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Sanctions as an Investment Risk

In the last two decades, the United States has dramatically increased its use of international economic and financial sanctions to stop or deter behaviors at odds with US national security or foreign policy. [The Treasury Department has estimated that the US had such sanctions on over 9,400 individuals, entities, and countries as of 2021, and that number has surely grown since then.](#)

In the new Trump administration, it appears that tariffs and other trade measures may be the preferred tools of power, but we still think US investors should keep an eye on the risks they face if their stock or bond holdings become subject to sanctions by the US or some other country. In this report, we describe the key types of sanctions, identify which sanctions may be most problematic for US investors, and discuss the challenges in predicting whether sanctions might be imposed against a particular country, entity, or individual. To wrap up, we provide a sample tool to keep track of sanctions risks and discuss the implications for investment strategy.

Types of Sanctions

Multiple US laws give Congress and the executive branch the power to impose coercive economic and financial measures against foreign countries, entities, and individuals to stop or change behaviors at odds with US national security interests or foreign policy. These are commonly referred

to as “sanctions.” However, there is no common, widely accepted definition of the term. Some US actions may be considered sanctions, while others may not. In this report, we focus on a fairly broad group of economic and financial sanctions. We do not address actions such as prohibiting some foreigners from entering the US, restricting certain imports or exports, or cutting off diplomatic relations with a foreign country. With regard to economic and financial sanctions, we discuss their various types to help investors understand what they need to watch out for. (Note: We are not lawyers, so our overview here should not be taken as a precise, comprehensive discussion of US sanctions law.)

Comprehensive vs. Targeted. One way to categorize a sanction is by how broadly it is applied. A **comprehensive** sanction is applied to an entire foreign country. [For example, the US maintains comprehensive sanctions barring US citizens, entities in the US, and other entities subject to US jurisdiction \(“US persons”\) from virtually all transactions with the countries, citizens, or residents of Iran, Cuba, North Korea, and Russia-controlled parts of Crimea.](#) The US also maintains **targeted** sanctions that bar US persons from transactions with specific foreign entities, individuals, or activities. Targeted sanctions are often referred to as “list based,” since the targeted entities or activities only become subject to the sanction when they are put on a special list. The most important “entity” list is kept by the Treasury Department’s Office of Foreign Asset Control.

Primary vs. Secondary. Another distinction is whether a sanction aims to stop or deter the behavior of US entities or non-US entities. A **primary** sanction generally imposes criminal or civil liability on US persons for transacting with sanctioned foreign entities. In contrast, a **secondary** sanction aims to stop or deter specified transactions between non-US persons, even if those transactions occur outside the US and have no direct connection with the US. The penalty for violating a secondary sanction is generally to deny the non-US person from certain privileges related to the US, such as access to the US financial system. The US maintains secondary sanctions of this type targeting Russia, Iran, Syria, and North Korea (see Table 1).

Table 1

Selected Countries Under US Sanctions

Source: Norton Rose Fulbright, June 2022

Primary	Secondary
US persons face criminal or civil liability for transactions with:	Non-US persons lose access to US financial system, risk being put on "entity list," etc. for certain transactions with:
Iran	Russia
Syria	Iran
Cuba	Syria
North Korea	North Korea
Rus. Crimea	Hong Kong
Afghanistan	
Belarus	
Burma	
China	
Iraq	
Lebanon	
Libya	
Mali	
Nicaragua	
Russia	
Somalia	
Venezuela	
Yemen	
Zimbabwe	

Note: Bolded names indicate countries for which virtually all transactions are barred. For non-bolded countries, only selected transactions are barred.

Key Sanctions for US Investors

The discussion above should make it clear that US persons or companies could potentially run afoul of all kinds of sanctions imposed by the federal government. For example, even the selected countries that Table 1 shows as subject to primary sanctions are quite numerous. Of those, only five countries are subject to wide restrictions covering virtually all transactions. For the other countries, a US person or firm could easily lose track of what transactions are or are not prohibited and accidentally violate the sanction. At the very least, US persons or firms considering transactions with these countries may incur significant legal expenses to manage their compliance risk. We suspect that this has had a chilling effect on US persons or companies considering transactions with such countries.

For countries subject to secondary sanctions, the legal and financial risks are arguably even higher. Non-US persons or firms trying to deal with these countries would not only shoulder high compliance costs to reduce legal risks, but an error could potentially have devastating effects. Given that the US dollar is the world's reserve currency, and the US financial system is at the heart of the global economy, non-US persons or firms that accidentally violate these sanctions could suddenly find themselves unable to transact with the US or other non-sanctioned companies. They might also lose the ability to transact with assets they hold in the US. If the violating non-US person or firm is placed on the US "entity list," it could be further paralyzed.

