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US Ratchets up Economic Sanctions Targeting Iran's Central Bank and Its Crude Oil Exports

On New Year's Eve, President Obama signed the annual defense authorization bill. Buried deep within this massive legislation were new restrictive sanctions against Iran's financial structure. These new sanctions not only seek to ban Iran's central bank from the US financial system but also seek to force anyone (including the central banks of other foreign countries) to choose between maintaining ties with the US financial system or doing business with Iran.

What's Critical

- New sanctions target the payment mechanism for Iranian crude oil sales, which account for a substantial portion of the Government of Iran's revenue.
- New sanctions further expand the use of anti-money laundering tools against Iran to designate the Islamic Republic of Iran a jurisdiction of primary money laundering concern.
- The financial sector of Iran has also been designated as a primary money laundering concern.
- New sanctions authorize a blanket freeze of *all* assets of *all* Iranian financial institutions in the United States as opposed to the previous sanctions program, which froze all assets of Iranian financial institutions listed on the SDN List.
- New sanctions prohibit US banks from maintaining correspondent accounts for any foreign financial institution deemed to have knowingly conducted or facilitated any significant financial transaction with the Central Bank of Iran.
- The President of the United States is given substantial flexibility and discretion in implementing the sanctions against foreign financial institutions.

Introduction

This latest action against Iran is another step in a long chain of sanctions by the US Department of the Treasury against Iranian financial institutions.[1] These measures also expand US foreign policy tools used to isolate Iran from US and international financial institutions by labeling Iran as a jurisdiction of primary money laundering concern. After many years of imposing sanctions that skirted around Iran's exportation of crude oil, the broad discretions and exceptions reserved to the President in this legislation suggest these new sanctions are likely the first stage of a multilateral and multinational effort by the United States, the European Union, and others to finally address Iran's crude oil sales.

Background

In November 2011, the International Atomic Energy Agency (the "IAEA"), the nuclear watchdog of the United Nations, released a report entitled *Implementation of the NPT Safeguards Agreement and Relevant Provisions of Security Council Resolutions in the Islamic Republic of Iran* in which the IAEA stated that it had serious concerns regarding possible military dimensions to Iran's nuclear program. The information available to the IAEA indicated that Iran has carried out activities relevant to the development of a nuclear explosive device, including amongst other things, (i) the acquisition of nuclear material, (ii) the development of fast-acting detonator technology, (iii) the conducting of feasibility studies relating to the integration of a nuclear device into a missile delivery vehicle, and (iv) preparatory experimentation for the testing of a nuclear device.

Although the trigger for the recent round of US economic sanctions was the IAEA report, since 2007 the US Treasury Department and, US foreign policy in general, has been cracking down on what were perceived to be the deceptive practices of Iranian banks seeking to circumvent US economic sanctions.[2] Those measures reflected the United States' growing uneasiness towards Iran for its lack of anti-money laundering and counter-terrorist financing laws. Since at least the passage of the Iran and Libya Sanctions Act in 1996, there has been a Congressional effort to present foreign oil companies with a simple choice: do business with Iran or do business with the United States. This latest round of US sanctions legislations takes this admonishment a step further and applies it more broadly to companies and entities generally doing business with the Central Bank of Iran, which is the facilitator of the payment stream for the sale of Iranian crude oil.

[1] See our client publication released February 2008 entitled *US Treasury Warns Financial Institutions of "Deceptive Practices" by Iranian Banks.*

[2] See US *Government Action has Implications for Non-US Banks* published in the February 2008 issue of e-finance & Payments Law & Policy; *Non-US Banks Are Target of Recent Economic Actions by US Government* published in the May 2008 issue of The Banking Law Journal, and *Iranian Banks Are Target of Recent Economic Actions by Enforcement Bodies* published in Volume 27, Number 12 of the December 2008 issued of Banking & Financial Services Policy Report.

In October 2007, OFAC first announced that it had added Iran's largest bank, Bank Melli, to the SDN List for its alleged connections to the proliferation of weapons of mass destruction. At the same time, OFAC took similar action against Bank Mellat, which allegedly supported Iran's nuclear programs. By adding these banks and several others to the SDN List in the last few years, OFAC has effectively prohibited all US persons (including US branches of non-US banks) from conducting any business with Iranian banks on the SDN List. Those measures were a direct result of both the private banking and correspondent banking sectors being previously identified by Congressional bodies as weak links in the US financial system.

