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US Executive Order and Implementing Regulations Impose New Extraterritorial Sanctions on Iran's Financial Sector with Important Implications For Non-US Companies

On February 27, 2012, the US Treasury Department published revisions to the Iranian Financial Sanctions Regulations (IFSR) (31 C.F.R. pt. 561) to implement the sanctions specified in section 1245 of the National Defense Authorization Act for Fiscal Year 2012 (NDAA), which the president signed into law on December 31, 2011. (*See* Iranian Financial Sanctions, 77 Fed. Reg. 11724 (Feb. 27, 2012).) Section 1245 of the NDAA required the president to impose sanctions on non-US financial institutions engaged in transactions with the Central Bank of Iran (CBI) and other designated Iranian banks. Under these new sanctions, non-US banks risk losing access to the US financial system if they continue doing business with Iranian banks, even if the transactions in question are not US dollar-denominated.

The release of the NDAA revisions to the IFSR is the latest in a series of actions the US government has taken to escalate the scope and reach of US economic sanctions on Iran in an effort to pressure Iran's leadership into ending the country's nuclear program. On February 5, 2012, the president issued Executive Order 13599, imposing new sanctions on all Iranian financial institutions, including the CBI, that require US banks and other US persons to block (i.e., seize) all property of such Iranian banks. Executive Order 13599 effectively excludes all Iranian banks from the US financial system.

These recent actions and the Executive Order President Obama signed in November 2011 expanding the Iran Sanctions Act's extraterritorial sanctions exemplify the consensus between Congress and the executive branch regarding the need to increase pressure on Iran to end its nuclear program, by forcing non-US banks to choose between doing business with Iran or doing business with the US The new revisions to the IFSR and the sanctions of Executive Order 13599 may affect a broad range of non-US, non-Iranian companies doing business with Iran.

Imposition of Sanctions on Foreign Financial Institutions Outside the US Under Section 1245 of the NDAA

The Treasury Department's IFSR revisions released February 27, 2012, implement the NDAA section 1245 sanctions applicable to non-US financial institutions. These sanctions

Contacts

John P. Barker
+1 202.942.5328

John B. Bellinger III
+1 202.942.6599

Baruch Weiss
+1 202.942.6819

Samuel M. Witten
+1 202.942.6115

are designed to further isolate Iranian financial institutions from the US banking system by prohibiting non-US financial institutions that do business with CBI and other designated Iranian financial institutions from maintaining correspondent accounts in the US. Unlike past US sanctions on Iran that primarily relate to nuclear weapons, terrorism, or petroleum, these new NDAA sanctions could impact a broad range of Iran-related financial transactions outside the United States, such as the sale of consumer goods to Iran or the purchase of crude oil from Iran.

Sanctions Imposed on Private Foreign Financial Institutions for Transactions with CBI and Designated Iranian Banks. Beginning February 29, 2012, under the NDAA and IFSR Sections 561.203(a) and (d), the US government may impose sanctions on privately owned "foreign financial institutions" that have knowingly conducted or facilitated a "significant" financial transaction with CBI or other Iranian financial institutions designated by the Treasury Secretary from opening or maintaining correspondent accounts or payable-through accounts in the US. (*See also* NDAA § 1245(d)(1)(A).) Section 10 of E.O. 13599 authorized the Secretary of the Treasury to carry out these sanctions. Designated Iranian financial institutions will appear on the Specially Designated Nationals List (SDN List), denoted with the symbol "[NDAA]" at the end of the list entry. (*See* Note 2 to 31 C.F.R. § 561.203(a).) Foreign financial institutions that the Treasury Department sanctions under this provision will appear on a new "Part 561 List" that will appear on the Treasury Department's Office of Foreign Assets Control (OFAC) website and be published in the Federal Register. (*See* 77 Fed. Reg. at 11725; Note 1 to 31 C.F.R. § 561.203(a).)

The NDAA does not define what constitutes a "significant" financial transaction with a designated Iranian financial institution. However, the revised IFSR provide guidance regarding what factors OFAC will consider in determining whether a transaction is a "significant financial transaction." Specifically, the IFSR apply the same standards in determining whether a transaction is a "significant financial transaction" under the NDAA sanctions as they do in determining whether a transaction is significant under the sanctions imposed by the Comprehensive Iran Sanctions, Accountability, and Divestment Act (CISADA). (*See* 31 C.F.R. § 561.404 (preamble).)

