IMPEDIMENTS TO CORRESPONDENT BANKING WITH IRAN

- Iran has faced economic sanctions that contributed to severe damage in its correspondent banking relationships disconnecting Iran from the global financial system and disrupting cross-border flows including trade finance and remittances.

- Despite the lifting of international nuclear sanctions on January 16, 2016—"Implementation Day" under the Joint Comprehensive Plan of Action (JCPOA)—Iranian banks face protracted difficulties in re-entering the international financial system through correspondent relationships with global banks.

- SWIFT reconnected the Central Bank of Iran (CBI) and a large number of Iranian banks, and over 200 small and medium-sized international banks have started correspondent relationships with Iranian banks which reduced the cost and improved the timeliness of payments.

- Important challenges that prevent Iranian banks fully reconnecting to global banks remain. Those mostly relate to remaining U.S. sanctions as well as the regulatory environment of enforcement, the significant deficiencies in Iran’s Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework including lack of transparency of Iranian companies. The absence of larger correspondent banks (Tier I) can hamper trade and investment, as large-scale operations often require banks with adequate financing capacity.

- Domestic policy reforms can potentially facilitate the reconnection to non-U.S. global banks. These reforms need to be targeted to bolstering the effectiveness of the AML/CFT framework including increasing entity transparency to improve the integrity of the financial sector and getting removed from the Financial Action Task Force’s (FATF) list of high-risk and noncooperative jurisdictions.

A. Sanctions on Iran’s Financial System Have Been Only Partly Lifted

1. **For the past 10 years, Iran has faced economic sanctions that severely damaged correspondent banking relationships (CBRs).** The first sanctions were imposed following the Iranian revolution in 1979. In 2006, the United Nations (UN) introduced its first sanctions on Iran to halt its uranium enrichment program. In 2012, the U.S., UN and the European Union (EU) tightened sanctions introducing an oil embargo and banning financial transactions with Iranian banks. This resulted in withdrawal of foreign banks from CBRs with Iranian banks. According to the CBI, the number of CBRs dropped from 633 in 2006 to around 50 in 2014.

2. **The JCPOA resulted in significant sanctions relief.** The EU economic sanctions targeting Iran which related to the nuclear program have been amended or removed altogether, lifting many of the restrictions for European banks to process transactions with Iranian banks or on behalf of Iranian entities. U.S. so-called “secondary” sanctions (see Box 1) have also been removed, with some exceptions, reducing the risk that non-U.S. financial institutions will be sanctioned by

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2 Secondary sanctions continue to apply to non-U.S. persons who knowingly facilitate significant transactions with or provide material or certain other support to individual and entities on the SDN list.
U.S. authorities for engaging in transactions with Iran or sanctioned Iranian entities. Thus, in principle, EU financial institutions are now free to undertake a wide range of transactions in Iran including in finance and energy sectors.

3. **However, other sanctions remain in place.** U.S primary sanctions\(^3\) apply to U.S. financial institutions and companies, including their non-U.S. branches (but not their subsidiaries). Moreover, with very limited exceptions, businesses and individuals related to the U.S. continue to be prohibited generally from dealing with Iran, including with the government. The so-called “U-Turn” transactions (Box 1) remain prohibited. U.S. dollar clearing restrictions have not been lifted and pose a significant challenge for non-U.S. banks who may do business in Iran, but may not be paid in U.S. dollars.\(^4\) Foreign financial institutions may process transactions denominated in U.S. dollar or maintain U.S. dollar-denominated accounts that involve Iran provided that such transactions or account activities do not involve, directly or indirectly, the U.S. financial system or any U.S. person and do not involve any person on the Specially Designated Nationals (SDN) list (box 1). As a result, non-U.S. companies are unable to access the U.S. financial system for transactions with Iranian counterparties. Companies with U.S. bank accounts cannot send or receive funds that are connected to Iranian business. Furthermore, transactions related to Iran involving significant amounts in nondollar currencies (e.g. India, Korea, Oman) are also proving difficult to convert into other currencies without converting into dollars first.

