finance.ec.europa.eu/eu-and-world/sanctions-restrictive-measures/overview-sanctions-and-related-resources_en#sanctions-against-russia

exploration to Russia. The sanctions regimes against Russia clearly signal that the US and EU do not accept Russia's policy towards Ukraine. These economic sanctions aim to change Russia's political behavior by targeting crucial functions and sectors of its economy. The underlying idea is that by imposing significant costs, Russia would be more inclined to cease its hostilities in Ukraine. Economic sanctions, a common tool in security policy, work by making aggressive behavior expensive, thereby persuading the targeted country to alter its actions. The design and effects of such sanctions have been extensively researched in academic literature. This report analyzes the sanctions against Russia using a framework derived from international sanctions literature. It examines how the sanctions impact the Russian economy, focusing on the specific systemic features that influence their effectiveness and how the Russian government's responses to the sanctions and the broader economic decline have affected the overall outcome. According to the analytical framework presented in this chapter, economic sanctions are imposed by the sender to inflict costs on the target with the aim of changing its political behavior regarding the relevant conflict. The theoretical model suggests that the costs incurred by the target country and the prospects of sanctions' success are influenced by various factors that can either enhance or diminish their impact. These factors are critical to understanding the success or failure of sanctions and form the basis of our analysis.

The empirical sanctions literature highlights several key factors. Higher costs imposed on the target generally increase the chances of success. Trade dependence between the sender and target can lead to high costs for both parties, though the literature's conclusions on this are mixed, with some studies indicating a positive impact on sanctions' success. The duration of sanctions also plays a role, with longer sanctions potentially accumulating higher costs for the

target but also allowing time to adapt and find ways around the restrictions. While empirical studies suggest that prolonged sanctions can sometimes be counterproductive, in our cases, duration was crucial for success. Also the participation of international institutions positively affects sanctions by coordinating multiple senders and providing legitimacy to the sanctions regime. However, third-party countries offering alternative trade opportunities can undermine sanctions' costs and efficiency, thus hindering their success.

Sanctions are generally less effective internally against authoritarian regimes compared to democracies because these regimes can control public opinion, blame economic hardships on the issuers and protect key elites and groups from economic hardship, making them more resilient.

A major challenge for any modernization program in Russia is that its post-1990s economic system still retains characteristics of the Soviet command system. Despite transitioning from a command economy to a market economy, the institutions that typically support market allocation remain weak. They are often overshadowed by informal institutions from the Soviet era and new forms of personal management that have emerged under Putin's leadership. This deficiency in Russia's market institutions is evident in the Worldwide Governance Indicators (WGI 2014), which measure governance across six dimensions: political stability and absence of violence/terrorism, voice and accountability, government effectiveness, regulatory quality, rule of law, and control of corruption. Over time, these indicators show that Russia's governance was generally low but improved until the early 2000s. However, since 2004, there has been significant deterioration in key areas such as the rule of law and control over corruption, with voice and accountability declining throughout Putin's leadership.

Weak institutions in Russia allow for the personal management of economic matters by the political sphere, a situation that necessitates keeping these institutions weak. This setup enables the pursuit of political rather than economic goals. The current Russian economic system can be seen as a hybrid: it combines inefficient, state-owned or state-controlled subsidized enterprises from the Soviet era with a market economy mainly composed of small and medium-sized businesses that developed after the system change. Within Putin's power-balancing system, loss-making Soviet-type enterprises are subsidized to maintain regime support. Revenues from high oil prices are distributed through what we can call a "rent management system," fostering "rent addiction." This term describes how investments in inefficient production by failing firms create continuous demands for resources to save jobs and capital. Some argue that preserving the old industrial structure and the politically-driven rent distribution system stifles the growth of the private, market-oriented sector. The rent-addicted sector operates under different rules, leveraging political connections to secure resources and production factors.

2.2 Areas of enforced sanctions

So reassuming the main areas in which mechanisms of economic and financial sanctions that have been implemented, by examining their objectives and implications are:

1. Diplomatic Sanctions:

Diplomatic sanctions represent one of the oldest forms of coercive diplomacy, aimed at signaling disapproval, isolating adversaries, and compelling behavioral change. These sanctions typically involve the severance or downgrading of diplomatic relations between states in response to perceived violations of international norms or acts of aggression.

- Embassies Closure: The closure of diplomatic missions and consulates serves as a symbolic gesture of diplomatic condemnation and withdrawal of recognition. This measure limits communication channels and diplomatic engagement, isolating the targeted state on the international stage.

- Expulsion of Diplomats: The expulsion of foreign diplomats and embassy staff constitutes a punitive measure designed to undermine diplomatic relations and disrupt intelligence-gathering activities. By expelling diplomats, states signal their displeasure and impose diplomatic costs on offending governments.

- Travel Bans: Travel bans and visa restrictions target individuals associated with sanctioned regimes or entities, limiting their ability to travel abroad and engage in diplomatic activities. These measures isolate key figures

within targeted governments and constrain their ability to interact with the international community.

2. Economic Sanctions:

Economic sanctions encompass a spectrum of measures aimed at disrupting trade, investment, and economic cooperation with targeted entities. These sanctions seek to impose economic costs, induce compliance, and coerce behavioral change through the manipulation of market forces and economic incentives.

- Trade Restrictions: Trade restrictions constitute one of the most common forms of economic sanctions, involving the imposition of tariffs, quotas, and export controls on targeted goods and services. These measures disrupt the flow of trade and commerce, imposing financial burdens on targeted industries and economies.

- Import and Export Bans: Import and export bans prohibit the trade of specific goods and commodities between sanctioned entities and external partners. By restricting access to vital resources and markets, import and export bans exert economic pressure and limit the operational capacity of targeted industries.

- Sectoral Sanctions: Sectoral sanctions target specific sectors of the economy, such as energy, finance, and technology, with the aim of undermining key sources of revenue and strategic advantage. These sanctions disrupt supply chains, limit access to critical resources, and impede technological innovation, posing significant challenges to targeted economies.

3. Financial Sanctions:

Financial sanctions encompass measures aimed at restricting access to financial markets, freezing assets, and disrupting financial transactions involving sanctioned entities. These sanctions seek to undermine the economic viability and operational capacity of targeted individuals, organizations, and governments.

- Asset Freezes: Asset freezes involve the seizure and freezing of financial assets, including bank accounts, investments, and real estate holdings, belonging to sanctioned individuals and entities. This measure prevents access to funds and financial resources, effectively immobilizing the economic assets of targeted parties.

- Capital Controls: Capital controls restrict the movement of capital across national borders, limiting the transfer of funds, investments, and financial assets to and from sanctioned jurisdictions. These measures aim to prevent capital flight, currency speculation, and illicit financial activities, thereby safeguarding the stability of domestic financial systems.

- Transaction Restrictions: Transaction restrictions impose limitations on financial transactions, including wire transfers, currency exchanges, and payment processing, involving sanctioned parties. These measures disrupt the flow of funds and financial services, impeding the operational capacity and liquidity of targeted entities.

5. Implementation and Enforcement:

The implementation and enforcement of economic and financial sanctions require robust mechanisms of monitoring, compliance, and enforcement to ensure their effectiveness and legitimacy, such as:

- Monitoring Mechanisms: Monitoring mechanisms involve the collection, analysis, and dissemination of information related to sanctioned entities, transactions, and activities. These mechanisms facilitate transparency, accountability, and oversight, enabling policymakers to assess the impact and efficacy of sanctions regimes.

- Compliance Measures: Compliance measures entail the development of legal frameworks, regulatory standards, and enforcement mechanisms to ensure compliance with sanctions regulations and prohibitions. These measures may include penalties, fines, and legal sanctions for violations of sanctions regimes, deterring illicit activities and promoting adherence to international norms.

- Enforcement Actions: Enforcement actions involve the coordination of law enforcement agencies, financial institutions, and regulatory authorities to detect, investigate, and prosecute violations of economic and financial sanctions. These actions may include surveillance, asset tracing, and interdiction efforts to disrupt illicit financial flows and illicit activities.

But there are also various challenges and limitation, despite their perceived efficacy and utility, economic and financial sanctions are not without challenges and limitations, which may undermine their effectiveness and legitimacy in the long run as well as unintended consequences: such that economic and financial sanctions may inadvertently harm civilian populations, exacerbate humanitarian

crises, and undermine the welfare of vulnerable communities. The unintended consequences of sanctions can erode support for sanctions regimes and provoke backlash from affected populations, limiting their effectiveness as instruments of coercion and diplomacy. Another elephant in the room is the evasion and circumvention of these sanctions: Sanctioned entities may seek to evade and circumvent sanctions through illicit channels, underground networks, and informal economies. The proliferation of alternative financing mechanisms, digital currencies, and offshore havens poses challenges to sanctions enforcement and compliance efforts, enabling sanctioned actors to evade detection and circumvent restrictions.

And at the end their fragmentation and overreach. The proliferation of economic and financial sanctions by multiple actors, each pursuing divergent policy objectives, can lead to a fragmented and inconsistent sanctions regime. The lack of coordination and cooperation among sanctioning states may undermine efforts to achieve collective security and promote international cooperation, exacerbating tensions and disputes in the global arena.

In conclusion, the forms and mechanisms of economic and financial sanctions reflect the complex interplay of power, diplomacy, and coercion in the realm of international relations.[8]

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[8] Hasada Masahiko, "Economic Sanctions in International Law and Practice", Routledge 2020

2.3 The EU sanctions on each economic sector

For what concern the European theoretical framework of the sanctions financial stability is fundamental for maintaining an economic growth, and robust financial resolution mechanisms are essential for achieving and maintaining it while weakening the target. Within the European Central Bank (ECB), the need for effective resolution mechanisms has been underscored by past financial crises. This part delves into the existing mechanisms within the ECB and the European Council through the analyzes their strengths and weaknesses and proposes strategies for enhancing them to meet future challenges.[9] The legal basis for financial resolution within the ECB is crucial, encompassing EU directives and regulations. The institutional architecture surrounding financial resolution involves multiple entities, including the ECB, Single Resolution Board (SRB), and national authorities. The ECB possesses various tools for resolving financial institutions, including bail-in, asset separation, and bridge institutions.

The High Representative and the European Commission jointly propose sanctions to the Council for unanimous adoption. After that, it is published in the Official Journal and becomes EU legislation. Furthermore, the Commission is essential in supervising Member States' application of penalties since it is the custodian of the treaties.

The EU imposes sanctions in advancing of global security and peace, averting hostilities in the name of democracy, the rule of law, human rights, and

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[9] European Council, https://data.consilium.europa.eu/doc/document/ST-5664-2018-INIT/en/pdf

the protection of international legal norms. EU sanctions can be applied against individuals, corporations, groups, organizations, and governments of non-EU nations through the following channels:

-weapons embargoes

-entry restrictions (travel bans).

-asset freezes and other economic policies like import and export limitations.

EU sanctions are commensurate to the goals they aim to accomplish and are carefully targeted, therefore, they seek to minimize any unexpected consequences while focusing on people in charge of the policies or acts that the EU wishes to affect. To address these challenges, the EU and the ECB initiated regulatory measures aimed not at impeding the market's growth but at mitigating the risks associated with potential exploitation for criminal purposes. EU lawmakers then have made concerted efforts to underscore connections between anti-money laundering/counter-terrorist financing (AML/CFT) and prudential concerns, supplementing the Union's existing legal framework. Initiatives such as amendments to the Capital Requirements Directive (CRD V) have been undertaken to delineate the correlation between prudential oversight and AML/CFT supervision, mandating prudential supervisors to respond to AML/CFT intelligence. Additionally, the Council of the European Union endorsed an Anti Money-Laundering Action Plan, aiming to achieve various objectives and enhance the efficacy of AML-CFT oversight. Central to this Plan is the Council's delineation of several short-term non-legislative actions targeting eight key objectives. Initially, the focus is on identifying the factors contributing to recent money laundering incidents in EU banks to inform potential future activities. Subsequently, efforts are directed towards pinpointing significant money laundering and terrorist financing issues, along with the most

effective prudential supervisory methods to address them, thus fostering supervisory convergence and integrating AML considerations into the prudential supervisory process. While seemingly straightforward, the third objective presents logistical challenges due to potential bureaucratic impediments from different institutions. Consequently, measures are proposed to facilitate effective collaboration between prudential and money laundering supervisors, enhancing supervision and information exchange among relevant authorities. Additionally, there is a recognition of the necessity to clarify the procedures for revoking a bank's authorization in cases of significant breaches, coupled with a call for improved oversight and information sharing among relevant authorities. The European Union (EU) has taken unprecedented steps in imposing sanctions on Russia following its full-scale invasion of Ukraine on February 24, 2022.[10] These measures build on earlier sanctions implemented after Russia's annexation of Crimea in 2014 and the subsequent failure to adhere to the Minsk agreements. The sanctions aim to exert significant economic pressure on Russia, thereby weakening its ability to continue its aggressive actions in Ukraine. This comprehensive analysis delves into the various facets of the sanctions, their impacts, and the broader implications for international relations and global economic stability.

The EU's approach includes targeted sanctions against individuals deemed responsible for actions undermining Ukraine's territorial integrity, sovereignty, and independence. High-profile figures such as Russian President Vladimir Putin, Foreign Minister Sergey Lavrov, and former Ukrainian President Viktor

[10] European Council, https://www.consilium.europa.eu/en/policies/sanctions-against-russia/sanctions-against-russia-explained/#trade.

Yanukovych are among those sanctioned. The sanctions extend to prominent businesspeople, oligarchs, high-ranking officials, military personnel, commanders of the Wagner Group, and pro-Kremlin propagandists. These measures typically involve asset freezes and travel bans, directly impacting the personal and economic freedoms of the individuals targeted.

Economic sanctions are a cornerstone of the EU's strategy to cripple the Russian economy. These sanctions encompass a wide range of restrictions, including prohibitions on imports and exports, asset freezes, and bans on providing various services to Russian entities. The sanctions aim to disrupt key sectors of the Russian economy, reducing the country's ability to sustain its military efforts and exerting pressure on its political leadership to change course.

One significant aspect of the economic sanctions is the prohibition on the export of high-tech goods to Russia. This includes items such as quantum computers, advanced semiconductors, and specific machinery, which are critical for Russia's technological and industrial capabilities.

The next step are sanctions targeting the banking and financial sectors are designed to isolate Russia from the global financial system. These measures include freezing the assets of sanctioned individuals and entities, prohibiting transactions with the National Central Bank of Russia, and limiting the ability of Russian banks to raise credit on international markets. Such restrictions severely constrain Russia's financial operations, affecting everything from day-to-day banking activities to long-term economic planning.

The freezing of foreign reserves is a particularly potent tool. By preventing Russia from accessing its reserves held abroad, the EU aims to create a liquidity crisis, making it difficult for Russia to stabilize its currency and manage its

economy effectively. This measure also sends a strong signal to the international community about the consequences of violating international norms.

Consequently trade restrictions are held in place, forming another crucial element of the EU's sanctions regime. The ban on the import of Russian crude oil, coal, diamonds, and other key resources is intended to deprive Russia of significant revenue streams. These measures are carefully designed to maximize economic pressure on Russia while minimizing the impact on EU economies.

The "No Russia Clause" is an innovative measure that prohibits the re-exportation of certain goods to Russia. This clause targets dual-use goods and advanced technology items that could be used in Russian military systems. By closing off indirect supply routes, the EU aims to ensure that its trade restrictions are not easily circumvented.[11]

The sanctions also extend to the transport and logistics sectors, Russian and Belarusian road transport operators are banned from entering the EU, disrupting supply chains and logistical operations. Additionally, Russian aircraft are prohibited from accessing EU airspace and airports, severely restricting Russia's aviation industry.

