

## Treasury Department Releases New Iran Financial Sanctions Regulations Targeting Foreign Financial Institutions

On August 16, 2010, the Treasury Department's Office of Foreign Assets Control (OFAC) issued new Iranian Financial Sanctions Regulations (IFSR) to implement provisions of the recently enacted Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISADA) that impose severe sanctions on foreign financial institutions that engage in financial transactions with certain Iranian entities. Although the new regulations primarily track the statutory provisions, they provide important additional guidance regarding which transactions with proscribed Iranian entities may be considered "significant transactions" that would trigger the imposition of sanctions. The Treasury Department may prohibit or severely restrict foreign financial institutions that "knowingly" violate the statute or regulations from participating in the US banking system.

The new regulations were not expected to be issued until late September, and their early issuance will require affected financial institutions to accelerate adoption of compliance plans. Foreign financial institutions will need to exercise extreme caution in their transactions with Iranian entities to avoid violating the IFSR and should maintain robust due diligence programs.

### Sanctions on Foreign Financial Institutions

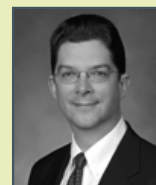
The new regulations implement Section 104(c) of CISADA, which prohibits foreign financial institutions from knowingly engaging in transactions—in any location and in any currency—that:

1. facilitate the efforts of the Government of Iran (including efforts of Iran's Islamic Revolutionary Guard Corps or any of its agents or affiliates) to (i) acquire or develop weapons of mass destruction or delivery systems for weapons of mass destruction or (ii) provide support for entities designated by the State Department as Foreign Terrorist Organizations or support for acts of international terrorism;
2. facilitate the activities of a person subject to financial sanctions pursuant to UN Security Council resolutions that impose sanctions with respect to Iran;
3. constitute money laundering to support activities (1)–(2) above;

### Contacts



**John B. Bellinger III**  
+1 202.942.6599



**John P. Barker**  
+1 202.942.5328



**Alan Avery**  
+1 212.715.1056



**Samuel M. Witten**  
+1 202.942.6115

4. facilitate efforts by the Central Bank of Iran, or any other Iranian financial institution, to support activities (1)–(2) above; or
5. facilitate a “significant transaction” or provide “significant financial services” to the Iranian Islamic Revolutionary Guard, its agents or affiliates that are on the Specially Designated Nationals List (SDN List), or any other financial institution whose assets have been blocked for activities related to Iran’s proliferation of weapons of mass destruction or support for international terrorism.

See 31 C.F.R. § 561.201(a).

### **Key Definitions: “Foreign Financial Institution,” “Knowingly” and “Significant”**

The new regulations define “foreign financial institutions” very broadly as including not only banks but a wide variety of international financial institutions. A “foreign financial institution” means any foreign entity that is engaged in the business of accepting deposits, making, granting, transferring, holding, brokering loans or credit, or purchasing or selling foreign exchange, securities, commodity futures or options, or procuring purchasers and sellers thereof, as principal or agent. See 31 C.F.R. § 561.308. Examples of “foreign financial institutions” include banks, other depository institutions, securities and commodity futures brokers and dealers, investment companies, and other similar institutions. Branches of foreign financial institutions located in the US are considered “US financial institutions,” not foreign financial institutions, and are subject to the separate restrictions for US financial institutions discussed below. See 31 C.F.R. § 561.309.

The regulations specify that a foreign financial institution will be subject to sanctions only if it *knowingly* engages in a prohibited transaction, which means the foreign financial institution either has actual knowledge, or should have known, of the conduct, circumstance, or result of the conduct. See 31 C.F.R. § 561.314(a). Given this standard, as in many other sanctions regimes, one important means of avoiding violations is to maintain a robust compliance program that

includes detailed due diligence into transactions, including reviewing the parties to a transaction, the beneficiaries of the transaction, and the purpose of the transaction. A strong compliance program will make it more difficult for the US Government to conclude that a violation of the regulations was conducted “knowingly,” and could also serve as an important mitigating factor in any disclosure of potential violations an institution makes to OFAC.

Many potential violations stem from the “facilitation” of certain conduct relating to Iran, its WMD program, its support for terrorism, or support for the Iranian Islamic Revolutionary Guard. The regulations provide several examples of actions that constitute facilitation, including providing currency, financial instruments, or securities; buying and selling; swapping; financing; approving; or guaranteeing. See 31 C.F.R. § 561.403. Section 561.403 further states that providing personnel or software, technology, or goods of any kind constitutes “facilitation” under the regulations. The section also prohibits providing “other services of any kind,” a phrase that could be interpreted broadly by Treasury to cover virtually any other service a financial institution might provide its customers.

The regulations require sanctions for “significant transactions” or the provision of “significant financial services” to the Iranian Revolutionary Guard and other entities blocked for reasons related to weapons proliferation or terrorism activities. OFAC identifies in these regulations factors it will take into account in deciding whether a transaction is “significant” including the size of the transaction(s); the number and frequency of the transactions; the nature of the transaction, including the type and complexity of the transaction(s) and its purpose; the extent of management involvement in the transaction; the proximity or “nexus” of the parties to the transaction with a blocked person appearing on the SDN List; the effect of the transaction on Iran’s ability to obtain weapons of mass destruction or commit acts of international terrorism; any effort to conceal the transaction; and other factors that OFAC may consider on a case-by-case basis.

## Possible Sanctions on Foreign Financial Institutions

The Treasury Department may subject foreign financial institutions to severe sanctions for engaging in the prohibited transactions described above. See 31 C.F.R. §§ 561.201(b) and (c). The most serious sanction would be to prohibit US financial institutions from opening or maintaining a correspondent account or a payable-through account in the United States. For a financial institution performing dollar transactions, the imposition of this sanction would be extremely disruptive.

