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IRAN SANCTIONS | CLIENT PUBLICATION

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Iran Sanctions Relief: Opportunities and Challenges for US and EU Financial Institutions

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Although US and EU sanctions targeting Iran are not likely to be lifted before early 2016, there are a number of issues which US-and EU-based financial institutions should be aware of in preparation for sanctions relief as a result of recent international agreement to lift sanctions in the Joint Comprehensive Plan of Action (the "JCPOA"). This client note highlights some of the main issues.

Key Takeaways

- **Sanctions begin to be lifted on "Implementation Day"**: the obligation for the US and the EU to begin to lift sanctions as set out in the JCPOA[1] takes effect on "Implementation Day." Implementation Day is particularly important for financial institutions, as this is the date on which the majority of financial restrictions in conducting business with Iran are lifted. Implementation Day is defined in the JCPOA as the date on which the International Atomic Energy Agency issues a report verifying that Iran has met its commitments under the JCPOA. This could take several months and the timetable will, in part, be driven by Iran. The US State Department estimates that Implementation Day is likely to take place in early 2016. Implementation Day is the first of a series of dates between Implementation Day and Termination Day (scheduled to take place on 23 October 2025) on which the US and EU will take steps to remove sanctions targeting Iran.[2]

1 The JCPOA is the agreed text between the P5+1, composed of the US, UK, China, Russia, France, and Germany, to lift sanctions targeting Iran, as published on 14 July 2015.

2 See our previous client publication on Iran sanctions for further details on key dates in the JCPOA, available at: http://www.shearman.com/~/media/Files/NewsInsights/Publications/2015/07/Looking-Forward-to-Lifting-of-Sanctions-Against-Iran-IP-071515.pdf

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- **Iran sanctions not covered by the JCPOA remain**: the JCPOA does not remove all US and EU sanctions targeting Iran. Certain US and EU sanctions which are outside of the scope of the JCPOA, such as those relating to terrorism and human rights violations in Iran, are likely to remain in force for many years.
- **Termination of US "secondary sanctions" which restrict non-US persons**: on Implementation Day, most US "secondary" sanctions will be terminated. Secondary sanctions prevent "US persons," such as US financial institutions, from conducting business with non-US persons if non-US persons fail to comply with the US secondary sanctions regime. "US person" is an extremely broad concept, which brings within the scope of US primary sanctions: (i) any US citizen; (ii) any overseas national permanently resident in the US, wherever situated in the world; (iii) any person while in the US; (iv) any US organized company and its foreign branches; (v) any US subsidiary of a foreign company; and (vi) any foreign company with a branch or other presence in the US. In practice, a very large number of financial institutions operating internationally are either US persons due to their business organization or, if they are not US persons, treat themselves as US persons to ensure that they do not inadvertently breach US sanctions.
- **However, US "primary sanctions" remain**: notwithstanding the lifting of US secondary sanctions on Implementation Day, non-US financial institutions will continue to be constrained by US "primary" sanctions (i.e. US rules which affect what US persons can do), particularly controls on US dollar clearing. Banks that violate US sanctions may be barred from clearing dollar transactions. There is currently no indication that non-US banks will be permitted to engage in dollar transactions relating to Iran. The continued existence after Implementation Day of US primary sanctions is likely to prevent many non-US financial institutions from wishing to be the first mover into Iran after Implementation Day, or even one of the first few.
- **OFAC have suggested that agreements with Iranians take into account for "snap back"**: recent guidance from the US Office of Foreign Assets Control (OFAC) suggests that agreements with Iranians should include termination provisions to account for the possibility of re-instatement of US or EU sanctions if Iran fails to comply with the terms of the JCPOA. There have not been similar pronouncements in the EU.
- **Financial institutions subject to the laws of more than one jurisdiction**: US- and EU-based financial institutions may also have duties to comply with Iran-related sanctions enacted by other jurisdictions even after US and EU sanctions begin to be lifted. Switzerland has recently repealed sanctions targeting Iran. Canada has indicated that it is not lifting Iran sanctions. There have not yet been clear pronouncements in Australia or Japan as to how or when their Iran sanctions may be lifted.