The EU has furthermore imposed a ban on the transport of Russian crude oil and petroleum products. This measure is coupled with a price cap mechanism designed to limit the revenue Russia can earn from its oil exports. The cap sets a

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[11] European Council, https://www.consilium.europa.eu/en/policies/sanctions-against-russia/sanctions-against-russia-explained/

maximum price at which Russian oil can be sold, with the goal of reducing Russia's income while maintaining stable global energy prices.

The energy sector is a major focus of the EU's sanctions, by restricting the import of Russian crude oil and refined petroleum products, the EU aims to cut off a vital source of revenue for the Russian government. These measures are part of a broader strategy to reduce Europe's dependence on Russian energy and promote energy security within the EU.

The price cap on Russian oil is then a particularly noteworthy measure. This cap is enforced in cooperation with international partners, including the G7, to ensure a unified approach. The cap not only limits the revenue Russia can earn from its oil exports but also stabilizes global energy prices by preventing drastic fluctuations.

In addition to trade and financial restrictions, the EU has imposed bans on providing various business-relevant services to Russian entities. These include accounting, auditing, and IT consultancy services, which are essential for the smooth functioning of any modern economy. By restricting these services, the EU aims to disrupt the operations of Russian businesses and reduce their competitiveness on the global stage.

The prohibition on the export of software for enterprise management and industrial design is another critical measure. This ban targets the technological

infrastructure that supports Russia's industrial and economic activities. By denying access to advanced software, the EU seeks to hinder Russia's ability to maintain and develop its industrial capabilities.[12]

The EU's sanctions also include measures targeting the maritime and aviation sectors such as Russian vessels are banned from accessing EU ports, significantly disrupting their maritime trade routes. Additionally, the export of aviation and space industry goods to Russia is prohibited, affecting the maintenance and operation of Russian aircrafts. These measures are designed to isolate Russia from critical global transport networks, making it more difficult for the country to engage in international trade and maintain its logistical operations. The restrictions on aviation goods, in particular, have a profound impact on Russia's ability to sustain its aerospace industry.

The sanctions extend also to high-value goods and luxury items, which are often seen as symbols of wealth and power. The import and export of luxury goods, including cars, jewelry, and high-end electronics, are banned. These measures are intended to target the Russian elite, reducing their access to luxury items and increasing the economic pressure on those who support the regime.

Despite the broad scope of the sanctions, the EU has included certain exemptions to allow for humanitarian aid, food, and medical products to reach those in need. These exemptions ensure that the sanctions do not unduly harm the general population or impede essential humanitarian efforts.

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[12] European Council, https://www.consilium.europa.eu/en/policies/sanctions-against-russia/sanctions-against-russia-explained/#trade

Cultural and diplomatic exemptions are also in place, allowing for the transfer of cultural goods on loan for formal cooperation and travel exemptions for diplomatic purposes. These exemptions are designed to maintain cultural exchanges and diplomatic relations while upholding the sanctions' overall objectives.

The effectiveness of the EU's sanctions relies heavily on international coordination and compliance, they are in fact are designed in collaboration with like-minded international partners, including the G7, to enhance their impact and reduce the potential for circumvention. This coordination ensures a unified approach to addressing Russia's aggression and upholding international norms.

To prevent circumvention, the EU has introduced tighter compliance rules and enhanced information-sharing mechanisms. Measures are in place to identify and counter deceptive practices, such as ship-to-ship transfers and automatic identification system (AIS) manipulations, which are often used to evade sanctions.

The next logical step is enforcing the sanctions, but this presents several challenges, particularly in ensuring that they are uniformly applied and effectively monitored. So, the EU has implemented various measures to address these challenges, including increased surveillance of financial transactions and trade activities, as well as cooperation with international partners to track and prevent sanctions evasion.

Despite these efforts, the effectiveness of the sanctions can be influenced by various factors, including the resilience of the Russian economy and the ability of the Russian government to find alternative trade partners and financial resources. The EU continues to adapt its sanctions regime in response to these

challenges, seeking to maintain pressure on Russia while minimizing adverse effects on EU businesses and citizens.

But there are broader Implications, the EU's sanctions against Russia have significant implications for international relations and global economic stability. By taking a strong stance against Russia's aggression, the EU aims to uphold international norms and support Ukraine's sovereignty, sending a clear message to other countries about the consequences of violating international law.

But there are collateral damages in the economic impact of the sanctions that extends beyond Russia, as affecting global supply chains and trade dynamics. The restrictions on Russian energy exports have contributed to volatility in global energy markets, prompting the EU and its partners to seek alternative sources of energy and enhance energy security. The coordination with international partners ensures a unified front, enhancing the overall impact of these measures.

As the situation evolves, the EU continues to adapt and expand its sanctions to maintain pressure on Russia while mitigating adverse effects on EU businesses and citizens. The sanctions not only serve as a tool of economic pressure but also as a statement of the EU's commitment to upholding international norms and supporting countries affected by aggression. The success of these sanctions will ultimately depend on their sustained enforcement

and the international community's collective resolve to hold Russia accountable for its actions.[13] And now a deep analysis for each sector is needed.

[13] EBA, https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Opinions/2021/963685/Opinion%20on%20MLTF%20risks.pdf.

2.4 Enforcing the sanctions, a technical framework

On February 28, the Council of the European Union (EU) responded to the Russian Federation's military aggression against Ukraine, which commenced in 2014, intensified notably in November 2021, escalated significantly in February 2022, and culminated on February 24 with the invasion of Ukraine, by enacting a set of sectoral restrictive measures, sanctions. These measures included prohibitions on transactions involving the Central Bank of the Russian Federation (commonly known as the Central Bank of Russia or CBR), a stakeholder and member of the Bank for International Settlements (BIS). Specifically, dealings related to the management of the CBR's reserves and assets, including transactions with any entity working on behalf of or under the direction of the CBR, were forbidden. However, exceptions were made for transactions deemed "strictly necessary to ensure the financial stability of the EU as a whole or the Member State concerned," subject to authorization by competent authorities of the Member States. In such cases, rapid notification to the Commission and other Member States was required. The United States (US), the United Kingdom (UK), Canada, Switzerland, and other nations also implemented similar policies.

Several noteworthy points arise from this context. Firstly, as part of its common foreign and security policy (CFSP), the Council implemented restrictive measures, including asset freezes, upon a proposal from the EU High Representative for Foreign Affairs and Security Policy and the Commission, in accordance with Article 215(1) of the Treaty on the Functioning of the European Union (TFEU). These measures are grounded in the Treaties, particularly Articles 29 of the Treaty on European Union (TEU) and 215 of the TFEU. Consideration of factors such as proportionality and relevant case law from the

Court of Justice of the EU (CJEU) is crucial in the design and application of these measures. The principle of proportionality dictates that EU action should be no more than necessary to achieve its objectives. Moreover, effective judicial protection for entities subject to restrictive measures necessitates the ability of the CJEU to rule on actions for damages resulting from such measures. Furthermore, sanctions on a central bank's foreign assets, which typically enjoy immunity under customary international law, can be imposed, including freezes on these assets. The global uniformity of implementation of such measures is paramount, as success depends on the central bank's reserve asset composition and the breadth of adoption by nations. This elucidates the nature of restrictive measures in response to Russia's actions destabilizing the situation in Ukraine, as outlined in Council Regulation (EU) No 833/2014 of July 31, 2014.

Down here it is shown how the Council behaved just after the starting of the civil war, imposing sanctions in different areas in order to avoid the perpetration of this behavior:

1) "It shall be prohibited to sell, supply, transfer or export, directly or indirectly, firearms, their parts and essential components and ammunition as listed in Annex I to Regulation (EU) No 258/2012 of the European Parliament and of the Council (1) and firearms and other arms as listed in Annex XXXV to this Regulation, whether or not originating in the Union, to any natural or legal person, entity or body in Russia or for use in Russia."[14]

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[14] Council Regulation EU,

https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02014R0833-20231001

“The transit via the territory of Russia of firearms, their parts and essential components and ammunition, as referred to in paragraph 1, exported from the Union shall be prohibited”.

Then it shall be prohibited to:

(a) “provide technical assistance, brokering services or other services related to the goods referred to in paragraph 1 and to the provision, manufacture, maintenance and use of those goods, directly or indirectly to any natural or legal person, entity or body in Russia or for use in Russia”;
(b) “provide financing or financial assistance related to the goods referred to in paragraph 1 for any sale, supply, transfer or export of those goods, or for the provision of related technical assistance, brokering services or other services, directly or indirectly to any natural or legal person, entity or body in Russia, or for use in Russia”;
(c) “sell, license or transfer in any other way intellectual property rights or trade secrets as well as grant rights to access or re-use any material or information protected by means of intellectual property rights or constituting trade secrets related to the goods and technology referred to in paragraph 1 and to the provision, manufacture, maintenance and use of those goods and technology, directly or indirectly to any natural or legal person, entity or body in Russia or for use in Russia”.

Moreover in the Article 2e:

1) “It shall be prohibited to provide public financing or financial assistance for trade with, or investment in, Russia. The prohibition in paragraph 1 shall not apply to”:
2) “Binding financing or financial assistance commitments was established prior to 26 February 2022; Provide financing or financial assistance

> related to the goods and technology referred to in paragraph 1 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 natural or legal person, entity, or body in Russia, or for use in Russia". "Additionally it shall be prohibited to provide technical assistance, brokering services, or other services related to the goods and technology referred to in paragraph 1 and to the provision, manufacture, maintenance, and use of those goods and technology, either directly or indirectly to any natural or legal person, entity or body in Russia, or for use in Russia."

The provisions outlined prohibit several activities related to involvement in the energy sector and mining and quarrying sector in Russia. This includes acquiring or extending participation in entities operating in these sectors, providing financing or loans to such entities, creating new joint ventures with them, and providing investment services directly related to these activities. These measures aim to restrict engagement with entities operating in these sectors, potentially due to geopolitical considerations or concerns about compliance with international norms.[15]

The European Commission and six governments (the UK, USA, Canada, Germany, France, and Italy) decided on another round of sanctions against Russia in response to growing demand to take decisive action against Putin. Certain ones, like the barring of Russian banks from SWIFT, had been anticipated. Others, like as the freezing of assets held by central banks, are said

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[15] Council Regulation EU,

https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02014R0833-20231001

to have surprised even Vladimir Putin. This note's goal is to examine the freeze's practical and legal ramifications. Based on Article 215 TFEU, I anticipate that the EU will revise Regulation (EU) 269/2014, the legislation that first imposed sanctions on Russia following the invasion of Crimea.

Let me start by discussing the sanction's economic impact. The Central Bank of Russia's (CBR) assets would be frozen as a result of the punishment. It goes without saying that a freeze of this kind might only practically affect foreign assets. The foreign assets held by all central banks worldwide, whether in the form of foreign cash or securities denominated in foreign currency, are ideally kept in the safe deposit boxes of foreign commercial banks, other central banks, and the Bank for International Settlements. These resources have two uses. They first let a central bank to purchase currency in exchange for other currencies in order to interfere in the currency market and stabilize it. Second, in the event that other payment methods stop functioning, central banks are permitted to conduct transactions using their foreign assets, whether for their own accounts or the accounts of their residents. Thus, the asset freeze is a supplement to Russia's removal from SWIFT. In essence, SWIFT is a banking communications system. But in order to have a more comprehensive view the Swift has to be considered one if not the most favorite tool for the American "soft" power projection.

Indeed, since September 11, 2001, the landscape of U.S. national security has undergone a profound transformation. While much attention has been rightfully paid to the shifts within military policy, the evolution of nonmilitary governmental entities, particularly the Department of the Treasury, has been equally significant. This transformation has seen the Treasury Department transition from a peripheral player in national security affairs to a pivotal force, earning it the nickname of "Obama's favorite non-combatant command." At the

core of this shift lies the integration of intelligence gathering and economic coercion into the Treasury's mandate.

The genesis of this evolution can be traced back to the immediate aftermath of September 11, when the U.S. government embarked on a comprehensive analysis of the events leading up to the tragedy and its failure to prevent it. Among the revelations was the exploitation of the global financial system by the perpetrators, who utilized simple wire transfers facilitated by the Society for Worldwide Interbank Financial Telecommunication (SWIFT) network. This realization underscored the critical intersection between financial transactions and national security, prompting a reevaluation of the Treasury Department's role.

Traditionally, Treasury had played a financial role in warfare but had never directly engaged in combat. However, in the wake of September 11, there emerged a consensus that Treasury needed to wage what was termed "shadow warfare." This paradigm shift necessitated a departure from facilitating financial flows to actively obstructing them. The strategy aimed to dismantle the financial infrastructure utilized by terrorists, forcing them into antiquated methods of transferring funds and ultimately rendering them unable to finance their operations. One of the key battlegrounds in this shadow war was SWIFT, a cooperative society owned by its member financial institutions. Despite previous attempts by the United States to access SWIFT data in the 1990s, the organization had rebuffed these efforts, citing concerns over privacy and jurisdiction. However, the events of September 11 compelled SWIFT to reconsider its stance. Recognizing its vulnerability to U.S. pressure, SWIFT reluctantly acquiesced to demands for access to its data, albeit with reservations. The cooperation between SWIFT and the U.S. government, though initially fraught with uncertainties, proved to be immensely valuable in uncovering the

financial networks of terrorist organizations. SWIFT's data became a crucial tool in identifying previously unknown connections and disrupting potential threats. However, maintaining this collaboration posed challenges, particularly in navigating legal and privacy concerns, both domestically and internationally. The secrecy surrounding the SWIFT program eventually gave way to public scrutiny following its disclosure by journalists. While initially met with resistance from European banking supervisors, the program ultimately garnered tacit approval from European governments, which recognized its utility in enhancing their own security measures. Subsequent negotiations between Europe and the United States solidified the arrangement, establishing protocols for data sharing while respecting privacy regulations. The integration of SWIFT data into national security efforts also found resonance in popular culture, reflecting its significance in contemporary narratives of espionage and counterterrorism. The portrayal of SWIFT as a clandestine tool in fictionalized accounts underscores its real-world impact and the blurred lines between intelligence gathering and financial surveillance.

In essence, the trajectory of SWIFT post-9/11 highlights the broader evolution of U.S. national security policy, where traditional boundaries between military and nonmilitary domains have blurred. The cooperation between SWIFT and the Treasury Department exemplifies the convergence of financial intelligence and counterterrorism efforts, underscoring the increasingly interconnected nature of global security challenges. As SWIFT continues to play a central role in monitoring and disrupting illicit financial activities, its transformation from a neutral entity to a critical component of U.S. national security infrastructure reflects the evolving dynamics of twenty-first-century warfare. Expulsion from the SWIFT increases the danger and complexity of international transactions rather than eliminating them. SWIFT has then a

fundamental role in enhancing financial sanctions, SWIFT indeed serves two primary functions: facilitating information exchange among participants and establishing messaging standards. Sanctions involving SWIFT prevent sanctioned entities from accessing its network. Despite this, public SWIFT standards make it challenging to prevent countries from creating parallel systems using the same standards. Moreover, as a cooperative, SWIFT prioritizes the interests of its entire member community. Consequently, it generally avoids making policy decisions that exclude or restrict user access but being under Belgian law, SWIFT must adhere to Belgian and EU regulations. At times, SWIFT has resisted political pressure to disconnect countries from its system.[16] These actions underscore SWIFT's commitment to neutrality as a financial service provider.

