

Iranian Sanction Relief Takes a Step Forward: OFAC Clarifies Use of U.S. Dollars in Iranian Transactions

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Client Advisory

October 18, 2016 by Matthew B. James

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On October 7, 2016, the U.S. Treasury Department's Office of Foreign Assets Control ("OFAC") updated its FAQs that discuss the scope of permissible transactions with Iran following the Iranian Nuclear Deal. While many questions still remain, OFAC at least resolved one of the most pressing concerns of European entities by expressly stating that foreign (i.e., non-U.S.) financial institutions may process transactions denominated in U.S. dollars.

Background

Before the Iranian Nuclear Deal

The Western world's current reluctance to conduct business with Iran stems in large part from the potentially devastating consequences of violating the U.S.-led sanctions regime put in place in response to, among other things, the perceived threat of Iran's nascent nuclear program. Before the implementation of the Nuclear Deal on January 16, 2016 ("Implementation Day"), the U.S., United Nations and European Union were engaged in a coordinated embargo against Iran, which included a prohibition on the provision of financial services to Iran and Iranian businesses. While the U.S. could not directly compel entities outside its jurisdiction to refrain from doing business with Iran, it applied harsh "secondary sanctions" to non-U.S. market participants that penalized them for doing so by imposing heavy fines and denying them access to the U.S. financial system.^[1] Entities that misinterpreted OFAC regulations or attempted to conceal their transactions with Iran did so at their peril. The most remarkable example of the application of secondary sanctions may be that of BNP Paribas in 2014, which pled guilty to violating sanctions against Iran, Cuba and Sudan. All told, Paribas eventually entered into an 8.9 billion dollar settlement with regulators and its oil and gas commodity-finance business was barred from clearing U.S. dollar transactions for one year.^[2] While the violations in that case were particularly egregious, other sophisticated financial institutions, such as Deutsche Bank, found themselves in trouble as well.^[3]

After the Iranian Nuclear Deal

The sanctions had their intended economic effect and eventually brought all concerned parties to negotiate what became the Iranian Nuclear Deal. Aside from the most obvious result of inducing Iran to make certain verifiable concessions regarding its nuclear program, the Iranian Nuclear Deal lifted many of the sanctions on financial transactions that had been in place. While U.S. persons are still broadly prohibited from doing business with Iran, the U.S. has largely eliminated the secondary sanctions program it once applied to non-U.S. market participants.^[4] Foreign entities no longer had to choose between doing business with Iran and doing business with the U.S. Implementation Day was meant to initiate Iran's economic reentry into the Western world.

Phantom Fears

The economic resurgence Iran had anticipated after Implementation Day seemed to stall. It quickly became clear that banks, particularly European banks, were still quite wary of running afoul of U.S. OFAC restrictions despite the ostensible lifting of secondary sanctions.^[5] Much of their hesitation came from the U.S.'s ongoing prohibition against any Iranian transactions involving "the U.S. financial system."^[6] In the absence of specific guidance, it was an open question whether transactions denominated in U.S. dollars were themselves violations of the continuing U.S. sanctions against Iran that could result in substantial fines.^[7] Assurances from U.S. Secretary of State John Kerry and U.S. regulators soon after Implementation Day did not overcome the lingering deterrent effect of the U.S.'s prior enforcement actions.^[8] Despite diplomatic efforts and meetings with foreign governments and financial institutions, European banks like Deutsche Bank announced that they would "[continue] to generally restrict business connected to Iran."^[9] The financial world's hesitancy was so great that the Iranian government publicly stated that "[i]t is a moral and contractual obligation of the West to deliver on what they committed themselves [to] in the [Nuclear Deal], even if it means helping banks with revised regulations, guidelines and policies."^[10]

OFAC Provides Specific Assurances Regarding the U.S. Dollar

While maintaining that Iran had a reciprocal obligation to promote the transparency of its government so that Western businesses and banks could avoid transacting with prohibited persons, the U.S. has recently issued specific guidance, stating that "[f]oreign financial institutions, including foreign-incorporated subsidiaries of U.S. financial institutions, *may process transactions denominated in U.S. dollars* or maintain U.S. dollar-denominated accounts that involve Iran or persons ordinarily resident in Iran"^[11] While the prohibition against involving the U.S. financial system in Iranian transactions remains firmly in place, necessitating robust compliance procedures, OFAC's specific reference to the use of the U.S. dollar seems to be in direct response to the expressed fears of some banks that, should an entity interpret the complex regulatory scheme on its own, U.S. prosecutors and regulators "might adopt a different and stricter interpretation of the rules."^[12] The clear hope is that this new guidance will provide foreign entities with greater certainty regarding legitimate business with Iran.

Initial Reactions and Recommendations

Foreign and domestic entities have been working hard to determine the scope of sanctions relief ever since Implementation Day, but there is already some optimistic support of OFAC's most recent efforts to clarify the legal landscape. According to BloombergMarkets, Eric Lorber of the Financial Integrity Network describes OFAC's announcement as "a green light to foreign companies—they can do business in U.S. dollars with Iran and Iranian parties without worrying about violating sanctions, as long as those dollars don't touch the U.S. financial system at all."^[13] Mr. Lorber, having previously worked in OFAC's Office of Chief Counsel and in the Office of Terrorist Financing and Financial Crimes, reinforces the idea that OFAC's guidance represents a "loosening of sanctions."^[14]

Foreign financial institutions, including those which are foreign-incorporated subsidiaries of U.S. financial institutions, may look upon the new guidance as the removal of an obstacle to doing business with Iranian entities. At the same time, they should remain vigilant in maintaining or even supplementing the compliance procedures they have in place to avoid violating other provisions of the sanctions program. In particular, transactions with Specially Designated National ("SDNs") and other identified persons remains broadly prohibited (regardless of the currency that is used). Clients are advised to review all of the most recent updates to OFAC's enforcement policies at: https://www.treasury.gov/resource-center/sanctions/Programs/Documents/jcpoa_faqs.pdf.

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Endnotes

- [1] https://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Pages/jcpoa_implementation.aspx
- [2] <http://www.bloomberg.com/news/articles/2014-07-09/bnp-paribas-pleads-guilty-in-u-s-to-violating-sanctions>
- [3] <http://www.bloomberg.com/news/articles/2015-11-04/deutsche-bank-pays-258-million-to-end-fed-n-y-sanctions-probe>
- [4] https://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Pages/jcpoa_implementation.aspx
- [5] <https://www.ft.com/content/62b84874-bd01-11e5-9fdb-87b8d15baec2>
- [6] <http://www.bloomberg.com/news/articles/2016-10-08/u-s-loosens-iran-sanctions-to-make-dollar-transactions-easier>
- [7] <http://www.reuters.com/article/iran-banks-idUSL5N18G2BI>;
- [8] <http://money.cnn.com/2016/05/12/news/iran-banks-europe-john-kerry/>
- [9] *Id.*
- [10] <http://www.reuters.com/article/iran-banks-idUSL5N18G2BI>
- [11] https://www.treasury.gov/resource-center/sanctions/Programs/Documents/jcpoa_faqs.pdf (at C.7) (emphasis added).
- [12] <http://www.reuters.com/article/iran-banks-idUSL5N18G2BI>
- [13] <http://www.bloomberg.com/news/articles/2016-10-08/u-s-loosens-iran-sanctions-to-make-dollar-transactions-easier>
- [14] *Id.*

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