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- Presidency progress report

PRESIDENCY PROGRESS REPORT
on the work of the Ad Hoc Working Party on the use of frozen and immobilised assets to support Ukraine's reconstruction during the Swedish Presidency

I. EXECUTIVE SUMMARY

This progress report presents a summary of the discussions taking place at the Ad Hoc Working Party on the use of frozen and immobilised assets to support Ukraine's reconstruction (AHWP) during the Swedish Presidency. In accordance with its mandate and the Presidency's work program, the AHWP discussions have proceeded along four strands: i) gathering of DATA on frozen and immobilized Russian assets, ii) providing an inventory and assessment of OPTIONS for the use of Russian assets in line with EU and international law, iii) performing a detailed analysis of FOCUS OPTIONS and iv) ensuring OUTREACH and international cooperation.

Within its broader mandate, the AHWP has discussed in more detail two options in relation to liquid assets of the Central Bank of Russia (CBR) that are immobilised in the EU. These options relate to i) prudent asset custodianship and ii) windfall contribution in respect of the revenues of financial institutions, such as central securities depositories, where CBR liquid assets are immobilised as a result of EU restrictive measures.

With this report the Presidency intends to inform the Committee of Permanent Representatives (COREPER) of the state of play in the deliberations and to invite COREPER to give guidance on the possible ways forward, including as regards the implementation of one or more options.

II. INTRODUCTION

1. Council and European Council discussions

The work of the AHWP is dictated by the political and financial imperative of supporting Ukraine given the massive scale of the damage caused by the Russian war of aggression, as recognized by the Council and the European Council on numerous occasions.

On 30 November 2022, following an invitation by the European Council of October 2022, the Commission presented an options paper on the use of frozen assets to support Ukraine's reconstruction (ST 15534/22).

On 12 December 2022, the Foreign Affairs Council broadly supported the notion that all avenues should be explored in relation to using frozen Russian assets for the post-war reconstruction of Ukraine.

On 15 December 2022, the European Council took stock of the options to use frozen assets to support Ukraine's reconstruction and for the purposes of reparation. It invited the Commission, the High Representative and the Council to take work forward, in accordance with EU and international law.

On 15 February 2023 the COREPER 2 established the AHWP.

The conclusions of the European Council of 9 February and especially those of 22-23 March 2023 state that that "Together with partners, the European Union will continue to step up work towards the use of Russia's frozen and immobilised assets for Ukraine's reconstruction and for the purposes of reparation, in accordance with EU and international law."

2. The mandate of the AHWP

As a direct response to the call of the European Council, the Swedish Presidency set up the AHWP, under the authority of COREPER, to be responsible for the preparatory work concerning the use of frozen and immobilised Russian assets in line with EU and international law to support Ukraine's reconstruction needs resulting from Russia's aggression against Ukraine. In line with its mandate, the AHWP addresses cross-sectoral subject matters, including legal, financial, economic and political questions related to the feasibility of using frozen and immobilised Russian assets to support Ukraine's reconstruction.

3. An overview of the work of the AHWP

The AHWP has met seven times during the Swedish Presidency (9 and 28 March, 25 April, 10 and 24 May, 7 and 13 of June 2023). The AHWP discussions have proceeded along four strands: i) gathering of DATA on frozen and immobilized Russian assets, ii) providing an inventory and assessment of OPTIONS for the use of Russian assets in line with EU and international law, iii) performing a detailed analysis of FOCUS OPTIONS and iv) ensuring OUTREACH and international cooperation.

The AHWP sees no credible legal avenue allowing for the confiscation of frozen or immobilized assets on the sole basis of these assets being under EU restrictive measures. Thus, AHWP has focused its work on examining the temporary use of liquid CBR assets immobilised as a result of the EU restrictive measures. It discussed legal aspects, especially the rules on State immunity under international law, the right to property under the Charter of Fundamental Rights and the legal basis for undertaking such an action, as well as economic and financial issues.

The Commission updated the group on data, related to the value, ownership (private or state owned), type of assets (such as cash, financial instruments) and location of the frozen and immobilised assets, as well as their currency, maturity and contractual conditions related to the Russian assets frozen and immobilised in the EU, with a focus on the assets of CBR. The Commission also regularly informed the AHWP on its efforts to ensure international coordination, especially with G7 countries, but also with other European partners.

The European Central Bank presented its views on economic, monetary and financial issues related to the use of frozen and immobilised Russian assets.

III. MAPPING OF DATA ON FROZEN AND IMMOBILISED RUSSIAN ASSETS

Following the expiry of the deadline for the first reporting requirements in the 10th package of EU restrictive measures against Russia, the Commission shared with the AHWP the latest data reported by private and public EU operators, with a focus on CBR assets. The most recent information confirmed the initial estimations that CBR assets in the EU amount to above EUR 200 billion, of which more than half are in cash and deposits. Most assets of the CBR are held by central securities depositories who are, as a result of EU restrictive measures, prevented from carrying out transactions related to the immobilised assets, including, in particular, transfers to the CBR. Smaller amounts are held by commercial and Central banks. While a substantial amount of assets has already matured and are therefore currently in cash, a sizeable amount of the remaining assets is in the form of securities, which will gradually transform into cash as they mature in the next 2 to 3 years.