The imposition of US sanctions on SWIFT would have had a significant impact on the global economy due to SWIFT's central role in the global payment system. In 2014, after Russia annexed Crimea, the US, EU, and Canada imposed targeted sanctions on Russian individuals and entities, including travel restrictions, asset freezes, and financing restrictions. On September 18, 2014, the European Parliament passed a nonbinding resolution urging EU members to exclude Russia from SWIFT; SWIFT opposed this resolution, emphasizing its commitment to neutrality. In March 2022, the EU, along with Canada, Japan, the UK, and the US, agreed to remove certain Russian and Belarusian banks from SWIFT. At the end SWIFT complied with these regulations, disconnecting seven Russian and three Belarusian banks and their subsidiaries on March 12,

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[16] Cipriani Marco, Golderb Linda, La spada Gabriele, Journal of Economic Perspectives—Volume 37, Number 1—Winter 2023—Pages 31–52, https://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.37.1.31

2022. Subsequently, three additional Russian banks, one Belarusian bank, and their subsidiaries were disconnected in June 2022.

Because of this, it is attractive to use foreign-held central bank reserves for financial transactions, which is precisely what the sanctions are meant to stop. In addition, if correspondence banking was included in the sanctions, the effect on payments would be significantly more pronounced. This would make it illegal for banks in the West to process payments for banks in Russia. It is worth noting that there is a method to get past the restriction on correspondence banking. One option would be to deal with Russia through the third-party banks or you could use payments in kind (like fossil fuels or agricultural products). Sanctions must involve commercial links in order to be fully effective, as the Iranian situation demonstrates. If not, smart actors will discover ways around them, and the individuals who are most affected by the disruption of payment systems are the common folks who want to transfer money to their family. [17]

This is mostly dependent on the foreign assets held by the CBR. They presently total $300 billion USD for the CBR. Large amounts of gold are frequently kept in storage at the Federal Reserve's New York branch by central banks. Not in the case of Russia, which its vast gold reserves are kept underground in Saint Petersburg and Moscow. Alternatively, the CBR formerly possessed substantial dollar reserves, mostly in the form of Treasury bonds. However, in response to the sanctions placed on Russia after the annexation of Crimea in 2014, it significantly reduced these assets. Foreign governments' central bank assets are protected against execution by customary international

[17] Verfassungsblog, https://verfassungsblog.de/hot-war-and-cold-freezes/

law. Regarding the precise boundaries of these immunities, however, international practice is anything from standard, and Article 19 of the UN treaty on Sovereign Immunities—a treaty that has not yet come into effect—only reflects this weakly. Due to the hybrid nature of central bank activities, many governments exclude commercial transactions from sovereign immunity, and it is sometimes challenging to determine whether assets are maintained, and transactions are undertaken for official or commercial purposes. Therefore, it only makes sense that when nations freeze the assets of central banks, they must provide justification for violating immunity. Two main points of contention immediately spring to mind.

First, as stated in Article 51 of the UN Charter, nations may use the right to collective self-defense. Ukraine has been the target of an "armed attack" that cannot be justified by neo-imperialist rhetoric about "security interests" or areas of influence, nor by a purported but untrue genocide against Russians in Ukraine. Ukraine has explicitly asked for the introduction of sanctions and has also urged the international community to assist in its self-defense.

Measures taken in self-defence may not exceed what is proportionate to achieve their purpose, i.e. to end the war. It is difficult to imagine that central bank freezes would exceed this threshold. Notably, by invoking self-defense, the sanctioning states do not get into an armed conflict with Russia, as their acts remain below the threshold of “armed attack” that would allow Russia to strike back with armed force. The second option would be to act like the Musketeers and use the "erga omnes" nature of the UN Charter's Article 2(4) ban against the use of force. It was established by the International Court of Justice in the Barcelona Traction case and suggests that, for the purposes of the relevant treaty, every state's right that is violated also qualifies as a breach of one's own. Article 42(b)(ii) of the Articles on State Responsibility reflects this idea. As a

result, if the international community as a whole is owed the obligation in question the prohibition of using force-a breach would radically change the position of all other states to which the obligation is owed with respect to the further performance of the obligation, then a state may assert that it is an insured state and take appropriate action.

This norm suggests a co-dependence between the mentioned requirements. The traditional example would be a disarmament pact, which is only effective if all nations carry out their responsibilities. However, I would argue that comparable arguments apply to UN Charter Article 2(4), particularly in light of the post-1990 European security architecture. The Paris Charter, which established this architecture, places particular emphasis on the value of amicable conflict resolution. According to this line of reasoning, as long as Russia continues to violate UN Charter Article 2(4), the governments placing sanctions on the CBR are free to respond proportionately. The provision set out in Article 50 of the Articles on State Responsibility is noteworthy because it emphasizes the fact that sanctioning governments are still obligated to uphold their human rights duties. It is consequently imperative that the effects of the sanctions on the Russian populace be properly monitored and taken into account, both legally and prudentially. [18]

A substantial portion of the CBR's foreign reserve assets were unavailable to it because to the sanctions placed on it. According to available data, the CBR’s reserve assets (in the form of foreign currency and predominantly foreign currency-denominated securities and gold) amounted in early 2022 to

[18] UN, https://legal.un.org/repertory/art2/english/rep_supp7_vol1_art2_4.pdf

(approximately) USD 630 billion. Those held in EU member states (in euro) were close to 25%; another 6.6% was held in the US (a significant additional amount of USD-denominated assets was held elsewhere), a 4.5% was held in the UK, and a 5% was held by international financial institutions. China, which did not impose such sanctions, was holding close to 14% of the CBR's reserve assets and more than 20% was held by the CBR itself, predominantly in gold.

The economic significance of the asset freeze is substantial. According to Joseph Borrell's statement, the freeze will affect the assets ("resources") of the Central Bank of Russia (CBR), primarily those located abroad. Central banks typically hold foreign assets, including foreign currency and securities, which serve various purposes such as currency market intervention and facilitating transactions. This freeze complements Russia's expulsion from SWIFT, by preventing the use of foreign-held reserves for payment transactions. The effectiveness of freezing assets hinges on the foreign asset holdings of the Central Bank of Russia (CBR), which presently stand at approximately 300 billion USD. While it is customary for central banks to hold gold reserves abroad, Russia predominantly stores its significant gold reserves domestically. Previously, the CBR maintained substantial dollar reserves, primarily in the form of treasury bonds, but decreased these holdings following sanctions imposed in 2014. Reports suggest that some of these assets may now be held within the Eurosystem, potentially in accounts at Bundesbank, estimated to be around 50 billion USD. Consequently, the EU, the US, and their allies could potentially freeze a considerable portion of the CBR's foreign assets.

In terms of legal ramifications, central bank assets of foreign states generally benefit from immunity from execution under customary international law (Article 2(4) of the UN Charter). Established in the Barcelona Traction case by the International Court of Justice, this principle implies that a violation of one

state's right constitutes a violation of any state's right under the respective treaty. Article 42(b)(ii) of the Articles on State Responsibility reflects this principle. However, the precise scope of these immunities varies, with some states exempting commercial transactions from sovereign immunities. States must justify the breach of immunity when freezing central bank assets, which can be achieved through avenues such as invoking the right of collective self-defense or asserting the "erga omnes" character of the prohibition of the use of force. These legal arguments may permit the freezing of CBR assets in response to Russia's actions in Ukraine, provided that the measures taken are proportionate and do not surpass the threshold of armed conflict. [19]

In summary, the freezing of central bank assets marks a significant escalation in sanctions against Russia, carrying both practical and legal implications. The economic repercussions will be contingent on the extent of the freeze and the CBR's asset holdings, while the legal justifications for such actions may entail intricate considerations of international law, particularly concerning sovereign immunity and collective defense. Within the framework of the EU's Common Foreign and Security Policy (CFSP), the EU has developed guidelines over time to ensure a solid legal foundation for each sanctions measure, along with provisions for humanitarian exemptions and access to judicial remedies.

The Council of the European Union emphasizes adherence to international law, human rights, and proportionality in implementing restrictive measures. Additionally, it underscores the need for exemptions to address basic needs, legal expenses, and humanitarian concerns. Regular assessments are conducted

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[19] Verfassungsblog, https://verfassungsblog.de/hot-war-and-cold-freezes/

to evaluate the impact and efficacy of EU sanctions. Judicial review of EU sanctions, both those stemming from UN Security Council resolutions and autonomous measures, is available before the EU General Court and the European Court of Justice. The evolution of EU sanctions towards greater consideration of human rights and due process has been significantly influenced by jurisprudence from court rulings. The central provision governing judicial review of EU measures is Article 263 of the Treaty on the Functioning of the European Union (TFEU), which grants natural or legal persons the right to challenge the legality of EU acts. Implemented additional restrictive measures in response to the Russian Federation's unwarranted and unjust military aggression against Ukraine.

The Council specifically decided to:

- Prohibit the provision of specialized financial messaging services (SWIFT) to Bank Otkritie, Novikombank, Promsvyazbank, Rossiya Bank, Sovcombank, VNESHECONOMBANK (VEB), and VTB BANK. This prohibition will take effect ten days after publication in the Official Journal of the EU and will also extend to any legal entity or body established in Russia with direct or indirect ownership of more than 50% by the aforementioned banks.

- Restrict investment, participation, or contributions to future projects co-financed by the Russian Direct Investment Fund.

- Restrict the sale, supply, transfer, or export of euro-denominated banknotes to Russia or any natural or legal person, entity, or body in Russia, including the government and the Central Bank of Russia, or for use within Russia.

Today's decisions complement the measures announced by the High Representative following the video conference of EU Foreign Affairs Ministers on February 27. This package also includes the provision of equipment and supplies to the Ukrainian Armed Forces through the European Peace Facility, a ban on the overflight of EU airspace and access to EU airports by Russian carriers, a ban on transactions with the Russian Central Bank, and the prohibition of state-owned media Russia Today and Sputnik from broadcasting in the EU.

The European Union strongly condemns the Russian Federation’s unwarranted and unjust military aggression against Ukraine and demands that Russia immediately cease its military actions, unconditionally withdraw all forces and military equipment from the entire territory of Ukraine, and fully respect Ukraine’s territorial integrity, sovereignty, and independence within its internationally recognized borders.

2.5 The Impact on the banking sector

By end-2021, foreign banks received $52 billion in US dollar funding from Russia, with 60% from Russian banks or the central bank. However, this share has consistently remained below 1% over the past decade, even if significant for banks in certain jurisdictions. Despite steps to settle obligations linked to Russia, vulnerabilities may arise if derivatives positions mature without access to roubles for settlement. As of January 2022, Russia's central bank reported foreign currency reserves at $152 billion, including $57 billion placed with foreign banks. On the other hand, the American Treasury itself applied a series of actions taken in coordination with the G7 in order to undermine Russia's revenue stream. Matters of fact One year after Russia initiated its unprovoked war against Ukraine, the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) is taking significant measures to weaken Russia's capacity to perpetuate its brutal conflict and secure the resources enabling it. Sanctions on the CBR limited access to a significant portion of its foreign reserves, hindering its ability to sell reserves to support the devalued rouble. Additionally, its capacity to provide foreign currency liquidity to banks and corporates for international financing decreased.

Consequently, the stability of the Russian financial system deteriorated, affecting stock market valuations and prompting a bank run. To address this, the CBR raised its key interest rate to 20% and released around $7 billion in local bank reserves on February 28 to boost market liquidity. However, despite some short-term effectiveness, threats to financial stability persisted, potentially leading to the failure of major banks, including subsidiaries of EU and other foreign credit institutions in Russia.

In one of its most substantial sanctions actions to date, US Treasury is declaring a new determination targeting the metals and mining sector of the Russian Federation economy under Executive Order 14024 and is also imposing sanctions on 22 individuals and 83 entities. Today's action, together with additional measures taken by the Department of State, the Department of Commerce, and the Office of the U.S. Trade Representative, in coordination with allies and G7 partners, further isolates Russia and obstructs its access to capital, materials, technology, and support sustaining its war against Ukraine, which has killed thousands and displaced millions of people.

Additionally, as Russia seeks ways to evade sanctions and export controls, the U.S. government is intensifying efforts to counter such evasion globally. Today's measures include designations of over 30 third-country individuals and companies connected to Russia's sanctions evasion efforts, including those related to arms trafficking and illicit finance.[20]

Despite over 80% of Russian banks already being under U.S. and international sanctions, OFAC is now sanctioning over a dozen additional Russian financial institutions, including one of the top ten largest by asset value. Sanctioned entities have been using smaller banks and wealth-management firms to evade these restrictions as Russia seeks new ways to access the global financial system. The newly sanctioned entities and individuals are involved in industries that support Russia's war against Ukraine, including those producing or importing high-tech equipment for Russian defense and making advanced materials for Russian weapons systems. Since the start of Russia's war against

[20] BIS quarterly review, https://www.bis.org/publ/qtrpdf/r_qt2206y.pdf

Ukraine, the U.S. and its allies have implemented extensive sanctions and export controls. Since February 2022, the U.S. Treasury has enacted over 2,500 sanctions, resulting in over 30 countries imposing similar measures against Russia. Russia's unprovoked war has significantly impacted its economy and defense capabilities. Sanctions and export controls have caused losses of hundreds of billions of dollars to Russia’s financial sector and hindered its technological progress. The U.S. will continue to impose sanctions as long as the conflict continues.

So, here’s the list of OFAC designated Russian banks pursuant to E.O. 14024 for operating or having operated in the financial services sector of the Russian Federation economy:

- Credit Bank of Moscow Public Joint Stock Company, one of Russia’s ten largest banks by asset value and located in Moscow, is Russia’s largest non-state public bank. The European Union removed Credit Bank of Moscow from the SWIFT international payment system in June 2022 and fully blocked the bank in December 2022. OFAC previously placed Credit Bank of Moscow on the Sectoral Sanctions Identifications List; it is now also subject to full-blocking sanctions.

- Joint Stock Company Commercial Bank Lanta Bank, a bank located in Moscow, Russia.

- Public Joint Stock Company Commercial Bank Metallurgical Investment Bank (Metallinvestbank), a bank located in Moscow, Russia. Metallinvestbank has used alternative payment routes to facilitate the receipt of payments for Russian exports.

- Public Joint Stock Company MTS Bank, a bank located in Moscow, Russia and Abu Dhabi, United Arab Emirates. The UK also designated this bank today.

- Novosibirsk Social Commercial Bank Levoberezhny Public Joint Company, a bank located in Novosibirsk, Russia.

- Bank Saint-Petersburg Public Joint Stock Company, a bank located in Saint Petersburg, Russia. The UK also designated this bank today.

- Joint Stock Commercial Bank Primorye, a bank located in Vladivostok, Russia.

- SDM-Bank Public Joint Stock Company, a bank located in Moscow, Russia.

- Public Joint Stock Company Ural Bank for Reconstruction and Development (UBRD), a bank located in Yekaterinburg, Russia. UBRD is also sanctioned by Canada and the UK.

- Public Joint Stock Company Bank Uralsib, a bank located in Moscow, Russia. The UK also designated this bank today.

- Bank Zenit Public Joint Stock Company, a bank located in Moscow, Russia. The UK also designated this bank today.

Additionally, Russia-based financial institutions OOO Zenit Finance, OOO Zenit Leasing, and OOO Zenit Factoring MSP were designated pursuant to E.O. 14024 for being owned or controlled by, or for having acted or purported to act for or on behalf of, directly or indirectly, Bank Zenit.

In conjunction with this action, OFAC has issued Russia-related General License GL60 authorizing the wind down and rejection of transactions involving certain financial institutions designated today through 12:01 a.m. eastern daylight time, May 25, 2023. In addition, OFAC has issued Russia-related GL61 authorizing the wind down of certain securities and derivatives transactions involving certain of these financial institutions through 12:01 a.m. eastern daylight time, May 25, 2023. OFAC also issued amended GL8F adding certain of these financial institutions to the authorization to process certain energy-related transactions.