United States Commitments under the JCPOA: Impacts for Financial Institutions

US Primary Sanctions:

US "primary" sanctions apply to US persons, as well as non-US entities that are owned or controlled by a US person, non-US persons who cause US persons to violate sanctions maintained by OFAC, and to persons involved in transferring US-regulated goods or technology to Iran.

With limited exceptions, US primary sanctions are untouched by the JCPOA and will remain in place after Implementation Day. Therefore, with few exceptions and subject to narrow licenses granted by OFAC (most of which do not have significant impacts in the financial sector—e.g. licenses for exportation of medical supplies to Iran), US persons will continue to be prohibited from engaging in transactions or dealings in, or with, Iran.

Primary sanctions encompass a broad range of financial activities, and include prohibitions on US dollar clearing for transactions involving Iranians or the Government of Iran (recent OFAC guidance suggests that there will be no licensing for US dollar clearing transactions with Iran), as well as rules enacted to address terrorism and human rights-related violations. Companies that are required to file quarterly or annual reports with the US Securities and Exchange Commission will continue to be required to disclose activities involving Iran in their reports under Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012. While the JCPOA requires that the US government takes "appropriate steps" to actively encourage changes to state and local sanctions laws to ensure consistency with the JCPOA, the extent of the US federal government's influence on US state and local prohibitions on activities involving Iran is currently unclear.

The JCPOA however provides for de-listing of a large number of Iranian entities and individuals, including 83 Iranian banks, from OFAC's Specially Designated Nationals and Blocked Persons List, the Foreign Sanctions Evaders List, and the non-SDN Sanctions Act List whose assets will no longer be frozen under US laws.

Since October 2012, OFAC has treated overseas subsidiaries of US companies as persons who are subject to US primary sanctions. The JCPOA carves out from primary sanctions, in full, any foreign subsidiaries of US companies, so that they may carry out activities as non-US persons from Implementation Day. The exemption does not apply to branches of US companies. In its most recent briefing, OFAC suggested that activities "consistent with the JCPOA" would be licensed for foreign subsidiaries of US entities, although we expect OFAC to provide more guidance on specific activities that are "consistent with the JCPOA in the coming months." We are expecting some guidance towards the end of October on the subsidiary question. However, OFAC does not expect to change its position that US persons, such as parent companies, may not facilitate activity that US persons could not do themselves. This poses a major practical obstacle for any activity of foreign subsidiaries.

Secondary Sanctions:

In contrast to the heavily restricted sanctions relief in the JCPOA in relation to US primary sanctions, most secondary sanctions will be terminated on Implementation Day. Secondary sanctions work by threatening non-US companies with the possibility of, among other things, being designated themselves as sanctions targets under US rules if they engage in transactions which are prohibited under the US secondary sanctions regime, even if those transactions take place entirely outside of US jurisdiction. Secondary sanctions currently apply in a number of areas affecting financial business with Iran, including those listed below which will be terminated on Implementation Day:

- Financial and banking transactions with specified Iranian banks and financial institutions, including the Central Bank of Iran;

- Transactions in Iranian Rial;
- Provision of US banknotes to the Government of Iran;
- Disposition of proceeds from the purchase of Iranian oil products;
- Purchase, subscription to, or facilitation of the issuance of Iranian sovereign debt, including governmental bonds;
- Provision of financial messaging services to the Central Bank of Iran and specified Iranian financial institutions;
- Underwriting services, insurance or re-insurance;
- Investment, including participation in joint ventures, goods, services, information, technology and technical expertise and support for Iran's oil, gas and petrochemical sectors; and
- Trade in gold and other precious metals.

To the extent that relevant laws permit non-US financial institutions to conduct the above activities from Implementation Day (as will be the case in the EU, as explained further below), US laws will no longer inhibit any such activity via the application of secondary sanctions.