The Commission informed the AHWP of the potential magnitude of revenues if these liquid assets were invested in accordance with a prudent investment strategy, in line with current practice within the CSDs.

IV. OVERVIEW OF DISCUSSIONS ON POSSIBLE OPTIONS FOR THE USE OF FROZEN AND IMMOBILIZED ASSETS

During the AHWP discussions, it was noted that important work is ongoing in other related work streams. Relevant aspects of international law are considered within COJUR, which was kept informed of the work of the AHWP. Work to ensure better coordination of the enforcement of EU sanctions takes place within the 'Freeze and Seize Task Force'. AHWP discussions highlighted that measures could be different for public assets (owned or controlled by listed entities and the CBR and affiliated entities) compared to those that could be possibly envisaged for private assets (owned or controlled by listed persons). With regard to the latter, the Presidency pointed to relevant work on two directives on amending the 2014 directive with a view to strengthening the EU's asset recovery and confiscation rules and reinforcing the powers of Asset Recovery Offices, and on the definition of criminal offences and penalties for the violation of sanctions.

Measures could be further distinguished according to the time horizon for their implementation. The AHWP agreed in its work programme that options that could be applied in the short to medium term could be discussed in view of the European Council in June, followed by proposals by the Commission/High Representative.

Measures, with a longer-term span could be considered by the AHWP for its further work. In this context, the Presidency suggests that consideration should be given in the relevant bodies to the possibility of amending relevant restrictive measures so that lifting of the restrictions on frozen and immobilised assets is linked to the settlement of claims against Russia and compensation of damages by Russia, in line with the G7 leaders Statement on Ukraine from 19 May: "Russia's sovereign assets in our jurisdictions will remain immobilized until Russia pays for the damage it has caused to Ukraine".

V. ANALYSIS OF THE FOCUS OPTIONS: (1) prudent asset custodianship and (2) windfall contribution

In line with the work program, the AHWP has given priority to an in-depth analysis of options with the highest potential of implementation in the short to medium term. Two such options figured prominently in the deliberations. Both options would be based on a CFSP legal basis, focus on revenues from cash and deposits and generate overall similar revenues – currently estimated at around 3 percent per annum.

1. Prudent asset custodianship

i. Description of the measure

Temporary active management, currently referred to as prudent asset custodianship, would have as objective to generate returns on investment that could be used in favour of Ukraine. This could take place in two variants, either on a centralised or decentralised basis. The "centralised model" would entail the temporary transfer of the assets to a central entity, which would carry out investment operations. This model, however, was not pursued beyond the initial discussions. The "decentralised model" would entail imposing an obligation on the current holders of liquid financial assets to re-invest the immobilised cash assets into certain asset groups and to transfer the returns to the EU.

ii. Possible advantages and disadvantages

a) legal considerations

Important legal considerations would have to be taken into account in light of the principle of state immunity before any steps towards the temporary use of immobilised assets of the CBR, including the possibility for prudent custodianship are taken. Due consideration

should be given as well to issues related to the right of property ¹. In the Presidency's assessment, uncertainties and reservations remain in the group in this regard.

b) economic and financial considerations

Investments on cash balances retained by the financial institutions, most notably the CSDs, would be carried out by or on behalf of the Union. Such investments may bring risks related to losses in case of negative returns and should ultimately be supported from the EU. Risks could possibly be mitigated to various degrees, but not completely eliminated. The Presidency's assessment is that the risk of potential losses, although currently considered remote, remains a concern.

2. Windfall contribution

i. Description of the measure

As a result of the EU restrictive measures, financial assets are blocked by the financial institutions, most notably the Central Securities Depositories (CSD), who hold assets of the CBR and who are currently prevented from transferring them to the CBR. By investing liquid assets, entities such as CSDs are generating large windfall profits.

In the windfall contribution option, each entity subject to the windfall contribution holding liabilities related to immobilized CBR assets would be required to transfer to the Union a substantial part of the windfall profits generated by their investments of the extraordinary cash related to the CBR that are thus blocked in their balance sheets.

The windfall contribution option should be able to provide significant revenues to reinforce the financing capacity of the Union. It should thus collect a substantial part of profits generated by entities such as CSDs, discounting a share for covering costs and maintaining incentives. At the same time its design and specific characteristics (such as the applicable rate, temporary scope of application, interaction with domestic taxes due and paid) should take account of the fundamental and systemic role that CSDs play in the financial system: the windfall contribution should therefore not affect the financial stability of the Union, preserve the business model of CSDs and be fair in terms of tax obligations at domestic level.

