

II. Financial sanctions

IAN ANTHONY

Types of sanction

As noted in section I, there are two general types of financial sanction. Asset-based financial sanctions require states to freeze the funds or other assets of the target, and to ensure that no funds and other assets are made available to them either directly or indirectly. There may also be a prohibition on a designated entity or person accumulating new assets. This might include, for example, blocking grants or loans to a sanctions target. Activity-based financial sanctions focus on the financial aspects of restricted or prohibited trade and commerce, including secondary services such as insurance cover. Iran has been the target of both asset-based and activity-based financial sanctions.

United Nations Security Council Resolution 1737 decided that all states should freeze the funds, other financial assets and economic resources owned or controlled by persons or entities designated by the Council as being engaged in, directly associated with or providing support for Iran's proliferation-sensitive nuclear activities or the development of nuclear weapon delivery systems.¹ The decision extended to persons or entities acting on behalf of, or at the direction of, designated persons or entities, as well as entities owned or controlled by them, including through illicit means.

Resolution 1737 applied to specific, named individuals and manufacturing companies. However, in 2007 Security Council Resolution 1747 called on states and international financial institutions not to enter into any new commitments for grants, financial assistance or concessional loans to Iran except for humanitarian or development purposes.²

The Security Council put in place activity-based financial sanctions in Resolution 1737. The resolution prohibits the transfer to Iran of specified items, and also prohibits financial assistance, investment or the transfer of financial resources or services, related to the supply, sale, transfer, manufacture or use of those prohibited items.³

In June 2010 the asset freeze was extended to include the Islamic Revolutionary Guard Corps (IRGC) as an entity, as well as 'any individuals or entities acting on their behalf or at their direction' and 'entities owned or controlled by them, including through illicit means'.⁴ This could be considered a turning point, in that UN Security Council Resolution 1929 contained

¹ United Nations Security Council Resolution 1737, 27 Dec. 2006.

² UN Security Council Resolution 1747, 24 Mar. 2007.

³ UN Security Council Resolution 1737 (note 1).

⁴ UN Security Council Resolution 1929, 9 June 2010.

what might be termed catch-all financial sanctions. The resolution calls on states to prevent the provision of financial services, including insurance or reinsurance, and to prevent the transfer of any financial or other assets or resources if they have information that provides reasonable grounds to believe that such services, assets or resources could contribute to Iran's proliferation-sensitive nuclear activities or the development of nuclear weapon delivery systems.

Resolution 1929 also called on states to prevent Iranian banks from opening new branches, subsidiaries or representative offices in their jurisdiction, and to prohibit the purchase of foreign banks by Iranian banks or financial institutions if they have information that provides reasonable grounds to believe that these activities could contribute to Iran's proliferation-sensitive nuclear activities or the development of nuclear weapon delivery systems. The same resolution requires states to prohibit financial institutions in their jurisdiction from opening subsidiary branches in Iran if those branches could contribute to proliferation-sensitive activities.⁵

The Joint Comprehensive Plan of Action and financial sanctions

The Joint Comprehensive Plan of Action (JCPOA) requires the lifting of nuclear-related financial sanctions on Iran related to banking activities, insurance, financial messaging services, trade financing, grants, financial assistance and concessional loans, sanctions on Government of Iran public-guaranteed bonds and associated services for all of these sanctions. The UN and European Union (EU) nuclear-related financial sanctions were lifted on 16 January 2016 (Implementation Day). The impact of these steps is likely to be significant. After paying off its creditors, gaining access to its foreign exchange reserves held in foreign banks is expected to provide Iran with nearly \$60 billion.⁶ The snap back provision of the JCPOA is an untested mechanism. However, there are also other issues that could complicate implementation of the plan.

National implementation and enforcement

Decisions by the UN Security Council to impose targeted financial sanctions must be implemented and enforced by all the UN member states. Although autonomous sanctions have been agreed within the framework of the EU, it remains the responsibility of each EU member state to ensure that these sanctions are implemented and enforced within their jurisdiction.

⁵ UN Security Council Resolution 1929 (note 4).

⁶ Katzman, K., *Iran Sanctions*, Congressional Research Service (CRS) Report for Congress RS20871 (US Congress, CRS: Washington, DC, 21 Jan. 2016), Summary.