Treasury can also impose one or more other restrictions that are very serious but not necessarily as disruptive as the outright prohibition on correspondent and payable-through accounts. These include:

- (1) prohibiting trade finance through the foreign financial institutions' correspondent accounts or payable-through accounts in the United States;
- (2) restricting the types of transactions a foreign financial institution may process through its correspondent accounts or payable-through accounts in the United States to certain limited types of transactions, such as personal remittances;
- (3) placing monetary limits on the transactions a foreign financial institution may process through its correspondent accounts or payable-through accounts in the United States; or
- (4) requiring US financial institutions to pre-approve all transactions a foreign financial institution may process through its correspondent accounts or payable-through accounts in those US financial institutions.

See 31 C.F.R. § 561.201(b).

Once Treasury determines that a foreign financial institution has violated Section 104(c) of CISADA, as implemented in 31 C.F.R. § 561.201(a), US financial institutions are prohibited from opening or maintaining a correspondent account or a payable-through account, unless Treasury has imposed one or more of the sanctions in 31 C.F.R. § 561.201(b).

Sanctions on a foreign financial institution's US accounts are effective when US financial institutions have actual or constructive notice of the sanctions imposed on the foreign financial institution. See 31 C.F.R. § 561.301. In this respect, OFAC could take the position that constructive notice could come, for example, from an announcement in the Federal Register, public OFAC press releases, or the listing of the foreign financial institutions on OFAC's Specially Designated Nationals and Blocked Persons List as the result of Treasury's designation under 31 C.F.R. § 561.201(a). US financial institutions have a ten-day grace period after the effective date of sanctions on a foreign financial institution in which they may engage in or allow transactions only for closing the foreign financial institution's account or transferring the funds out of the United States. See 31 C.F.R. § 561.504. US or foreign financial institutions may seek a specific license from OFAC to conduct transactions after the ten-day grace period expires. There is, however, no guarantee that OFAC would grant a specific license other than for transactions to close the US accounts of a foreign financial institution sanctioned under the IFSR.

## Sanctions on Persons Owned or Controlled by US Financial Institutions

The IFSR focus primarily on foreign financial institutions, but also include important restrictions on US financial institutions. The IFSR prohibit any person "owned or controlled" by a US financial institution from knowingly engaging in any transaction with or benefitting the Iranian Islamic Revolutionary Guard or any of its agents or affiliates whose property or interest in property are blocked pursuant to the International Emergency Economic Powers Act (IEEPA). See 31 C.F.R. § 561.202. Those entities are named on the SDN List with an "[IRGC]" next to their entry.

The IFSR do not define the term "owned or controlled," but the term could be interpreted to include branch offices of US financial institutions or subsidiaries owned by US financial institutions. Note that these sanctions apply to any "person," not just financial institutions, and can include any individual or entity "owned or controlled" by a US financial institution.

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If a person owned or controlled by a US financial institution violates the prohibition on transactions with the Iranian Islamic Revolutionary Guard and related entities, the parent US financial institution is subject to civil penalties under the IEEPA, 50 U.S.C. § 1705(b). The maximum civil penalty under IEEPA is US\$250,000 or twice the value of the transaction that violated the sanctions. See 31 C.F.R. § 561.701(a). Willful violations of the IFSR may result in criminal penalties, which can include a fine of up to US\$1 million and 20 years of imprisonment for individuals violating the sanctions. See 31 C.F.R. § 561.701(b).

Because the standard for a violation is that the person owned or controlled by the US financial institution must “knowingly” engage in prohibited transactions, strong, detailed, well-implemented compliance plans can help prevent violations and mitigate penalties should a violation occur. Also, foreign financial institutions must remain aware that their branch offices in the United States are considered “US financial institutions” under the IFSR. See 31 C.F.R. § 561.309. Foreign financial institutions’ branch offices outside the United States are not considered US financial institutions. *Id.*

## Conclusion

The enactment of CISADA has already affected businesses in the petroleum and other industries, leading a number of them to curtail or eliminate altogether their business with Iran. Now that the Treasury Department has issued the IFSR to implement CISADA’s provisions relating to foreign financial institutions, these institutions must exercise extreme caution in their transactions to avoid violating the IFSR. Foreign financial institutions should employ detailed due diligence in their transactions to avoid sanctions violations.

For additional details about CISADA and the impact of the US’s new Iran sanctions on the oil industry and refined petroleum products, please see Arnold & Porter’s recent advisory entitled New Iran Sanctions Targeting Oil Industry and International Banking Institutions, available at [http://www.arnoldporter.com/resources/documents/Advisory-New\\_Iran\\_Sanctions\\_Targeting\\_Oil\\_Industry\\_and\\_International\\_Banking\\_Institutions\\_07010-1.pdf](http://www.arnoldporter.com/resources/documents/Advisory-New_Iran_Sanctions_Targeting_Oil_Industry_and_International_Banking_Institutions_07010-1.pdf).

*We hope that you have found this advisory useful. If you have any questions, please contact your Arnold & Porter attorney or:*

**John B. Bellinger III**

+1 202.942.6599  
John.Bellinger@aporter.com

**John P. Barker**

+1 202.942.5328  
John.Barker@aporter.com

**Alan Avery**

+1 212.715.1056  
Alan.Avery@aporter.com

**Samuel M. Witten**

+1 202.942.6115  
Samuel.Witten@aporter.com

**Michael E. Ginsberg**

+1 202.942.5585  
Michael.Ginsberg@aporter.com

**Nicholas L. Townsend**

+1 202.942.5249  
Nicholas.Townsend@aporter.com

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