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Sanctions and Secondary Risks: lessons from Russia, Iran and China

February 2025

Originally aimed at punishing specific nations, sanctions have evolved into a tool for influencing global behaviour, particularly in high-stakes countries like Russia, China and Iran. With the increasing complications of international trade and finance, sanctions have, for some time, not been limited to direct penalties on the targeted countries; they now extend to businesses, their principals and financial institutions operating within, or engaging with, these jurisdictions.

The rise of secondary sanctions has been a key development. These sanctions penalise third-party businesses (often multinational corporations) that maintain relationships with sanctioned entities. Companies in Europe or Asia that continue to engage with Russian and Iranian firms (which have had sweeping financials restrictions applied) risk exclusion from Western markets and financial systems. China, on the other hand, has only faced sanctions applied to it that target those areas critical to national security and technology. Secondary sanctions have, therefore, expanded the reach of economic pressure, making it harder for businesses to navigate the increasingly fragmented global marketplace, although some still do try.

Several key questions arise from this growing trend. Why are secondary sanctions expanding, and how do they alter the nature of business operating within sanctioned jurisdictions? What impact do these secondary penalties have on global trade and corporate strategy? These questions form the basis for understanding the strategic risks and opportunities business must consider when engaging in regions facing heavy sanctions.

Sanctions are employed for various reasons, typically linked to geopolitical objectives, national security concerns and the protection of human rights.

Russia: economic and financial penalties were first imposed on Russia following its annexation of Crimea in 2014. Since then, several more serious sanctions packages have been applied, primarily due to the invasion of Ukraine, aiming to cripple the Russian economy and reduce its ability to finance military actions. The sanctions are designed to target key sectors like energy, finance and defence, while also limiting Russian access to critical technologies and capital markets.

Iran: sanctions against Iran are driven by concerns over its nuclear program (China also complies with these sanctions against Iran), as well as its human rights record and destabilising movements in the Middle East. These measures aim to pressure Iran to curb its nuclear ambitions and to limit its involvement in regional conflicts, including support for militant groups like Hezbollah, Hamas and the Houthi rebels.

China: targeted sanctions against China focus on issues related to human rights, particularly in Xinjiang, and its practices involving technology transfer and intellectual property (IP) theft. Additionally, geopolitical tensions, particularly regarding Taiwan and China's stance in the South China Sea, have driven sanctions aimed at curtailing its growing global influence.

Key stakeholders

Governments imposing sanctions: major actors include the US Treasury's Office of Foreign Assets Control (OFAC), the European Union (EU) and the UK, each using sanctions to align with foreign policy goals and pressure enemy states into compliance.

Financial institutions enforcing compliance: banks and other financial entities play an important role in governing sanctions by monitoring transactions and blocking access to the global financial system.

Multinational corporations: businesses must assess and mitigate risk associated with operating in, or engaging with, sanctioned jurisdictions. Non-compliance can result in severe financial penalties, loss of market access and reputational damage, making risk management a key part of strategic decision-making.

As secondary sanctions expand, business with ties to Russia, Iran and China face increasing challenges. In Russia, secondary sanctions have primarily targeted the energy sector, notably oil and gas exports. Western financial institutions and multinational corporations that continue to engage with Russian entities, risk exclusion from global financial systems and potential penalties from the US OFAC. Despite these pressures, Russian companies have found workarounds, such as leveraging alternative currencies like the Chinese yuan and cryptocurrencies, though these solutions are fraught with risk related to volatility and limited acceptance.

Iran, long subject to comprehensive sanctions, faces a similar issue. Secondary sanctions on Iranian entities (especially in the oil and gas sectors) have made it difficult for business to maintain relationships with Iranian companies without exposing themselves to Western financial isolation. In response, Iran has increasingly relied on informal trade networks and partnerships with countries like China and Russia, as well as other BRICS members. However, these adaptations often come at the cost of transparency and heightened legal and financial risk, making compliance a tough task for business.

China, the world's second-largest economy, is also under increasing scrutiny, especially in the technology and semiconductor sectors. Sanctions imposed by the US and EU have sought to restrict China's access to advanced technologies, critical to its manufacturing and innovation capacity. In retaliation, China has ramped up its efforts to develop domestic technologies and alternative supply chains. The long-term effectiveness of these self-sufficiency strategies remained uncertain until China's recent, highly publicised release of the Deep Seek AI engine. Deep Seek AI is impressive, despite using older chip technology compared to the advanced processors utilised by OpenAI and ChatGPT because of its innovative approach to optimising performance and efficiency.

By leveraging specialised algorithms and enhanced architectures tailored to its hardware, Deep Seek AI developers have achieved the same comparative processing performance and accuracy as Open AI's Chat GPT 4o, without the reliance on cutting-edge chips. This highlights China's ability to innovate within the constraints of existing technologies, making the system more cost-effective and sustainable in the long term.

Businesses operating in China must carefully navigate these evolving regulatory changes, balancing the risk of secondary sanctions with the country's vast market potential.

The expanding risk of secondary sanctions - case studies

The expanding scope of secondary sanctions has led to notable instances where business has faced substantial repercussions for their associations with sanctioned entities.

On 23 August 2024, the US announced a new round of sanctions, targeting 95 companies from third-party countries. Nearly half of these firms (45 in total) were based in China, with additional entities from the UAE (15 companies) and Turkey (12 companies).

Secondary sanctions, which accounted for 72 of the 95 cases, were primarily issued for supplying Russia with electronics, industrial goods and equipment. Transport and logistics companies faced penalties in 7 cases for facilitating deliveries to Russia. Six companies were sanctioned for engaging in transactions involving Russian-origin precious metals.

Four companies were targeted for supplying materials, including drones, to Russia's military-industrial sector. A further 3 firms faced sanctions for providing consulting and communication services to sanctioned Russian entities. The measures also included penalties against 2 companies involved in liquefied natural gas transactions and equipment deliveries for gas liquefaction. Lastly, 1 company was sanctioned for operations within Russia's mining sector.

In August 2024, the US OFAC imposed sanctions on several subsidiaries of Russia's Nornickel, a major mining company, due to their involvement in sectors supporting Russia's military activities. This action forced Nornickel to reassess its international partnerships and supply chains to avoid further penalties.

In January this year, the Financial Times reported a significant rise in demand for sanctions compliance advice, highlighting the complexities financial institutions encounter in abiding by these restrictions.

"*ETF* (exchange-traded fund) *issuers need to stay on top of securities sanctioned in their jurisdiction, but also in the jurisdictions of the investors they intend to target for the instrument*", said Bodmer, senior product manager at SIX Financial Information. "*With sanctions, to some extent, you have to try to predict the future*", said Sara Nordin, partner at law firm White & Case.

This surge underscores the importance of strong compliance frameworks to prevent inadvertent violations that could lead to severe financial and reputational damage.

Conclusion

As secondary sanctions widen their reach, businesses operating in, or engaging with, Russia, Iran and China face mounting risk that demand proactive and well-informed thinking. Recent sanctions developments, such as the August 2024 measures, targeting third-country entities, indicate the rapid expansion of extraterritorial enforcement and the growing exposure for companies across sectors. The cases involving Nornickel and the 72 secondary sanctions cases in August 2024, reiterate the severe consequences of non-compliance, from supply chain disruption to financial penalties and reputational harm.

Foot note: it should be noted that much of the references to US sanctions on Russia could potentially become obsolete over the next month, as part of the negotiated peace deal over Ukraine. Despite the obvious load protest, if these sanctions are removed, it is unlikely that the EU and UK would be in a position to maintain them for long. That said, until such a deal is confirmed, all the above still stands.