

Treasury Department Issues Iranian Financial Sanctions Regulations

On August 16, 2010, the U.S. Department of the Treasury issued, with immediate effect, the [Iranian Financial Sanctions Regulations](#) (the “**Regulations**” or “**IFSR**” – 31 CFR 561) to implement subsections 104(c) and 104(d) of the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (“**CISADA**”).¹ Please see our [previous memorandum](#) for a discussion of CISADA. Although the Regulations do not require notice of proposed rulemaking, the Office of Foreign Assets Control (“**OFAC**”) will accept comments on the final rule. OFAC is not required to respond to the comments or to amend or republish the final rule. Comments may be submitted on or before October 15, 2010. All comments received will become available to the public.

CISADA Provisions

Section 104(c) of CISADA directs the Secretary of the Treasury, by regulation, to prohibit or place strict conditions on the opening or maintenance of correspondent or payable-through accounts in the United States by foreign financial institutions found to engage in various activities that facilitate Iranian efforts to acquire or develop weapons of mass destruction (“**WMD**”) or WMD delivery systems or to support foreign terrorist organizations; facilitate activities of persons designated under UN Security Council sanctions against Iran’s nuclear program; or engage in various related activities.

Section 104(d) of CISADA prohibits any person owned or controlled by a U.S. financial institution (such as a foreign subsidiary) from knowingly engaging in any transaction with or benefiting Iran’s Islamic Revolutionary Guard Corps (“**IRGC**”) or any of its agents or affiliates whose property is blocked under the U.S. International Emergency Economic Powers Act (“**IEEPA**”).

Section 104(e) of CISADA, requiring the Secretary of the Treasury to prescribe due diligence measures concerning correspondent and payable-through accounts, is not implemented in the IFSR. There is no deadline in CISADA for implementation of this provision.

Correspondent Accounts or Payable-Through Accounts of Certain Foreign Financial Institutions

Section 561.201 of the IFSR provides that upon a finding by the Secretary of the Treasury that a foreign financial institution engages in one or more of the activities described below, the Secretary must either –

- (1) Add the name of the foreign financial institution to Appendix A to the IFSR, and a U.S. financial institution shall be prohibited from opening or maintaining a correspondent account or a payable-through account in the United States for that foreign financial institution; or
- (2) Issue an order or regulation imposing one or more of the following strict conditions, or other conditions, on the opening or maintaining by a U.S. financial institution of a correspondent account or a payable-through account in the United States for that foreign financial institution:
 - (a) Prohibiting any provision of trade finance through the correspondent account or payable-through account of the foreign financial institution;

¹ OFAC issued an [IFSR Fact Sheet](#) describing the new Regulations.

- (b) Restricting the transactions that may be processed through the correspondent account or payable-through account of the foreign financial institution to certain types of transactions, such as personal remittances;
- (c) Placing monetary limits on the transactions that may be processed through the correspondent account or payable-through account of the foreign financial institution; or
- (d) Requiring pre-approval from the U.S. financial institution for all transactions processed through the correspondent account or payable-through account of the foreign financial institution.

A foreign financial institution may be designated by the Secretary of the Treasury or become subject to an order or regulation imposing conditions under Section 561.201 of the IFSR if, in any location or currency, it knowingly² –

- (1) Facilitates the efforts of the Government of Iran (including efforts of the IRGC or any of its agents or affiliates) to acquire or develop WMD or delivery systems for WMD or to provide support for organizations designated as foreign terrorist organizations or support for acts of international terrorism;
- (2) Facilitates the activities of a person subject to financial sanctions pursuant to UN Security Council Resolutions 1737, 1747, 1803, or 1929 or any other resolution adopted by the Security Council that imposes sanctions with respect to Iran;
- (3) Engages in money laundering to carry out an activity described in preceding paragraph (1) or (2);
- (4) Facilitates efforts by the Central Bank of Iran or any other Iranian financial institution to carry out an activity described in preceding paragraph (1) or (2); or
- (5) Facilitates a significant transaction or provides significant financial services for –
 - (a) Iran's IRGC or any of its agents or affiliates whose property and interests in property are blocked pursuant to IEEPA; or
 - (b) A financial institution whose property and interests in property are blocked pursuant to IEEPA in connection with Iran's proliferation of WMD or delivery systems for WMD or Iran's support of international terrorism.