The aggressive and complex nature of the US's comprehensive sanctions helps explain why the US sanctions on Russia for its 2022 invasion of Ukraine have been relatively successful. The sanctions certainly have had loopholes, and nefarious actors from Russia

and elsewhere have developed tactics to get around the sanctions. Nevertheless, the US has been able to dramatically reduce specifically targeted interactions with Russia by demonstrating its willingness to cut violators out of the US financial system and/or freeze their assets. We think the US freeze on Russia's reserve assets is a key reason why many global central banks have sharply increased their purchases of gold since 2022. Gold may be less susceptible to US asset freezes, so some central bank chiefs have boosted their purchases, helping to drive gold prices to record levels.

We presume the US's targeted, list-based sanctions have been similarly successful. As noted above, these sanctions can prohibit US or non-US persons from transacting with specific companies, subsidiaries, or even facilities and individuals. By specifically naming targeted entities, these sanctions provide a bright-line indication of persons or companies to avoid. However, a US or non-US person could find themselves at risk if they are dealing with a company that is suddenly and unexpectedly placed on an entity list. For example, the US regularly places more Chinese firms on its list of sanctioned companies serving that country's military.

In sum, there are many ways in which investors could potentially face risks from the US sanctions regime. They could own stocks or bonds issued by a US firm that violates a primary sanction and becomes subject to criminal or civil liability. They could be invested in a non-US firm that violates a secondary sanction and finds itself locked out of the US financial system. Perhaps most severely, they could own stocks or bonds of countries that suddenly become subject to comprehensive sanctions or companies that suddenly become subject to targeted sanctions. In those cases, if the

investor can't sell, he or she might be forced to hold the asset on their books, potentially at a value of \$0.

Challenges in Predicting Sanctions

One key question is whether and how an investor could gauge the risk of suddenly being impacted by a change in US sanctions policy. Below we lay out a simple rubric to help an investor think about any particular investment's sanctions risk.

Top-Down Geopolitical Analysis. As noted above, there are a couple dozen foreign countries subject to comprehensive sanctions by the US, but over 9,400 companies or individuals subject to targeted, list-based sanctions. A review of the targeted sanctions shows that they can be extremely specific, which suggests they are often based on secret intelligence not available to the public. Therefore, investors might find it very difficult to predict which of a country's many specific entities could suddenly be hit with targeted sanctions. We think it would be more fruitful for investors to first prioritize understanding which countries or groups of countries are most at risk of being sanctioned. Once those countries are identified, investors should focus on which economic sectors of an at-risk country might be targeted. Only at that point, within the most at-risk countries and sectors, should the investor try to gauge the most at-risk companies.

- As growing US isolationism and tensions with China fracture the world into relatively separate geopolitical and economic blocs, [Confluence has developed a method to predict the membership of the US bloc, the China bloc, and the several blocs in between.](#) Since the US and China blocs are increasingly at odds with each other, we think the first step in gauging sanctions risk should be to consult our *bloc*

analysis (see Appendix). Top countries in the China bloc (such as China itself, Russia, Iran, North Korea, and Venezuela) are often at odds with US national security or foreign policy, and the US government is very public about those disputes. But other countries in the China bloc also are at risk of angering the US, if only because they support China politically. In general, membership in the China bloc is probably a yellow flag that the country and its companies are at heightened risk of US sanctions.

- Even if a country is not in the China bloc, US policymakers could be angry with its leaders or policies. The next step in the risk-assessment process is to monitor and gauge press reports on *major international disputes* involving the US. If a country is increasingly at odds with the US, it and its companies are at heightened risk of sanctions.
- Of course, US disputes with other countries are usually specific to certain issues, such as a worsening military balance of power, potential military aggression, technology theft, trade barriers, etc. If a country is at heightened risk of US sanctions, then companies in specific sectors will be especially at risk. As we noted above, for example, the US has sanctions on Chinese firms supporting the People's Liberation Army or producing surveillance equipment. Adversarial countries highly reliant on a particular economic sector might also find that sector targeted merely because it is a source of leverage for the US (Venezuela's oil sector is probably one example). Therefore, investors should be especially concerned about investing in the most *controversial or important sectors of adversarial countries*. Other

sectors, such as utilities, may be much less at risk.

Direct vs. Indirect Exposure. Finally, investments in particular companies can be directly or indirectly at risk of sanctions. In our view, companies organized, owned, headquartered, or primarily active in an adversarial country are more likely to be hit with US sanctions. In contrast, US leaders are likely to be less concerned about companies or entities that merely deal with sanctioned countries or companies. For example, firms that simply sell non-controversial goods to a US adversary may be relatively less at risk.

