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INTERNATIONAL BANKING

Expert Analysis

Squeezing Iran—Banks Are Caught in the Middle

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In recent months, the U.S. government has stepped up its attempts to isolate Iran from any access to the U.S. financial system. Most direct access generally has been prohibited under economic sanctions that have been in place since 1979.

On Oct. 11, 2011, the Federal Register published a final rule, issued by the Financial Crimes Enforcement Network (FinCEN), the U.S. Treasury Department's anti-money laundering agency, that implements section 104 of the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISADA).[1] The section prohibits or restricts banks in the United States, including U.S. offices of non-U.S. banks, from maintaining correspondent accounts for non-U.S. banks that may be engaged in activity that benefits the government of Iran, Iran's Revolutionary Guard Corps (IRGC) or any of its agents or affiliates that are subject to U.S. economic sanctions imposed under the International Emergency Economic Powers Act (IEEPA).[2] CISADA also requires that those banks more closely monitor transaction activity by the non-U.S. bank through its U.S. correspondent account.

On Nov. 21, 2011, the Treasury Department announced additional sanctions against Iran, based on its determination that the country of Iran itself was a jurisdiction of "primary money laundering concern" under section 311(a) of the USA Patriot Act,[3] and proposed the imposition of additional prohibitions on U.S. banks on the maintenance of correspondent accounts for any Iranian-affiliated bank not already subject to IEEPA sanctions and apply enhanced due diligence regarding its correspondent accounts with non-U.S. banks to ensure that transactions flowing through those correspondent accounts are not indirectly benefiting an Iranian-affiliated bank.[4]

Finally, on Dec. 31, 2011, President Barrack Obama signed the National Defense Authorization Act for Fiscal Year 2012 (NDAA), which imposes yet more sanctions against Iran, including, potentially, a prohibition on access by Iran's central bank to the U.S. financial system.[5]

This month's column will discuss these new measures. Unless otherwise specified, use of the term "U.S. bank" in this column also includes the U.S. offices of non-U.S. banks.

Background

For more than 30 years, there have been economic sanctions imposed against Iran. Today, U.S. banks generally are prohibited from doing business with any Iranian financial institution, subject to certain exceptions.[6]

CISADA was signed into law on July 1, 2010, and imposed additional sanctions on Iran. Section 104(c) requires that the Treasury Secretary prohibit or restrict the opening or maintenance by a U.S. bank of a correspondent or payable-through account[7] for a non-U.S. bank if that non-U.S. bank "knowingly": (1) facilitates Iranian government, including IRGC, efforts to acquire weapons of mass destruction (WMD) or to support international terrorism; (2) engages in dealings with Iranian persons subject to United Nations Security Council economic sanctions; (3) engages in money laundering or facilitates the efforts of the Central Bank of Iran to aid Iran's WMD programs, support Iran's sponsorship of terrorism, or support persons under those UN sanctions; or (4) conducts significant business with the IRGC, its affiliates, or other financial institutions that are subject to the Iranian IEEPA sanctions.

> Recent measures emphasize the U.S. government's expectation that non-U.S. banks should cut their ties with any Iranian-linked institutions.

Section 104(e) directs the Treasury Secretary to require a U.S. bank maintaining a correspondent account or payable-through account in the United States for a non-U.S. bank to do one or more of the following: (1) audit the activities carried out by the non-U.S. bank through its correspondent account, (2) submit reports to the Treasury Department regarding those transactions specified in section 104, (3) certify that the non-U.S. bank is not knowingly engaging in any transactions specified in section 104, and/or (4) establish due diligence policies designed to detect whether the non-U.S. bank has engaged in transactions specified in section 104. The Treasury Secretary may waive such prohibitions for purposes of the U.S. "national interest."

A Notice of Proposed Rulemaking was published in the Federal Register on May 2, 2011,[8] proposing that at the request of FinCEN, a U.S. bank that maintains a correspondent account for a specific non-U.S. bank identified by FinCEN in its request must ask that non-U.S. bank, and report to FinCEN, whether the non-U.S. bank maintains a correspondent account for, or has processed one or more transfers of funds within the preceding 90 calendar days other than through a correspondent account related to, any Iranian financial institution subject to IEEPA sanctions or related to the IRGC or any of its agents or affiliates subject to IEEPA sanctions (collectively, the "covered funds transfers"). The U.S. bank also must report to FinCEN if, within 365 days of its original response to the U.S. bank regarding FinCEN's request for information, the non-U.S. bank informs the U.S. bank that it has established a new correspondent account for an Iranian-linked financial institution subject to IEEPA sanctions. A proposed model certification form for reporting the responses to FinCEN also was issued for comment.

