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Treasury Department Creates Assurance Mechanism for Humanitarian Trade with Iran

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November 5, 2019 – On October 25, 2019, the U.S. Department of the Treasury ("Treasury Department"), Financial Crimes Enforcement Network ("FinCEN"), issued a final rule under Section 311 of the USA PATRIOT Act that identified Iran as a "jurisdiction of primary money laundering concern." At the same time, the Treasury Department and the U.S. Department of State ("State Department") announced that they would establish a mechanism for financial institutions and governments to increase transparency into humanitarian trade with Iran. Both measures target financial transactions involving Iranian financial institutions and place additional due diligence requirements on U.S. and non-U.S. financial institutions with respect to these transactions.

USA PATRIOT Act Measures

Section 311 of the USA PATRIOT Act, 31 U.S.C. § 5318A, authorizes FinCEN, upon designating a non-U.S. country a "primary laundering concern," to require U.S. financial institutions and domestic financial institutions to take one of five enumerated "special measures," including enhanced record keeping and reporting requirements.

FinCEN classified Iran as a jurisdiction of primary laundering concern, citing Iranian financial institutions like the Central Bank of Iran's ("CBI") money laundering activities on behalf of organized criminal groups, international terrorists, and entities involved in the proliferation of weapons of mass destruction. FinCEN also pointed to high levels of official and institutional corruption in Iran and a lack of comprehensive bank supervision and anti-money laundering laws as further justification for the designation.

Based on its finding that Iran is a jurisdiction of primary laundering concern, FinCEN determined that the Fifth Special Measure under Section 311 was appropriate. The Fifth Special Measure prohibits "the opening or maintaining of correspondent accounts in the United States for, or on behalf of, Iranian financial institutions, and the use of foreign financial institutions' correspondent accounts at covered U.S. financial institutions to process transactions involving Iranian financial institutions." Additionally, the Fifth Special Measure imposes enhanced due diligence requirements on covered financial institutions to guard against prohibited transactions involving Iranian financial institutions, including requirements to notify owners of correspondent accounts that the financial institutions will not process transactions with Iranian financial institutions. Finally, the Fifth Special Measure requires affected financial institutions to implement "risk-based procedures" and screening mechanisms to comply with the requirements.

The Fifth Special Measure is likely to push covered U.S. financial institutions to increase scrutiny of transactions processed for foreign banks to ensure that those transactions are not, in fact, for the benefit of Iran. While foreign banks are generally not subject to U.S. primary sanctions against Iran (which apply to U.S. citizens, permanent residents, persons physically present in the U.S., and entities incorporated under U.S. law or owned or controlled by a U.S. person), the effect of the measure could be to indirectly pressure them to comply with the U.S. embargo against Iran. Because the due diligence required by covered U.S. financial institutions is likely to be comprehensive, foreign banks will be incentivized to choose either ongoing access to U.S. correspondent accounts (thereby allowing them to conduct transactions in U.S. dollars) or continuing business with Iran. In this way, the effect of the measure may be similar to U.S. secondary sanctions, which can apply extraterritorially to entities without a direct nexus to the United States.

Humanitarian Mechanism

In connection with the Section 311 action, the Treasury Department announced a humanitarian mechanism "to help ensure that participating governments and financial institutions commit to conducting enhanced due diligence requirements to mitigate the higher risks associated with Iran-related transactions."

Since the United States withdrew from the Joint Comprehensive Plan of Action ("JCPOA") in May 2018, European governments that remain parties to the deal have tried to persuade the U.S. government to guarantee Iranian imports of humanitarian aid. These governments have noted that, while humanitarian aid is largely exempted from U.S. sanctions prohibitions, foreign financial institutions may avoid all transactions involving Iran out of fear of U.S. primary or secondary sanctions. Many foreign banks now refuse to facilitate any humanitarian trade with Iran, causing a potential shortage of medicine and food in parts of the country.

These financial institutions' risk aversion is neither unfounded nor unreasonable, as the U.S. sanctions regime authorizes various secondary sanctions against foreign financial institutions that facilitate significant transactions with Iran. For example, under the National Defense Authorization Act ("NDAA"), secondary sanctions are authorized against non-U.S. financial institutions that facilitate significant transactions with the CBI, unless the transaction falls under certain humanitarian exemptions. An exemption under the NDAA authorizes foreign financial institutions to facilitate transactions for the sale of food, medicine, or medical devices to Iran, but payments related to other humanitarian items could trigger secondary sanctions if they are considered "significant transactions."

By establishing a humanitarian mechanism, the Treasury and State Departments are presumably responding to concerns expressed by foreign governments by instituting a process "to ensure unprecedented transparency into humanitarian trade with Iran." Citing FinCEN's designation of Iran as a "primary money laundering concern," the Treasury Department announcement stated that the mechanism is intended "to help mitigate the high risk of doing business in a country whose repressive leaders remain intent on diverting resources to fund terrorism." The mechanism is specially designed to restrict CBI's role in the humanitarian trade.

Secretary of the Treasury Steven Mnuchin explained that the mechanism would promote the "unfettered flow of humanitarian aid to the Iranian people" by ensuring that international companies "do not run afoul of sanctions" in the provision of that aid. The humanitarian mechanism establishes a process through which governments and financial institutions may receive written confirmation from the U.S. government that transactions involving humanitarian aid to Iran are carried out in strict compliance with U.S. sanctions. However, the humanitarian mechanism, as described in the Treasury Department's October 25, 2019 press release, will impose increased due diligence requirements on financial institutions and require foreign financial institutions to provide the U.S. government "a substantial and unprecedented amount of information" to receive these assurances.

In a separate document detailing these enhanced due diligence requirements, the Treasury Department explained that, to receive confirmation, foreign financial institutions must "collect, maintain, and report to Treasury, with appropriate disclosure and use restrictions, a great deal of information on a monthly basis." For example, the Treasury and State Departments could require foreign financial institutions to include information to identify and verify the identities of Iranian customers, information about the underlying business relationship, monthly statement balances of Iranian financial institutions' accounts, a list of Iranian designated individuals and entities with which Iranian customers have existing business arrangements, and other detailed information about the transactions involving humanitarian goods. These due diligence requirements could be viewed as setting a *de facto* compliance standard in transactions involving Iran, whether or not those transactions involve humanitarian aid.

Based on the initial information provided by the Treasury Department, this humanitarian mechanism may deter, rather than incentivize, financial institutions from engaging in humanitarian aid transactions with Iran. For one, the enhanced due diligence measures will without question require financial institutions to incur significant additional compliance costs. Furthermore, the due diligence requirements require substantial information from Iranian financial institutions, which may be unwilling to voluntarily share details about their existing customers or transactions with the U.S. government. Initial reactions to the measure have alleged that it will, counterintuitively, further isolate Iran from international markets by forcing banks to "scour" their foreign business relationships for connections to Iran.

It is unclear from the announcement whether financial institutions facilitating humanitarian aid with Iran are *required* to participate in the humanitarian mechanism, or whether they may continue operating without assurances that their activities comply with U.S. sanctions. In any event, in light of steep penalties that the Treasury Department has imposed on non-U.S. financial institutions in recent years for violating Iranian sanctions, some institutions may find that the U.S. government assurances are a positive step in the right direction.

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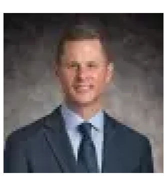

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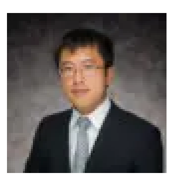

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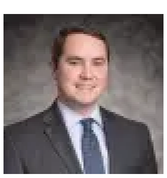

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