2.6 The impact on the oil export

The United States and its international Coalition are steadfast in their commitment to diminishing Putin’s gains. However, halting the flow of Russian oil could adversely impact the global economy by depriving emerging markets of energy and causing a surge in global oil prices. To curb Kremlin profits while ensuring stable energy markets, the Coalition introduced a unique policy in 2022: imposing a price limit on Russian oil. This policy allows service providers in Coalition nations to engage in the Russian oil trade only if the oil is sold at or below a specified cap. In response to this policy, Russia opted to sell its oil at a significant discount to market prices to maintain access to key Coalition service providers.

This strategy proved effective in the year following the announcement of the price cap. Kremlin oil tax revenues dropped by over 40% in the first nine months of 2023 compared to the previous year, while global energy supply remained steady. Consequently, the Kremlin sought ways to circumvent the restrictions by investing resources in adapting and evading them. During the summer and fall of 2023, the Kremlin increased its oil exports through a “shadow fleet,” which consists of ships, insurers, and other service providers with opaque ownership structures known for evading sanctions. Additionally, the Kremlin and its proxies devised new methods to defraud Coalition service providers and exploit their services. These factors, coupled with price hikes in the global oil market, led to Russia earning prices on its oil that exceeded the cap. In response, the Coalition initiated the second phase of the price cap in October 2023, aiming to enhance enforcement of the price cap for trades

utilizing Coalition services while raising the costs for Russia to sell oil through alternative shipping networks.

The price cap represents an innovative policy endeavor aimed at restricting the price Russia can receive for its crucial export, supported by a multilateral sanctions framework. Thus, it is imperative to remain adaptable and analytical in evaluating its efficacy. Three months into the second phase of the price cap, we offer three key observations on its progress.

Firstly, the price at which Russia sells its oil has significantly decreased since the start of the second phase. This decline reflects both global reductions in oil prices during this period and a notable widening in the discount Russia receives compared to other global oil suppliers.[21]

Secondly, energy market participants, analysts, and even Putin's oil officials attribute the increasing discount on Russian oil to heightened enforcement efforts by the Coalition, indicating that the second phase is yielding results.

Thirdly, Russian oil export volumes have remained stable in recent months, indicating that the price cap is helping maintain a consistent energy supply to global consumers and businesses. Additionally, the price cap, coupled with key sanctions enforcement measures, is reducing Putin's profits from oil sales.

The Coalition remains committed to further diminishing Kremlin profits while upholding market stability and energy supply. This strategy leaves Putin with limited options: he can either sell his oil under the price cap for

[21] Treasury, https://home.treasury.gov/news/featured-stories/phase-two-of-the-price-cap-on-russian-oil-two-years-after-putins-invasion

significantly less than other global suppliers or incur high costs by exporting it through non-Coalition channels. Throughout the summer of 2023, Russian earnings remained severely restricted due to a substantial discount, despite relatively stable oil supply. During this period, the discount began to narrow as Russia redirected significant oil exports to a shadow fleet operating independently of G7 service providers. Although this approach incurred costs for Russia, the ability to sell oil without Coalition service providers or by falsifying attestations to them enabled Russia to sell substantial volumes of oil above the price cap.

In October, the Coalition initiated the second phase of the price cap, aimed at bolstering compliance with trades occurring within or below the price cap and increasing the costs for Russia associated with using the shadow fleet. As Russia encounters new obstacles in utilizing the shadow fleet and market participants become increasingly cautious about violating the price cap, Russia finds itself with limited options once again. It is compelled to heavily discount its oil—either to sell below the price cap or to offer non-Coalition buyers more significant discounts.

Since October, the United States has implemented successive rounds of enforcement actions under the price cap, targeting vessel owners, shipping companies, and an oil trader engaged in trading above the cap using Coalition services, as well as identifying vessels as blocked property of these entities. These actions also involved designations of obscure and opaque intermediaries in the supply chain supporting Russia's oil trade, thereby increasing the costs of exporting oil beyond the cap.

Since October, consequently, the discount on Russian oil has noticeably increased, fluctuating from a low of $12-13 to a peak of $20 in January and

stabilizing around $19 as of late February. The factors influencing this discount are intricate, and pinpointing specific causal factors requires careful analysis. Nonetheless, this outcome aligns with the objectives of the price cap's second phase: to compel Russia to further discount its oil (whether under the cap with Coalition services or without them). Notably, various commentators, including Putin's own oil czar, have linked the escalating discount to the price cap's second phase. Several examples include:

- Deputy Prime Minister Alexander Novak acknowledged that the sanctions issued to enforce the price cap were pressuring Russia to sell at lower prices, as reported by Bloomberg.
- The International Energy Agency connected the heightened discount on Russian oil to the enforcement of the price cap in its January 2024 Oil Market Report.
- ClearView Energy Partners observed that OFAC's ramp-up of enforcement actions seemed to be achieving its intended goals, preserving Russian export flows while reducing proceeds to the Kremlin.

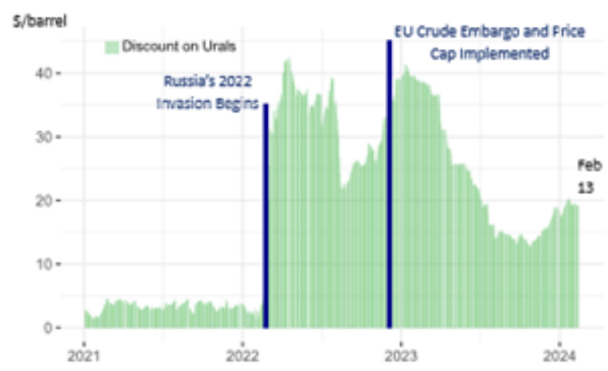

Figure 1: Comparison between Russian and Non-Russian Crude Oil Prices and between on Urals and Brent, S&P Global Commodity insight

The price cap serves two objectives: to reduce Russia's war financing capabilities and to uphold energy market stability. Ideally, it aims for Russia to supply ample energy to emerging markets and businesses at highly discounted rates, thus limiting Putin's profits—maintaining energy supply while minimizing profits.

Figure 2 illustrates the trend in Russia's seaborne crude and refined product exports alongside Kremlin revenues from major oil taxes. While revenues offer insight into profits, the Coalition's endeavors to heighten Kremlin costs are crucial in profit reduction. However, since costs are less transparent, our focus here is on revenues. Upon the price cap's implementation, Russian oil tax revenues notably decreased (by over 40 percent comparing the first nine months of 2023 to the same period of 2022), despite stable or slightly increased seaborne exports (rising from approximately 6 to 6.2 million barrels per day, partially offsetting the EU pipeline export decline). Despite significant discounts, Russia continued supplying oil to the market. In summer 2023, this effect partially reversed as the discount on Russian oil diminished. Nonetheless,

export volumes have largely remained steady in recent months, with oil tax revenues nearly returning to late-summer 2023 levels.

Figure 2: Russian Oil Tax Revenue, Russian Ministry of Finance

Certainly, ambiguity and lack of transparency prevail in these markets, prompting the Coalition to persistently observe energy market trends to grasp how the price cap and our sanctions enforcement impact Russia's fiscal status and global energy markets. [22]

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[22] Treasury, https://home.treasury.gov/news/featured-stories/phase-two-of-the-price-cap-on-russian-oil-two-years-after-putins-invasion

As observed in the previous summer and fall, Russia will persist in investing resources to evade these sanctions, necessitating ongoing adaptation and innovation in our approach. However, as we approach the two-year milestone of this extensive invasion, it is crucial to acknowledge that the Coalition's solidarity and readiness to implement inventive policy measures are effecting change: maintaining oil availability while constraining Putin’s gains.

Now the next logical step is to endure these sanctions, by avoiding Russia to circumvent them and how and who has the right to enforce and supervise them.

2.7 What is the role of Banking Supervision in the financial sanctions adopted by the European Union since Russia invaded Ukraine?

Financial supervisors do not impose these sanctions, nor do they monitor banks' compliance with them but banks are responsible for implementing and monitoring compliance with the different sanction's regimes.

However, Banking supervisors do not have a mandate to assess and enforce banks' compliance with the different sanctions regimes, on the other hand sanctions can have implications for banking supervision.

For example, if a bank is fined for breaching the sanctions regime, it could reduce the bank's capital, potentially affecting its capacity to weather losses. Similarly, a bank that doesn't respect sanctions risks damaging its reputation, which eventually could also hurt its business.

The ECB does not enforce these sanctions, nor does it oversee banks' adherence to them. Banks bear the responsibility for implementing and ensuring compliance with various sanctions regimes. Meanwhile, individual Member States are tasked with detecting violations of EU sanctions and imposing penalties when necessary. We focus on evaluating banks' governance and internal controls, as they are pivotal in guiding a bank's adherence to sanctions.

In practical terms, this entails verifying that a bank is adequately prepared to comply with the sanctions. This involves robust oversight from the board and senior management regarding the impact of sanctions regimes on the entire organization. It's essential that the bank maintains robust internal control mechanisms, such as an active compliance department to monitor developments

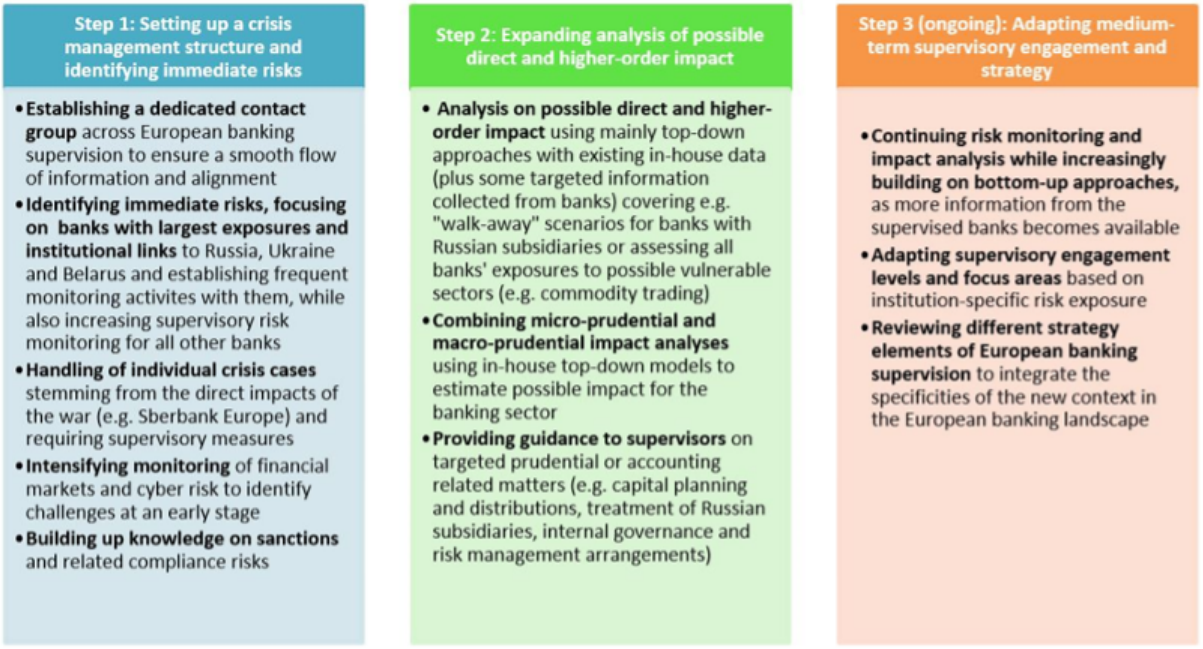
under different sanctions regimes and evaluate their effects on the bank, as well as risk management protocols for transaction approval and client interactions. Overall, banks must ensure their procedures can mitigate legal and reputational risks. If a competent authority identifies a breach, it may use its own enforcement powers, such as imposing fines. Additionally, breaching sanctions could lead to criminal investigations, legal actions, and significant reputational damage for banks.

Should the national competent authority discover a breach by a bank, the ECB, as a supervisor, may address the situation within its purview. This might involve assessing the breach's impact on the bank's resilience or considering it in the evaluation of the bank's governance framework during the annual Supervisory Review and Evaluation Process. It could also factor into assessments of the bank's authorizations or in evaluations of managerial suitability. The ECB always approaches supervisory measures from a prudential perspective rather than a sanctions perspective.

At the beginning of the implementation of sanctions the European banking supervisors have been prompted to react swiftly as well. Initially, both supervisors and banks were confronted with more questions than answers. The supervisory apprehensions encompassed a wide range of risks, including direct and indirect exposures to Russia, cyber threats, banks' operational readiness for sanctions and countermeasures, and concerns regarding potential impacts on trade, economic growth, and inflation. Recognizing the urgency of the situation, the Supervisory Board of the ECB promptly acknowledged that the only viable

approach to address this challenge was to mobilize all relevant stakeholders within European banking supervision to act collectively. [23]

Consequently, the Single Supervisory Mechanism responded to this complex new reality in three sequential stages.



As an initial measure, the Supervisory Board established a contact group to consolidate the pertinent information and expertise required across European

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[23] ECB, https://www.bankingsupervision.europa.eu/press/publications/newsletter/2022/html/ssm.nl220518_1.en.html

banking supervision. One of the primary responsibilities of this group was to compile a comprehensive overview of both major and minor banks that appeared to be most susceptible to risks arising from the military conflict and its potential escalation. These primarily included banks with Russian ownership, those with subsidiaries in Russia or Ukraine, and those with significant Russian exposures on their balance sheets. A daily supervisory monitoring framework was implemented for these banks, accompanied by an increase in the frequency of supervisory interactions across the board, aimed at promptly identifying any emerging risks and potential impacts.

An impact assessment revealed that, overall, banks had manageable direct exposures to Russia, although some exceptions began to surface within a few weeks. Particularly, banks with Russian ownership encountered and continue to face significant challenges related to reputational and operational issues, exacerbated by the imposition of Western sanctions. The operational disruptions and reputational harm had a swift and considerable impact on a few specific institutions (including Sberbank Europe, RCB Bank, and Amsterdam Trade Bank), leading to their winding down or restructuring, albeit without causing further contagion to the broader banking sector.

Furthermore, European supervisors closely monitored banks with operations in Ukraine, as their subsidiaries in the country encountered substantial difficulties in maintaining banking services for the local population and facilitating the relocation of local staff to safer locations as necessary. Supervisory oversight of financial markets and cyber risk activities was also intensified. While turbulence began to surface relatively quickly in specific financial market segments (such as commodities and energy trading), the level of cyber risk within banks remained unexpectedly low during this phase. Nevertheless, banks should remain vigilant, as ongoing monitoring and readily

deployable emergency plans will enable them to swiftly implement countermeasures if required.

Despite the generally reassuring outcomes of the initial examination of direct impacts on banks, supervisors also grappled with specific bank crises and secondary effects, alongside numerous lingering uncertainties.

Several larger banks with subsidiaries in Russia exhibited heightened exposures to the conflict zone. For these institutions, supervisors had to assess the potential fallout of a worst-case scenario known as the "walk-away" scenario, which entailed the assumption that banks would be compelled to abandon their subsidiaries and write down their cross-border exposures to the region. The results of this top-down analysis indicated that the affected banks possessed sufficient strength to weather the consequences: the average depletion of CET1 capital in this extreme scenario stood at approximately 90 basis points before taxes, and the individual banks' capital depletion metrics remained below 200 basis points. This would not compromise the banks' ongoing adherence to supervisory requirements and buffers. Additionally, several banks conducted their own analyses on this matter, yielding broadly similar findings.

After evaluating the direct impacts on banks, supervisors shifted focus to potential risks arising from indirect effects, taking a more medium-term perspective. Such risks might manifest through various channels, such as exposures to vulnerable sectors (e.g., those grappling with disruptions in the value chain or escalating energy costs) or the repercussions of a deteriorating macroeconomic outlook.

