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Snapback – Iran reacts to US sanctions

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*US re-imposition of sanctions on Iran and global financial institutions wary of dealing with the country have Tehran dusting off its pre-2015 sanctions-busting playbook, writes **Paul Cochrane** from Beirut. Old networks are being renewed, including with neighbouring countries and China, but there are more obstacles for the Iranian government to contend with this time around.*



Persepolis - bas relief

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On 5 November [2018], six months after the USA pulled out of the Joint Comprehensive Plan of Action (JCPOA) agreement inked in 2015, Washington DC imposed sanctions on Iran targeting the oil sector, banking, and shipping industries. The European Union (EU) and other jurisdictions supporting the JCPOA are in a quandary: keep trading with Iran, as legally permitted under the agreement, or risk being cut off from the US financial system due to the renewed sanctions regime.

EU dilemma

While the other signatories of the JCPOA – the EU, China and Russia – want to keep the agreement going, along with major importers of Iranian hydrocarbons such as Turkey and India, countries are finding it

hard to resist the “extra-territorial effects of US sanctions”, said Roger Matthews, senior director at Dechert LLP’s international trade and EU law practice in London. “China and Russia are less exposed than the EU to the reintroduction of US sanctions, including secondary ones, as their businesses are less integrated into the US economy; similarly, their banks are more insulated from the reach of US measures than most European banks. So, although China and Russia certainly feel the effects of US secondary sanctions, the EU reaction is the most difficult one,” said Matthews.

The stance of the UK’s Treasury is indicative of the EU’s position, said Tashfin Shafique, managing partner and founder of London-based Emerge Consultants, which advises clients on governance, risk and compliance globally. The UK’s Director of the Office of Financial Sanctions Implementation (OFSI) at HM Treasury, Rana Lalgie has said, noted Shafique, “our position has not changed, we advise all companies to do enhanced due diligence, and we are still advising UK companies to export to Iran. The door is open, but we still have the issue of transactions.”

Indeed, there is the rub. Since the JCPOA eased sanctions only a dozen European banks have been willing to carry out transactions with Iranian companies and individuals, such as Austria’s Erste Group Bank, Germany’s DZ Bank, France’s Bank Wormser Frères, and Switzerland’s BCP Bank.

And that was before the US re-imposed sanctions; while the US had relaxed sanctions it still blocked US-based banks from handling financial transactions unless granted specific waivers: “Since 2016, EU banks have not had much reassurance [from regulators] regarding the extra-territorial reach of primary and secondary sanctions, especially to facilitate US dollar transactions, and given the history of large fines from [the US Treasury’s] Office of Foreign Assets Control (OFAC), EU banks are taking a precautionary approach,” said Matthews.

That stance has become even more entrenched in the lead-up to the November reintroduction of US sanctions. “I’m finding a lot of reluctance by financial institutions, and the closing down of any links with Iran. It is going to be very hard engaging with Iran going forward,” said Shafique.

A way to pay?

Europe (especially the European Union, the UK, France and Germany) has pushed back against the US position, with the establishment of a special purpose vehicle (SPV) mooted by the EU to facilitate transfers outside the orbit of the US financial system. No country however appears willing to host the SPV, however. “The EU’s political will to get something done is very high and I expect they will set up a SPV. But I don’t see larger EU corporates using it, although the EU hopes some small and medium sized enterprises (SMEs) will. That said, it is not going to be a large-scale vehicle (for transactions) in the near term,” said Peter Harrell, who worked on Iran sanctions for former President Barack Obama’s State Department and is now a fellow at the Center for a New American Security.

The SPV may get a further push now that SWIFT, the Belgium-based global financial messaging service, is to disconnect US-targeted Iranian banks.

With large European firms having already pulled out of Iran, from French oil giant Total to Germany’s Siemens halting new deals in the country, the trade set to continue is by SMEs that either benefit from US licences exempting them from sanctions against Iran or do not have a footprint in the US market.

“It should be remembered that the US’s secondary sanctions target certain sectors and don’t prohibit everything; some exports, such as many conventional or non-sensitive manufactured goods are not so affected, although the associated payments might be, which is where the EU’s proposed SPV may become relevant. For most businesses I’d advise high degree of caution in business with Iran, for not only the sanctions risk but also the money laundering and corruption risk,” said Matthews.

SMEs would do well to adopt a cautious approach with Iran, said Saeed Ghasseminejad, senior advisor on Iran at the Foundation for Defense of Democracies, a Washington DC-based think-tank. “The US Treasury has not historically gone after SMEs, usually after big companies or fronts, so they may feel they are secure, but Treasury could discourage trade by making an example of SMEs,” said Ghasseminejad.

