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The restrictive measures imposed by the European Union on the Central Bank of the Russian Federation and some considerations relating to financial stability

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The restrictive measures imposed by the European Union on the Central Bank of the Russian Federation and some considerations relating to financial stability¹

Professor Dr Christos V. Gortsos²

The restrictive measures addressed to the Central Bank of the Russian Federation and their impact

On the measures

In view of the Russian Federation's military aggression against Ukraine,³ the Council of the European Union (EU) adopted on 28 February a package of sectoral restrictive measures (sanctions), which, *inter alia*, included a ban on transactions with the Central Bank of the Russian Federation, (hereinafter the 'Central Bank of Russia', or 'CBR'),⁴ which is a member (and shareholder) of the Bank for International Settlements (BIS).⁵ In particular, it is provided that:

first, transactions related to the management of reserves as well as of assets of the Central Bank of Russia, including transactions with any legal person, entity or body acting on behalf of, or at the direction of, the Central Bank of Russia, are prohibited; and

second, by way of derogation, the competent authorities may authorise a transaction if it is strictly necessary to ensure the financial stability of the EU as a whole or of the Member State concerned,

¹ This article was first published in *EU LAW LIVE*, weekend edition No 92, Special Issue: The EU in the Wake of Russia's Military Attack on Ukraine, 5 March, pp. 11-16, available at: <https://eulawlive.com/weekend-edition/weekend-edition-no92>.

² Professor of Public Economic Law at the Law School of the National and Kapodistrian University of Athens. The author wishes to thank three anonymous referees for their valuable comments; the usual disclaimer applies. The cut-off date for information included in this brief paper is 3 March 2022 (14:00 CET).

³ It is noted that on 1 March the European Court of Human Rights (ECtHR) granted urgent interim measures in regard of the Russian Federation's ongoing military operation on Ukrainian territory; see at: [https://hudoc.echr.coe.int/eng-press#{"itemid":\["003-7272764-9905947"\]}](https://hudoc.echr.coe.int/eng-press#{).

⁴ See at: https://www.bis.org/about/member_cb.htm. It is interesting to observe how the current asset freezes will affect the CBR's position in this international financial organisation in view of the latter's statutory task (Article 3 of its Statutes of 2005) to provide additional facilities to its member central banks for international financial transactions and act as a trustee or agent with regard to international financial settlements entrusted to it under agreements with the parties concerned.

⁵ The press release of the Council of the EU is available at: <https://www.consilium.europa.eu/en/press/press-releases/2022/02/28/eu-adopts-new-set-of-measures-to-respond-to-russia-s-military-aggression-against-ukraine>. The key legislative act of relevance is Council Regulation (EU) No 833/2014 of 31 July 2014 "concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine" (OJ L 229, 31.7.2014, pp. 1-11), as in force after its subsequent amendments, including the most recent ones (see just below). This Regulation, adopted based on Article 215 of the Treaty on the Functioning of the European Union (TFEU)), gives effect to certain measures provided for in Council Decision 2014/512/CFSP of 31 July 2014 concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine (OJ L 229, 31.7.2014, pp. 13-17). The latter was adopted based on Article 29 of the Treaty on European Union (TEU). The Council Decision is directly binding on EU Member States, while the Council Regulation is binding on any person or entity under EU jurisdiction.

in which case the Member State concerned shall immediately inform the other Member States and the Commission of its intention to grant an authorisation.⁶

Similar measures were adopted by the United States (US)⁷ and the United Kingdom (UK).⁸

Furthermore, among the additional restrictive measures adopted by the Council of the EU on 2 March, it became prohibited to sell, supply, transfer, or export euro-denominated banknotes to the Russian Federation or to any natural or legal person, entity, or body in the Russian Federation, including its government and its Central Bank, or for use therein.⁹ In addition, as of 12 March, it will be prohibited to provide specialised financial messaging services, which are used to exchange financial data (SWIFT system), to specific Russian banks or to any legal person, entity or body established in Russia whose proprietary rights are directly or indirectly owned for more than 50% by these banks.¹⁰

On the impact

The restrictive measures taken by the Council of the EU, including asset freezes, form part of its common foreign and security policy (CFSP)¹¹ and are anchored in the Treaties.¹² They should be

⁶ Council Regulation (EU) 2022/334 of 28 February 2022 “amending Council Regulation (EU) No 833/2014 (...)” (OJ L 57, 28.2.2022, pp. 1-3), adding, respectively, paras. 4 and 5-6 to Article 5a.

