The Russia (Sanctions) (EU Exit) (Amendment) (No.2) Regulations 2022

Lead department	Foreign, Commonwealth and Development Office
Summary of proposal	The application of financial sanctions, relating to the securities and money-market instruments (SMMI), sovereign debt and correspondent banking and sterling payments, on the Russian Federation.
Submission type	Impact assessment (IA) – 7 March 2022
Legislation type	Secondary legislation
Implementation date	1 March 2022
Policy stage	Final
RPC reference	RPC-FCDO-5166(1)
Opinion type	Formal
Date of issue	1 April 2022

RPC opinion

Rating[1]	**RPC opinion**
Fit for purpose	The RPC welcomes the submission of this IA for independent scrutiny and the engagement with the department to ensure that the assessment is as robust as possible, given the time constraints. We consider the overall analysis to be proportionate and fit for purpose. We identified some methodological issues with the calculation of the EANDCB in the IA, which the department has subsequently addressed with supplementary clarification. We recommend that the department reflects these changes to the estimates in the published IA.

[1] The RPC opinion rating is based only on the robustness of the EANDCB and quality of the SaMBA, as set out in the Better Regulation Framework. RPC ratings are fit for purpose or not fit for purpose.

Business impact target assessment

	Department assessment	RPC validated
Classification	Qualifying regulatory provision[2]	Qualifying regulatory provision
Equivalent annual net direct cost to business (EANDCB)	£7.5 million	£7.5 million *(2019 prices, 2020 pv)*
Business impact target (BIT) score	£37.5 million	£37.5 million
Business net present value	-£64.3 million	
Overall net present value	-£64.3 million	

[2] The published IA noted that the measures included in the IA were a non-qualifying regulatory provision, however, the department has since clarified that it is a qualifying regulatory provision, which the RPC validates.

RPC summary

Category	Quality[3]	RPC comments
EANDCB	**Green**	The EANDCB is fit for purpose. To calculate the impacts of the SMMI measure, the IA uses foregone revenue as a proxy for foregone profit. The department has provided supplementary information to the RPC to support this approach.
Small and micro business assessment (SaMBA)	**Green**	The IA gives a clear justification for why small and micro businesses (SMBs) are not exempt and notes that the measures introduced should not incur further costs to firms' current compliance processes for the existing sanctions regime.
Rationale and options	**Weak**	The IA illustrates the market failures under the status quo. However, this could be improved by discussing the process by which the specific products and/or sectors were targeted for sanctions measures and why/how these achieve the policy objectives. The IA appraises the preferred option against a suitable do-nothing option.
Cost-benefit analysis	**Satisfactory**	The IA deploys a simple cost-benefit analysis to model the quantified impacts. Where it is not possible to monetise, a qualitative assessment of the impacts is provided.
Wider impacts	**Weak**	The IA provides some general conclusions on the wider impacts of the measures on overall UK-Russian bilateral trade. It provides a qualitative assessment of the UK's competitive advantage and identifies the risks of higher compliance costs to business from divergent sanctions regimes across jurisdictions. The analysis would benefit from consideration of competition and consumer impacts as well as the risks of trade diversion and the impacts of retaliatory measures.
Monitoring and evaluation plan	**Satisfactory**	The IA notes the statutory requirement from the Sanctions and Anti-Money Laundering Act 2018 to review the regulations annually. The department could detail how it intends to monitor the realised impacts to business, in addition to reviewing and reporting the regulations' impacts against the intended policy outcomes.

[3] The RPC quality ratings are used to indicate the quality and robustness of the evidence used to support different analytical areas. Please find the definitions of the RPC quality ratings here.

Summary of proposal

Following the Russian assault on Ukraine, the UK government has amended the existing sanctions package against the Russian Federation. The IA considers the following financial measures:

- SMMI: the prohibition on a person connected with Russia, or those acting on their behalf or at their direction, as well as those owned by such persons or those acting on their behalf or at their direction, from raising finance on UK capital markets or receiving of loans or credit arrangements from UK persons.
- Sovereign debt: prohibition on the issuance of Russian sovereign debt in the UK, trading on the secondary market, as well as making loans or credit available to the Russian state.
- Correspondent banking and sterling payments: giving the UK government the legal power to prohibit UK credit or financial institutions from opening or maintaining of correspondent bank accounts with a designated person or from processing a sterling payment to, from or via a designated person.

The IA notes that Russia is the UK's 15th largest export market for financial services, insurance and pensions. The IA anticipates that the measures would have a net present value of -£64.3 million over a 10-year appraisal period.

EANDCB

The RPC has clarified with the department that the impacts of these measures meant that it is a qualifying regulatory provision for the BIT. The estimated EANDCB is £7.5 million, which is derived from the opportunity costs of future profit from SMMI.

The IA sets out that these measures will not cause firms to incur additional familiarisation and training costs as UK businesses are already required to check the existing UK Sanctions List. The analysis would benefit from noting any realised impacts following the precedent in implementing similar sanctions for other jurisdictions. The IA explores the costs of compliance screening software; however, it believes that any new costs are negligible as these are sunk costs and likely to have been incurred prior to the introduction of the measures. However, the IA should explore the legal costs that firms will face when interpreting the measures as well as the impacts on firms complying with changing and/or increased sanctions by the UK government and other jurisdictions.