To address these concerns, the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 ("the Act"), which constituted Title III of the USA PATRIOT Act, was enacted. The Act requires every US financial institution to implement an anti-money laundering compliance program. The Act also expanded due diligence and record keeping obligations and specifically granted the Secretary of the Treasury additional authority to implement certain special measures if the Secretary determines that reasonable grounds exist to find that there is a primary money laundering concern. These special measures include:

- maintaining transaction records or filing reports concerning the transactions that track the identity and address of each participant in the transaction, including the originator of the funds transfer and the ultimate beneficial owner;
- obtaining and retaining information concerning the beneficial ownership of any account opened or maintained in the United States by a non-US person; and
- identifying each customer of a foreign financial institution who is permitted to use, or whose transactions are routed through, a US "payable-through account" or a correspondent account, and gathering the same information that would be gathered for any domestic customer in the ordinary course of business.

The Act further provided that, if the Secretary of the Treasury determined that a correspondent account or payable-through account held by or on behalf of a foreign financial institution would involve any of the elements of primary money laundering concern, then the opening or maintaining of such accounts may be prohibited or otherwise restricted. The designation of a non-US financial institution as a primary money laundering concern can have very serious consequences.

Although US economic sanctions against Iran already prohibit almost all imports and exports between the United States and Iran, prior US sanctions against Iran have been directed at specific aspects of Iran's economy, in particular Iran's nuclear program, its production and importation of refined petroleum products, and Iran's Revolutionary Guard Corps.[3] Previous sanctions, however, always stopped short of targeting Iran's exportation of crude oil, which was valued at US $85 billion in 2010. These new sanctions bring to bear on Iran additional pressures associated with being labeled a primary money laundering concern in the attempt to cripple the Government of Iran's oil revenues.

[3] For full coverage of US sanctions targeting Iranian banks please see our client publications entitled *Global Compliance Risks Increase with Expanded International Sanctions Against Iran* and *New US Economic Sanctions Create Risks for Non-US Financial Institutions* released in July 2010 and September 2010 respectively.

The New US Legislation

Title XII, Section 1245 of the National Defense Authorization Act for Fiscal Year 2012 ("Sec. 1245") imposes further sanctions with respect to the financial sector of Iran. The legislation's aim is to create a serious chilling effect on the willingness of any financial institution anywhere in the world to continue to do business with Iran. The activities that are made sanctionable by Sec. 1245 supplement those activities that are already sanctionable under the Iran Sanctions Act, as amended by the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010.

Designates Iran as a Jurisdiction of Primary Money Laundering Concern

The Financial Crimes Enforcement Network of the Department of the Treasury in its notice of finding, pursuant to Title III of the Patriot Act, on November 21, 2011 identified Iran as a jurisdiction of primary money laundering concern. This designation was based on a growing body of public information about (i) Iran's banking sector's illicit and deceptive conduct designed to facilitate the Iranian government's support for terrorism and (ii) its pursuit of nuclear and ballistic missile capabilities and Iran's use of government agencies and state-owned or controlled financial institutions to effect said goals. This designation is effective immediately.

Authorizes the Freezing of All Assets of Iranian Financial Institutions

Section 1245 requires that the President, pursuant to the International Emergency Economic Powers Act, block and prohibit all transactions in all property and interests in property of an Iranian financial institution, if such property and interests in property are in the United States, come within the United States, or come into the possession of a US person. Although the statute does not automatically freeze all Iranian bank assets in the United States, as a practical matter, it mandates that the President enact regulations that effectuate the freezing of all Iranian assets within the United States. Thus, it is likely that in the very near future the President will be issuing an executive order or regulation blocking such Iranian property in the United States or within the possession of a US person.