Section 561.404 of the IFSR lists seven factors OFAC considers in determining whether a transaction is "significant." These factors are: (1) the size, number, and frequency of transactions or financial services performed; (2) the nature of the transaction(s) or financial services performed; (3) the level of awareness and involvement of management and whether the transaction is part of a pattern of conduct; (4) the nexus between the party to the transaction or transactions or the provider of the financial services and a blocked person; (5) the effect of the transaction or financial services on the sanctions' objectives; (6) whether the transaction or financial services involve an attempt to obscure or conceal the actual parties or true nature of the transaction or financial services; (7) the extent of the involvement of CBI in the transaction; and (8) any other factors that OFAC deems relevant, on a case-by-case basis.

If a foreign financial institution for which a US financial institution maintains a correspondent account or a payable-through account is sanctioned by the Treasury Department under NDAA section 1245, there is a 10-day grace period in which the US financial institution may engage in a limited set of transactions—those transactions needed to close the account and transfer the remaining funds to an account of the foreign financial institution located outside the US. (*See* 31 C.F.R. § 561.504(a).) The US financial institution must file a report with OFAC within 30 days of closing the account. (*See* 31 C.F.R. § 561.504(b).)

This general sanction applicable to foreign financial institutions engaging in transactions with designated Iranian banks does not apply to foreign financial institutions "owned or controlled by the government of a foreign country." OFAC has defined "foreign financial institutions owned or controlled by the government of a foreign country" to be any foreign financial institution—including foreign countries' central banks—in which the government of a foreign country owns a 50 percent or greater interest or is otherwise controlled by a foreign government. (*See* 31 C.F.R. § 561.323.)

This general sanction also does not apply to transactions involving sales of food, medicine, or medical devices to Iran. (*See* NDAA § 1245(d)(2); 31 C.F.R. § 561.203(f).) OFAC defines "food" as items intended to be consumed by animals or humans for nutrition, and "medicine" and "medical devices" as those terms are defined in the Federal Food, Drug, and Cosmetic Act. (*See* 31 C.F.R. § 561.327.) Non-US financial institutions will not be subject to the NDAA sanctions for engaging in transactions with CBI or designated Iranian financial institutions if the transactions involve the sale of food, medicine, or medical devices to Iran.

Sanctions Imposed on Any Foreign Financial Institutions for Petroleum-Related Transactions Involving Iran. Under new IFSR sections 561.203(d) and (e), the US government may impose sanctions on any foreign financial institutions—both private and government-owned or -controlled foreign financial institutions—that knowingly engage in significant financial transactions with CBI or other designated Iranian banks involving the purchase of petroleum or petroleum products from Iran beginning June 28, 2012, that is, 180 days after the NDAA's enactment. Under these provisions of the IFSR, even a non-US central bank or another foreign government "owned or controlled" bank would face sanctions for engaging in transactions related to purchases of Iranian petroleum. (*See* 31 C.F.R. § 561.203(d)(2), (e); NDAA §§ 1245(d)(3), (d)(4)(c).) Moreover, under new IFSR section 561.203(e), the US government will sanction government-owned or -controlled foreign financial institutions that engage in sales of petroleum or petroleum products to Iran beginning June 28, 2012. (*See also* NDAA § 1245(d)(3).) (The general imposition of sanctions for transactions by private foreign financial institutions with CBI and designated Iranian banks described above, which takes effect February 29, 2012, covers transactions involving private foreign financial institutions, the CBI or designated Iranian banks, and sales of petroleum or petroleum products to Iran.)

There are a number of important distinctions between the general imposition of sanctions for transactions with designated Iranian banks and the imposition of sanctions for petroleum transactions. First, the imposition of sanctions on government-owned or -controlled banks are limited to transactions involving the purchase or sale of petroleum or petroleum products to or from Iran. Privately owned foreign financial institutions may be sanctioned for engaging in any significant financial transaction with a designated Iranian bank.

Second, petroleum transactions enjoy a longer grace period than nonpetroleum transactions. To be subject to the sanctions, the petroleum sale or purchase must take place on or after June 28, 2012, 180 days or more after the NDAA's enactment. By contrast, sanctions could be imposed on privately owned foreign financial institutions for nonpetroleum sale transactions involving CBI or another designated Iranian bank on or after February 29, 2012—60 days after the enactment of the NDAA.

Third, the sanctions on transactions involving Iranian petroleum are effective only if the president has determined that the price and supply of non-Iranian petroleum is sufficient to allow purchasers to "reduce significantly" in volume purchases of Iranian petroleum. (*See* NDAA §1245(d)(4)(B); 31 C.F.R. § 561.203(g).) The NDAA and the implementing IFSR regulations require the president to make an initial determination by March 30, 2012—90 days after the NDAA's December 31, 2011 enactment—of whether the price and supply of non-Iranian petroleum is sufficient that purchasers can reduce significantly in volume purchases of Iranian petroleum. (*See* NDAA § 1245(d)(4)(B); 31 C.F.R. § 561.203(g).) Thereafter, the president must make such a determination every 180 days. (*See* NDAA § 1245(d)(4)(B); Note to 31 C.F.R. § 561.203(g).) The purpose of this provision is to respond to concerns that the sanctions will cause economically damaging increases in the worldwide price of petroleum. Therefore, this determination appears to be designed as a method for the president to effectively put NDAA section 1245's petroleum-related sanctions on hold if their application after the 180-day grace period causes a significant spike in oil prices that threatens to harm the economy.