Concerning exposures to vulnerable sectors, supervisors utilized loan-level data on banks’ corporate clients (accessible through the Anacredit database) to pinpoint banks with apparent exposure to such sectors early on and to outline

monitoring and follow-up requirements on a bank-specific basis. Energy and commodity trading firms garnered particular attention considering Russia's significant role in European energy imports and the increased volatility in commodity markets. A focused, in-depth analysis of banks' business relationships with key traders provided supervisors with an initial overview of risks associated with this business segment. Moving forward, these insights will be refined and will guide forthcoming supervisory discussions with relevant banks.

Moreover, the uncertainty stemming from the ongoing conflict is expected to exert a notable influence on the European economy. To comprehensively assess the micro- and macroprudential implications of the conflict on significant institutions under European banking oversight, experts at the ECB have conducted a top-down desktop vulnerability analysis using stress test assumptions. This evaluation is highly dependent on the assumptions made and will therefore be revised as macroeconomic conditions demand. The analysis revealed that while certain banks may need to take measures to ensure compliance with minimum capital requirements in adverse scenarios, the overall capital shortfall remained limited even in the most severe situation.

Generally speaking, European banking oversight has generally avoided offering standardized guidance to banks in this context. Instead, supervisors have concentrated on conducting personalized evaluations on a bank-specific basis. For example, supervisors assess individual banks' strategies regarding

dividend payouts or share repurchases considering the anticipated impact of the worsening macroeconomic conditions on their capital positions.[24]

So, the remark in these valuations must be adapting medium-term supervisory engagement and strategy. By that it is meant that both banks and supervisors are facing a growing realization that a complete and swift return to the pre-war economic conditions in Europe is becoming increasingly improbable, as certain economic fundamentals appear to have shifted. Consequently, in the forthcoming months, European banking supervisors will endeavor to deepen their comprehension of the medium- to long-term repercussions and will adjust their supervisory strategies and focal points to align with the new landscape. This effort will be built upon the ongoing supervisory discourse with, and the insights gleaned from, the supervised institutions.

The crisis has largely affirmed the ECB's supervisory priorities, with credit risk remaining a primary area of concern for banks, albeit with a transition in focus from service sectors particularly impacted by the pandemic to energy-intensive sectors and segments susceptible to upward shifts in interest rates. Additionally, concerns regarding outsourcing, IT, and cyber risk persist. Concurrently, as further sanctions are contemplated and enforced, both bankers and supervisors must remain highly vigilant to detect potential new areas of risk and stand prepared to address them promptly and flexibly. In addition to the

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[24]https://www.bankingsupervision.europa.eu/press/publications/newsletter/2022/html/ssm.nl220518_1.en.html

immediate risks prompted by the Russian invasion of Ukraine, banks and supervisors must also devote appropriate attention to pre-existing and more fundamental risks and vulnerabilities. These include tackling challenges arising from the formulation and implementation of banks' digital transformation strategies, as well as addressing physical and transitional risks associated with global climate change.

Against this complex backdrop, ECB Banking Supervision, in close coordination with national competent authorities, has reassessed its strategic objectives for the next three years. This reassessment is founded on a comprehensive evaluation of the primary risks and vulnerabilities confronting supervised banks, considering the progress achieved on last year's endorsed priorities and informed by the outcomes of the 2022 Supervisory Review and Evaluation Process (SREP). Despite significant changes in circumstances compared to the previous year, which have heightened the probability and severity of risks facing the banking sector, the supervisory priorities and corresponding activities outlined in 2022 remain pertinent for addressing both immediate challenges and enduring structural vulnerabilities within the banking sector.

Given the prevailing circumstances, exercising caution is imperative. Hence, supervisors must persist in monitoring and evaluating the appropriateness and robustness of banks' provisioning practices and capital positions, along with their forecasts and distribution plans, as part of their routine supervisory functions. This encompasses assessing banks' progress towards meeting the minimum requirement for own funds and eligible liabilities (MREL), particularly considering the prevailing macro-financial conditions.

2.7 Supervisory priorities and risk assessment for the next years

The supervisory priorities of the SSM for the next years are designed to reinforce supervisory endeavors in achieving medium-term strategic objectives while adapting the focus to evolving challenges. Supervised entities will be urged to enhance their resilience to immediate macro-financial and geopolitical shocks, tackle digitalization challenges, and fortify the steering capabilities of management bodies, and intensify efforts to address climate change. These are the three main supervisory priorities and the associated vulnerabilities that banks are anticipated to tackle in the upcoming years. ECB Banking Supervision will conduct specific actions to evaluate, oversee, and track the identified vulnerabilities. Each vulnerability aligns with its broader risk category. Vulnerable sectors denote those sectors that are particularly responsive to the prevailing macroeconomic conditions.[25] The primary objective of strategic planning within ECB Banking Supervision for the next three years is to formulate a robust strategy. Employing a comprehensive and collaborative approach, this process entails conducting a thorough evaluation of the principal risks and vulnerabilities within the European banking sector. The supervisory priorities aim to foster effectiveness and uniformity in the supervisory planning

[25] ECB, https://www.bankingsupervision.europa.eu/banking/priorities/html/ssm.supervisory_priorities202212~3a1e609cf8.en.html

of the Joint Supervisory Teams (JSTs) while facilitating a more efficient allocation of resources. Furthermore, they assist in establishing risk tolerance levels and offer guidance for prioritizing risks in the Supervisory Review and Evaluation Process (SREP), recognizing that vulnerabilities and challenges may vary from one bank to another.

Moreover, these supervisory priorities aid national supervisors in delineating their own priorities for overseeing less significant institutions in a proportional manner. Transparent communication of these priorities serves to elucidate supervisory expectations to banks, heightens the impact of supervision on the resilience of the banking sector, and contributes to ensuring a fair and equitable regulatory environment. ECB Banking Supervision continually monitors and evaluates the evolution of risks and vulnerabilities within supervised institutions, as well as the progress made in implementing the chosen priorities. And if there are shifts in the risk landscape tools as periodic reviews of strategic priorities will empower ECB Banking Supervision to adapt its focus and initiatives flexibly in response. This adaptability holds particular significance in the current climate of economic and geopolitical uncertainty.

The subsequent sections delve into further detail regarding the outcomes of the risk identification and assessment process, outlining the supervisory priorities and the corresponding work programs for 2023-2025. Additionally, supervisors undertake regular activities as part of their ongoing interactions with banks, which complement the efforts directed towards the priorities.

The economic prospects for the euro area have markedly worsened throughout the year due to elevated inflation levels and the repercussions of the conflict between Russia and Ukraine. Uncertainties persist for the upcoming months. The earlier rebound in economic activity observed in the first half of

2022, attributed in part to the gradual easing of pandemic-related restrictions, has decelerated. Russia's incursion into Ukraine prompted a series of sanctions from Western nations, reciprocated by Russia, resulting in soaring prices of energy, food, and commodities, alongside disruptions in energy provision. Consequently, inflationary pressures heightened, culminating in record-high inflation rates in the euro area. These factors, coupled with a resultant decline in confidence, compounded pre-existing supply chain challenges and contributed to a dimmer economic outlook. Amidst a climate of heightened uncertainties, the primary downside risks to economic growth include prolonged conflict in Ukraine, an escalation of geopolitical tensions, escalating energy prices, and inflation. If coupled with further disruptions in energy supply and rationing, these factors could precipitate a recession in Europe. The aim of ECB Banking Supervision in the forthcoming months is to enhance the resilience of banks directly under its oversight to immediate macro-financial and geopolitical disturbances. The 2023 EU-wide stress test, overseen by the European Banking Authority (EBA), will bolster this endeavor and inform the results of the upcoming Supervisory Review and Evaluation Process (SREP) cycle, thereby contributing to the supervisory priorities for 2023. Detailed in the subsequent section are other supervisory initiatives, which are more tailored to specific risks. Additionally, ongoing follow-up activities related to certain priorities from the previous year are being conducted as part of routine supervisory functions. By these actions emerged the vulnerabilities highlighted are deficiencies in managing credit risk, particularly in relation to exposures to susceptible sectors. So, the strategic goal must be that banks have to be tasked with promptly rectifying inherent shortcomings within their credit risk management framework, encompassing all stages from loan origination to risk monitoring and mitigation, while ensuring timely resolution of any deviations from regulatory standards and supervisory anticipations.

Banks are expected to promptly detect and alleviate any accumulation of risks within their exposures to sectors susceptible to fluctuations in the prevailing macroeconomic conditions, notably those influenced by the conflict in Ukraine and real estate portfolios. While volumes of NPLs continued to decrease in the first half of 2022, tighter financing conditions and an increasing risk of recession have started to affect credit conditions in Europe. This will affect households and businesses differently, depending on factors such as their debt levels or susceptibility to the prevailing macro-financial environment. Specifically, the shock in energy prices and disruptions in the supply chain resulting from the conflict in Ukraine are predominantly affecting economic sectors associated with the production and processing of raw materials, energy suppliers, and energy-intensive industries such as agriculture and air, land, and water transportation. Elevated input costs are also burdening the construction sector, while gas supply interruptions may further weigh on major gas consumers in several euro area countries, including producers of metals, chemicals, food, and beverages. [26]

Although banks have made some strides in recent years, the 2022 Supervisory Review and Evaluation Process (SREP) revealed persistent deficiencies in risk management controls within supervised institutions, particularly concerning loan origination and monitoring, the classification of distressed borrowers, and provisioning frameworks. Despite many banks having devised remedial action plans to rectify gaps identified in the 2020 "Dear CEO"

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[26]https://www.bankingsupervision.europa.eu/banking/priorities/html/ssm.supervisory_priorities202212~3a1e609cf8.en.html

initiative, certain deficiencies persist, notably in forbearance practices, assessments of unlikeliness-to-pay (UTP), and provisioning methodologies.

So the key components of the supervisory priorities work program are:

- Focused examinations of loan origination and monitoring, evaluating adherence to relevant EBA guidelines, particularly concerning residential real estate portfolios.
- Focused examinations of IFRS 9 to evaluate selected banks' compliance with supervisory expectations outlined in the 2020 “Dear CEO” letter (emphasis on residual issues) and scrutiny of specific modeling aspects, including overlays.
- In-depth assessments of forbearance and unlikeliness-to-pay (UTP) policies, addressing remaining issues identified in the “Dear CEO” initiative, considering the current macro-financial climate. On-site inspection (OSI) initiatives targeting IFRS 9 compliance, with a focus on large corporates, small and medium-sized enterprises, and retail portfolios, as well as commercial real estate and collateral (expansion from 2022).
- Focused OSIs on energy and/or commodity traders.
- Targeted joint on-site/internal model examinations for significant portfolios in vulnerable sectors to evaluate the adequacy of internal ratings-based (IRB) models, accounting models, and credit risk management frameworks. Internal model assessments and subsequent follow-ups by Joint Supervisory Teams (JSTs) to evaluate IRB model adjustments related to new regulatory requirements and to follow up on previous targeted reviews of internal models (TRIM) findings.

Regardless of a slowdown in leveraged loan issuances in recent quarters, supervised institutions continue to hold high outstanding volumes and associated vulnerabilities due to the nature of counterparties (high-yield/low credit rating and/or high leverage) and instruments (typically floating rate and covenant-lite loans), as they adapt to macroeconomic uncertainties. This year, ECB Banking Supervision has intensified efforts to enhance banks' compliance with supervisory expectations outlined in ECB guidance. Moving forward, supervisors will monitor banks' actions in response to these measures to rectify outstanding deficiencies concerning the corresponding supervisory expectations. ECB Banking Supervision stands prepared to levy additional capital charges on supervised institutions demonstrating inadequate progress in addressing these deficiencies. Regardless the significant supervisory efforts already taken to address vulnerabilities arising from banks' significant sensitivities to interest rate and credit spreads, as well as their exposure to counterparty credit risk, these associated risks persist. The probability of witnessing additional instances of high volatility and market repricing in the near future remains elevated. Considering this, supervised institutions are anticipated to maintain vigilant oversight and prudent management of these underlying risks, which retain their relevance and significance in the prevailing circumstances. So the strategic aim will be: Banks with significant reliance on funding sources, particularly those deemed less stable, should enhance their funding diversity by formulating and implementing robust multi-year funding strategies, considering challenges arising from evolving funding conditions.

In the first half of 2022, supervised institutions generally reported satisfactory liquidity coverage ratios (LCRs) and net stable funding ratios (NSFRs), indicating resilience against potential liquidity and funding shocks. However, a lack of funding diversification exposes certain institutions to market

disruptions. Extraordinary monetary policy measures introduced during the pandemic, notably the third series of targeted longer-term refinancing operations (TLTRO III), prompted some banks to increase central bank funding while reducing reliance on market-based funding like commercial papers and covered bonds. Anticipated repayments will necessitate banks to further diversify their funding sources, replacing central bank funding with potentially costlier and shorter-term alternatives, placing pressure on their prudential ratios and profitability, particularly amidst increasing economic risks and gradual monetary policy tightening. Risks associated with banks' heavy dependence on TLTRO III funding and related exit strategies warrant ongoing supervisory attention, as emphasized by some Joint Supervisory Teams (JSTs) in this year's Supervisory Review and Evaluation Process (SREP). Hence, supervised institutions will be required to develop, implement, and adjust as necessary a robust and dependable liquidity and funding strategy, encompassing exit strategies, and addressing rollover risks and concentration in funding structures.

Supervised entities are continually formulating, implementing, and refining strategies to facilitate the digitalization of their banking services and operations, catering to the evolving needs and preferences of consumers. Concurrently, the adoption of new technologies can bolster efficiency, thereby enhancing banks' profitability. While supervised entities have recently reported improved profitability due to heightened interest rate expectations, heightened competition from digital leaders within the banking sector and external digital natives—such as financial technology (fintech) and bigtech players—could jeopardize banks' business models if they fail to adapt promptly to the changing landscape. Considering this context and following this year's prioritized initiatives aimed at enhancing understanding and benchmarking of banks' practices, ECB Banking Supervision will persist in its efforts in this realm and will conduct targeted on-

site inspections (OSIs) and reviews of specific facets of banks' digital transformation strategies and utilization of innovative technologies. Joint Supervisory Teams (JSTs) will also address outlier institutions identified in these assessments to complement the overarching strategy and encourage banks to rectify any structural deficiencies uncovered. Releasing supervisory guidelines regarding digital transformation strategies and the findings of the 2022 benchmarking endeavor. Conducting focused evaluations of (a) banks' digital transformation strategies and (b) their adoption of innovative technologies, supplemented by Joint Supervisory Team (JST) follow-up with banks if significant shortcomings are detected. Carrying out targeted on-site inspections (OSIs) pertaining to digital transformation, encompassing both the IT infrastructure and business model aspects of the strategies. That's where the risk in data aggregation and reporting appears, so banks must effectively address enduring deficiencies and establish robust and efficient risk data aggregation and reporting frameworks to facilitate effective oversight by management bodies and meet supervisory expectations, particularly during crises.

Timely and accurate data access and reporting are essential for strategic navigation, robust risk management, and informed decision-making, both in normal circumstances and times of stress. Against this backdrop, ECB Banking Supervision has closely monitored supervised institutions' data quality, risk data aggregation capabilities, and risk reporting practices. Persistent deficiencies in these areas have been repeatedly highlighted in annual Supervisory Review and Evaluation Process (SREP) exercises, as banks have shown sluggish and inadequate progress in closing gaps concerning supervisory expectations and Basel Committee on Banking Supervision principles for effective risk data aggregation and reporting. Key vulnerabilities include inadequate oversight by management bodies, fragmented and non-standardized IT infrastructures,

limited capacity for data aggregation at the group level, and banks' remediation plans with restricted scope and ambition.