The comment period ended on June 1, 2011. On Oct. 11, 2011, a final rule was published in the Federal Register, effective that day, that contained few substantive changes from the proposed rule.[9] Among the more substantive changes made in the final rule in response to the comments were the following:

- Added an option for U.S. banks to report instances in which they have not received a response from the non-U.S. bank; this was in response to comments raising concerns that some non-U.S. banks may not respond due to home country privacy laws.
- Clarified that a transfer of funds "related to" an Iranian-linked financial institution subject to IEEPA sanctions means a transfer that is "for or on behalf of, directly or indirectly" such Iranian-linked financial institution.
- Clarified the language regarding reporting to FinCEN when a U.S. bank could not make a determination as to whether one of its non-U.S. bank correspondents maintained a correspondent account for an Iranian-linked financial institution, or had processed a covered funds transfer.
- Revised the required filing deadline from 30 days to 45 calendar days.
- Added the requirement that if the U.S. bank

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receives the requested information only after the 45 calendar day deadline has passed, it must submit the information to FinCEN within 10 calendar days of receiving the information.

Corresponding changes were made to the model certification form. The form has not been reprinted in the Code of Federal Regulations but is available on the FinCEN website.[10]

Section 311 of Patriot Act

The "Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA Patriot Act), was signed into law on Oct. 26, 2001, shortly after the terrorist attacks of Sept. 11, 2001.[11] Title III of the act strengthened various anti-money laundering laws and added new tools for the Treasury Secretary to use to combat terrorism. Section 311(a) of the act grants the Treasury Secretary the authority to designate a particular non-U.S. jurisdiction, financial institution, class of transactions, or type of account to be of "primary money laundering concern," and, based on that determination, require U.S. banks to take certain "special measures" regarding that particular non-U.S. jurisdiction, financial institution, class of transactions, or type of account (collectively, a "Section 311 designee").[12]

These "special measures" include (i) requiring enhanced reporting and recordkeeping concerning transactions or relationships with respect to a Section 311 designee, (ii) requiring additional steps to be taken to obtain and retain information concerning the beneficial ownership of any account opened or maintained in the United States by a non-U.S. person that involves a Section 311 designee; (iii) requiring that a U.S. bank opening or maintaining a payable-through account or correspondent account in the United States for a non-U.S. bank involving a Section 311 designee identify each customer of the non-U.S. bank who will be permitted to use, or have transactions routed through, such accounts; and (iv) in consultation with the Secretary of State, the Attorney General, and the chairman of the Federal Reserve Board, prohibiting, or imposing conditions upon, the opening or maintaining in the United States by any U.S. bank of a correspondent account or payable-through account for or on behalf of a non-U.S. bank, if such correspondent account or payable-through account involves any Section 311 designee.

On Nov. 25, 2011, the Director of FinCEN, as the delegate of the Treasury Secretary, published in the Federal Register his determination that the country of Iran was a jurisdiction of "primary money laundering concern," based on the belief that Iran directly supports terrorism, is developing nuclear/ballistic missile and other WMD capabilities, and "uses deceptive financial practices to facilitate illicit conduct and evade sanctions."[13] As a result, FinCEN noted, there is a risk that financial institutions may unknowingly be facilitating Iran's illicit activities.

Based on that determination, on Nov. 28, 2011, FinCEN issued a Notice of Proposed Rulemaking (NPRM) proposing that U.S. banks and certain other financial institutions located in the United States ("covered financial institutions") be required to review their account records and terminate any correspondent account for or on behalf of an Iranian banking institution (including the Central Bank of Iran) that had not been blocked previously under IEEPA sanctions and not establish any such accounts.[14]

In addition, a covered financial institution would be required to perform special due diligence on its correspondent accounts maintained for non-U.S. banks that is "reasonably designed to guard against their improper indirect use by Iranian banking institutions." If the covered financial institution knows, or has reason to know, that one or more of its correspondents provides services to Iranian banking institutions, the special due diligence requirement, at a minimum, requires the covered financial institution to notify those correspondents that they may not provide Iranian banking institutions with access to the correspondent account maintained at the covered financial institution. In addition, the covered financial institution must take "reasonable steps" to identify any indirect use of its correspondent accounts by Iranian banking institutions, to the extent that such indirect use can be determined from transactional records maintained in the covered financial institution's normal course of business.