Fourth, there is a special exception for financial institutions located in cooperating countries. A non-US financial institution subject to sanctions for engaging in sanctionable petroleum-related transactions with CBI or other designated Iranian financial institutions may avoid sanctions if the president determines that the country with primary jurisdiction over such non-US financial institution has "significantly reduced" its volume of crude oil purchases from Iran since the president's last 180-day report on the sanctions' effect on the worldwide supply and price of petroleum (or preceding 90-day period in the case of the first 90 days after the NDAA takes effect). (*See* NDAA § 1245(d)(4)(D); 31 C.F.R. § 561.203(h).) According to guidance released by OFAC on February 14, 2012, the US government will determine whether a country has "significantly reduced" its purchases of Iranian crude oil through an interagency process led by the State Department and including the Treasury Department, Energy Department, and the Director of National Intelligence. The US government will consider such factors as the quantity of a country's reduction in purchases of Iranian crude oil, whether that country has terminated contracts for future delivery of Iranian crude oil, and other similar actions. (*See* OFAC Frequently Asked Questions, Question 174, *available at* http://www.treasury.gov/resource-center/faqs/Sanctions/Pages/answer.aspx#174.)

Presidential Waiver. Under the NDAA, the president may waive imposition of sanctions on non-US financial institutions for transactions with CBI or other designated Iranian financial institutions if he determines that the waiver is in the US national interest and provides a report to Congress. (*See* NDAA § 1245(d)(5).) The waiver can last for no more than 120 days. The president may renew the waiver if he makes a new determination that the waiver is in the US interest and provides a new report to Congress. (*Id.*)

Executive Order 13599 - Blocking Property of All Iranian Financial Institutions in the US

Executive Order 13599 (E.O. 13599) blocks all property or interests in property of the Iranian government or any Iranian financial institution that comes into the US or into the possession or control of a US person (including non-US branches of US entities). Under these sanctions, US financial institutions must *seize any funds* associated with an Iranian financial institution. Previously for transactions involving an Iranian financial institution, unless the Iranian financial institution appeared on the SDN List, US financial institutions were required only to reject the transaction and could return the funds to the sender. Now, any transaction involving any Iranian financial institutions—including CBI—will be blocked, and the funds seized, if it enters the US banking system. US persons are also prohibited from facilitating any transactions involving non-US participants that would violate the sanctions if performed by a US person. The Secretary of the Treasury is responsible for enforcing the sanctions under E.O. 13599, through OFAC.

E.O. 13599 represents a potentially significant elevation of US sanctions on Iran, particularly as it relates to transactions involving non-US persons. Transactions involving CBI and any other Iranian bank that enter the US banking system are required to be blocked, even if both the party initiating the transaction and the beneficiaries of the transaction are not US persons and the transaction is only passing through the US banking system. For example, a payment by a non-US, non-Iranian party to an Iranian party through an Iranian bank will be blocked if it enters the US banking system.

OFAC issued General License A, effective February 6, 2012, providing that transactions authorized by OFAC prior to E.O. 13599 remain authorized through their listed expiration dates. This includes licenses granted under the authority of the Trade Sanctions Reform and Export Control Act of 2000 (TSRA licenses).

Given the visibility of the new sanctions and the high levels of congressional support for the new sanctions, it is likely that these sanctions will be a high-enforcement priority for OFAC and closely monitored by the relevant congressional committees.

Expansion of the Iran Sanctions Act's Extraterritorial Sanctions Under Executive Order 13590

In November 2011, prior to the enactment of the NDAA and the issuance of E.O. 13599, the US government imposed new sanctions on Iran through Executive Order 13590 (E.O. 13590). The president signed E.O. 13590 on November 21, 2011, in order to expand the US's existing Iran sanctions under the Iran Sanctions Act as amended by the Comprehensive Iran Sanctions, Accountability, and Divestment Act (CISADA) (described in a previous Client Advisory, *available at* http://www.arnoldporter.com/public_document.cfm?id=16093&key=17D1.).