4. **The United Nations, the EU and the U.S. maintain “black lists” of prohibited individuals and entities under Iran sanctions.** Not all listed entities under the Iran program were removed on Implementation Day, and U.S. and non-U.S. companies continue to be prohibited from dealing with listed individuals and entities. Additionally, companies still face restrictions on doing business with Iranian individuals and entities—even if they are removed from the SDN List—because of continuing U.S. sanctions on Iran’s weapons program and human rights violations.

5. **In relation to the (AML/CFT), the Financial Action Task Force (FATF) listed Iran on its “black list.”** In October 2007, the FATF originally called on countries to take measures to mitigate the money laundering and terrorism financing (ML/TF) risks emanating from Iran, primarily by asking financial institutions to apply enhanced due diligence measures when dealing with transactions to or from Iran. From February 2008 onwards, it called on countries to apply effective countermeasures to protect the international financial system from the ML/TF risks emanating from Iran. In June 2016,

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\(^3\) The U.S. maintains sanctions against Iran related to support for terrorism, proliferation of weapons of mass destruction including ballistic missiles, support for persons involved in human rights abuses in Syria or for the Government of Syria and support for persons threatening the peace, security, or stability of Yemen, and human rights abuses. For more information: [https://www.treasury.gov/resource-center/sanctions/Programs/Documents/jcpoa_faqs.pdf](https://www.treasury.gov/resource-center/sanctions/Programs/Documents/jcpoa_faqs.pdf)

\(^4\) Non-U.S. banks also need to conduct due diligence to ensure that they are not transacting with entities and individuals on the Specially Designated Nationals list.
following Iran’s commitment to addressing the significant deficiencies in its AML/CFT framework, the FATF decided to keep Iran on the public statement (the “black list”), while calling for a suspension of countermeasures for a period of twelve months.

Box 1. Glossary of U.S. Economic Sanctions

**JCPOA**: On July 14, 2015, the P5+1 (China, France, Germany, Russia, the United Kingdom, and the United States), the European Union, and Iran concluded a Joint Comprehensive Plan of Action (JCPOA) to ensure that Iran’s nuclear program will be exclusively peaceful. October 18, 2015 marked Adoption Day of the JCPOA, the date on which the JCPOA came into effect and participants began taking steps necessary to implement their JCPOA commitments. January 16, 2016, marks Implementation Day of the JCPOA.

**Primary Sanctions**: For the purpose of primary U.S. sanctions administered by the U.S. Treasury-Office of Foreign Assets Control (OFAC), the term “U.S. person” means any U.S. citizen, permanent resident alien, entity organized under the laws of the U.S. or any jurisdiction within the U.S. (including foreign branches), or any person in the U.S. Secondary sanctions generally are directed toward non-U.S. persons for specified conduct involving Iran that occurs entirely outside of U.S jurisdiction and does not involve U.S persons.

**Secondary Sanctions**: Those are generally being directed toward non-U.S. persons for specified conduct involving Iran that occurs entirely outside of U.S jurisdiction. “Non U.S. person” means any individual excluding any U.S. citizen, permanent resident alien, entity organized under the U.S. laws or any jurisdiction within the U.S (including foreign branches), or any person in the U.S.

**SDN List**: As part of its enforcement efforts, OFAC publishes a list of individuals and companies owned or controlled by, or acting for or on behalf of, targeted countries. It also lists individuals, groups, and entities, such as terrorists and narcotics traffickers designated under programs that are not country-specific. Collectively, such individuals and companies are called “Specially Designated Nationals” or “SDNs.” Their assets are blocked and U.S. persons are generally prohibited from dealing with them.

**U-Turn general license**: These licenses allowed U.S dollar clearing activities involving Iran prior to its revocation in November 2008, was not reinstated on Implementation day, and U.S. financial institutions continue to be prohibited from clearing transactions involving Iran with the exception of transactions that exempt or authorized by a general or specific license.¹

**Snap-back of sanctions**: Under the JCPOA, there is a period of 10 years during which Iran could be subjected to the reinstatement of sanctions in case of nonperformance of its nuclear-related obligations. Both the UN and the U.S. have “snap-back” provisions to reinstate sanctions instantly in such event.

