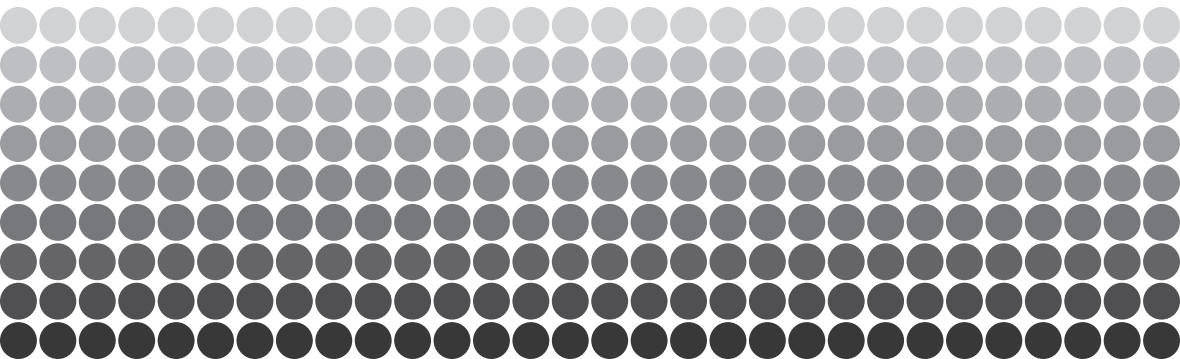


SIPRI YEARBOOK 2013

Armaments, Disarmament and International Security

Financial sanctions and other restrictive measures

IAN ANTHONY



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III. Financial sanctions and other restrictive measures

IAN ANTHONY

A variety of restrictive measures have been used to prevent proliferation of nuclear, biological and chemical weapons, and missile systems for their delivery. These measures include restrictions on trade, financial sanctions and restrictions on travel. Restrictions on trade can be either general or targeting particular goods. Financial sanctions can include, for example, the freezing of funds or economic resources, prohibitions on financial transactions or requirements for prior approval before entering into such transactions, and restrictions on the provision of export credits or investment funds. Examples of restrictions on travel include flight bans and restrictions on the admission of named individuals. In 2012 an important understanding was reached among the states that play a central role in managing the international financial system on how to use financial sanctions to support non-proliferation. In addition, new and expanded measures were adopted to attempt to bring about a change in the national nuclear policy of Iran.

The Financial Action Task Force

The Financial Action Task Force (FATF) is an intergovernmental body established in 1989 by the Group of Seven (G7) to combat money laundering and block financing that might facilitate terrorist acts.¹ The number of states participating in the FATF has subsequently expanded and the task force has broadened its agenda to take account of other illicit activities—including the proliferation of nuclear, biological and chemical weapons—that could be considered threats to the integrity of the international financial system.

While the FATF first investigated recommendations related to proliferation financing in 2008, it was not until February 2012 that it published revised recommendations that addressed proliferation financing for the first time.² The recommendations have two objectives in relation to proliferation: (a) ensuring consistent and effective implementation of targeted financial sanctions when these are called for by the United Nations Security

¹ On FATF see annex B, section III, in this volume; and the FATF website, <<http://www.fatf-gafi.org>>.

² Financial Action Task Force (FATF), *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations* (FATF/Organisation for Economic Co-operation and Development: Paris, 2012), <http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf>. See also Bauer, S., Dunne, A. and Mičić, I., 'Strategic trade controls: countering the proliferation of weapons of mass destruction', *SIPRI Yearbook 2011*, pp. 441–43.

Council; and (b) helping countries implement effective national mechanisms to enable their authorities to ‘cooperate, and, where appropriate, coordinate domestically with each other concerning the development and implementation of policies and activities to combat money laundering, terrorist financing and the financing of proliferation of weapons of mass destruction’.³ At the same time, the FATF published a detailed guidance document that described the most effective ways to implement the recommendations at the national level.⁴

In 2012 the FATF’s membership comprised 34 participating states (including almost all of the important financial centres) as well as two regional organizations: the European Commission and the Gulf Cooperation Council.⁵ The FATF also has both associated partners and observers. Associated partners are mostly specialized regional networks of financial regulators responsible for overseeing anti-money laundering measures. The group of observers is a heterogeneous mix of banks, UN bodies, European Union (EU) agencies and specialized intergovernmental networks (e.g. those involved in combating drug trafficking). In order to become an associated partner or an observer, entities must promise to implement FATF recommendations. Therefore, the recommendations on proliferation financing should ‘cascade’ through FATF cooperation networks to virtually all parts of the world in coming years.

Strengthening restrictive measures against Iran

Between 2006 and 2010 the UN Security Council adopted a series of resolutions that introduced a range of restrictive measures on Iran as part of an attempt to persuade Iran to modify its national nuclear programme to reduce proliferation risks.⁶ The restrictive measures mandated in the resolutions were relatively narrow, primarily directly linked to the supply of goods or services that could make a direct contribution to a nuclear weapon programme or a programme to develop a ballistic missile delivery system for a nuclear weapon.

