

International Trade Alert

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OFAC Guidance on U.S. Dollar Transactions Involving Iran

On October 7, 2016, the U.S. Department of the Treasury, Office of Foreign Assets Control (OFAC) published **new guidance** clarifying (a) circumstances under which non-U.S. financial institutions (FFIs) may engage in U.S. dollar transactions involving Iran; (b) when residual “secondary” U.S. sanctions on Iran can affect transactions involving affiliates of Iranian Specially Designated National (SDNs); and (c) U.S. government expectations for conduct of compliance screening and due diligence in Iran-related transactions otherwise permissible under U.S. sanctions relief implemented pursuant to the Joint Comprehensive Plan of Action (JCPOA or “the Agreement”) in January 2016.

Together, these clarifications provide guidance of particular relevance to non-U.S. financial services institutions, which, to date, have proven reluctant to support or participate in Iran-related transactions, notwithstanding sanctions relief measures under the JCPOA implemented by the United States and the European Union. The OFAC guidance follows substantial outreach and meetings of senior Obama Administration officials with major institutional lenders and financial institutions in Europe and elsewhere in recent months encouraging greater participation and support for transactions permitted under JCPOA sanctions relief. Those efforts are consistent with apparent U.S. diplomatic and strategic interests in seeing the JCPOA yield tangible benefits within Iran that validate the value of Iran’s commitments under the Agreement espoused by the country’s current government. It remains to be seen in the weeks ahead to what extent this latest guidance will prove effective in providing a level of comfort necessary to overcome legal, business and reputational risk concerns that appear to have deterred foreign financial institutions from participating in Iran-related transactions.

Limited U.S. Dollar Transactions Permissible

The new OFAC guidance provides that FFIs, including non-U.S. subsidiaries of U.S. financial institutions, can process U.S. dollar-denominated transactions and maintain U.S. dollar-denominated accounts outside of the United States on behalf of Iranian parties, including the government of Iran, the Central Bank of Iran and Iranian financial institutions, provided that the transactions or account activities do not directly or indirectly involve:

- U.S. persons (including the U.S. financial system)
- any SDN
- sanctionable conduct, including support for terrorism, Iran’s human rights abuses, proliferation of weapons of mass destruction and their means of delivery (including ballistic missiles), and support for persons involved in human rights abuses in Syria or for the Government of Syria.

Notwithstanding sanctions relief under the JCPOA, many FFIs, especially European financial institutions, have been reluctant to resume business involving Iran because of risk that they may unwittingly violate residual U.S. secondary sanctions on Iran or damage established relationships with U.S. banks or institutional investors. Additionally, a substantial number of major European banks have paid large fines—in some cases amounting to billions of dollars in penalties—in recent years for violations of U.S. sanctions and are reasonably weary of exposure to future sanctions liability. While many non-U.S. companies appear eager to engage in authorized transactions with Iran, the reluctance of major FFIs to participate in such transactions has arguably limited the level of Iran-related economic activity that was envisioned following the JCPOA.

While this clarification appears to open the door to FFIs maintaining U.S. dollar accounts on behalf of Iranian parties, the potential transfer of funds to or from such accounts continues to be severely constrained. Specifically, FFIs will need to ensure that U.S. dollar transfers to or from such accounts are not processed through the U.S. financial system, including U.S.-located branches or correspondent accounts, or otherwise involve U.S. financial institutions (including their non-U.S. branches, but not their non-U.S. subsidiaries) or other U.S. persons.

Among other open questions, it remains unclear how U.S. dollar-denominated transactions could be processed without transiting such U.S. touch points in practice, given that these transactions generally are processed through correspondent banking relationships that FFIs maintain with U.S. financial institutions. Moreover, even if the transactions do not involve the U.S. financial system, FFIs will need to ensure that the underlying account activities do not implicate any of the continuing restrictions noted in the new guidance, as described above.

Accordingly, while this is the first time that OFAC has articulated circumstances under which processing U.S. dollar transactions or maintaining U.S. dollar accounts on behalf of Iranian parties is permissible, it is important to recognize that OFAC and other agencies of the Treasury Department have not otherwise amended or eased the transaction monitoring and other compliance obligations and restrictions with which FFIs must comply in the conduct of their activities within U.S. jurisdiction.

Secondary Sanctions

In the new guidance, OFAC also provides clarification that non-U.S. persons will not be subject to U.S. secondary sanctions for engaging in transactions with non-SDNs that are minority owned, or partially or wholly controlled, by an SDN. Remaining U.S. secondary sanctions provide a basis for the United States to sanction any party (including non-U.S. persons) for providing material support to, or engaging in a significant transaction with, entities blocked pursuant to certain U.S. executive orders and included on the OFAC SDN List. In this clarification, OFAC “recommends exercising caution” when engaged in transactions involving entities that are minority owned, or partially or wholly controlled, by SDNs “to ensure that such transactions do not involve Iranian or Iran-related persons on the SDN List.”

Due Diligence Guidance

The guidance also clarifies that, for non-U.S. persons conducting due diligence on a potential Iranian counterparty, screening the name of the Iranian counterparty against the SDN List is a minimum standard that should be met, but is not necessarily sufficient on its own to address potential risks of involvement of U.S.-sanctioned Iranian parties in a transaction. The guidance indicates that non-U.S. persons should engage in additional due diligence procedures, consistent with their internal risk assessment processes and industry best practices. Further, the guidance reflects OFAC's expectations that non-U.S. persons will consult with local regulators in the markets where they operate regarding further due diligence expectations. The guidance also includes recommendations for non-U.S. entities to maintain records documenting the due diligence efforts in conjunction with participation in such transactions.

The guidance further specifies OFAC's expectations that FFIs will perform due diligence on their own customers, but not necessarily on their customer's Iranian customers. This clarification provides useful and practical guidance to FFIs on OFAC's expectations regarding the extent to which so-called "KYCC" (know your customer's customer) practices are required in the context of Iran-related transactions.

Conclusion

While OFAC has taken steps to address practical concerns that have been expressed by non-U.S. FFIs, nonetheless, important questions and uncertainties remain. Accordingly, until OFAC affirmatively authorizes activities necessary for Iran-related transactions outside the United States, such as by reauthorizing "U-Turn" financial transactions that transit the U.S. financial system, it remains to be seen to what extent FFIs will engage in such activities, particularly in consideration of broader legal, business and reputational risk concerns.

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