⁷ For the official press release by the U.S. Department of the Treasury, see at: <https://home.treasury.gov/news/press-releases/jy0612>.

⁸ For the official statement by Her Majesty’s Treasury and the UK Office of Financial Sanctions Implementation, see at: <https://www.gov.uk/government/news/uk-statement-on-further-economic-sanctions-targeted-at-the-central-bank-of-the-russian-federation>.

⁹ This prohibition does not apply to the sale, supply, transfer or export of euro denominated banknotes provided that this is necessary for the personal use of natural persons travelling to Russia or members of their immediate families travelling with them; or the official purposes of diplomatic missions, consular posts or international organisations in Russia enjoying immunities in accordance with international law; Council Decision (CFSP) 2022/346 of 1 March 2022 “amending Decision 2014/512/CFSP concerning restrictive measures in view of Russia’s actions destabilising the situation in Ukraine” (OJ L 63, 2.3.2022, pp. 5-7), para. (1), inserting new Article 1f to Decision 2014/512/CFSP, as well as Council Regulation (EU) 2022/345 of the same date “amending Regulation (EU) No 833/2014 (...)” (OJ L 63, 2.3.2022, pp. 1-4), para. (1), inserting new Article 5i to Regulation (EU) No 833/2014. See also the press release of the Council of the EU at: <https://www.consilium.europa.eu/en/press/press-releases/2022/03/02/russia-s-military-aggression-against-ukraine-eu-bans-certain-russian-banks-from-swift-system-and-introduces-further-restrictions>.

¹⁰ Council Decision (CFSP) 2022/346, para. (1), inserting new Article 1e to Decision 2014/512/CFSP and Council Regulation (EU) 2022/345, para. (1), inserting new Article 5h to Regulation (EU) No 833/2014. The banks referred to therein are listed in (the new) Annex VIII to Decision 2014/512/CFSP and Annex XIV to Regulation (EU) No 833/2014.

¹¹ The measures are taken upon a proposal from the EU High Representative for Foreign Affairs and Security Policy and the Commission (Article 215(1) TFEU). Apart from sanctions autonomously adopted by the EU, some others are mandated by the United Nations (UN) Security Council.

¹² Namely, the above-mentioned Articles 29 TEU and 215 TFEU.

designed and applied with due respect to, *inter alia*, the principle of proportionality¹³ and the relevant case law of the Court of Justice of the EU (CJEU).¹⁴

This is not the first time that the EU is sanctioning the central bank of a third country (for the sake of either implementing UN Security Council Resolutions or furthering the CFSP objectives). Previous precedents are the restrictive measures imposed on the Central Bank of Syria (by the US and the UK as well) for the financial support provided to the regime of Bashar al-Assad.¹⁵ More frequent resort to this form of sanctions has been made by the US Department of Treasury Office of Foreign Assets Control (OFAC) and most recently in the case of the central banks of Iran, the Donetsk People Republic, North Korea, and Venezuela.¹⁶

Sanctions (freezes) on a central bank's foreign assets, which, under customary international law, enjoy *in principle* immunity,¹⁷ can be imposed and be considered as effective to the extent that they can ban transactions and operations involving the national currency of the countries imposing them, assets denominated in that currency and held in custody in these countries, and financial firms located in these countries, as well as block the central bank's property established in these countries, which hence cannot be disposed of. The extent of their uniform implementation worldwide is also of paramount importance; if restrictive measures are taken by some countries only, their effectiveness will ultimately depend on the composition of the central bank's reserve assets.

In the case under consideration, restrictive measures have been taken so far, *inter alia*, by the EU, the US, the UK, Canada, and Switzerland (other G7 members are expected to follow suit as well). According to available data, the Central Bank of Russia's reserve assets (in the form of foreign currency and predominantly foreign currency-denominated securities and gold) amounted in early 2022 to (approximately) US\$630 billion.¹⁸ Those held in EU member states (in euro) are close to 25%; another 6.6% is held in the US (a significant additional amount of US\$-denominated assets are held elsewhere), a 4.5% held in the UK, and a 5% held by international financial institutions. China,

¹³ According to Article 5(4) TEU, the principle of proportionality mandates the content and form of EU action not to exceed what is necessary to achieve the objectives of the Treaties. Moreover, EU institutions must apply that principle as laid down in the Protocol (No 2) attached to the Treaties on the application of the principles of subsidiarity and proportionality.