In June 2010 the UN Security Council recommended (but did not require) that states take broader steps—for example, inspecting all air and sea cargo bound for Iran, preventing financial services that may be used for sensitive nuclear activities and generally subjecting the Iranian banking

³ Financial Action Task Force (note 2), page 11.

⁴ Financial Action Task Force (FATF), *Best Practices Paper on Recommendation 2: Sharing Among Domestic Competent Authorities Information Related to the Financing of Proliferation* (FATF: Paris, 2012).

⁵ For a full list of FATF members see annex B in this volume.

⁶ On recent developments with regard to Iran see chapter 7, section I, in this volume.

sector to closer scrutiny.⁷ However, unlike previous measures, the resolution did not gain the support of all members of the Security Council, with two non-permanent members (Brazil and Turkey) voting against it. Public statements by China and Russia, which both have a veto on Security Council decisions, suggested that future proposals to introduce additional restrictive measures would be unlikely to gain the necessary support.⁸

Since 2010 a number of states and the EU have adopted restrictive measures against Iran that go far beyond what can be agreed in the UN Security Council. Some features of these sanctions are particularly noteworthy. First, after an extended period in which states sought restrictive measures that were narrowly targeted, in 2012 the scope of sanctions was expanded to the point where widespread damage would inevitably be caused to the Iranian economy. Second, a number of the measures also apply to any legal entity incorporated or constituted under the law of a state other than that which has put the measures in place. For example, under the terms of a number of the measures enacted in the United States, restrictive measures apply to foreign subsidiaries of a US company even if they are incorporated or constituted under the laws of another country.⁹

Traditionally, the extraterritorial application of restrictive measures has been controversial, to the point where some European governments have instructed companies incorporated under their laws to disobey US restrictive measures.¹⁰ However, in the case of restrictive measures applied to Iran this feature appears to be increasingly accepted. Cooperation among like-minded states to implement measures and share information on enforcement appears to be expanding.¹¹ These developments suggest that the

⁷ UN Security Council Resolution 1929, 9 June 2010; and Wezeman, P. D. and Kelly, N., 'Multi-lateral arms embargoes, 2010', *SIPRI Yearbook 2011*, pp. 447–48.

⁸ Melnikov, V., 'U.S. Iran sanctions threaten ties with Russia—official', RIA Novosti, 13 Aug. 2012, <<http://en.rian.ru/russia/20120813/175189517.html>>; and 'China slams new US–Iran sanctions as “serious violation of intl rules”', Russia Today, 1 Aug. 2012, <<http://rt.com/news/iran-fresh-sanctions-obama-552/>>.

⁹ In Aug. 2012 the Iran Threat Reduction and Syria Human Rights Act of 2012 applied US sanctions on Iran to US-controlled offshore subsidiaries. In Oct. 2012 the executive order implementing the sanctions on Iran established a 'grace period', until 13 Feb. 2013, during which time offshore subsidiaries could wind down their commercial relations with Iran. White House, 'Executive Order from the President regarding authorizing the implementation of certain sanctions set forth in the Iran Threat Reduction and Syria Human Rights Act of 2012 and additional sanctions with respect to Iran', 9 Oct. 2012, <<http://www.whitehouse.gov/the-press-office/2012/10/09/executive-order-president-regarding-authorizing-implementation-certain-s>>.

¹⁰ In 1996 the EU introduced legislation instructing companies not to implement extraterritorial dimensions of the US Iran and Libya Sanctions Act of 1996. Council Regulation (EC) no. 2271/96 of 22 Nov. 1996 protecting against the effects of the extra-territorial application of legislation adopted by a third country, and actions based thereon or resulting therefrom, *Official Journal of the European Union*, L309, 29 Nov. 1996, pp. 1–6.

¹¹ Australia, Canada, Japan, South Korea and Switzerland have also adopted some or all of the restrictive measures enacted by the EU and the USA. See Katzman, K., *Iran Sanctions*, Congressional Research Service (CRS) Report for Congress RS20871 (US Congress, CRS: Washington, DC, 15 Oct. 2012); Autonomous Sanctions Regulations 2011, Australian Select Legislative Instrument 2011 no. 247 as amended, 21 Aug. 2012, <<http://www.comlaw.gov.au/Details/F2012C00562>>; and Swiss

urgent need to address the proliferation concerns arising from Iran's nuclear programme have generated a growing consensus, at least within the Euro-Atlantic community, on the need for restrictive measures.

European Union decisions on restrictive measures

In addition to actions intended to implement decisions of the UN Security Council more effectively, the EU introduced several new and important restrictive measures in 2012.