Section 1(a) of E.O. 13590 gives the Secretary of State authority to impose sanctions on certain persons (including those outside US jurisdiction) that "knowingly" sell, lease, or provide "goods, services, technology, or support" to Iran that could "directly and significantly contribute to the maintenance or enhancement of Iran's ability to develop petroleum resources located in Iran." In order for sanctions to be imposed, the goods, services, technology, or support in question must have a fair market value of at least US$1 million or an aggregate value of US$5 million in a 12-month period. The sanctions apply to both US and non-US persons—that is, they are intended to have extraterritorial effect. In addition, the sanctions apply to successor entities of violators.

Since CISADA's enactment on July 1, 2010, US and non-US persons have been subject to sanctions for making "investments" that "directly and significantly contribute to the enhancement of Iran's ability to develop petroleum resources" of at least US$1 million or an aggregate value of US$5 million in a 12-month period. (*See* CISADA §102(a).) Under CISADA, the sale of "goods, services, technology, information, or support" for production or exportation of "refined petroleum products" is sanctionable. However, sale or provision of such goods or services would typically not be considered an "investment" contributing to the "enhancement of Iran's ability to develop petroleum resources"—and therefore not prohibited under CISADA—because an "investment" generally requires some share of ownership, royalties, or profits. E.O. 13590 expands the prohibition on sales of goods, technology, and services to Iran to those articles that will enhance Iran's ability to develop petroleum resources, such as, for example, oil field equipment (in amounts exceeding E.O. 13590's monetary thresholds). Senior members of the Obama administration and OFAC officials have confirmed that E.O. 13590 was intended to enhance the US's existing Iran sanctions by enabling the State Department to sanction "upstream oil and gas activities" that "go beyond investment to the provision of goods and services." *See* Briefing by Senior Administration Officials on Sanctions on Iran, November 21, 2011, *available at* http://iipdigital.usembassy.gov/st/english/texttrans/2011/11/20111122091555su4.964411e-02.html#axzz1jABmw6jd (last visited February 13, 2012).

In addition, section 1(b) of E.O. 13590 grants the Secretary of State authority to sanction US and non-US entities that knowingly sell, lease, or otherwise provide goods, services, or technology to maintain or expand Iran's domestic production of petrochemical products. To be sanctionable, the goods, services, or technology provided must have a fair market value of at least US$250,000 or an aggregate value of US$1 million in a 12-month period. This also represents an expansion of the CISADA sanctions, as CISADA did not specifically target Iran's production of petrochemical products.

As with E.O. 13599 and the NDAA, E.O. 13590 is intended to have extraterritorial effect. Foreign companies that sell specified goods or services to Iran could face sanctions under E.O. 13590, including a ban on granting US export licenses for export or re-export of any goods or services to the sanctioned non-US company, a ban on imports into the US from the sanctioned non-US company, and blocking transactions involving the sanctioned company that enter the US banking system. (*See* E.O. 13590, §§ 2, 3.)

Imposition of Special Measure Against Iran as a Jurisdiction of Primary Money Laundering Concern under Section 311 of the USA PATRIOT Act

On November 28, 2011, the Financial Crimes Enforcement Network (FinCEN) issued a notice of proposed rulemaking identifying Iran as a jurisdiction of primary money laundering concern. (*See* Amendment to the Bank Secrecy Act Regulations—Imposition of Special Measure Against the Republic of Iran as a Jurisdiction of Primary Money Laundering Concern, 76 Fed. Reg. 72878 (Nov. 28, 2011).) FinCEN imposed the fifth special measure authorized by the USA PATRIOT Act, which prohibits US financial institutions from opening or maintaining correspondent accounts for any foreign financial institution if such account would indirectly benefit Iranian entities. (*Id.* at 72879.) Under this measure, US banks cannot open or maintain correspondent accounts for Iranian banking institutions. (*Id.* at 72882.)

Conclusion

The NDAA, its implementing regulations in the IFSR, and the two recent Executive Orders represent significant new steps that reflect the substantial, bipartisan commitment in Washington to force Iran to terminate its nuclear program. E.O. 13599 further cuts off Iranian financial institutions from the US financial system. The additional sanctions in the NDAA authorize extraterritorial sanctions on non-US financial institutions. E.O. 13590 expands the sanctions on the Iranian petroleum sector. All of these new US sanctions are part of a recent trend begun in 2010 with CISADA to impose sanctions on non-US parties for activities involving Iran. Given the strong US support for these new sanctions, we expect that Congress will watch closely to assess the implementation and enforcement of these various new sanctions on Iran and would be prepared to enact further sanctions if necessary.

If you have any questions about any of the topics discussed in this Advisory, please contact your Arnold & Porter attorney or any of the following attorneys:

John P. Barker
+1 202.942.5328
John.Barker@aporter.com

John B. Bellinger III
+1 202.942.6599
John.Bellinger@aporter.com

Baruch Weiss
+1 202.942.6819
Baruch.Weiss@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