Overall throughout the severe repercussions of the pandemic and the invasion of Ukraine, the euro area banking sector demonstrated resilience and continued to support the economy. Banks under ECB supervision-maintained capital and liquidity buffers at comfortable levels, relatively unchanged. In contrast, during the 2008 global financial crisis, euro area banks were unprepared and compelled to deleverage to restore balance sheets, worsening the economic downturn.[27]

The substantial countercyclical policy response to the pandemic by European and national authorities, surpassing that of the global financial crisis, significantly contributed to sustaining financial stability. In fact, banks have managed the situation effectively thus far. The direct repercussions of the war appear to have been manageable, even for those banks with significant exposures to Russia. Regarding its indirect effects, the macroeconomic shock induced by the war has not yet significantly impacted banks' balance sheets. Overall, capital and liquidity ratios experienced slight declines from the end of 2021 to the second quarter of 2022, yet they remained robust, surpassing pre-pandemic levels and approaching historical highs. Concurrently, the total non-performing loan ratio of banks under ECB supervision continued its downward trend to reach an unprecedented low of 1.9% during the same period.

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[27]ECB,
https://www.bankingsupervision.europa.eu/press/interviews/date/2023/html/ssm.in230110~27fd2272fa.en.html

Additionally, banking profitability, gauged by return on equity, which had already shown improvement during the initial economic recovery stages of the pandemic, has been further reinforced by the favorable impact of the interest rate cycle turnaround on net interest margins. In the second quarter of 2022, the return on equity for banks under ECB supervision surged to 7.6%, marking the highest level recorded since the inception of ECB Banking Supervision. Although data beyond 2022 is not yet available, we anticipate that bank profitability dynamics remained robust due to the favorable contributions of lending volumes and margins to the growth of net interest income.

Market participants appear then optimistic about the continued momentum in bank profitability, projecting its extension into 2024. However, this optimism persists despite significant downward revisions in real growth expectations by both public and private sector analysts since the onset of the war in Ukraine.

Markets are currently banking on the idea that, despite persistent high inflation, the advantages of elevated interest rates will outweigh the drawbacks stemming from increased provisions for loan losses, reduced loan volumes, and heightened operational expenses amidst an economic downturn. However, it's prudent to approach this assumption with caution for several reasons.

Firstly, the benefits of interest rate hikes are not uniformly distributed among the banks under our supervision. Their reception depends on various factors such as their business model, balance sheet structure, and their sensitivity to economic cycles. Consequently, even if the overall impact of rising interest rates on the banking system appears positive, individual banks may experience divergent outcomes due to unique factors. Secondly, the current economic risks lean heavily towards the downside. Any deviations from expected growth could exacerbate the disparities in outcomes among banks resulting from rising

interest rates. A particular concern is the potential deterioration in asset quality, despite the ongoing reduction in non-performing loans among banks under ECB supervision in 2022. If interest rates continue to climb and economic conditions worsen, there are indications that this positive trend may reverse. Additionally, there are apprehensions about the impact of rising interest rates on specific market segments where banks may be particularly vulnerable, such as residential and commercial real estate, consumer lending, leveraged finance, and energy-intensive corporate sectors. Therefore, it's crucial for banks to remain vigilant about the downside risks to the economic outlook and take proactive steps to manage associated risks.

Thirdly, the evolving macroeconomic landscape shapes the potential response of the public sector should the downside risks materialize. While the pandemic prolonged the persistence of low interest rates, the conflict in Ukraine has accelerated the need for a departure from this environment. The imperative to combat inflation and return it to levels consistent with the ECB's primary objective of maintaining price stability constrains the scope of potential policy measures available to support economic activity. Consequently, banks should not factor in expectations of future public sector interventions into their balance sheet management strategies, as any such measures are likely to be more targeted compared to those enacted during the pandemic.

It is therefore crucial that banks continue to adapt their business models because, to remain viable, they cannot rely on higher interest rate margins alone. Furthermore, while the normalization of interest rates may appear to align with increased profitability, it's important to note that costs related to credit risk and

asset valuations are expected to remain manageable.[28] However, banks' responsiveness to the interest rate cycle may vary based on factors such as their size and business model. Additionally, it's evident that higher interest rates alone won't significantly bolster bank profitability unless overall economic activity remains robust.

I reported three key areas where banks need to focus as they adapt their business strategies.

Firstly, digitalization is crucial. The euro area banking sector has long grappled with low profitability, often stemming from structural issues like excess capacity and cost inefficiencies. Digital technologies will offer an avenue for efficiency improvement and revenue growth, allowing banks to stay competitive with fintechs, big tech companies, and other digital entities. While investing in digitalization involves upfront costs and operational risks, it's imperative for banks to embrace this path in today's landscape.

Secondly, banks must address climate-related and environmental risks. The surge in fossil fuel prices due to the conflict in Ukraine has underscored the urgency of transitioning to alternative energy sources. Although the war may temporarily impede the shift towards net-zero emissions, the quest for energy independence is expected to accelerate the green transition in the medium term, heightening transition risks. Banks need to enhance their climate risk

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[28]ECB,

https://www.bankingsupervision.europa.eu/press/interviews/date/2023/html/ssm.in230110~27fd2272fa.en.html

management efforts and prioritize investments in green technologies to align with evolving environmental standards.

Thirdly, bank funding is a critical consideration. While debates often center on central bank policy rates and their impact on banks' financial performance, funding costs, which are also influenced by the interest rate cycle, receive less attention. The ECB's measures have provided stable funding during market uncertainty, but the expected reduction in Eurosystem funding may lead banks to rely more on market-based funding, potentially at higher costs, affecting interest margins. Banks should carefully plan their funding strategies and consider the implications for their business model viability.

Overall, the greatest risk for banks in this phase of the interest rate cycle is complacency. Neglecting opportunities in digitalization and the green transition could widen profitability disparities between banks, leaving them vulnerable. Developing viable business models that address these factors is crucial for attracting favor from markets and investors, potentially resulting in lower funding costs.

2.8 Countermeasures adopted by Russia to limit the effect and exposure to sanctions since the early invasion of Crimea (2014-2019)

Building on the previous chapter, rejection and resistance to sanctions is the more traditional and expected response, a sentiment that is clearly applicable to the case of Russia. Instead of accepting concessions, the target state typically seeks ways to circumvent sanctions, either by forging relationships with secondary actors—such as other states, companies, or individuals—or through clandestine smuggling operations. This chapter will explore Russia's ability to recover from sanctions and its capabilities that allow it to evade sanctions.

Despite significant sanctions that initially impacted Russia, the country's economy largely recovered after 2016, even regaining some of its diplomatic standing. By the examples of the past, target states often do whatever is necessary to reject concessions and avoid sanctions. My analysis of the recent Iran case showed how US sanctions on Iran's gasoline imports failed due to a lack of appreciation for Iran's commitment to keeping its cars on the road and its ability to use unconventional methods to mitigate sanctions. Nephew and Miyagawa both highlight how extending and expanding sanctions increase risk and uncertainty, further entrenching target states in their original positions. In rejecting concessions, Russia also made efforts to avoid sanctions, recover, and adapt to this new reality. At his annual press conference on December 20, 2018, President Putin asserted that Russia is an "emerging, mighty and powerful" player, one that must be reckoned with even if the West does not wish to do so. He acknowledged that Russia initially faced "some adverse effects," but emphasized that Russia adjusted its economic planning and, as a result, claimed

that the “Russian economy has adapted to sanctions,” and even benefitted from the sanctions regime.

Between 2016 and 2018, Russia’s GDP increased by nearly 30%, from $1.283 trillion to $1.658 trillion, closely mirroring global oil prices and its GNI. Russia’s real GDP growth, which had declined from 1.8% in 2013 to -2.3% in 2015, rebounded to 2.3% by 2018, comparable to the EU’s levels. Foreign Direct Investment (FDI) in Russia, which initially decreased in 2015-2016, recovered in 2017 and 2018. In terms of trade, total exports, which had decreased from 2014 to 2016, steadily increased from 2017 to 2019, surpassing $35 billion per month. Russia’s total export of goods rose from $301.8 billion annually in 2016 to $451.5 billion annually in 2018. Similarly, imports of goods, which had fallen from $286.6 billion in 2014 to $182.8 billion in 2015, climbed back to $260 billion by 2017. Trade in services also recovered, with imports growing from $72.5 billion in 2016 to $92 billion in 2018, and exports of services increasing from $47.4 billion in 2016 to $61.3 billion in 2018. Figures 1-5 in Appendix B illustrate further developments in Russia’s main economic indicators.

Russia’s oil exports increased by approximately 16%, from 4,488 barrels per day in 2014 to 5,080 barrels per day in 2016, and remained above 5,000 barrels per day through 2016-2018, reaching peak levels similar to those of 1988 and 2004-2008. Natural gas exports also rose to unprecedented levels, with a near 30% increase from 2014 to 2018, surpassing previous peaks in 2006-2008, 2011, and 2013. Russia’s oil production has consistently increased since 2000, unaffected by sanctions, reaching over 11,000 MBPD (thousands of barrels per day) in late 2018, its highest level ever. Although natural gas production

declined by 5.4% from 2013 to 2015, it recovered in 2016 and grew by 15.2% to an unprecedented 690 billion cubic meters in 2018. [29]

Additionally, Russia's arms sales remained robust, with annual sales between $5.4-6.7 billion post-sanctions, despite the financial restrictions on its energy sector and an arms trade ban. Although Russia's trade and production were initially strained by sanctions, they recovered and achieved new heights in some sectors.

After sanctions were imposed, Russia experienced an inflation rate as high as 15.5% in 2015, a significant increase from the 7% average from 2010-2014. This inflation rapidly decreased the value of the ruble, raising prices of all goods and impacting the relatively low average income of Russian citizens, who felt the rising prices acutely. Many individuals reduced their holdings in rubles, opting for more stable foreign currencies like the USD, further harming the ruble's value. However, Russia's inflation rate dropped to well under 8% after 2016, reaching 2.4% in January 2019. Russia's net capital account, which had suffered a $42 billion drop in 2014, quickly recovered in 2015, showing rising capital flows until at least the last quarter of 2019.

Russia's government budget, which had a 0.5% GDP deficit in 2014, increased to a 3.4% deficit in 2016, but rebounded to a 2.9% surplus in 2018. This recovery can be attributed to Russia's reliance on energy exports, which account for 47% of the federal budget and 30% of GDP. The general government net lending or borrowing index, reflecting the difference between government revenue and expenditure, showed that Russia's government

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[29] Judy Twigg, "Russia Is Winning the Sanctions Game," The National Interest, March 14, 2019

reversed its trend of net borrowing and began net lending by 2018. Government gross debt remained stable, slightly above 16% of GDP between 2014-2016, and between 14-16% of GDP from 2016-2018.

Regarding the World Economic Forum's (WEF) Global Competitiveness Index, Russia climbed from 64th place in 2014 to 43rd from 2017 onward. The WEF noted that despite the 2014 currency crisis and rising inflation, Russia improved its market efficiency, regulatory business environment, and domestic competition, reflecting government efforts to enhance the business climate. By 2018, the WEF confirmed Russia's increased competitive performance due to better growth prospects, stabilization of its macroeconomic context, reduced inflation, low government debt, a large market size, growing ICT adoption, and utilization of human capital. The most recent WEF evaluation in 2019 highlighted further improvements in Russia's macroeconomic environment, overcoming the effects of the 2015 recession, reducing inflation to as low as 3%, maintaining sustainable public financing, and enhancing innovation capability through increased R&D expenditure.

Diplomatically, Russia also made significant strides, successfully pivoting to secondary states and other markets, strengthening bilateral ties with some sender states to undermine the sanctions regime, and being readmitted to the Council of Europe with the support of France and Germany. Discussions about Russia's potential readmission to the G7 also took place in 2019. However, despite these adaptations and recoveries, Russia's economy continues to face challenges, such as lower capital inflow, quasi-closure of international financial markets to Russian entities, and reduced availability of loans and venture capital. The financial system remains limited in depth, constraining the competitiveness of Russian firms and investment needed to achieve greater value chain sophistication. The WEF also pointed out Russia's weak entrepreneurial culture,

limited interaction, and diversity, which significantly constrain its workforce potential. Russia's weakest pillars remain innovation, institutions, and transparency, including corruption.

Besides understanding Russia's adaptation to sanctions, it is crucial to establish its intent to do so. The National Economic Security Strategy, adopted on May 15, 2017, clearly indicated Russia's intent to counter economic difficulties exacerbated by sanctions. The strategy, developed after a Security Council meeting on July 3, 2015, outlines challenges and threats to Russia's economic security and the government's intention to counter these threats. The strategy identifies two major threats: the use of economic and high-tech advantages by developed countries as instruments in global competition, and the use of discriminatory measures against key sectors of the Russian economy. Although the strategy does not explicitly name sender states or the West, it clearly points to these nations and frames the sanctions regime as part of their efforts to counter Russia in global competition.

President Putin, during the 2015 Security Council meeting, labeled sender states as "geopolitical opponents" and argued that they are unlikely to change their "hostile course" due to global rivalry. This framing exemplifies Russia's labeling of the sanctions regime as hostile and discriminatory, measures usually protected under investment treaties. For the Russian government, restrictive measures against key sectors and limited access to international financial resources are significant challenges. Despite acknowledging these challenges, President Putin argued that they have also created new opportunities for Russia.

The 2017 National Economic Security Strategy, which will last until 2030, outlines several goals to ensure economic security and counter threats: strengthening economic sovereignty, bolstering economic resistance to internal

and external threats, developing the national governance system, economic forecasting and strategic planning, developing human potential, and establishing conditions for modern technology development. Following Putin's emphasis on reducing Russia's dependence on negative external factors in 2015, the strategy prioritizes advancing retaliatory measures to combat sanctions. The strategy also emphasizes improving the investment climate, de-offshorization, structural change, enhancing export capacity, developing a stronger financial system, and import substitution. [30]

[30] Judy Twigg, "Russia Is Winning the Sanctions Game," The National Interest, March 14, 2019

3. THE SPILLOVER EFFECT: THE SBERBANK STUDY CASE

3.1 An overview

As discussed in previous chapters, the United States has enacted significant and unprecedented measures in response to Russia's further invasion of Ukraine. These measures include severe economic sanctions designed to impact the Russian economy and financial system both immediately and in the long term. The U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC), in collaboration with allies and partners, has announced extensive sanctions targeting the core of Russia's financial infrastructure. These sanctions affect its largest financial institutions and restrict both state-owned and private entities from raising capital, effectively severing Russia from the global financial system. Nearly 80 percent of all banking assets in Russia are impacted, promising profound and enduring effects on the Russian economy and financial system.