Any person who violates, attempts or conspires to violate, or causes a violation of the prohibitions of Section 561.201 is subject to IEEPA civil and criminal penalties.

Determination of Significant Transactions and Significant Financial Services

The IFSR provide that the Secretary of the Treasury may consider the totality of the facts and circumstances in determining whether a transaction or financial service is significant. Section 561.404 includes a non-exhaustive list of factors that the Secretary of the Treasury may consider. These factors include:

- (1) *Size, Number, and Frequency*: The size, number, and frequency of transactions or financial services performed over a period of time.
- (2) *Nature*: The nature of the transaction(s) or financial services, including the type, complexity, and commercial purpose of the transaction(s) or financial services.

² See definition below.

- (3) *Level of Awareness; Pattern of Conduct.* Whether the transaction(s) or financial service(s) are (i) performed with the involvement or approval of management or only by clerical personnel, and (ii) part of a pattern of conduct or the result of a business development strategy.
- (4) *Nexus:* The proximity between the party to the transaction or the provider of the financial services and a blocked person.
- (5) *Impact.* The impact of the transaction(s) or financial services on the objectives of CISADA, including:
 - (a) The benefit, economic or otherwise, conferred or attempted to be conferred on a blocked person;
 - (b) Whether and how the transaction(s) or financial services contribute to the proliferation of WMD or delivery systems for WMD, to support for international terrorism, or to the suppression of human rights; and
 - (c) Whether the transaction(s) or financial services support humanitarian activity.
- (6) *Deceptive practices:* Whether the transaction(s) or financial services involve an attempt to obscure or conceal the actual parties or true nature of the transaction(s) or financial service(s).

Transactions Related to Closing a Correspondent Account or Payable-through Account

Section 561.504 provides that U.S. financial institutions that maintain correspondent accounts or payable-through accounts for a foreign financial institution that becomes listed on Appendix A to the IFSR under Section 561.201(c) will have a 10-day period after the effective date of such designation and listing to (i) process (or permit the foreign financial institution to execute) only those transactions for the purpose of, and necessary for, closing the account and (ii) transfer the funds remaining in the account to an account of the foreign financial institution located outside of the United States and close the account. The IFSR provide that specific licenses may be issued on a case-by-case basis to authorize other types of transactions and/or transactions that occur beyond the 10-day period. A U.S. financial institution is not authorized to unblock or otherwise deal in any blocked property in the process of closing a correspondent account or payable-through account for a foreign financial institution listed in Appendix A to the IFSR.

Prohibitions on U.S. Financial Institutions' Foreign Subsidiaries

Section 561.202 of the IFSR provides that any person that is owned or controlled by a U.S. financial institution is prohibited from knowingly engaging in any transaction with or benefiting Iran's IRGC or any of its agents or affiliates whose property and interests in property are blocked pursuant to IEEPA. A complete listing of blocked parties may be found on OFAC's Specially Designated Nationals and Blocked Persons List (the "**SDN List**"). The IRGC-related blocked parties are identified by the special reference "[IRGC]" at the end of their entries on the SDN List.

A U.S. financial institution is subject to IEEPA civil and criminal penalties if any person it owns or controls violates, attempts or conspires to violate, or causes a violation of Section 561.202, and the U.S. financial institution knew or should have known of such violation, attempt or conspiracy.

General

Definitions. The IFSR address prohibited conduct and affected persons by defining significant terms used in the regulations.

"*Foreign financial institution*" and "*U.S. financial institution*" are defined broadly and in similar terms, with the important difference that only the latter includes insurance companies.

