

# OFAC Sanctions Related to the Russian Invasion of Ukraine

Insights

March 21, 2022

In light of the dramatic expansion of the number of persons and entities subject to sanction by the U.S. Treasury's Office of Foreign Asset Controls ("**OFAC**") in response to the Russian invasion of Ukraine, we wanted to send out a brief alert that you should periodically check the status of investors in your funds to determine whether they have become subject to these sanctions and, if any investors have become subject to sanctions, ensure that you are taking the appropriate actions. This is a rapidly evolving area and we will continue to assess and refine or make additional recommendations for our clients in this regard.

**What Sanctions Have Been Declared By OFAC:** OFAC has issued a combination of "blocking" sanctions ("**Blocking Sanctions**") as well as restrictions on new debt or equity transactions in respect of 13 specific Russian firms and their majority owned subsidiaries ("**Debt/Equity Restrictions**") as of the date of this alert. This alert focuses on your relationship with your fund investors, and in that respect, the Blocking Sanctions are of greatest relevance. The Debt/Equity Restrictions expand upon existing similar debt/equity restrictions imposed against certain Russian financial and energy firms that have been in place for many years and these expanded restrictions only apply to transacting in, or providing financing for, new debt or equity issued after 12:01a.m. EDT time on March 26, 2022 by such firms.

**Blocking Sanctions:** As many of you are familiar, OFAC maintains a list ("**SDN List**") of Specially Designated Nationals and Blocked Persons ("**SDN**") and under the Blocking Sanctions U.S. firms are prohibited from buying, selling, or otherwise engaging in transactions with blocked parties (taking such action is referred to as

**“Blocking”**). While the SDN List includes readily determined blocked parties, e.g., the Russia Direct Investment Fund (Russia’s sovereign wealth fund), you should be aware that SDN blocked parties also include entities that are majority owned, whether individually or in the aggregate, by one or more persons on the SDN List even if such majority owned entity is not listed on the SDN List (**“Deemed SDN”**). Tracing ownership to arrive at a Deemed SDN determination could potentially present a significant challenge. This challenge is further complicated by the fact that OFAC continues to expand the SDN List as the conflict in Ukraine escalates.

**What is “Blocking”:** A more accurate term for Blocking Sanctions would be “freezing” sanctions. U.S. firms are prohibited from buying, selling, or otherwise engaging in transactions related to blocked parties, absent OFAC authorization. A fund that has an investor on the SDN List (or is majority controlled by parties on the SDN List), is required to “freeze” such investor’s investment in the fund. The Blocking Sanctions regime was not developed with VC/PE funds in mind, so there are many unanswered questions on how “freezing” should be implemented with respect to a “blocked” fund investor. But at a very high level, “freezing” would involve (1) opening a segregated interest-bearing bank account, in the firm’s name, at a U.S. bank; (2) transferring such SDN investor’s ownership percentage in any liquid assets held by the fund to such account; (3) segregating such SDN investor’s share of any non-liquid assets (such as private securities) held by the fund until such time as they can be transferred to the segregated account (much of this may have to be implemented by “book entries” in the fund’s accounting records); (4) refraining from any and all dealings with the investor absent OFAC authorization, which would include (i) no capital calls, (ii) no distributions (amounts that would otherwise be distributed to the SDN investor must be transferred to the applicable segregated account), (iii) no redemptions or transfers of such SDN investor’s interest in the fund, and (iv) no receipt of management fees or carried interest with respect to the SDN investor’s interest in the fund; and (5) ***filing a blocking report with OFAC within 10 days of such investor becoming an SDN or a Deemed SDN.***

**Strict Liability for Violations:** Civil violations of the Blocking Sanctions are determined on a strict liability basis. There are no general exceptions for passive, non-controlling investments nor for holdings of public equities. Given the difficulty in making Deemed SDN determinations described above, combined with the immediate blocking/freezing requirement and the short 10-day OFAC notice filing requirements, timely compliance may present a challenge for funds that do not have clear knowledge of the backgrounds of all of their investors.

**Determinations as to SDN Status of Investors:** While there is no statutory/regulatory requirement that funds perform OFAC SDN screening in respect

of their investors, as a practical matter, it is the only means of effectively minimizing the risk of dealing with sanctioned parties. OFAC guidance strongly encourages periodic re-screening of counterparties, which includes existing investors. There is no specified frequency of re-screening. The timing and frequency of re-screening a fund's investors should be determined based on a firm's risk profile (e.g. investor type and geography). Failure to conduct an initial screening (and re-screening) of a fund's investors may be treated as an aggravating factor – with the potential for enhanced monetary penalties – in any OFAC enforcement action.

As described above, screening determinations may be difficult to make for Deemed SDN entities. These majority owned entities will not necessarily be listed on existing OFAC SDN databases that are readily searchable by your in-house personnel. The better your investor relations team knows your investor base, the easier it will be to determine your potential compliance burdens for screening.

**Initial Immediate Screening Recommendation:** We recommend that all of our fund clients promptly examine all of their funds' existing investor bases and at a minimum perform a search against the OFAC SDN database. Please note that there are several different website options for running searches, including batch searches, and searches with “fuzzy” logic or a range of filtering options to refine search hits (as well as wider searches for other lists/issues outside the scope of this alert). The search sites run by OFAC and FINRA can be found here: FINRA's OFAC Search Tool, here [CSL Search](#), and [OFAC Sanction Search List](#).

While we believe such a search is a good first step, we recommend that you develop your firm-specific risk assessment program based on the composition of your investor base and then determine how often to re-screen your investors. A fund with only U.S. individuals as investors should generally have a lower level of risk and reduced need for significant additional screening or frequency of re-screening (for example, periodic re-screening may be undertaken to primarily identify an individual fund investor newly added to the SDN List). Funds with global investor bases, through intervening entities, or referred from third party investment advisory firms, have significantly higher risk levels to manage and potential investigatory burdens. Such firms may want to screen more often and engage third party vendors to run more extensive screening on a regular basis.

**Additional Screening Resources:** There are a range of vendors and software available to implement a screening process and to search beyond the names explicitly listed on the OFAC SDN List. These vendors and software can provide more extensive screening data for investors that are not well known to your principals or

investor relations team. We have no doubt that each of these vendors is being inundated with queries currently, so please bear that in mind.

**Screening Service Providers:** These vendors specialize in adverse media reviews (which generally include screening), but will offer the screening as a separate service:

1. Integrity Risk: Justin White [jwhite@integrityriskintl.com](mailto:jwhite@integrityriskintl.com); Dorian Baker [dbaker@integrityriskintl.com](mailto:dbaker@integrityriskintl.com)
2. TDI: Laura Hurley [hurley@tdinternational.com](mailto:hurley@tdinternational.com); Alex Willson [willson@tdinternational.com](mailto:willson@tdinternational.com)
3. Exiger: Sarah Shoemaker [sshoemaker@exiger.com](mailto:sshoemaker@exiger.com); Akane Kokubo [akokubo@exiger.com](mailto:akokubo@exiger.com)

**Software Solutions:** The platforms can provide both manual searching solutions or automated continuous solutions:

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2. Refinitiv WorldCheck
3. DOW Jones Risk & Compliance
4. E2 Open / Amber Road
5. Firco Insight (Accuity)
6. Visual Compliance
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