Imposition of Sanctions Against the Entire Iranian Banking Sector and the Central Bank of Iran

Pursuant to Sec. 1245, the financial sector of Iran, including the Central Bank of Iran, has also been designated a primary money laundering concern by the US Secretary of the Treasury pursuant to Section 5318A of Title 31 of the United States Code. Such designation was made because of the threat to the US government and US financial institutions resulting from the illicit activities of the Government of Iran, including its pursuit of nuclear weapons, support for international terrorism, and efforts to deceive responsible financial institutions and evade economic sanctions. This designation is effective immediately.

Further, sixty days after Sec. 1245's enactment, *i.e.*, March 1, 2012, financial institutions are prohibited from opening or maintaining in the United States correspondent or payable-through accounts if the President determines that the financial institution has knowingly conducted or facilitated any significant transaction with the Central Bank of Iran or another Iranian financial institution designated by the Secretary of the Treasury for the imposition of sanctions. Application of this sanction is likely to occur only after a careful investigation and warning to the financial institution that such a determination is being considered. The President may also impose sanctions with respect to any dealings with the Central Bank of Iran except as it relates to the sale of food, medicine, or medical devices to Iran.

Imposition of Sanctions with Respect to Foreign Central Banks

As it relates to foreign central banks, sanctions will be imposed against a foreign financial institution owned or controlled by the government of a foreign country for the sale or purchase of petroleum or petroleum products to or from Iran conducted 180 days after the date of enactment, *i.e.*, June 29, 2012. Even after June 29th, these sanctions are likely to be imposed only after a careful investigation, the submission of the necessary report(s) to Congress, and the issuance of a warning to the financial institution that such a determination is being considered.

President Given Broad Discretion

The new sanctions confer broad discretionary powers to the President to determine whether non-Iranian oil supply is sufficient. Sixty days after enactment, *i.e.*, March 1, 2012, and every sixty days thereafter the Administrator of the Energy Information Administration is required to submit to Congress a report detailing the availability and price of petroleum and petroleum products in places outside of Iran. Ninety days after enactment, *i.e.*, March 31, 2012, and every 180 days thereafter the President is required to make a determination based on the reports referenced above whether the price and supply of petroleum and petroleum products produced in countries other than Iran is sufficient to allow purchasers of Iranian petroleum and petroleum products to reduce significantly in volume their purchases from Iran. In other words, the President is given the discretion not to impose sanctions against purchasers of Iranian petroleum or petroleum products based on his determination of the availability of alternative suppliers, and that the country with primary jurisdiction over the foreign financial institution has "significantly reduced" (without elaboration) its volume of crude oil purchases from Iran.

Further, the President may even waive the imposition of sanctions for a period of not more than 120 days, and may renew that waiver for indefinite periods thereafter if he determines that such waiver is in the national security interest of the United States. Given the broad flexibility and discretion reserved to the President, the only sanctions that are automatically enacted are the two that designate Iran as a jurisdiction of primary money laundering concern and the financial sector of Iran as a primary money laundering concern.

Sanctions Are Designed as a Multilateral Diplomacy Initiative

Given the broad discretion conferred to the President and the timing of this legislation, it is clearly intended to be implemented as a multilateral and multinational diplomacy initiative amongst the US and EU allies to dissuade countries from purchasing oil from Iran. These sanctions, when combined with other measures being proposed or implemented by other countries, are designed to cripple Iran's oil revenues in the hope that Iran will be stifled in its attempts to acquire items that could contribute to its conventional, nuclear, chemical, or biological weapons programs.

Further, as noted by the President in his signing statement, to the extent that Sec. 1245 would interfere with his constitutional authority to conduct foreign relations by directing the Executive branch to take certain positions in negotiations or discussions with foreign governments, he will treat this provision as "non-binding." While the President's signing statement does not specify any particular subsection, and is generally directed at Sec. 1245, the language used in the signing statement seems to be particularly applicable to Sec. 1245(e), which states that: "The President shall carry out an initiative of multilateral diplomacy to persuade countries purchasing oil from Iran (i) to limit the use by Iran of revenue from purchases of oil . . . and (ii) to prohibit purchases by Iran of dual-use technology." Given the international developments and the issuance of the sanctions noted below, it seems that multilateral diplomacy with broad Presidential flexibility to impose these sanctions is an intended purpose of these sanctions.