For purposes of Section 561.201(a)(5) of the IFSR, which sets forth certain transactions that could result in the designation of a foreign financial institution under the IFSR, “*financial services*” “include” (*i.e.*, might not be limited to) loans, transfers, accounts, insurance, investments, securities, guarantees, foreign exchange, letters of credit, and commodity futures or options.

The IFSR provide a more detailed description of facilitation than is found in most OFAC sanctions programs. As used in Section 561.201, “*facilitate*,” when used with respect to certain efforts, activities or transactions, refers to “the provision of assistance by a foreign financial institution for those efforts, activities, or transactions, including, but not limited to, the provision of currency, financial instruments, securities, or any other transmission of value; purchasing; selling; transporting; swapping; brokering; financing; approving; guaranteeing; or the provision of other services of any kind; or the provision of personnel; or the provision of software, technology, or goods or any kind.”

Although the restrictions of the IFSR apply only to persons or foreign financial institutions that “knowingly” engage in prohibited transactions or activities, the term “*knowingly*” means that a person had “actual knowledge, or should have known, of the conduct, the circumstance, or the result.”

Delegation; Consultation. Section 561.802 provides a delegation stating that any action that the Secretary of the Treasury is authorized to take pursuant to Section 104(c), (d) or (i) (“Definitions”) of CISADA or the IFSR may be taken by the Director of the OFAC or by any other person to whom the Secretary has delegated authority so to act. Section 561.803 provides that in implementing Section 104 of CISADA and the IFSR, the Secretary of the Treasury shall consult with the Secretary of State and may, in his or her sole discretion, consult with other agencies and departments and with such other interested parties as he or she considers appropriate.

Commentary

The Treasury Department issued a [press release](#) on August 20, 2010 stating that the Department had concluded three weeks of global engagement with governments and the private sector on Iran in Bahrain, Brazil, Ecuador, Japan, Lebanon, South Korea, Turkey and the United Arab Emirates, led by Under Secretary for Terrorism and Financial Intelligence, Stuart Levey; Assistant Secretary for Terrorist Financing, David Cohen; and Deputy Assistant Secretary for Terrorist Financing and Financial Crimes, Daniel Glaser. The Treasury reported that these officials urged U.S. partners and allies to ensure rigorous, comprehensive implementation of UN Security Council Resolution 1929. They also briefed government officials and banking sector leaders on financial provisions of CISADA and the IFSR. In early September, Japan and South Korea announced the imposition of new sanctions on Iran that implement UN Security Council Resolution 1929. The U.S. Government issued statements commending these efforts. The announcements by Japan and South Korea followed the recent imposition of new sanctions on Iran by the European Union, Canada and Australia.

In a recent *New York Times* article, Mr. Levey was quoted as saying, “It would not be in our best interest to act without warning. We’re more interested in changing behavior than in ‘getting’ somebody.” Nonetheless, the enactment of CISADA and the issuance of the IFSR has left U.S. and foreign financial institutions concerned about the possible effects of the new legislation and regulation on their business, as well as the adequacy of their existing compliance due diligence. For example, it is possible that foreign financial institutions could be targeted under CISADA Section 104(c) for performing their obligations under contracts that remain legally binding under local law. The IFSR do not provide any potential relief in such a situation. Such situations have been brought to OFAC’s attention through bank trade associations, and might also furnish the basis for comments on the IFSR as published. In the past, secondary boycott measures like CISADA have become the source of diplomatic friction between the United States and its trading partners. It remains to be seen whether such division will be revived as the remaining provisions of CISADA are implemented.

Because of the controversial nature of CISADA's secondary boycott provisions targeting foreign financial institutions, it is particularly disappointing that the IFSR fail to provide guidance on what compliance steps under Section 104(e) of CISADA will be required of domestic financial institutions with respect to foreign financial institutions for which they maintain correspondent or payable-through accounts. Comments on this omission could help the Treasury Department understand the potential compliance and customer relationship burdens that domestic financial institutions might face through certain implementations of Section 104(e), and thus guide the Department in crafting appropriate implementing regulations.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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