National legislation in the USA applies to any transactions where payments are made in the USA, come within the USA or come within the possession or control of a US person. This gives US laws considerable extra-territorial impact, since many international transactions are dollar denominated and therefore at some point pass through the US financial system. The Office of Foreign Assets Control (OFAC) in the US Department of the Treasury, which is responsible for enforcing financial sanctions, has regularly punished foreign as well as US entities considered to be violating sanctions law.

In 2010 the USA expanded the scope of so-called secondary sanctions—sanctions imposed on foreign entities considered by US authorities to be violating the provisions of financial sanctions.⁷ These sanctions target any foreign financial institutions that knowingly facilitate, participate in or assist a sanctioned activity by denying them access to the US market and to the US financial system. The USA used these kinds of financial secondary sanctions to exert pressure on sections of the Iranian economy, particularly the oil and gas sector and the shipping industry. For example, in 2012 the USA imposed sanctions on non-US banks if they were processing payments through Iran's Central Bank. The provisions applied to foreign central banks only if the transactions with Iran's Central Bank were for oil purchases. The US President was empowered to waive these sanctions if the state where the bank was headquartered had 'significantly reduced' its imports of oil and gas from Iran.⁸ In 2013 the USA imposed sanctions on non-US persons and institutions engaged in financial transactions with Iran's shipping and ship-building sectors or the provision of associated services.⁹

The EU stopped short of imposing these kinds of extra-territorial measures. However, its central position in the global economy allowed the EU to impose a range of financial sanctions that had far-reaching implications for Iran's economy. In January 2012 the EU froze the assets of Iran's Central Bank being held in EU member states; and in March 2012 the EU blocked access to systems for clearing banking transactions to a list of sanctioned Iranian banks.¹⁰ In addition, the banks were no longer able to use the Belgium-based Society for Worldwide International Financial Transfers (SWIFT), the world's most important secure financial messaging service.¹¹

⁷ US Congress, Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISADA), Washington, DC, 1 July 2010.

⁸ US National Defense Authorization Act 2012, section 1245, paragraph (d)(4)(D).

⁹ US National Defense Authorization Act 2013, section 1244, paragraph (c)(1).

¹⁰ 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; Council of the European Union, 'Council Regulation No 267/2012 of 23 Mar. 2012 concerning restrictive measures against Iran', *Official Journal of the European Union*, L88, 23 Mar. 2012.

¹¹ Katzman (note 6), p. 35.

In March 2012 the EU also banned the granting of financial loans or credit to Iranian persons involved in the oil and gas sector.¹²

The USA issued a series of waiver determinations and findings that include foreign nationals on JCPOA Adoption Day, which took effect on Implementation Day.¹³ Prior to Implementation Day, the USA had also relieved certain specific sanctions as required in the JCPOA. With regard to all other sanctions, however, the US Treasury has explained that the US Government ‘will continue to vigorously enforce our sanctions against Iran, including by taking action against those who seek to evade or circumvent our sanctions’.¹⁴ The specific scope of sanctions relief is extremely complicated, and there is an attendant risk that US and, perhaps in particular, foreign entities will misunderstand the relevant regulations and find themselves subject to enforcement actions.

De-risking and over-compliance

The logic of targeted sanctions is that they should be relieved in response to a change in behaviour by the target. It follows that Iran should see immediate benefits from full implementation of what has been agreed within the framework of the JCPOA. However, decisions on whether to take up new commercial opportunities in Iran will be made, first and foremost, by the private sector.

The overall picture regarding the current scope of financial sanctions remains complicated and rather uncertain. In these circumstances, whether Iran is able to benefit from sanctions relief will depend in part on whether foreign private banks and financial institutions feel that the risk of doing business in Iran, or with Iranian entities, is acceptable in the light of the potential rewards.

The financial authorities, most notably OFAC, have taken an active approach to enforcing financial sanctions on Iran. They have been assisted in this by two fairly recent developments. First, the national legislation enacted in the wake of past terrorist attacks, in particular the attacks on the USA in September 2001, requires banks and financial institutions to collect and store much more information about their customers than was previously the case. The legislation also requires banks and financial institutions to provide this information to the regulatory authorities under certain conditions. Second, the rapid spread of digital technology within the financial system has made it possible to assemble and analyse large amounts of data much more quickly and efficiently than in the past.

