

Impact of US Treasury's Special Measures Against Iranian Financial Sector and State Department's Designations on Non-US Banks

Last night, the Obama Administration unveiled additional sanctions measures directed at deterring transactions between non-US persons and Iran, including through additional restrictions on US correspondent banking activity and expanded authority to retaliate against entirely non-US activity involving Iran's energy sector.

First, the US Treasury Department ("**Treasury**") designated Iran as a jurisdiction of primary money laundering concern under Section 311 of the USA Patriot Act ("**Section 311**"). Treasury indicated an intention (through a preliminary rulemaking) to prohibit the opening or maintaining of correspondent accounts by any domestic financial institution for or on behalf of Iranian banking institutions, including, among others, the Central Bank of Iran, also known as Bank Markazi Iran ("**Bank Markazi**").¹ Second, the US State Department and Treasury's Office of Foreign Assets Control ("**OFAC**") designated various Iranian individuals and entities under Executive Order 13382 for their role in Iran's nuclear procurement networks. Third, and of greatest potential significance, President Obama issued Executive Order 13590 (the "**Executive Order**"), expanding the range of conduct involving the energy sector of Iran that could trigger US retaliatory measures against non-US persons.

The Section 311 Designation

The Section 311 designation against Iran subjects the entire Iranian financial sector, including Bank Markazi, private Iranian banks, and branches and subsidiaries of Iranian banks globally, to special measures under Section 311.² Because of the OFAC sanctions already in place against Iran, the special measures, when imposed through a final rulemaking, will not create any substantial new regulatory obligations but rather have only marginal impact. The Section 311 special measure proposed by Treasury would, among other things, prohibit the use of US correspondent accounts by Iranian banks, directly or through intervening non-Iranian, non-US correspondent banks. Furthermore, the special measure would require US financial institutions

to "apply special due diligence to correspondent accounts," including notifying non-US correspondent account holders as appropriate that they must not provide Iranian banking institutions with access to their US correspondent account.

In consequence of these measures, non-US financial institutions should ensure that their US correspondent accounts are not accessed, directly or indirectly, by Iranian financial institutions, except for payments that are licensed or authorized under OFAC regulations.

The Executive Order

Under the newly-issued Executive Order, the State Department has the authority to impose the same sweeping retaliatory measures as provided for under the Iran Sanctions Act ("ISA") against any person globally that:

- (1) knowingly, on or after the effective date of the order, sells, leases, or provides to Iran goods, services, technology, or support that has a fair market value of \$1,000,000 or more or that, during a 12-month period, has an aggregate fair market value of \$5,000,000 or more, and that could directly and significantly contribute to the maintenance or enhancement of Iran's ability to develop petroleum resources located in Iran; or
- (2) knowingly, on or after the effective date of this order, sells, leases, or provides to Iran goods, services, technology, or support that has a fair market value of \$250,000 or more or that, during a 12-month period, has an aggregate fair market value of \$1,000,000 or more, and that could directly and significantly contribute to the maintenance or expansion of Iran's domestic production of petrochemical products.

Retaliation can extend to parent and subsidiary firms as well as the entity actually engaged in the subject activity, and, in the most extreme cases, can include a blocking of the targeted firms' assets and blanket prohibition against transactions between US persons and the targeted firms.

Because the Executive Order applies only to activity undertaken after 21 November 2011, it does not necessarily provide a basis for retaliation in relation to the pre-existing Iran-related contracts of non-US firms. However, the State Department might be expected to reference the Executive Order as an additional source of negotiating leverage or legal authority for retaliation in the event it also decides to investigate the pre-existing activity of particularly non-US firms under the ISA.

The Rising Tide of Iran Sanctions

The new measures are the latest in a long line of US financial sanctions designed to isolate Iran from the global financial markets and chill foreign investment in the energy sector of Iran. From 2006 onwards, the prohibitions contained within prior OFAC sanctions against Iran were successively increased, culminating in the revocation of the U-turn exception in November 2008, thus effectively prohibiting non-US banks from transacting through the US financial system or with US persons on behalf of Iranian banks or persons located in Iran. In July 2010, President Obama signed into law the

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Comprehensive Iran Sanctions, Accountability and Divestment Act ("**CISADA**"), which directed retaliation under ISA against non-US firms engaged in certain proscribed non-US activity involving Iran's energy sector and authorized OFAC to impose sanctions against non-US banks engaged in entirely non-US business with, among others, various designated Iranian banks.³ In August 2010, OFAC issued the Iranian Financial Sanctions Regulations ("**IFSR**") prohibiting US financial institutions from opening or maintaining correspondent bank accounts for any non-US financial institution designated pursuant to the IFSR.

The Section 311 designation and Executive Order also respond to pressure from Congress, including a variety of current legislative initiatives to deter any transactions in any currency between non-US banks and Bank Markazi. Whether the Obama Administration's new initiatives will have the intended effect of relieving Congressional pressure for even more extreme measures against non-US banks and other non-US persons in relation to the non-US dealings with Iran remains to be seen. What is now clear, however, is that the Obama Administration no longer acknowledges or accepts any international law restraints on the use of extraterritorial measures to punish (or at least threaten to punish) non-US firms engaged in business entirely outside the jurisdiction of the United States with Iran.

¹ FinCEN Notice of Proposed Rule Making, "Financial Crimes Enforcement Network; Amendment to the Bank Secrecy Act Regulations- Imposition of Special Measure against the Islamic Republic of Iran as a Jurisdiction of Primary Money Laundering Concern, including the Central Bank of Iran within the Definition of Iranian Banking Institution," 31 CFR Chapter X, RIN 1506-AB16, Department of the Treasury (November 21, 2011).

² The special measures will not become effective until the Financial Crimes Enforcement Network ("**FinCEN**") issues a final rule following a notice and comment period.

³ <http://www.state.gov/e/eeb/esc/iransanctions/docs/160710.htm>