¹ Prior to November 2008, U.S. financial institutions were authorized to process certain transfers for the direct or indirect benefit of Iranian banks, other persons in Iran or the Government of Iran, provided such payments were initiated offshore by a non-Iranian, non-U.S. financial institution and only passed through the U.S. financial system en-route to another offshore, non-Iranian, non-U.S. financial institution.
B. Progress in Re-connecting Iranian Banks with Global Financial Banks

6. JCPOA sanction relief resulted in reconnecting Iran’s financial system to small and medium-size non-U.S. banks. According to the CBI, 238 small and medium-sized international banks\(^5\) have started correspondent relationships with Iranian banks. Bankers’ Almanac has 178 reports of CBRs in 11 different currencies (See Figures 1 and 2). Those are opening accounts and letters of credit with foreign banks and conduct currency transfers in the form of issuing payment orders for foreign exchange services and imports. However, the lack of larger correspondent banks (mostly Tier I) can hamper trade and investment, as large-scale operations often require banks with adequate financing capacity.

7. Increased access has bought benefits. SWIFT reconnected the Central Bank of Iran and 15 nonsanctioned Iranian banks\(^6\) in February 2016 (having been disconnected in March 2012), allowing them to resume cross-border payment transfers related to oil shipments and other foreign trade with foreign counterparts. In addition, international branches of Iranian banks opened in Europe and were reconnected to TARGET 2.

8. Important challenges remain that prevent Iranian banks fully-reconnecting to global non-U.S. banks. Those are mainly related to:

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\(^5\) According to same report, 13,995 letters of credit (worth $12.8 million) were opened. The report notes that in 2014, Iranian banks had 50 CBRs (633 before the sanctions) and has risen to 238 by end-2016.

\(^6\) Not all of the EU sanctions on Iranian banks have been repealed. Swift continues to be prohibited from providing specialized financial messaging services to several EU-sanctioned Iranian banks under EU regulation (which are also those still under the U.S. Specially Designated Nationals List).
a. **The complexity of the remaining sanctions**: For the first time in many years, U.S. and EU sanctions on Iran are no longer broadly aligned. The commitments of the United Nations, U.S and EU under the JCPOA and related sanctions relief vary widely, raising significant compliance challenges for financial institutions which follow both U.S. and EU rules. In addition, half of U.S. states have restrictions on companies that do business in Iran. As of June 2016, thirty-two states (including New York where most global U.S. banks conduct their operations including CBRs) and Washington D.C have some form of state-level sanctions with the most frequent being measures to block investments of pension funds and government contracts with companies doing business in Iran. Furthermore, non-U.S. global banks must also take into account the possibility that nuclear sanctions could be re-imposed or “snapped back” (see box 1) in the event that Iran has not fulfilled its obligations. Finally, sanctions are in some instances being renewed or intensified. On December 15, 2016, the Iran Sanctions (10 years) extension Act became law. On February 3, 2017, other nonnuclear sanctions, including SDN list restrictions, were broadened to cover new individuals (13) and companies (12) in February 2017 following Iran’s test of ballistic missiles.

b. **The regulatory environment related to major enforcement actions against banks**: Global banks face an extremely high compliance burden to do business with Iran. In recent years, various financial institutions have faced large fines for violations of economic sanctions. As a result, banks have upgraded their compliance measures and this has increased their costs and which has eroded the profitability of CBRs.

c. **FATF listing and deficiencies in the AML/CFT regime**. Although the FATF eased its stance on Iran in light of action plan to address AML/CFT deficiencies, Iran will need to enhance its AML/CFT framework substantially in order to be removed from the “black” list which would ease its full return to the international financial system.

d. **Difficulty of foreign banks in identifying prohibited individuals and entities**. Non-U.S. companies have to conduct careful due diligence to ensure that they are not dealing with prohibited counterparties, and the compliance process is extremely difficult and costly in part because of lack transparency and complex ownership structure of many Iranian corporates that makes it very difficult to identify their ultimate beneficial owner(s).

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8 The Iran and Libya Sanctions Act of 1996 (ILSA) was a 1996 Act of Congress that imposed economic sanctions on firms doing business with Iran and Libya. On September 30, 2006, the act was renamed to the Iran Sanctions Act (ISA), as it no longer applied to Libya, and extended until December 31, 2011.
C. Potential Policy Options that can Facilitate the Reconnection to Non U.S. Global Banks

9. **Domestic policy reforms can potentially facilitate the reconnection to non-U.S. global banks.** Those mainly related to bolstering the effectiveness of the AML/CFT framework including improving entity transparency in order to improve the integrity of the financial sector, get removed from the FATF list of high-risk and noncooperative jurisdictions, and facilitate further the re-integration of the domestic financial system into the global economy.