Not all secondary sanctions are removed, however. Most importantly, non-US financial institutions may be sanctioned themselves if they engage in significant transactions with Iranian persons or entities that remain designated on OFAC SDN lists after Implementation Day, such as Bank Saderat.

As a result of the fact that US financial institutions remain constrained by US primary sanctions after Implementation Day whereas non-US financial institutions appear to be ring-fenced from the scope of OFAC's jurisdiction, there appears to be a significant advantage for non-US financial institutions under the JCPOA in being able to conduct business with Iran. In reality, however, the position is likely to be more nuanced, with non-US financial institutions remaining cautious to do business with Iran for fear of incorrectly navigating the complex US primary sanctions regime. In short, those non-US financial institutions which treat themselves as US persons for the purpose of sanctions compliance in many respects (generally to avoid inadvertently coming into the fold of and breaching US rules) are likely to continue to follow US rules. There are concerns over increasingly aggressive enforcement action by US regulators in recent years against non-US financial institutions for activities such as "stripping" references to sanctioned persons or subject matter in payment messages which are directed to US correspondent banks. This is particularly likely to be the case for non-US financial institutions which have US branches, significant US business or which use intra-group support services with a US element, where the risks are highest. Acknowledging these issues, the UK Department for Business, Innovation and Skills, has stated in a recent notice to business that "[e]ven as sanctions are lifted Iran will remain a challenging place to do business, and banks and other financial institutions may remain reluctant to handle Iran-related transactions while full US sanctions remain in place."

European Union Commitments under the JCPOA: Impacts for Financial Institutions

From Implementation Day, European financial institutions will be permitted to engage in a wide range of financial activities which are currently prohibited by EU Regulation 267/2012 on Iran sanctions (the "EU Regulation"), including the following:

- Transfers of funds between EU persons and entities, including financial institutions, and Iranian persons and entities (including financial institutions) without prior authorisation or notification;
- Banking activities, including the establishment of new correspondent banking relationships and the opening of new branches and subsidiaries of Iranian banks in the territories of EU member states;
- The provision of insurance and re-insurance;
- Transactions in public or public-guaranteed bonds;
- Investment in the oil, gas and petrochemical sectors;
- The delivery of Iranian banknotes and coinage; and
- The export of gold, precious metals and diamonds.

Just like the US, the EU has rules in place which freeze the assets of designated Iranian persons by prohibiting the making available of "funds" or "economic resources" to such persons (in each case, broadly defined), as well as preventing the travel of such persons into or through EU Member States. Under the JCPOA, asset freeze measures targeting Iranians are to be lifted in two phases. First, on Implementation Day, there will be a de-listing of certain Iranian banks including the Central Bank of Iran and its European subsidiaries, and certain Iranian oil, gas, petrochemical and shipping industry companies, including the National Iranian Oil Company, as listed in Attachment 1 to Annex II of the JCPOA. There will be a second round of de-listings of persons listed in Attachment 2 to Annex II of the JCPOA on the earlier of 18 October 2023 or the International Atomic Energy Agency reporting that all nuclear material in Iran remains in peaceful activities (described in the JCPOA as "Transition Day"). Entities which remain listed until Transition Day include Ansar Bank and Bank Saderat. Provision of financial messaging services (i.e. SWIFT) to persons who remain designated is only permitted from Transition Day.

EU sanctions related to Iran's human rights record and support for terrorism (i.e. sanctions which do not relate to the JCPOA's subject matter of "nuclear"-related sanctions) will remain in place and will continue to be enforced by EU Member States.

Sanctions May "Snap Back"

The JCPOA provides for a "snap back" of sanctions so that participants may re-instate sanctions targeting Iran individually or in conjunction with other JCPOA participants in the event that there is "significant non-performance" by Iran of its commitments under the deal. Contracts signed during any relief period (i.e. a period between applicable sanctions being lifted and then being re-instated) are protected for that period.