A covered financial institution must utilize a risk-based approach when deciding what, if any, additional due diligence it should utilize to defend itself against indirect use of its non-U.S. bank correspondent accounts by Iranian banking institutions, other than what already is specified in the proposed rule.

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Should a covered financial institution obtain knowledge that a correspondent account is being used by a non-U.S. bank to provide indirect access to an Iranian banking institution, it must take "all appropriate steps" to prevent such indirect access, including notification to the non-U.S. bank correspondent account holder and, where necessary, terminating such correspondent account, except to the extent that such indirect access to the correspondent accounts is necessary to conduct transactions involving Iranian banking institutions that are not otherwise subject to U.S. sanctions against Iran.

Comments are due by Jan. 27, 2012.

Defense Authorization Act

Obviously not wanting to wait for the FinCEN rulemaking process to conclude with respect to imposition of new sanctions under section 311 of the USA Patriot Act, in the NDAA (National Defense Authorization Act), Congress added section 1245, which requires that the President (i) must prohibit a U.S. bank from opening a correspondent account for, and prohibit or impose strict conditions on the continued maintenance of a current correspondent account for, a non-U.S. bank "that the President determines has knowingly conducted or facilitated any significant financial transaction with the Central Bank of Iran or another Iranian financial institution" subject to economic sanctions under IEEPA, and (ii) may impose sanctions under IEEPA with respect to the Central Bank of Iran.

These directives are subject to certain limited exceptions, such as applying the sanctions to the central and government-controlled banks of countries other than Iran only if those countries engage in, or otherwise facilitate, the purchase or sale of oil or oil products to or from Iran, on or after June 28, 2012.[15]

After that date, the President must impose those sanctions with respect to financial transactions for oil or oil products if the President determines that there is a sufficient supply of such commodities elsewhere in the world that can be used to reduce the transactions they otherwise would have with Iran. The President may waive the imposition of sanctions for up to120 days at a time, subject to renewal if the President determines that a waiver is in the U.S.'s national security interests.

In signing the NDAA, the President issued a signing statement[16] objecting to certain parts of the bill, including section 1245 because it and certain other sections would interfere with his constitutional authority to conduct foreign relations and stated that if the application of section 1245 or any of the other sections he cites conflict with his authority, the President will treat those sections as non-binding. The President, presumably through the Secretary of the Treasury, has until Feb. 29, 2012, to implement these mandatory sanctions provisions.[17]

Conclusion

Taken together, these recent measures emphasize the U.S. government's expectation that non-U.S. banks should cut their ties with any Iranian-linked institutions. Other jurisdictions, such as the European Union, are considering imposing similar requirements. As a practical matter, the costs to a non-U.S. bank of being cut off from the U.S. financial system or other major financial market should far outweigh any benefit that bank may gain from continuing to engage in transactions with entities associated with a country subject to international sanctions.

1. Pub. L. 111-195, July 1, 2010.
2. 50 U.S.C. 1701 et seq.
3. Pub. L. 107-56, 115 Stat. 298, Oct. 26, 2001; section 311(a) is codified at 31 U.S.C. §5318A.
4. http://www.treasury.gov/press-center/press-releases/Pages/tg1367.aspx.
5. H.R. 1540, Dec. 31, 2001, Pub. L. 112—, 125 Stat.—.
6. See 31 C.F.R. Parts 535, 560, 561 and 562.
7. The statute uses the term "financial institution" which includes banking organizations, securities broker dealers, insurance company, currency exchange, and investment banker and investment company.
8. 76 Fed. Reg. 24410, May 2, 2011.
9. 76 Fed. Reg. 62607, Oct. 11, 2011.
10. www.fincen.gov.
11. Pub. L. 107-56, Oct. 26, 2001.
12. 31 U.S.C. §5318A.
13. 76 Fed. Reg. 72756, Nov. 25, 2011.
14. 76 Fed. Reg. 72878, Nov. 28, 2011.
15. The legislation makes this provision effective "on or after that date that is 180 days after the date of the enactment of this Act."
16. http://www.whitehouse.gov/the-press-office/2011/12/31/statement-president-hr-1540.
17. The legislation makes this provision effective "on or after that date that is 60 days after the date of the enactment of this Act."