Scoring Sanctions Risks: An Example

Putting it all together, we think an investor could develop a simple scoring rubric to keep track of the sanction issues outlined above. Table 2 (next page) provides an example of such a rubric. In this example, the investor would calculate a sanctions risk score for each stock held in the portfolio or being considered for inclusion. Risk scores would be higher for the stocks of companies that are: a) connected with the China bloc, b) connected with a country in dispute with the US, and c) connected with an economic sector at issue in the dispute. For each risk dimension, the subscore would be higher if the firm is directly involved, e.g., organized or headquartered in a China-bloc country. The subscore would be lower if the firm is only indirectly involved, e.g., it merely sells to the China-bloc country. Finally, the investor might want to categorize the investments depending on their total sanctions-risk score. In the example, stocks with a total sanctions-risk score of 5 or more might be considered high risk. In that case, the investor might establish procedures to closely monitor US relations with the stock's country and sector and be ready to jettison the holding if the relations worsen.

Table 2
A Sample Scoring Rubric for Sanctions Risk

	Home Country in China Bloc?	Home Country in Dispute w/ US?	Sector Involved in US Dispute?	Sanctions Risk Score
Stock A	2	2	2	6
Stock B	2	2	1	5
Stock C	2	1	1	4
Stock D	0	2	1	3
Stock E	0	1	1	2
Stock F	0	1	0	1

Note: Score of 2 applied for direct relationships (firm is organized in a China-bloc country, in a sector involved in a dispute, etc.). Score of 1 applied for indirect relationships (firm only sells to a China-bloc country, in a sector peripheral to a dispute, etc.).

To provide a sense of how the sample scoring rubric could work, let's assume that Stock A represents a surveillance-equipment firm organized, owned, headquartered, and focused on mainland China. Since China leads the China bloc and is in many sharp disputes with the US, and since those disputes often revolve around China's military and surveillance industries, Stock A gets a subscore of 2 for each sanctions-risk dimension, for a total of 6. Meanwhile, let's say Stock B is also a Chinese firm, but it merely produces common filters that may or may not go into military vehicles. Stock B's sector is relatively less at risk of sanctions, so its total score is 5.

At the other extreme, Stock D might represent a pharmaceutical company that is organized, owned, headquartered, and focused on a country outside the China bloc, but its home country is nevertheless in a sharp dispute with the US over drug trafficking. It therefore scores 2 on the second risk dimension. Since the firm produces chemicals that are sometimes used to make illicit drugs, it scores 1 on the third dimension. The stock's total score is 3, indicating much less risk than Stock A or Stock B, but still enough to be concerning.

Investment Implications

To reiterate, the risk rubric above is merely an example of a tool that investors could use to systematically assess whether their investments are at risk of US sanctions. As noted above, investors can't entirely eliminate the risk of a holding being suddenly hit with sanctions, given that US sanctions often appear to be driven by special intelligence that is unavailable to the public. Some sanctions can easily show up "out of the blue."

Going forward, we think investors should assume that stocks or bonds issued by firms organized, headquartered, and/or heavily active in countries of the China bloc are generally at heightened risk of US sanctions. Stocks or bonds issued by firms associated with specific countries in sharp dispute with the US are probably at even more risk. Firms would be at maximum risk if they are also in disputed sectors, such as defense industry, surveillance, advanced computer chips, artificial intelligence, electric vehicles, or batteries. Investors don't necessarily need to avoid or immediately sell investments at heightened sanctions risk, but they may want to earmark them and their home country for closer monitoring. In these cases, investors should pay close attention to incoming geopolitical news and assessments of the geopolitical environment, such as those we provide in our [Daily Comment](#) and [Bi-Weekly Geopolitical Report](#).

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CIM's Global Geopolitical and Economic Blocs, 2024

Sources: IMF, UN International Trade Centre, etc.