¹⁴ See, e.g., the judgment of 6 October 2020 of the CJEU in (the Iranian) *Bank Refah Kargaran v Council of the European Union* (Case C-134/19 P, ECLI:EU:C:2020:793), where, the Grand Chamber, *inter alia*, ruled (para. 43) that “*the principle of effective judicial protection of persons or entities subject to restrictive measures requires, in order for such protection to be complete, that the [CJEU] be able to rule on an action for damages brought by such persons or entities seeking damages for the harm caused by the restrictive measures taken in CFSP Decisions*”.

¹⁵ See Council Regulation (EU) No 36/2012 of 18 January 2012 “concerning restrictive measures in view of the situation in Syria (...)” (OJ L 16 19.1.2012, pp. 1-32), especially Articles 11, 11a and 21a.

¹⁶ See at: <https://www.treasury.gov/about/organizational-structure/offices/Pages/Office-of-Foreign-Assets-Control.aspx/sdn>.

¹⁷ On the reasons justifying the infringement of immunity when freezing central bank assets, see by means of mere indication Goldmann, Matthias (2022): *Hot War and Cold Freezes: Targeting Russian Central Bank Assets*, Verfassungsblog, 28 February, available at: <https://verfassungsblog.de/hot-war-and-cold-freezes>.

¹⁸ Source: Central Bank of Russia, data as of 31 January 2022 (see also at <https://www.statista.com/chartoftheday>).

which has not imposed such sanctions, is holding close to 14% of the CBR's reserve assets and a percentage of more than 20% is held by the CBR itself, predominantly in gold.¹⁹

Accordingly, taking as a given that the above-mentioned restrictive measures are effectively implemented, the CBR will have no access to quite a significant portion of its foreign reserve assets. Thus, it is not able to sell this tranche of reserves in markets to support the exchange rate of the national currency, i.e., the rouble, which has already been severely traumatised since the outbreak of the tensions. Under these conditions, a significant negative spillover effect on the inflation rate will also be triggered. In addition, the CBR's capacity to provide liquidity in foreign currency (e.g., US\$, euros or UK pounds) to banks and non-financial corporates to cover their international financing needs is apparently also reduced.

Furthermore, the surplus in the country's current account balance (estimated at approximately US\$120 billion) may need to be used for the repayment of foreign debt (even though there are strong indications in international capital markets that the Russian Federation may even default on its sovereign debt denominated in foreign currencies) and be further affected by capital outflow from the private sector (unless the capital controls already imposed in the country prove to be effective). Consequently, the CBR's freely available foreign reserve assets are expected to further decline in the forthcoming months.

Considerations relating to financial stability

The situation in the Russian Federation

Another closely related aspect is the impact of the restrictive measures taken on the stability of the Russian financial system. The valuation of companies listed in the stock exchange has already been severely negatively affected, while a 'bank run' is manifest as well, which induced the Central Bank of Russia on 28 February to increase its key interest rate from 9.5% to 20%, due to the drastic change of external conditions for the Russian economy, and to free an amount of (approximately) US\$ 7 billion in local bank reserves to help improve liquidity in the market.²⁰ However, even if this measure were to prove partly effective on a short-term basis, threats to financial stability are apparent. A reduction in the deposit base, in combination with the downgrading of the Russian economy by rating agencies, an economic depression, a higher inflation rate and a weakened rouble, the ban on access to the SWIFT system (as already noted), the inability of the CBR to provide financing in foreign currency, and the overall impact of the restrictive measures imposed, will inevitably, *inter alia*, limit the banking system's capacity to finance the real sector of the economy and lead to a significant (eventually exponential) rise to non-performing loans. In the worst-case scenario, this could result in conditions of severe financial instability prompted by the non-viability of some large banks in the country – eventually also subsidiaries of EU (and other foreign) credit institutions in Russia.²¹

¹⁹ Source: Central Bank of Russia, data as of June 30, 2021 (*ibid*).

²⁰ For an overview of the measures taken by the CBR on 28 February, see at: <https://www.forbes.com/sites/siladityaray/2022/02/28/russian-central-bank-hikes-interest-rate-to-20-as-rouble-sinks-to-record-low/?sh=6082679d7a7e>.

²¹ In such a case, and in order to ensure that no spillover effects would affect financial stability in the EU as a whole or in a Member State concerned, the exceptional (above-mentioned) provisions of Article 5a(5)-(6) of Council Regulation (EU) No 833/2014 may need to be activated.