EU, UK, and Canadian Sanctions

The European Union, the United Kingdom, and Canada also have imposed or are in the process of imposing additional sanctions against Iran as well.

EU Sanctions

As of the time of this publication, European Union countries continue to move closer to an agreement on an embargo on Iranian oil. A final decision, however, is not expected to occur before the end of January. Any oil embargo is likely to be carried out in stages to avoid major disruptions in global supplies. Still, the measure by some of Iran's most significant crude oil purchasers underscores the international sanctions community's firm assessment that swift and drastic action is mandated in response to the IAEA report that Iran is continuing its uranium enrichment and nuclear weapons programs.

UK Sanctions

The HM Treasury has also imposed new financial restrictions against Iran because of the risk of terrorist financing or money laundering activities. These new restrictions are embodied in the Financial Restrictions (Iran) Order 2011 (the "Order"), which came into force at 3:00 PM on November 21, 2011. The HM Treasury has also published a Notice which provides an explanation of the restrictions, and the Order should be read in conjunction with this Notice.

The Order prohibits "relevant persons" (defined as "persons operating in the financial sector") from (i) entering into, or (ii) continuing to participate in, any transaction or business relationship with certain Iranian financial institutions. As a result of the Order, "relevant persons" must effectively end all existing professional and commercial relationships and cease business transactions with Iranian financial institutions.

Canadian Sanctions

Although Canada has yet to officially release its revamped sanctions against Iran, it has publicly stated that it will be imposing further sanctions under its Special Economic Measures Act ("SEMA") that will target "virtually all transactions with Iran." The new sanctions will (i) prohibit the provision of financial services to or from Iran of any person in Iran, (ii) expand the list of prohibited goods to include all goods used in the petrochemical, oil, and gas industry in Iran, (iii) amend the list of prohibited goods to include additional items that could be used in Iran's nuclear program, and (iv) add the known leadership of the Iranian Revolutionary Guard and other entities to the list of designated persons found in Schedule 1 of the SEMA regulations.

Asian Trip by US Secretary of the Treasury

On a related note, the Secretary of the Treasury, Timothy Geithner, is traveling to Beijing, China and Tokyo, Japan for meetings on January 10-12 with senior government officials to discuss the state of the global economy, policies to strengthen global growth, and other economic issues of mutual importance. Secretary Geithner will also discuss continued coordination with international partners in the region to increase pressure on the Government of Iran, including financial measures targeting the Central Bank of Iran. China, which is Iran's top purchaser of crude oil, has voiced strong opposition to US sanctions against Iran, and its Foreign Ministry spokesman, Hong Lei, has stated that China opposes one country placing its domestic law above international law and imposing unilateral sanctions on other countries.

Conclusions

The Obama Administration appears to be willing to use a widening array of US foreign policy tools to apply pressure on Iran to abide by the terms of the Treaty on the Non-Proliferation of Nuclear Weapons, of which Iran is a signatory. The broad discretion reserved for the President by these sanctions, and his signing statement suggesting that the Executive has even wider leeway to implement these sanctions, make the future difficult to predict. One thing that seems certain, however, is that the international community is collaborating to implement a multilateral and multinational sanctions framework against Iran.

The recent measures taken by the international community against Iran and its financial institutions demonstrate the manner in which financial laws aimed at curtailing terrorism, money laundering, and other international crimes are used to implement foreign policy objectives. Such measures affect not only financial institutions with a presence in the United States or the European Union but also those institutions located elsewhere that engage in transactions with US or EU financial institutions. These actions further demonstrate the extraterritorial reach of US laws and regulations, which can carry significant consequences for non-US banks operating internationally.

We will be following development in this area closely.

If you wish to receive more information on the topics covered in this publication, you may contact your regular Shearman & Sterling contact person or any of the following:

Stephen Fishbein
New York
+1.212.848.4424
sfishbein@shearman.com

Bradley K. Sabel
New York
+1.212.848.8410
bsabel@shearman.com

Philip Urofsky
Washington, DC
+1.202.508.8060
philip.urofsky@shearman.com

Richard Kelly
London
+44.20.7655.5788
richard.kelly@shearman.com

Danforth Newcomb
New York
+1.212.848.4184
dnewcomb@shearman.com