The JCPOA contains a novel solution to the problem of one or more EU Member States vetoing sanctions, which arises as a result of the requirement under the Treaty on the Functioning of the European Union that EU Member States unanimously agree to the imposition of sanctions as they relate to the foreign policy of the EU. The way this is achieved is to "suspend" rather than "terminate" EU Council Decision 2010/413/CFSP, which provides the legal authority for the EU

Regulation. Because Council Regulations only require a qualified majority of EU Member States to be passed, as opposed to unanimous EU Member State consent in the case of Council Decisions, re-instatement of provisions of the EU Council Decision is achievable by the approval of a qualified majority of EU Member States by Council Regulation. A Council Regulation may then legislate for sanctions to be re-instated.

Possible Impact on Loan Documentation

Recent guidance from the US State Department suggests that, while there would not be an effort to penalize businesses who engaged in legitimate activities during the time of sanctions relief, contracts entered into during that period should include a provision that permits termination in the event of a "snap back." Representations and warranties addressing sanctions risk in current loan documentation may not adequately cover "snap back" risk and therefore should be re-evaluated.

Deals Cannot Be Made Yet

Financial institutions may engage with Iranians for business purposes, provided they do not enter into or negotiate any contracts. In short: doing deals is not yet permitted. In a recent guidance call, OFAC recommended that businesses be "exceedingly cautious" in exploring talks with Iranians prior to lifting of sanctions, because arranging for contracts or services would be in violation of current sanctions in place.

European "Blocking" Regulations

So long as US primary sanctions targeting Iran remain in place, German financial institutions may find themselves in a conflict situation between requests from a US counterparty to comply with US primary sanctions targeting Iran which remain in place after Implementation Day, and German "anti-boycott" laws, in particular, Section 7 of the Foreign Trade and Payments Ordinance, which prohibits German residents from declaring their participation in a boycott against another state in the context of foreign trade. The EU also has anti-blocking Regulations in place (Regulation 2271/96), which prevent EU persons from complying with any requirement or prohibition in US Iran (or Cuba)-related sanctions. Although repeal of US Iran-related secondary sanctions will mean that the EU blocking Regulations are not likely to operate to regulate any activity that could realistically be a problem in practice, the EU blocking Regulations make an important political statement against the extra-territorial scope of US rules to EU persons and, accordingly, it is possible that these rules may not be immediately repealed.

Other Considerations Relating to Conducting Business in Iran

It is critical to understand the Iranian regulatory environment. Iranian laws have fallen out of touch with international standards since the imposition of sanctions and are undergoing significant change in light of the JCPOA. Financial institutions who wish to establish operations in Iran would need to obtain a regulatory licence from the Iranian government. When dealing with government officials and other counterparties, companies should always be sensitive to the wide-ranging extra-territorial scope of some anti-corruption laws, such as the US Foreign Corrupt Practices Act and the UK Bribery Act. Due diligence must also address who the true counterparty is, which may be challenging. Travel to Iran carries a particular set of risks, as the US government authorizes travel and travel-related activities in Iran, but has not excluded from sanctions prohibitions any transactions or contracts that could result from such travel. The UK Foreign & Commonwealth Office no longer advises against all but essential travel to Iran, although contracts cannot be signed with Iranians while in Iran.

Final Thoughts

Although there has been a rush to Tehran to do business across many sectors, prior to Implementation Day (in other words, now) the risk of getting sanctions compliance wrong is at its most acute. Many businesses have begun to explore business opportunities with Iran, which has left little time to assess and manage legal and compliance risk. There is a danger of enforcement action from a multiplicity of enforcement agencies in the US and/or the EU in the absence of a careful legal assessment of the risks involved in proposed activity. Non-US persons that are considering doing business in Iran must also be conscious of the jurisdictional reach of US sanctions, and the need to exclude the involvement of impermissible US elements in such business, which may involve recusing US citizens from certain transactions. The fact that sanctions were not drafted with a process of sanctions lifting in mind has led to ambiguity as to permitted activity in certain cases and interpretative challenges. The absence of regulatory guidance in the US and the EU to date (subject to reminders that sanctions are still fully in place and will be enforced) is likely to be addressed as Implementation Day approaches, which will provide some clarity for those anticipating business opportunities in Iran.

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