¹² Council of the European Union (note 10).

¹³ US Department of State, Waiver Determinations and Findings, 18 Oct. 2015.

¹⁴ US Department of the Treasury, US Department of State, ‘Guidance relating to the continuation of certain temporary sanctions relief pursuant to the JPOA prior to the implementation of the JCPOA’, Washington, DC, 7 Aug. 2015.

This combination of more active enforcement, greater transparency and new analytical tools has made both regulators and the financial sector much more vigilant with regard to possible evasion of sanctions. It has also increased the probability that violations will be detected. This applies to inadvertent and accidental non-compliance, as well as to deliberate violations of sanctions law.

Financial sanctions have been the focus of intensive discussions between regulators and the private sector because the complexity of the regulations has made it difficult to be compliant with certain provisions. In particular, the provisions of regulations related to beneficial ownership and activity-based financial sanctions have been highlighted as presenting challenging problems. The provision that the target of a sanction should not benefit indirectly from a transaction requires banks and financial institutions to understand many more aspects than would normally be the case. In regard to activity-based financial sanctions, banks and financial institutions would not typically be experts in the substantive elements of the transaction. Where sanctions regulations require denial of finance if 'such services, assets or resources could contribute to Iran's proliferation-sensitive nuclear activities, or the development of nuclear weapon delivery systems', compliance requires information and knowledge not typically found in a bank.¹⁵

The complexity and risk associated with financial sanctions appear to have led some private companies to avoid all transactions in which there is an Iranian connection, even when the transaction is probably sanctions compliant. Rather than making an individual assessment of potential transactions, risk-averse actors simply avoid any risk by indiscriminately prohibiting finance to Iranian clients.

This risk aversion is perhaps understandable given the very large penalties imposed in recent years on major international banks, such as Barclays Bank and BNP Paribas, as well as other financial actors, such as PayPal.¹⁶ The settlement reached between the United States Department of Justice and BNP Paribas involved total financial penalties of almost \$9 billion, of which \$140 million was a fine, and the remainder was forfeiture of the proceeds from transactions with sanctioned parties over an extended period.¹⁷ In addition

¹⁵ This formulation is taken from United Nations Security Council Resolution 1929, 9 June 2010.

¹⁶ US regulators levied a \$100 million fine against Switzerland's UBS bank in 2004; \$80 million against Dutch bank ABN Amro in 2005; \$350 million against the British Lloyds TSB and \$536 million against Switzerland's Credit Suisse in 2009; \$298 million against the British bank Barclays in 2010; as well as \$619 million against Dutch bank ING, \$8.6 million against Japan's Bank of Tokyo-Mitsubishi UFJ and \$674 million and \$1.92 billion respectively against the UK's Standard Chartered Bank and HSBC in 2012 for unauthorised transactions with Iran and other sanctioned countries. See Katzman (note 6). See also US Department of the Treasury, Civil Penalties and Enforcement Information, [n.d.].

¹⁷ United States Department of Justice, 'BNP Paribas agrees to plead guilty and to pay \$8.9 billion for illegally processing financial transactions for countries subject to US economic sanctions', Press Release, 30 June 2014.

to large fines, penalties have also limited the possibility of doing business in the USA or engaging in dollar-denominated transactions elsewhere—both essential to the survival of companies.

The World Bank, the G20 Financial Stability Board (FSB) and the Financial Action Task Force (FATF) have worked together to understand the extent of de-risking and find ways to reduce any unnecessary loss of financial access by countries under targeted sanctions.¹⁸

In the USA, regulators have entered into a closer dialogue with the private financial sector to clarify enforcement decision making and provide reassurance that one-off mistakes will not be punished heavily, but ‘egregious activity that was knowingly carried out over long periods of time’ will be subject to vigorous enforcement actions.¹⁹

¹⁸ Financial Action Task Force (FATF), ‘FATF clarifies risk-based approach: case-by-case, not wholesale de-risking’, Paris, 23 Oct. 2014.

¹⁹ US Department of the Treasury, Remarks by Acting Under Secretary Adam Szubin at the ABA/ABA Money Laundering Enforcement Conference, Press Release, 16 Nov. 2015.