US Bloc		US-Leaning		Neutral		China-Leaning		China Bloc	
Country	GDP (Bil. \$)	Country	GDP (Bil. \$)	Country	GDP (Bil. \$)	Country	GDP (Bil. \$)	Country	GDP (Bil. \$)
United States	27,357.8	Argentina	654.9	Brazil	2,173.7	India	3,572.1	China (incl HK, Macao)	18,086.1
Germany	4,457.4	Thailand	514.9	United Arab Emirates	504.2	Indonesia	1,371.2	Russia	1,997.0
Japan	4,212.9	Bangladesh	446.3	Vietnam	433.7	Saudi Arabia	1,067.6	Iran	403.5
United Kingdom	3,344.7	Malaysia	415.6	Algeria	244.7	Nigeria	374.9	Pakistan	338.2
France	3,031.8	Egypt	393.9	Ukraine	177.2	Venezuela	97.1	Kazakhstan	260.5
Italy	2,255.5	South Africa	377.7	Ethiopia	159.7	Côte d'Ivoire	80.0	Iraq	254.4
Canada	2,140.1	Peru	267.6	Kenya	108.9	Azerbaijan	76.6	Kuwait	161.8
Mexico	1,788.9	Qatar	234.2	Tanzania	79.4	Congo, Dem. Rep.	67.3	Ecuador	120.2
Australia	1,741.9	Oman	109.1	Serbia	75.2	Zimbabwe	32.2	Angola	94.4
Korea	1,712.8	Ghana	76.3	Tunisia	51.3	Zambia	28.4	Uzbekistan	90.9
Spain	1,581.2	Libya	45.0	Cambodia	41.9	Sudan	25.7	Turkmenistan	77.1
Netherlands	1,117.1	Nepal	41.0	Bosnia and Herzegov.	27.2	Mozambique	21.4	Belarus	71.8
Turkey	1,108.5	El Salvador	34.0	Benin	19.4	Mali	20.7	Myanmar	64.5
Switzerland	885.1	Senegal	31.4	West Bank and Gaza	18.6	Burkina Faso	20.4	Cameroon	49.0
Poland	808.4	Georgia	30.5	Yemen	18.4	Mongolia	19.9	Bolivia	46.5
Taiwan	756.6	Trinidad and Tobago	28.1	Moldova	17.1	Kyrgyz Republic	12.8	Papua New Guinea	31.0
Belgium	630.1	Botswana	20.4	Guyana	17.1	Togo	9.1	Armenia	24.2
Sweden	593.3	Madagascar	15.8	Rwanda	14.0	Djibouti	4.0	Guinea	23.0
Ireland	545.8	Mauritius	14.4	Namibia	12.3	Solomon Islands	1.6	Gabon	20.5
Austria	519.7	Malawi	13.1	Somalia	11.7	Comoros	1.3	Chad	17.5
Israel	509.5	Montenegro	7.4	Mauritania	10.5	Afghanistan	NA	Niger	16.5
Singapore	501.4	Liberia	4.4	Kosovo	10.5			Lao P.D.R.	15.2
Norway	485.5	Andorra	3.7	South Sudan	7.3			Brunei Darussalam	15.1
Philippines	436.6	Guinea-Bissau	2.0	Maldives	6.7			Congo, Republic of	14.4
Denmark	405.2	San Marino	2.0	Burundi	4.2			Tajikistan	11.9
Colombia	363.6	Samoa	0.9	Cabo Verde	2.5			Equatorial Guinea	10.3
Romania	345.9	Dominica	0.7	St. Lucia	2.5			Sierra Leone	3.9
Chile	335.7	São Tomé and Príncipe	0.7	Gambia	2.4			Suriname	3.8
Czech Republic	332.0	Kiribati	0.3	Lesotho	2.2			Bhutan	2.9
Finland	300.5	Tuvalu	0.1	Seychelles	2.2			Central African Republ	2.6
Portugal	287.4			Antigua and Barbuda	2.0			Timor-Leste	2.3
New Zealand	249.0			Grenada	1.3			Eritrea	NA
Greece	238.3			Vanuatu	1.2			Cuba	NA
Hungary	212.6			St. Kitts and Nevis	1.1			North Korea	NA
Morocco	144.0			St. Vincent and Gren.	1.0				
Slovak Republic	132.1			Palau	0.3				
Dominican Republic	120.0			Nauru	0.2				
Guatemala	102.0			Lebanon	NA				
Bulgaria	101.6			Sri Lanka	NA				
Costa Rica	86.5			Syria	NA				
Luxembourg	85.8								
Panama	83.4								
Croatia	82.0								
Lithuania	77.9								
Uruguay	77.2								
Slovenia	68.2								
Uganda	51.8								
Jordan	51.0								
Bahrain	44.7								
Paraguay	43.9								
Latvia	43.6								
Estonia	40.8								
Honduras	34.9								
Cyprus	32.2								
Iceland	31.0								
Albania	22.7								
Haiti	21.5								
Malta	21.0								
Jamaica	18.9								
Nicaragua	17.4								
North Macedonia	14.8								
Bahamas	13.8								
Barbados	6.4								
Fiji	5.5								
Eswatini	4.9								
Aruba	3.9								
Belize	3.1								
Tonga	0.5								
Micronesia	0.5								
Marshall Islands	0.3								

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