Iran Sanctions Changes Will Impact Foreign Financial Institutions in 2016

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The historic agreement that the P5+1 (the United States, the United Kingdom, France, China, Russia and Germany) and the European Union reached with Iran on July 14, 2015, which came into effect January 16, 2016, will uniquely affect non-U.S. financial institutions. In recent years, such institutions have been the focal point of U.S. efforts to increase sanctions pressure on Iran, and the present easing of U.S. secondary sanctions provides measured relief for foreign financial institutions and other foreign companies engaged in certain activities involving Iran. Still, the U.S. embargo on Iran remains very much in place, and the vast majority of transactions involving Iran continue to be prohibited for U.S. persons.

The easing now means that non-U.S. financial institutions will be able to engage in certain business with Iran, including many Iranian financial institutions, without the threat of secondary sanctions. Some secondary sanctions risks persist, and restrictions applicable to U.S. persons remain largely unchanged, so non-U.S. financial institutions must approach their potential business with Iran with caution and diligence.

The Agreement. As discussed in our July 23, 2015, client alert, the agreement provides Iran with phased relief from United Nations, United States and European Union nuclear-related sanctions in exchange for technical steps Iran takes. U.N., U.S. and EU sanctions relief was to begin on "Implementation Day," if and when the International Atomic Energy Agency verified that Iran had taken specific actions set out in the agreement. Implementation Day occurred on January 16, 2016, and the United States is carrying out its relief by terminating select executive orders issued by the president, committing not to exercise certain discretionary authorities, waiving specific statutory provisions and issuing certain licenses.

Secondary Sanctions Relief. The vast majority of U.S. sanctions relief provided under the agreement affects only "secondary sanctions," a set of measures that targets foreign banks and other foreign companies engaged in certain activities involving Iran. The U.S. embargo on Iran remains in place, with only limited openings created by the agreement for U.S. individuals and entities.

The U.S. secondary sanctions that were lifted on Implementation Day include those with respect to financial activities conducted by non-U.S. financial institutions, such as: transactions with specific individuals and entities, including the Central Bank of Iran, most Iranian financial institutions and certain other important Iranian commercial actors (such as the National Iranian Oil Company and the Islamic Republic of Iran Shipping Lines); transactions in the Iranian rial; and the provision of U.S. banknotes to the government of Iran.

In addition, non-U.S. financial messaging service providers are now allowed to readmit delisted Iranian financial institutions to their networks without exposure to secondary sanctions. Secondary sanctions on financial transactions in support of certain trade activities (*e.g.*, energy, automotive, shipping, shipbuilding and precious metals) have also been suspended.

Pursuant to a general license issued by the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) on Implementation Day, non-U.S. financial institutions that are owned or controlled by U.S. persons and are established or maintained out of the United States are now permitted, with certain exceptions, to engage in these activities subject to sanctions relief.

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Secondary Sanctions Risks Expected to Remain. Significantly, much of the U.S. secondary sanctions architecture, including statutes such as the Comprehensive Iran Sanctions, Accountability and Divestment Act of 2010 and the Iran Freedom and Counter-Proliferation Act of 2012, remains in place. As a result, non-U.S. financial institutions that engage in significant transactions with Iranian individuals and entities that remain on the OFAC List of Specially Designated Nationals and Blocked Persons (SDN List) continue to risk losing access to dollar-clearing through U.S. financial institutions. While many significant commercial enterprises in Iran were removed from the SDN List on Implementation Day, certain Iranian banks and other entities — such as Bank Saderat and Khatam al-Anbiya — remain listed and are not scheduled for removal by OFAC as part of the agreement. The likelihood that additional Iranian individuals and entities will be added to the SDN List continues, particularly as U.S. sanctions on Iran related to terrorism or human rights generally are not affected by the Agreement. Indeed, on January 17, 2016, OFAC designated 11 entities and individuals involved in procurement on behalf of Iran's ballistic missile program.

No Return of the U-Turn. Since the agreement does not significantly change the sanctions landscape for U.S. persons, most transactions involving Iran remain prohibited for U.S. persons. Until November 2008, a general license permitted U.S. financial institutions to clear "U-turn" transactions, *i.e.*, Iranian U.S. dollar transactions that began and ended with a non-U.S. and non-Iranian financial institution. Many observers wondered whether the U-turn general license would be reinstated as part of the U.S. sanctions relief under the agreement, but the U.S. Department of the Treasury publicly sought to dispel that prospect ahead of Implementation Day, and no accommodation was made to allow U-turn transactions on Implementation Day. Transactions involving Iran processed by or through U.S. financial institutions will continue to present a risk of sanctions violation for non-U.S. financial institutions and could result in civil or criminal penalties.

Possibility of Sanctions Snapback. Any member of the P5+1 retains the ability to snap back U.N. sanctions if it deems Iran is not meeting the terms of the agreement. Similarly, the president can re-impose suspended U.S. sanctions if Iranian obligations are not met. To ensure compliance, it will be important for non-U.S. financial institutions to closely monitor the specific contours of the relief and observe the progress of the relief as it is phased in.