The first spillover effect in the euro area and the immediate activation of the resolution framework

The reputational impact of the geopolitical tensions has also been felt in the banking union where Russian banks were operating. In order, thus, to protect financial stability and bank depositors amidst that crisis situation, taking into account the significant deposit outflows experienced by the Austrian parent of Sberbank Europe AG (a subsidiary of Sberbank of Russia, whose majority shareholder was the Russian Federation) and its two subsidiaries in Croatia and in Slovenia, and in order to prevent any negative externalities to the banking system in the euro area, the Single resolution Board (SRB) decided, on 28 February, that these credit institutions, which were significant and hence under its remit, were failing or likely to fail in accordance with Article 18 of the Single Resolution Mechanism Regulation (SRMR).²²

The decision was taken on the basis of the assessment made previously on the same date by the European Central Bank (ECB) that Sberbank Europe AG and its two subsidiaries are failing or likely to fail since, taking into account their deteriorating liquidity situation, there were sufficient grounds supporting the determination that they would, in the near future, be unable to pay their debts as they fall due.²³ It is also noteworthy that the SRB has applied, for the first time (to the best of the author's knowledge), the so-called 'moratorium', i.e., a suspension of payments, enforcement, and termination rights to the three credit institutions in the group.²⁴

The SRB has taken its decisions concerning the resolution of these credit institutions just one day later, on 1 March. Unlike in previous cases involving a group (ABLV), this time the decision was not the same for all group members. In particular:

On the one hand, it decided that no resolution action is necessary for the Austrian parent of Sberbank Europe AG, after having assessed that the conditions for resolution in accordance with Article 18 SRMR were not met; it was considered as not providing critical functions to the economy and its winding-up under normal insolvency proceedings would not have a negative impact on financial stability or the economy in Austria.²⁵

On other hand, assessing that there was a public interest in resolving the two subsidiaries in order to protect financial stability and avoid disruption to the Croatian and Slovenian economies and, hence, all three resolution conditions were met, the SRB adopted resolution schemes for the two subsidiaries of Sberbank Europe AG and decided to transfer all shares of the group's Croatian

²² The SRB press release is available at: <https://www.srb.europa.eu/en/content/srb-determines-sberbank-europe-ag-austria-and-its-subsidiaries-croatia-and-slovenia-failing>.

²³ The ECB press release deeming these banks as failing or likely to fail is available at: <https://www.bankingsupervision.europa.eu/press/pr/date/2022/html/ssm.pr220228~3121b6aec1.en.html>.

²⁴ Depositors were able during the moratorium to withdraw a daily allowance amount, determined by the respective national resolution authorities. This moratorium mechanism was introduced by the amendments to the EU resolution framework pursuant to the legislative '2016 banking package'.

²⁵ Insolvency procedures will be carried out according to Austrian law, while eligible deposits are protected by activation of the payout function of the national deposit guarantee scheme.

subsidiary to the Croatian Postbank (Hrvatska Poštanska Banka) and of the group's Slovenian subsidiary to Nova Ljubljanska Banka (NLB).²⁶

Concluding remarks

An early assessment of the effects of the restrictive measures targeting the Central Bank of Russia leads to the conclusion that the EU, along with some other countries, have significantly stepped up the pressure on the Russian Federation in the aftermath of the military aggression against Ukraine. Their first-round effectiveness seems to be granted (albeit mitigated by China's lack of participation in the sanctioning process) and the negative implications for the real sector of the economy, the currency, the banking system, and financial markets in the Russian Federation will intensify.

However, a concern has been raised whether, and if so to what extent, these restrictive measures could be by-passed either with the use of means of payments which are still beyond the radar of public policy-oriented regulation, or by other means of arbitrage.²⁷ Pursuant to the main results of the most recent meeting of the ECOFIN Council of 2 March 2022:

“Member States agreed to further investigate actions to avoid any circumvention of the sanctions, especially by the use of crypto assets”.²⁸

This important dimension requires, however, deeper analysis and cannot be further discussed in the context of this brief overview.

²⁶ This SRB press release is available at: <https://www.srb.europa.eu/en/content/sberbank-europe-ag-croatian-and-slovenian-subsidiaries-resume-operations-after-being-sold>. The resolution scheme was approved by the Commission on the same day in accordance with Article 18 SRMR (the official press release is available at: https://ec.europa.eu/commission/presscorner/detail/en/ip_22_1492). All three decisions will be implemented by the national resolution authorities, the Austrian Financial Market Authority, the Croatian National Bank, and the Bank of Slovenia.

²⁷ On this second aspect, see Goldmann (2022), *op. cit.*

²⁸ See at: https://www.consilium.europa.eu/en/meetings/ecofin/2022/03/02/?utm_source=dsms-auto&utm_medium=email&utm_campaign=Informal+video+conference+of+economy+and+finance+ministers.