Trade East, not West

Iran has condemned the US re-imposition of sanctions, with President Hassan Rouhani vowing the country will “proudly break the sanctions”. According to analysts, Iran will go back to the tried and tested means of sanctions evasion used prior to 2015. Conversely, regulators and compliance officers around the world are prepping for the same.

“For banks the real issue is to dust off the kinds of evasion typologies and red flags looked for intensely in 2012, 2013 and 2014, as Iranians will probably go back to those tactics over the next 12 to 14 months,” said Harrell.

China is Iran’s largest trade partner and was a major conduit for Iranian transactions pre-2015. While Beijing has opposed the unilateral sanctions, China is more hesitant about serving as one of Iran’s primary financial outlets. At the beginning of November, the Bank of Kunlun, owned by Chinese state-run energy giant CNPC and considered a key Chinese conduit for Iranian transactions, stopped accepting Chinese Yuan Renminbi-denominated Iranian payments after stopping Euro payments in the summer. Such reluctance, unlike prior to 2015, is over US sanctions concerns.

“We are seeing larger Chinese banks and companies shy away from Iran, as they were struck by the US\$1 billion fine that [mobile phone company] ZTE paid (in the USA in mid-2018 for evading sanctions on Iran and North Korea), so there may be de-risking by Chinese majors. But do I really think China over the long term is going to largely exit Iran as a market? No, but it will be smaller banks and companies that will stay on,” said Harrell.

The current trade war between China and the USA is a further factor for Beijing not being willing to “be seen as Iran’s white knight”, added Harrell. “China doesn’t want to invest in a highly political ‘we are saving Iran’ issue. The trade war with the US is more important than Iran, which is a second or third tier issue.”

While Iranians want oil exports to continue and financial lines to remain open with China, Tehran is – maybe unsurprisingly – not overly keen on relying on China. “China is the best place for Iran to continue having trade and the goods they need, but China has not been a very honest partner with Iran, charging them premium prices for services. Tehran has often said China was supposed to release funds [for oil payments] but has not always done it,” said Ghasseminejad.

However, with few other alternatives, Iran will keep using Chinese financial institutions, despite ongoing tensions between Chinese banks and Iranian customers, according to Ghasseminejad. He added there have been reports of Asadollah Asgaroladi, one of Iran’s richest men, and Chairman of the Iran-China Joint Chamber of Commerce, trying to establish an Iran-China bank.

Meanwhile, other old and new conduits are being utilised by Iranians. “It is not just China, but the Gulf, Iraq and the Caucasus that banks need to be watching out for as well,” said Harrell. “Georgia and Armenia are places to watch, as many Iranian business networks were established there over the last few years,” said Ghasseminejad. With Armenia sharing a border with Iran, and Georgia with Armenia, they may become preferred bases for sanctions busting, he added.

Dubai in the United Arab Emirates (UAE) has been a major re-export and financial hub for Iran, and remains so, but due to heightened tensions between the Gulf Cooperation Council (GCC) countries and Iran, and anxiety about US sanctions, “it is going to be very difficult to have any connection between Dubai and Iran going forward,” said Shafique.

Oman, which has kept good relations with Iran and the Gulf countries, may take over from Dubai, although it lacks the Emirate’s infrastructure and financial services. Nonetheless, Bank Muscat has been planning an Iranian joint venture, with a branch in Tehran and one in the Omani capital, Muscat, according to Shafique.

A new outlet for Iran may come through the Indian-financed port of Chabahar, in south-east Iran, which is mainly used by India for trade with Afghanistan, for which the US has issued a waiver from its sanctions. “It could become a big hole in the US sanctions system as we will be relying on Indian and Afghan officials to prevent sanctions-busting schemes through that channel,” said Ghasseminejad.

Turkey, which has also been granted a waiver by the US, is likely to remain as a trade hub for Iran due to its long land border, but the Turkish financial sector has been spooked by the trial this year of a Halk Bank executive in the US for evading sanctions. The bank facilitated the flow of some US\$1 billion in Iranian funds through a scheme that involved exporting gold to Dubai.

“If Turkey doesn’t obey the new Iran sanctions there will be a higher fine for Halk Bank, so there’s more leverage for the US to use against Turkey,” said Selcuk Colakoglu, director of the Ankara-based USAK Center for Asia-Pacific Studies.

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