Building on President Biden's initial sanctions, the U.S. Treasury Department is now targeting Russia's leading financial institutions, including imposing sanctions on Russia's two largest banks and nearly 90 financial institution subsidiaries worldwide. The Treasury is also sanctioning more Russian elites and their families, and introducing prohibitions on the issuance of new debt and equity by major Russian state-owned enterprises and large privately owned financial institutions. These measures aim to severely undermine Russia's ability

to raise capital, crucial for its aggressive actions. They are designed to impose immediate costs, disrupt and degrade future economic activities, isolate Russia from international finance and commerce, and diminish the Kremlin’s future power projection capabilities. Russia's large financial services sector, predominantly controlled by state-owned entities, relies heavily on the U.S. financial system for its domestic and international business activities. The sanctions imposed by the United States today cut off key segments of the Russian financial system and economy from this vital financial infrastructure and broader access to the U.S. dollar.[31] The United States closely collaborated with its partners to ensure that the economic repercussions of these sanctions primarily impact the Government of the Russian Federation (GoR) and its economy, while minimizing effects on America and its allies. Over several months, Treasury engaged in sustained financial diplomacy, working almost daily with partners and allies at every level. This effort has fostered a unity of purpose, resolve, and technical coordination, resulting in a wide range of impactful measures that will significantly affect Russia. The Treasury is taking unprecedented action against Russia’s two largest financial institutions, Public Joint Stock Company Sberbank of Russia (Sberbank) and VTB Bank Public Joint Stock Company (VTB Bank), fundamentally crippling their ability to operate. Russian financial institutions conduct about $46 billion in foreign exchange transactions globally each day, with 80 percent of these transactions involving U.S. dollars. The vast majority of these transactions will now be disrupted. By cutting off Sberbank and VTB Bank — which together account

[31] Treasury, https://home.treasury.gov/news/press-releases/jy0608

for more than half of Russia's banking system by asset value — from processing payments through the U.S. financial system, Russian financial institutions affected by today's action will lose access to the remarkable reach, efficiency, and security of the U.S. financial system.[32]

The Treasury is imposing correspondent and payable-through account sanctions on Sberbank. As Russia's largest financial institution, holding about a third of all bank assets in the country and majority-owned by the Russian government, Sberbank plays a critical role in the Russian economy. It holds the largest market share of savings deposits, is the main creditor to the economy, and is considered a systemically important financial institution by the government. Within 30 days, the Office of Foreign Assets Control (OFAC) will require all U.S. financial institutions to close any Sberbank correspondent or payable-through accounts and reject any future transactions involving Sberbank or its foreign subsidiaries. This means that any payments Sberbank attempts to process in U.S. dollars for its clients, covering sectors from technology to transportation, will be disrupted and rejected when they reach a U.S. financial institution. To implement sanctions on Sberbank, OFAC issued Directive 2 under E.O. 14024, "Prohibitions Related to Correspondent or Payable-Through Accounts and Processing of Transactions Involving Certain Foreign Financial Institutions" (the "Russia-related CAPTA Directive"). This directive prohibits U.S. financial institutions from: (i) opening or maintaining a correspondent account or payable-through account for any entity subject to the prohibitions of the Russia-related CAPTA Directive, or for their property or interests in

[32] Treasury, https://www.treasury.gov/about/organizational-structure/offices/Pages/Office-of-Foreign-Assets-Control.aspx/sdn.

property; and (ii) processing transactions involving any such entities or their property or interests in property. Consequently, U.S. financial institutions must reject these transactions unless they are exempt or authorized by OFAC. Under Directive 2 of Executive Order 14024, Sberbank and 25 of its foreign financial institution subsidiaries, which are at least 50 percent owned directly or indirectly by Sberbank, are listed in Annex 1 to the Russia-related CAPTA Directive. These subsidiaries include banks, trusts, insurance companies, and other financial companies located in Russia and six other countries. Sberbank and other affiliated entities subject to the Russia-related CAPTA Directive have been added to OFAC's List of Foreign Financial Institutions Subject to Correspondent Account or Payable-Through Account Sanctions (CAPTA List). This list serves as a reference tool providing notice of OFAC actions regarding foreign financial institutions prohibited or restricted from opening or maintaining correspondent or payable-through accounts in the United States. All foreign financial institutions that are 50 percent or more owned, directly or indirectly, by Sberbank are subject to the prohibitions of the Russia-related CAPTA Directive, even if they are not specifically listed on OFAC's CAPTA List.[33] The prohibitions outlined in the Russia-related CAPTA Directive will take effect at 12:01 a.m. Eastern Daylight Time on March 26, 2022. By this time, U.S. financial institutions must have closed any correspondent or payable-through accounts maintained for Sberbank, the entities listed in Annex 1 of the Russia-related CAPTA Directive, and any foreign financial institutions that are 50 percent or more owned by these entities. Additionally, after March 26, 2022, U.S. financial institutions are prohibited from processing transactions involving

[33] Treasury, https://home.treasury.gov/news/press-releases/jy0608

these institutions and must reject such transactions unless exempt or authorized by OFAC.

3.2 The position of Sberbank Europe and its group in the Banking Union

The geopolitical tensions arising from Russia's military aggression against Ukraine also reverberated within the European Union's banking system, particularly affecting Russian banks operating within it. This impact was notably felt within the European Banking Union (BU), particularly concerning the Austrian parent company of Sberbank Europe AG, referred to henceforth as "Sberbank Europe (Austria)." Sberbank Europe (Austria) served as the parent credit institution of an EU banking group headquartered in Vienna, operating as a wholly-owned subsidiary of Sberbank of Russia, the largest bank in the Russian Federation. Classified as a "significant" supervised entity under Article 6(4) of the Single Supervisory Mechanism Regulation (SSMR), it fell under the direct prudential oversight of the European Central Bank (ECB), given Austria's participation in the BU. Furthermore, its subsidiaries in two other participating BU Member States, namely Sberbank d.d. in Croatia and Sberbank banka d.d. in Slovenia, were also classified as significant and directly supervised by the ECB.

The negative impact primarily manifested in informational and reputational forms, stemming from heightened geopolitical tensions that led to a liquidity strain on Sberbank Europe (Austria) and its aforementioned BU subsidiaries due to their association with their parent bank, Sberbank of Russia. However, it's noteworthy that there was minimal interconnectedness between these credit

institutions and other establishments within the BU, mitigating the potential for contagion through real channels. Therefore, there was little prospect for the activation of contagion mechanisms within the broader banking system of the European Union. Moreover

In late February 2022, Sberbank Europe (Austria) and its aforementioned BU subsidiaries witnessed significant withdrawals of deposits, attributed to the reputational fallout from geopolitical tensions. Consequently, there was a rapid and substantial decline in the liquidity position of the banking group within the BU. Under these circumstances, on February 27th (i.e., one day prior to the initial imposition of sanctions on the CBR), the ECB concluded that these credit institutions were experiencing or likely to experience failure (referred to as 'FOLTF').[34] This determination was reached considering the deteriorating liquidity situation caused by substantial deposit outflows, which severely impacted their liquidity reserves and liquidity coverage ratio (LCR). Moreover, their readily accessible "counterbalancing capacity" was deemed inadequate to offset these outflows. Hence, there were sufficient grounds to support this determination, as outlined in Article 18(1) of the Single Resolution Mechanism Regulation (SRMR), indicating that they would soon be unable to meet their financial obligations as they fall due. The objective behind this action was to safeguard financial stability by averting adverse spillover effects in the euro area banking system and protecting bank depositors.

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[34] Gorstos Christon, The EU's Restrictive Measures on the Russian Central Bank: Some Financial Stability Perspectives in Light of the Sberbank Cases, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4702482

Following the immediate communication of the FOLTF assessment by the ECB to the Commission and the SRB on the same date, the latter concurred with the assessment. On February 27th, in line with its mandate under the SRMR and considering the Valuation 1 Report of the same date, the SRB confirmed that these credit institutions, all falling under its jurisdiction, were indeed FOLTF. It promptly communicated its assessment to the ECB as well. To be clear, an ECB assessment on FOLTF represents a "supervisory evaluation" concerning an individual bank, forwarded to the SRB to facilitate the latter's own resolution appraisal. Secondly, ECB assessments on FOLTF serve as purely factual evaluations that do not legally obligate the SRB in any manner. They lack legal efficacy and are categorized as "preparatory measures," maintaining the applicant's legal status unchanged. These assessments present a factual appraisal conducted by the ECB regarding whether the applicant and its subsidiary are encountering or likely to encounter failure. However, they do not impose any binding obligations but rather serve as the foundation for the SRB to formulate resolution plans or make decisions indicating that resolution is not in the public interest.

The second prerequisite for the resolution of the three credit institutions within Sberbank's BU banking group (in compliance with Article 18(1) SRMR as well) was also fulfilled. Both the SRB and the ECB assessed that there were no feasible alternative private sector measures or supervisory actions (including early intervention measures or the write-down or conversion of relevant capital instruments in accordance with Article 21 SRMR) to be executed within a reasonable timeframe, with a realistic chance of restoring the position of Sberbank Europe (Austria) at the group level and in each of its afore mentioned subsidiaries within the BU.

In this instance, the newly established "moratorium tools" were also put into action for the first time. Specifically, given that two of the three conditions for resolution in accordance with Article 18(1) SRMR were satisfied, the SRB implemented a suspension of payments, enforcement, and termination rights (commonly referred to as a "moratorium") across all three credit institutions within Sberbank Europe's BU group. During this moratorium, which remained in effect until the end of March 1st, depositors were permitted to withdraw a predetermined daily allowance, as stipulated by the respective national resolution authorities. So, On March 1, 2022, the SRB made determinations regarding the resolution (or lack thereof) of the credit institutions within Sberbank Europe's BU group. Unlike a previous case involving another group (ABLV), this time the SRB's determinations varied for each group member. Specifically, concerning Sberbank Europe (Austria), the SRB concluded that no resolution action was warranted. This decision diverged from the uniform approach taken in the ABLV case. The SRB arrived at this conclusion after evaluating whether the third condition for resolution, as outlined in Article 18(1) SRMR, was met. Firstly, the functions carried out by this credit institution, such as deposit-taking, lending activities, and payment services, were deemed non-"critical." Discontinuation of these functions would not lead to the disruption of essential services for Austria's real economy or financial stability within Austria or other Member States. Moreover, the institution's failure was not anticipated to result in significant adverse effects on financial stability within Austria or other Member States.

Secondly, winding up the institution under normal insolvency proceedings in Austria would not yield significant adverse effects on financial stability or the economy within the country. Such a winding-up process would achieve the resolution objectives outlined in Article 14 SRMR to the same extent as

resolution. Considering the circumstances of the case, the characteristics of Sberbank Europe (Austria), and its specific financial and economic situation, the two prerequisites related to the "public interest" criterion (as delineated in Article 18(1) and (5) SRMR, as previously discussed) were not met. [35]

As SRMR, Article 18(1), first sub-paragraph, point (c) and Article 18(5) highlights: “For the purposes of point (c) of paragraph 1 of this Article, a resolution action shall be treated as in the public interest if it is necessary for the achievement of, and is proportionate to one or more of the resolution objectives referred to in Article 14 and winding up of the entity under normal insolvency proceedings would not meet those resolution objectives to the same extent.” Consequently, the SRB opted not to proceed with resolution measures for this credit institution, as outlined in the initial resolution plan, due to an unfavorable public interest assessment (PIA). Thus, in accordance with Article 18(8), it determined that the institution should undergo an orderly winding-up process in compliance with relevant Austrian legislation. The SRB's resolution plan for the banking group, dated May 3, 2021, concluded that resorting to national insolvency proceedings for Sberbank Europe (Austria) lacked credibility.[36]This determination stemmed from the belief that the subsidiaries would struggle to function independently if abruptly separated from their parent company, given their significant reliance on it. Consequently, in the event of a potential

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[35] Gorstos Christon, The EU’s Restrictive Measures on the Russian Central Bank: Some Financial Stability Perspectives in Light of the Sberbank Cases, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4702482

[36] SRB, https://www.srb.europa.eu/en/content/srb-determines-sberbank-europe-ag-austria-and-its-subsidiaries-croatia-and-slovenia-failing

resolution event, it was deemed that resolution measures might be necessary. The preferred resolution strategy identified involved the utilization of the bail-in resolution tool at the level of the credit institution (governed by Article 27 SRMR), with the sale of business tool identified as an alternative strategy. It is important to note, however, that the SRB retains discretion to evaluate, considering these circumstances, that the resolution objectives could be more effectively achieved by adopting measures not specified in the resolution plan. In general, the SRMR and BRRD (Banking Recovery and resolution directive) emphasize the 'extraordinary' nature of resolution measures, regardless of a credit institution's size and/or interconnectivity. Recitals (45) BRRD and (59) SRMR are bold in this regard. In accordance with Commission Delegated Regulation (EU) 2016/1075 of 23 March 2016 "supplementing [the BRRD] with regard to regulatory technical standards specifying the content of (…) resolution plans and group resolution plans" (OJ L 184, 8.7.2016, pp. 1-71, as in force and adopted by virtue of multiple BRRD Articles), when assessing the resolvability of a credit institution, the SRB must implement a four-stage strategy, the starting point of which is the assessment of the feasibility and credibility of liquidating it under normal insolvency proceedings.

3.3 Resolution Decisions in relation to the subsidiaries of Sberbank Europe's BU group

Unlike Sberbank Europe (Austria), the SRB adopted resolution decisions and a resolution scheme for its two subsidiaries in Croatia and Slovenia on March 1, 2022, in accordance with Article 18(6) of the SRMR.63 In this respect, it decided, following a marketing procedure, to transfer all shares of the group's Croatian subsidiary (Sberbank d.d.) to the Croatian Postbank (Hrvatska Poštanska Banka) and all shares of the group's Slovenian subsidiary (Sberbank banka d.d.) to Nova Ljubljanska Banka d.d. (NLB). The decisions were made based on an assessment that, unlike their parent company, there was indeed a "public interest" in resolving these two subsidiaries. The resolution action was deemed necessary to achieve specific objectives: firstly, ensuring the continuity of the critical function related to lending to small and medium-sized enterprises (SMEs) through the Slovenian subsidiary; and secondly, avoiding adverse effects on financial stability concerning both subsidiaries.

The Single Resolution Board determined that liquidating these subsidiaries through the standard insolvency processes of Croatia and Slovenia would not achieve the resolution objectives as effectively. Therefore, in these instances, a positive public interest assessment (PIA) was affirmed. In fact In accordance with its resolution plans for these credit institutions of 3 May 2021, the SRB assessed that their liquidation under normal insolvency proceedings would not be credible, since it would not achieve the resolution objectives, as referred to in Article 14(2) SRMR, to the same extent as resolution, while also considering that such a liquidation would likely have severe adverse effects on the

functioning of the entire financial system and the real economy of Croatia and Slovenia, respectively)). In these cases, thus, the SRB followed the resolution plan. On February 27, 2022, facing significant liquidity problems affecting all three Sberbank Europe group credit institutions, the SRB conducted two provisional valuations in accordance with Article 20(5) SRMR. The first valuation, "Valuation 1," assessed all three institutions to determine if they met the conditions for resolution, i.e., whether a positive or negative PIA should be made. The second valuation, "Valuation 2," focused solely on the two subsidiaries that were resolved, aiding in decisions about the transfer of assets, rights, liabilities, or ownership instruments, and defining commercial terms under Article 24(2)(b) SRMR for them. The timing of these valuations, immediately following Russia's military aggression against Ukraine on February 24, 2022, strongly indicates that the liquidity situation of the affected credit institutions had already begun to deteriorate significantly before the first set of sanctions on the CBR was imposed. The legal basis was the The legal basis for this is Article 20(5)(f) SRMR. Both Valuation Reports were prepared in accordance with the requirements of the Commission's "Delegated Regulation on valuation before resolution". This regulation was adopted under Article 36(15) BRRD. The non-confidential versions of these Valuation 1 Reports are available in the aforementioned set of documents related to the "Sberbank collapse in Europe" of June 10, 2022.[37] All three aforementioned SRB Decisions were directed to the respective NRAs: the Austrian Financial Market Authority, the Croatian National Bank, and the Bank of Slovenia. The decisions related to