In January 2012 the Council of the EU decided that, in the light of the potential use of revenues derived from the energy sector to fund proliferation-sensitive nuclear activities, new investment in the petrochemical sector in Iran would be prohibited. In March the scope of the restrictive measures was expanded significantly to prohibit the purchase of oil and petroleum products from Iran.¹² In December this was extended to cover natural gas.¹³

A second new element in EU restrictive measures was the decision to impose restrictive measures against the Central Bank of Iran, in the light of evidence that it was involved in activities to circumvent existing UN and EU sanctions.¹⁴

In March 2012 the Council took a new decision to deny specialized financial messaging services—which are used to exchange financial data—to specified Iranian entities and individuals.¹⁵ Immediately after the EU decision, the Society for Worldwide Interbank Financial Telecommunication (SWIFT), which is incorporated in Belgium and subject to EU law, announced that it would discontinue its communications services to Iranian financial institutions subject to EU sanctions. SWIFT's chief executive officer noted that 'disconnecting banks is an extraordinary and unprecedented step for SWIFT. It is a direct result of international and multilateral action to intensify financial sanctions against Iran'.¹⁶ Trans-

State Secretariat for Economic Affairs, 'Iran: Federal Council takes steps to improve legal certainty and prevent possible evasion', Press release, 19 Jan. 2011, <<http://www.seco.admin.ch/aktuell/00277/01164/01980/?lang=en&msg-id=37283>>.

¹² Council of the European Union, Council Regulation (EU) no. 267/2012 of 23 March 2012 concerning restrictive measures against Iran and repealing Regulation (EU) no. 961/2010, *Official Journal of the European Union*, L88, 24 Mar. 2012.

¹³ Council of the European Union, Council Regulation (EU) no. 1263/2012 of 21 December 2012 amending Regulation (EU) no. 267/2012 concerning restrictive measures against Iran, *Official Journal of the European Union*, L356, 22 Dec. 2012.

¹⁴ Council of the European Union, Council Implementing Regulation (EU) no. 54/2012 of 23 Jan. 2012 implementing Regulation (EU) no. 961/2010 on restrictive measures against Iran, *Official Journal of the European Union*, L19, 24 Jan. 2012, pp. 1–5.

¹⁵ Council of the European Union, Council Decision 2012/152/CFSP of 15 Mar. 2012 amending Decision 2010/413/CFSP concerning restrictive measures against Iran, *Official Journal of the European Union*, L77, 16 Mar. 2012, p. 18.

¹⁶ SWIFT is the digital network through which more than 10 000 financial institutions and corporations in 212 countries exchange financial information. Society for Worldwide Interbank

actions involving gold, diamonds and other precious metals, which could provide an alternative means of payment once access to financial systems was restricted, were subsequently prohibited.

In November 2012 the responsible financial authority within the Bank of France imposed penalties on the manager of a Paris branch of an Iranian bank.¹⁷ This was the first instance of an imposition of sanctions on an individual bank manager based on a breach of the restrictive measures in an EU regulation on Iran. In France, the decision was interpreted as a strategic signal from the responsible authorities to the banking sector about the need for vigilance and compliance.

The actions taken by the EU were part of a wider effort by a number of like-minded states to apply more restrictive financial measures against Iran. For example, under previous restrictive measures, while US persons were instructed not to execute transactions involving the Iranian Government, they could simply reject them rather than being required to freeze the related assets. However, after the US administration's adoption in February 2012 of new restrictions, all financial transactions involving any Iranian financial institution must be blocked by all US persons (including financial institutions).¹⁸

The progressive introduction of new and more restrictive financial sanctions has made it more difficult for Iranian entities to gain access to the international financial system. This has reportedly led Iran to receive payments in local currency through a domestic bank in some trading partners when implementing foreign trade transactions.¹⁹ This effectively forces Iran to buy goods in the local market to the equivalent value of items it exports—a form of barter arrangement.

Financial Telecommunication (SWIFT), 'SWIFT instructed to disconnect sanctioned Iranian banks following EU Council decision', Press release, 15 Mar. 2012, <http://www.swift.com/about_swift/shownews?param_dcr=news.data/en/swift_com/2012/press_releases_SWIFT_disconnect_Iranian_banks.xml>.

¹⁷ Autorité de Contrôle Prudentiel, Commission des Sanctions, 'Bank Tejarat Paris, M. Mohammad Mahdian, M. Hossein Fazeli', Procédure n° 2011-03, 27 Nov. 2012, <http://www.acp.banque-france.fr/fileadmin/user_upload/acp/publications/registre-officiel/20121127-Decision-de-la-commission-des-sanctions.pdf>.

¹⁸ US President, 'Blocking property of the Government of Iran and Iranian financial institutions', Executive Order no. 13 599, 5 Feb. 2012, *Federal Register*, vol. 77, no. 26, 8 Feb. 2012.

¹⁹ Parent, V. and Hafezi, P., 'Iran turns to barter for food as sanctions cripple imports', Reuters, 9 Feb. 2012.