10. **Iran has made already made progress in strengthening the AML/CFT framework.** In March 2016, the Parliament adopted a CFT law and made a high-level political commitment to implement an action plan (Box 2). The authorities have requested a Fund assessment of the AML/CFT regime against the FATF standard which will take place late 2018. They also became an observer to the Eurasian AML/CFT group.

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<th>Box 2. Iran’s Action Plan with the FATF</th>
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<td><strong>In June 2016, Iran made a formal high-level commitment to FATF to implement its action plan to strengthen its AML/CFT framework.</strong> As a result, although FATF decided to keep Iran on the public statement (the “black list”), it called for a suspension of countermeasures for a period of twelve months. Full implementation of the plan will allow Iran to be considered for complete removal from FATF listing. However, if the FATF determines that Iran has not demonstrated sufficient progress, the call for countermeasures will be re-imposed.</td>
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<td><strong>The suspension of the countermeasures eased Iranian banks reconnection to the small and medium size banks.</strong> Countermeasures comprise, among others, enhanced due diligence on the quality of respondent institution’s AML/CFT controls; restrictions on opening of correspondent accounts; and not allowing Iranian banks to open subsidiaries in foreign jurisdictions. FATF maintained its call on members to apply enhanced due diligence to business relationships and transactions with natural and legal persons from Iran. Each member country can continue imposing countermeasures based on its own assessment of risks and independently of any call by the FATF.</td>
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<td><strong>Most of the items under the action plan are related to legislation and regulations.</strong> The action plan with the FATF includes 10 items with deadlines between May 2017 and January 2018 that are intended to rectify Iran’s strategic AML/CFT deficiencies. They are related to the proper criminalization of the money laundering and terrorist financing offenses, confiscation and provisional measures, freezing of terrorist financing assets in line with relevant United Nations Security Council Resolutions, ensuring proper AML/CFT requirements (preventive measures and customer due diligence) for the financial sector, enhancing the role of the financial intelligence unit and the reporting of suspicious transactions, ratifying relevant United Nations Conventions (Palermo convention on transnational organized crime, 2000; New York convention for the suppression of the financing of terrorism , 1999), and improving international cooperation in regulating alternative remittance systems, wire transfers, and cash couriers.</td>
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11. **However, the Iranian AML/CFT framework needs further strengthening as a matter of priority.** Iran needs to adopt significant reforms to bring its framework in line with international standards and improve its effectiveness. This will take time as the authorities have to develop an effective framework to address and mitigate underlying inherent risks, which will allow correspondent banks to improve the risk profile of Iran. In addition to meeting the action plan with the FATF, reforms should prioritize improving the understanding of ML/TF risks, enhancing the regulatory and supervisory frameworks, and bolstering entity transparency:
a. **Iranian authorities should improve their understanding of ML/TF risks** by conducting a national risk assessment in line with the FATF standards.

b. **AML/CFT regulation and supervision should be built around a forward-looking risk-based assessment.** The CBI should enhance the risk-based supervision of banks and impose corrective actions and sanctions when relevant.

c. **Mechanisms need to be developed to ensure entity transparency.** This would improve compliance with international standards and lower the cost of compliance for correspondent banks. A public registry for beneficial ownership would allow timely access to adequate, accurate, and current information on beneficial ownership of all types of entities in Iran. In June 2016, the United Kingdom launched a public register for beneficial ownership information of companies to enhance their transparency. This made the information available and accurate, and easily accessible.

d. **Iranian banks should continue improving their compliance to enhance their relationship and bolster trust with correspondent banks.** This could be done by investing in AML/CFT internal controls including by upgrading compliance systems and training staff, specializing in low risk business, and getting external certification or third part audit of their AML policies and procedures. Correspondent banks can provide technical assistance to clarify their risk tolerance policies to Iranian banks as well as help build their capacities.

Finally, continued strengthening of the framework in line with international standards will help mitigate the risks related to ML/TF and underlying offenses (e.g., corruption, tax crimes).
References