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37 Brussels Commentary on European Banking Union, C.H. Beck, München – Hart Publishing, Oxford

resolution were accompanied, as noted, by the resolution scheme. The NRAs were required to take all necessary measures to implement this scheme in accordance with Article 29 of the SRMR by exercising their resolution powers. As previously mentioned, Sberbank Europe (Austria) is undergoing winding up under Austrian insolvency law. Additionally, eligible deposits with this credit institution were covered and reimbursed by the Austrian deposit guarantee scheme, Einlagensicherung AUSTRIA GmbH ("DGS Austria"), up to 100,000 euros per depositor, in line with the provisions of the law that transposed the EU Deposit Guarantee Schemes Directive (DGSD) into Austrian legislation upon activation of the pay-out function. Regarding the coverage level of 100,000 euros per depositor per credit institution is established in Article 6(1) of the DGSD. DGS Austria also covered the deposits of the German branch of Sberbank Europe (Austria) under Article 14(1). Additionally, according to the law that transposed Directive 2001/24/EC on the reorganization and winding up of credit institutions into Austrian legislation, particularly Article 9(1), the winding-up proceedings initiated by the Austrian authorities also extended to the German branch of Sberbank Europe.[38]

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[38] EU Banking and Insurance Insolvency, Chapter II, Second edition, Oxford University Press, Oxford

3.4 Pending Cases before the Court of Justice of the European Union (CJEU)

But as in the As in previous resolution cases, the resolution of Sberbank Europe (Austria) and its subsidiaries in Croatia and Slovenia prompted judicial review by the CJEU of the resolution actions undertaken by the SRB, the Council, and/or the Commission. These actions were brought by the former Sberbank Europe (Austria), now renamed MeSoFa Vermögensverwaltungs AG, and by Sberbank of Russia. Specifically, the first action was brought by Sberbank Europe (Austria) on 18 July 2022 in Case T-450/22, Sberbank Europe v SRB. In this case, Sberbank Europe requested that the Court annul the SRB's "No Resolution-Decision" of 1 March 2022, pursuant to Article 264 TFEU. The action is based on seven pleas in law, alleging, among other things, that the SRB exceeded its competence by adopting this decision instead of simply refraining from any action in accordance with its finding that the conditions of Article 18 SRMR were not met, and that it failed to grant Sberbank Europe the right to be heard.[39]

Sberbank Europe (Austria) filed two additional actions in August 2022. The first, filed on 18 August in Case T-523/22, Sberbank Europe v Council and Others (specifically, the Commission and the SRB), contends, based on nine

[39] SRB, https://www.srb.europa.eu/system/files/media/document/2022-06-10_SRB-Non-confidential- version-of-the-decision-in-respect-of-Sberbank-Europe-AG.pdf?destination=/en/admin/content/media.

pleas in law, that the Court should annul (pursuant to Article 264 TFEU): (a) the SRB Decision SRB/EES/2022/20 of 1 March 2022, which adopted a resolution scheme for its Slovenian subsidiary, along with the aforementioned Valuation Reports 1 and 2 of 27 February, and (b) if applicable, the approval of the resolution scheme by the Commission and/or the Council. [40]

The second action, filed on 19 August in Case T-524/22, Sberbank Europe vs Council and Others (including the Commission and the Board), similarly argues, based on nine pleas in law, that the SRB Decision of 1 March 2022, which adopted a resolution scheme for its Croatian subsidiary, and its corresponding Valuation Reports 1 and 2 of 27 February, and if applicable, its approval by the Commission and/or the Council, should be annulled by the Court pursuant to Article 264 TFEU. Among other claims, Sberbank Europe asserts that the contested decision presupposes the SRB's authority to make binding determinations on the parent entity's insolvency status, which should be exclusively determined by the competent national courts. [41] Finally, in the actions brought on 15 September 2022 in Cases T-571/22 and T-572/22, both titled Sberbank Europe v SRB, Sberbank Europe (Austria) argues, based on two pleas in law, that the Court should annul the SRB Decisions SRB/EES/2022/37 and SRB/EES/2022/36 of 5 July 2022.

[40] Gorstos Christon, The EU’s Restrictive Measures on the Russian Central Bank: Some Financial Stability Perspectives in Light of the Sberbank Cases, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4702482

[41] European Banking Institution, https://ebi-europa.eu/publications/eu-cases-or-jurisprudence

These decisions determined the expenses related to the resolution of its Croatian and Slovenian subsidiaries, respectively, and instructed the Croatian National Bank and the Bank of Slovenia to deduct these expenses from the purchase price payable to Sberbank Europe. But in August 2022, Sberbank of Russia contested the SRB's assessments and the Commission's decisions endorsing the resolution schemes for the Croatian and Slovenian subsidiaries of Sberbank Europe (Austria) before the Court. Specifically, on 20 August, Sberbank of Russia brought actions in Cases T-525/22 and T-526/22, both titled Sberbank of Russia v Commission and SRB. In these cases, the bank argues, based on three pleas in law for each case, that the Court should annul: in the first case, the SRB Decision SRB/EES/2022/21 of 1 March 2022 regarding the adoption of a resolution scheme for the Croatian subsidiary, along with its Valuation Reports 1 and 2, as well as Commission Decision (EU) 2022/948 of 1 March 2022 endorsing that resolution scheme; and in the second case, the SRB Decision SRB/EES/2022/20 of 1 March 2022 regarding the adoption of a resolution scheme for the Slovenian subsidiary, along with its Valuation Reports 1 and 2, as well as Commission Decision (EU) 2022/947 of 1 March 2022 endorsing that resolution scheme. Furthermore, on 22 August 2022, Sberbank of Russia initiated another action in Case T-527/22, Sberbank of Russia v SRB. In this case, the bank argues, based on three pleas in law, that the Court should annul the SRB Decision SRB/EES/2022/19 of 1 March 2022 regarding the assessment of the conditions for resolution concerning Sberbank Europe (Austria), along with its Valuation Report 1 of 27 February.

SUMMARY TABLE: **The pending Cases before the**

Court			
Case (in chronological order)	**Applicant**	**Defendant**	**Subject matter**
Case T-450/22 18 July 2022	Sberbank Europe(Austria)	SRB	Declaring void, the “No Resolution-Decision” of 1 March 2022 with respect to Sberbank Europe (Austria)
Case T-523/22 18 August 2022	Sberbank Europe (Austria)	Council, Commission and SRB	Declaring void: (a) Decision SRB/EES/2022/20 of 1 March 2022 adopting a resolution scheme with respect to the Slovenian subsidiary and Valuation Reports 1-2; and (b) if applicable, the approval of the scheme by the Commission and/or the Council Action has been dismissed as inadmissible – to the extent it is directed against the Council – by Order of the General Court of 8 September 2023
Case T-524/22 18 August 2022	Sberbank Europe (Austria)	Council, Commission and SRB	Declaring void: (a) Decision SRB/EES/2022/21 of 1 March 2022 adopting a resolution scheme with respect to the Croatian subsidiary and Valuation Reports 1-2; and (b) if applicable, the approval of the scheme by theCommission and/or the Council Action has been dismissed as well as inadmissible – to the extent it is directed against the Council – by Order of the General Court of 8 September 2023
Case T-525/22 20 August 2022	Sberbank of Russia	Commission and SRB	Annulment of: (a) the above Decision SRB/EES/2022/21 (in respect of the Croatian subsidiary) and of

			Valuation Reports 1-2; and (b) Commission Decision (EU) 2022/948 endorsing that resolution scheme Action dismissed as inadmissible by Order of the General Court of 10 October 2023; against this Order, Appeal was lodged on 20 December2023 (**Case C-791/23 P**)
Case T-526/22 20 August 2022	Sberbank of Russia	Commi ssionand SRB	Annulment of: (a) the above Decision SRB/EES/2022/20 (in respect of the Slovenian subsidiary) and of Valuation Reports 1-2; and (b) Commission Decision (EU) 2022/947 endorsing that resolution scheme Action dismissed as inadmissible by Order of the General Court of 10 October 2023; against this Order, Appeal was lodged on 20 December2023 (**Case C-792/23 P**)
Case T-527/22 22 August 2022	Sberbank of Russia	SRB	Annulment of Decision SRB/EES/2022/19 of 1 March 2022 on the assessment of the conditions for resolution in respect of Sberbank Europe (Austria) and of Valuation Report 1 Action dismissed as inadmissible by Order of the General Court of 10 October 2023; against this Order, Appeal was lodged on 20 December2023 (**Case C-793/23 P**)
Case T-571/22 15 September 2022	Sberbank Europe (Austria)	SRB	Annulment of Decision SRB/EES/2022/37 of 5 July 2022 on the determination of the expenses related to the resolution of the Croatian

			subsidiary

3.5 Concluding remarks and considerations

As previously discussed in detail, following the escalation of geopolitical tensions between Russia and Ukraine, and even before sanctions were imposed on the CBR by Council Regulation (EU) 2022/334 on 28 February 2022, the credit institutions within the Sberbank Europe (Austria) banking group in the BU suffered a severe reputational crisis, leading to a rapid and significant deterioration in the group's liquidity situation. Initially, according to the non-confidential version (dated 10 June 2022) of the FOLTF assessment conducted by the ECB for Sberbank Europe (Austria), as of 31 January, the ECB activated enhanced monitoring for that credit institution under its "Emergency Action Plan framework". This activation was communicated to the SRB, leading to a continuous exchange of information between the ECB and the SRB, which intensified on 22 and then further on 24 February. Additionally, the escalation of geopolitical tensions, preceding any sanctions, created uncertainty about potential severe sanctions and their impacts on the credit institution, leading to significant outflows. Moreover, on 24 February, Sberbank Europe (Austria) was directly sanctioned by the OFAC, necessitating all US financial institutions to close correspondent or payable-through accounts with Sberbank of Russia within 30 days and reject any future transactions involving this Russian bank or its foreign subsidiaries.

Finally, several subsidiaries also faced acute liquidity outflows in the preceding days. Thus, the issues had already begun well before the Russian invasion of Ukraine. (ECB FOLTF Assessment for Sberbank Europe (Austria), point 24). Furthermore, as detailed in the aforementioned Decision SRB/EES/2022/19 of 1 March 2022 concerning the evaluation of resolution conditions for Sberbank Europe (Austria), the

liquidity situation of the institution and its subsidiaries in Croatia and Slovenia deteriorated further by 23 February, particularly intensifying on 24 February coinciding with the Russian Federation's invasion of Ukraine, due to a significant wave of deposit withdrawals. Concurrently, most correspondent banks of Sberbank Europe (Austria) terminated their business relationships, especially in USD transactions. It was also reported that Sberbank was notified on 25 February of the CBR's decision to restrict the transfer of foreign currency-denominated funds to/from any banking subsidiaries of Sberbank of Russia located in jurisdictions where sanctions were imposed against Russian entities or officials. Despite the measures taken, its counterbalancing capacity continued to decline so, the SRB promptly informed the Commission about the rapidly deteriorating situation of Sberbank Europe (Austria) already on 25 February and engaged extensively with the Commission over the following days to provide updates on relevant developments.

Consequently, the severe liquidity challenges faced by Sberbank's banking group in the BU, which posed threats to financial stability, were evident even before the imposition of the initial set of sanctions on the CBR on 28 February. These concerns regarding financial stability were directly connected to (and caused by) the reputational and informational spillover effects resulting from the escalation of geopolitical tensions. This prompted the ECB and the SRB to commence preparations for resolution measures concerning these credit institutions and subsequently formally activate the resolution framework on 27 February. (Regulation (EU) 2022/334 was adopted by the Council on 28 February 2022 having regard to the joint proposal of the High Representative of the Union for Foreign Affairs and Security Policy and of the Commission, which must have been sent before the date of the Regulation's adoption). Thus, the decisions made regarding Sberbank Europe (Austria) and its subsidiaries in the BU were not solely prompted by the imposition of sanctions on the CBR on 28 February 2022; however, it is reasonable to assume that

the ECB and the SRB were well aware of the impending imposition of these sanctions and anticipated them.

Additionally, it can be argued that the imposition of these sanctions, regardless, exacerbated a developing crisis, which fortunately was contained early enough in its formation. Conversely, it is notable that despite these adverse effects on financial stability within the EU, the extraordinary provisions of Article 5a(5)-(6) of Council Regulation (EU) No 833/2014 were not activated, to the best of the author's knowledge. The SRB's Decisions dated 1 March 2022 regarding the winding up of Sberbank Europe (Austria), following the evaluation that the cumulative conditions for resolution action outlined in Article 18(1) SRMR were not met, and the resolution, employing the sale of business resolution tool, of its two subsidiaries in Croatia and Slovenia, represented a decisive response by this EU agency to address the financial difficulties faced by these significant credit institutions, as determined by the ECB in its FOLTF assessment and subsequently confirmed by the SRB.

These actions affirmed, among other things, that the bank resolution framework established in the EU, through the BRRD and the transposition into EU law of related FSB international financial standards (specifically, its Key Attributes developed in response to the GFC), and later bolstered by the SRMR in the aftermath of the fiscal crisis in the euro area, has strengthened the "bank safety net" in a dual manner; Firstly, institutionally, the BRRD mandated Member States to establish resolution authorities (along with resolution funds), while the SRMR instituted a centralized resolution authority (SRB) for the Banking Union (BU) within the Single Resolution Mechanism (SRM). [42] Secondly, both legislative measures assigned National Competent Authorities (NCAs), including the ECB within the BU, the primary

[42] EUR-LEX, Decision SRB/EES/2022/19, points (10) and (48)-(49)

responsibility of assessing which credit institutions qualify as Failing or Likely to Fail (FOLTF).

They also empowered resolution authorities, including the SRB within the BU, with the authority to address solvency crises and/or liquidity crises in an orderly manner—either by deciding on the winding up of credit institutions with a negative Public Interest Assessment (PIA) or by applying various resolution tools. This approach aims to preserve financial stability without resorting to public funds or bank bailouts, as was often the case during and immediately following the Global Financial Crisis (GFC), while safeguarding covered depositors. Given these conditions, and in the author's perspective, the effective implementation of the Comprehensive Resolution and Recovery Directive (CMDI) framework, introduced since 2015, including its resolution component, can be sufficient to mitigate negative spillover effects on the financial system and maintain its stability. This is even applicable in situations where such effects may arise due to sanctions imposed on central banks, as observed in the case of Sberbank Europe (Austria) and its subsidiaries in the BU. Consequently, the correlation between the imposition of restrictive measures and concerns about financial stability can be effectively managed, with any resultant shocks being absorbed.[43] The credit institutions within Sberbank Europe's Banking Union (BU) group were deemed significant for centralized prudential oversight and resolution within the BU. However, their size was not substantial enough to generate interconnectedness-induced spill-over effects into the euro area banking system during the crisis provoked by the Russian Federation's military aggression against Ukraine on 24 February 2022. Nonetheless, as previously mentioned, even credit

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[43] Gorstos Christon, The EU’s Restrictive Measures on the Russian Central Bank: Some Financial Stability Perspectives in Light of the Sberbank Cases, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4702482

institutions of considerable magnitude and high interconnectivity should not be resolved if winding them up is considered credible and feasible.

While Sberbank Europe (Austria) might not have represented the most typical case in this regard, the decision to wind it up was indeed made by the SRB, unlike its subsidiaries, which were resolved based on differing Public Interest Assessments (PIAs). As discussed, the Comprehensive Resolution and Recovery Directive (CMDI), including its resolution component, still exhibits weaknesses, particularly concerning the feasibility of resolving the largest credit institutions in the euro area and, conversely, winding up (rather than resolving) smaller ones. Many of these weaknesses are addressed in the European Commission's 2023 proposals for amending this framework.[44] Nevertheless, the swift actions taken by the ECB and the SRB effectively preserved the stability of the banking system in the euro area during a severe liquidity crisis affecting the credit institutions within Sberbank Europe's BU group. Furthermore, it is noteworthy that no depositor incurred losses. Moreover, besides being the first instance where the SRB adopted differentiated courses of action for credit institutions within the same group identified as Failing or Likely to Fail (FOLTF), unlike the ABLV case, it also marked the first utilization of newly established moratorium tools. This provided an additional safeguard for depositors.

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[44] Order of the General Court of 6 May 2019 in Case T-281/18, *ABLV Bank AS vs European Central Bank*

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