The question of legal ownership of these assets was in focus during deliberations. Whereas a legal analysis confirmed that the assets in question are not assets of the CBR and that the CBR rather has a *claim* towards the custodians for payment of the amounts contractually due, it was nevertheless felt in the group that further certainty would be needed on the issue of assets ownership, in addition to the need to clarify other matters of a legal or financial nature.

ii. Possible advantages and disadvantages

a) legal considerations

Legally speaking, the Union would under this option not assume the responsibility for the management of these assets, which would considerably reduce the legal risks. At the same time, such risks and questions related to EU and international law are still under discussion.

b) economic and financial considerations

Economically speaking, the option would most probably produce a very similar financial outcome to that of prudent asset custodianship. However, there would be important differences as neither the Union nor any of its international partners should have to assume

¹ See Article 17 of the Charter of Fundamental Rights and Article 1 of Protocol 1 of the European Convention on Human Rights.

the burden of active management as the custodians would maintain their investment policy as they do today. Accordingly, the Union or its Member States should not have to bear the budget responsibility for any possible losses related to asset management.

Since the windfall contribution should not change in any way the ownership of the assets, it would not impact the legal situation of the assets immobilized as a result of EU restrictive measures. Instead, it will only have an impact on the revenues obtained from investing such assets. The option should carry a lower risk of negative market perceptions in comparison with the prudent asset custodianship but might, as was pointed out during the discussions, entail additional risks for the business model of EU custodians.

3. ECB's views on both models

The ECB provided its views from the viewpoint of the international role of the euro and the risks to the international monetary system. As the second reserve currency in the world, the euro brings substantial economic benefits to the euro area. Three factors play a key role in ensuring the international appeal of a currency: liquidity, reliability and predictability. In ECB's view, using interest rate proceeds from immobilized central bank assets may encourage official reserve holders to turn their back on the euro. Both options mentioned in this section might raise risks of undermining the legal and economic foundations on which the international role of the euro depends. The implications could be substantial according to the ECB: it may lead to a diversification of reserves away from euro-denominated assets, increase of financing costs for European sovereigns and lead to trade diversification.

According to the ECB, the options under consideration do not carry such risks to the same degree. Custodianship is an unprecedented move and could be perceived as interference with contractual agreements and with the freedom to invest official reserves. This risk would be lower under the windfall contribution option, but still significant. It should also be considered that such a measure could fragilize European custodians if custodians in other jurisdictions are not subject to comparable measures.

The ECB underlined that international coordination would be a crucial factor in mitigating the risks.

VI. INTERNATIONAL OUTREACH

A key consideration for the approach taken would be the position of other jurisdictions, and by G7 partners in particular. Alignment in the approach would have both political and financial benefits, reducing the potential of first mover disadvantages, as proven by the internationally coordinated application of the initial package of sanctions against Russia.

The Commission has been regularly reporting to the AHWP on its discussions with other countries to explain the EU thinking and seek international coordination.

It has become clear that the EU is by far the jurisdiction where the largest volume of CBR assets is being immobilized. Therefore, it may be understandable that the issue could be a more urgent priority for the EU, compared with other jurisdictions. However, as highlighted in the European Council's conclusions, as well as in subsequent AHWP discussions and in the ECB contribution, it is important that the EU proceeds together with partners. Coordinated decisions with international partners, especially at G7, would be called for in order to mitigate the risks that have been identified. Therefore, the EU should further strengthen coordination with other jurisdictions, including by improving the understanding on the location of most Russian assets held outside of the EU, in line with G7 statements on the need to continue efforts to "fully map holdings of Russia's sovereign assets immobilized" in G7 jurisdictions. The Commission could be called on to step up efforts to promote such coordination, by further explaining to G7 and other international

partners that the EU is exploring options, such as the windfall contribution, which would complement the initial EU restrictive measures with respect to deciding the destination of potential revenues generated as a result of the existing immobilisation measures. As such they should not have any further impact on the CBR assets immobilised in the EU.

VII. CONCLUSION AND NEXT STEPS

The 22-23 March 2023 European Council conclusions requested that the EU “step up work towards the use of Russia’s frozen and immobilised assets for Ukraine’s reconstruction and for the purposes of reparation, in accordance with EU and international law”. In accordance with this request, the AHWP has undertaken an examination of the financial, legal and political consequences of the options currently presented. According to the Presidency’s assessment of those discussions, the AHWP has expressed openness towards continuing working on the windfall contribution option, whilst taking the utmost account and respect of the international monetary system, the international role of the euro, financial stability and the business model of custodians.

The Presidency is of the view that continued discussions would benefit from a more elaborated proposal. The Presidency invites therefore the Commission and the High Representative to consider further steps in this area, taking into account also the possibility to allow for further reflection and consideration on some of the legal and economic issues discussed at the AHWP, and especially as regards the important aspect of ensuring international coordination.

As for further work, it is the view of the Presidency that the AHWP should continue to work in a problem-solving and results-oriented manner, allowing for continued assessment of the feasibility and appropriateness of various options regarding both frozen and immobilized Russian assets. Furthermore, it is the view of the Presidency that future work, in appropriate bodies, should include preparations for linking the lifting of the restrictions on frozen and immobilised assets to the settlement of claims against Russia and compensation of damages by Russia, in line with the G7 leaders Statement on Ukraine from 19 May.

The Presidency submits this report to the COREPER as input for its consideration on the best way forward, considering the discussions at the AHWP, and invites it to advise on the most appropriate course of action.