The IA discusses its approach to calculating the costs to the UK financial markets by considering the capital raised in equity and debt issuances and, therefore, the ancillary fees, over the period of 2015 to 2021. This takes into account the fall in listings of Russian entities, following the introduction of sanctions against Russia in 2014. The department has provided supplementary information from the Bank of England to support the use of fees as a suitable proxy of foregone profit, in order to calculate the EANDCB. The IA would benefit from consideration to any other indirect impacts or knock-on effects on structured debt and related asset-backed securities markets and trading and on UK businesses that may use these financial products to hedge specific risks.

The IA concludes that the impacts of the sovereign debt, particularly in secondary markets, measure are negligible due to low historic volumes. Further, the IA notes there are no direct impacts from the correspondent banking measure as this an enabling power.

The IA discusses the potential costs of non-compliance, such as penalties and fees to business, although it correctly excludes these costs in the calculation of the EANDCB.

SaMBA

The IA gives a clear justification for why it is not possible to exempt SMBs from the measure, noting any exemptions would undermine its effectiveness. The IA notes that the new measures will be implemented through established channels, with which businesses are already familiar, however, it notes that SMBs may still face disproportionately higher familiarisation, compliance and legal costs.

The SaMBA could be improved with additional data or information to help readers to understand the composition of the industry and how many SMBs could be directly affected by the measures.

Rationale and options

The IA notes that there are no appropriate non-governmental or private sector solutions or existing sanctions packages, which provide an adequate level of sanctions to deter Russia. It highlights that a failure to intervene would undermine the UK's reputation as an upholder of international law, human rights, freedom of expression and democracy. The IA summarises the market failure that persists, whereby UK businesses do not have incentives to reduce their economic ties in a coordinated or complete manner as the private benefits to UK businesses do not account for the wider societal costs to Ukraine or of the violations of international law. Noting the possible available choices for applying sanction measures, ranging from a total ban to applying sanctions on specified products or sectors, the IA would benefit from focusing its discussion on the process by which the sectors for sanctions were chosen.

The IA presents the policy objectives and a preferred option. It considers the preferred option against a do-nothing option, whereby the existing sanctions regime is applied against Russia.

Cost-benefit analysis

Given the ever-evolving nature of international developments, the RPC recognises that the IA's cost-benefit analysis is proportionate and that it considers the measures' monetised and un-monetised impacts. The IA outlines the data and methodology used to quantify the impacts, including limitations to the analysis and modelling assumptions. Where the IA has identified insufficient data, it has provided a qualitative assessment of the impacts.

In calculating the quantified impacts of SMMI, the IA applies a simplifying assumption that the issuances and associated fees are spread equally throughout the appraisal period. It analyses high and low scenario impacts based on a range of fees.

Wider impacts

The IA provides an overview of the bilateral trading relationship between Russia and the UK, noting that it is worth £16 billion per year and accounts for 109,000 jobs across the supply chain. It concludes that the measures will reduce economic activity between the UK and Russia, and the financial services, energy and real estate sectors most affected. The IA could include further consideration to any impacts on competition and consumers.

The IA comments on the measures' impact on the UK's competitive advantage with respect to the perceived compliance burden; however, it states that this could be offset by a reputational benefit as a 'clean' place to do business. Given the global importance of the UK's capital markets, the IA should also note the risk of the role of sanctions with respect to the increased politicisation of the free capital market, which may reduce the attractiveness of investing in or via the UK.

In addition, the IA explores how a divergence from US and EU sanctions may have an impact on businesses through increased compliance costs. However, it points to a possible behavioural response whereby businesses set compliance thresholds to match the most stringent sanctions for simplicity, and to reduce risk. The IA should provide further evidence or information to support this argument. The IA could recognise the risk of trade diversion effects and would benefit from considering further scenarios given the uncertainty, especially how the impacts to UK businesses may vary should the UK act unilaterally or in a concerted manner with other economies such as the US and EU.

The IA highlights risks of retaliation by the Russian government when implementing the measures, noting that this may be not symmetric and is currently not quantifiable. The IA could provide further information on the UK's imports of Russian financial services and identify any possible impacts and costs of retaliatory measures occurring or indeed, if Russia sanctions the sale of assets held by UK investors, which may cause a loss in value. Further, the IA could provide consideration of the impacts associated with the possible "chilling effects" if UK firms, including pension funds, choose to divest Russian securities and assets, although currently not required under the measures.

Monitoring and evaluation plan

The IA notes the statutory requirement from the Sanctions and Anti-Money Laundering Act 2018 to review the measures, as part of the wider Russia sanctions regime, to assess whether they are still appropriate for their stated purpose(s), and to lay a report before Parliament.

The IA could detail how the department intends to monitor and evaluate the impacts on business and confirm whether such information will be included in the annual report to Parliament.