



Iran's financial institutions and OFAC

How to manage secondary sanctions risks



United States (“U.S.”) sanctions against Iran are constantly evolving, making it difficult for busy compliance professionals to stay current. Additionally, non-U.S. entities face the possibility of U.S. secondary¹ sanctions if they violate these laws, even if their activity is permissible under local country laws and regulations. As discussed below, the U.S. government is increasing efforts to isolate Iran from the rest of the world and raising the stakes for non-U.S. entities engaging in legal trade involving Iran. This may put non-U.S. companies in the challenging position of maintaining access to both U.S. and Iranian banks.

The U.S. Department of the Treasury, Office of Foreign Assets Control’s (“OFAC”), recent action designating 18 Iranian banks² makes the sanctions landscape even trickier to navigate. Non-U.S. companies are facing additional pressures to limit their interactions with these banks or risk repercussions. Understanding this new action in the context of your business activity and developing a compliance plan will help manage the risk. At KPMG, we have the substantive knowledge and practical experience to help your institution evaluate sanctions risks and develop mitigating controls.

OFAC targeting the Iranian financial sector

On October 8, 2020, OFAC sanctioned 18 major Iranian banks after identifying Iran’s financial sector pursuant to Executive Order 13902 (E.O. 13902). E.O. 13902 authorizes OFAC to impose sanctions on key Iranian economic sectors. As a result of a determination that these banks are critical to “[f]und and support [Iran’s] nuclear program, missile development,

terrorism and terrorist proxy networks, and malign regional influence”³ they were added to the List of Specially Designated Nationals and Blocked Persons (“SDNs”). While the majority of Iranian banks were already subject to secondary sanctions, these new designations seek to ensure that these risks associated with secondary sanctions apply to the entire Iranian banking system, making unauthorized (by the U.S.) cross-border business nearly impossible.

Financial institutions and non-U.S. persons engaging in transactions with these banks had a 45-day wind-down period before becoming subject to sanctions. This period ended on November 22, 2020. Additionally, General License L authorizes transactions with Iranian financial institutions for certain humanitarian-related transactions or activities, such as conducting or facilitating a transaction for the provision (including any sale) of agricultural commodities, food, medicine, and medical devices to Iran.⁴

¹ Secondary sanctions put pressure on third parties to stop their activities with the sanctioned country by threatening to cut-off the third party’s access to the sanctioning country.

² U.S. Department of the Treasury press release, “Treasury Sanctions Eighteen Major Iranian Banks,” dated October 8, 2020.

³ Ibid.

⁴ U.S. Department of the Treasury’s Office of Foreign Assets Control Frequently Asked Question #845.

However, after November 22, 2020, a non-U.S. person or entity engaging in “significant”⁵ transactions with one of these banks on the SDN List may be subject to sanctions. Should that occur, U.S. persons and entities would be precluded from conducting business with these designated entities and any assets coming within the jurisdiction of the U.S. would be required to be blocked.

What is the impact?

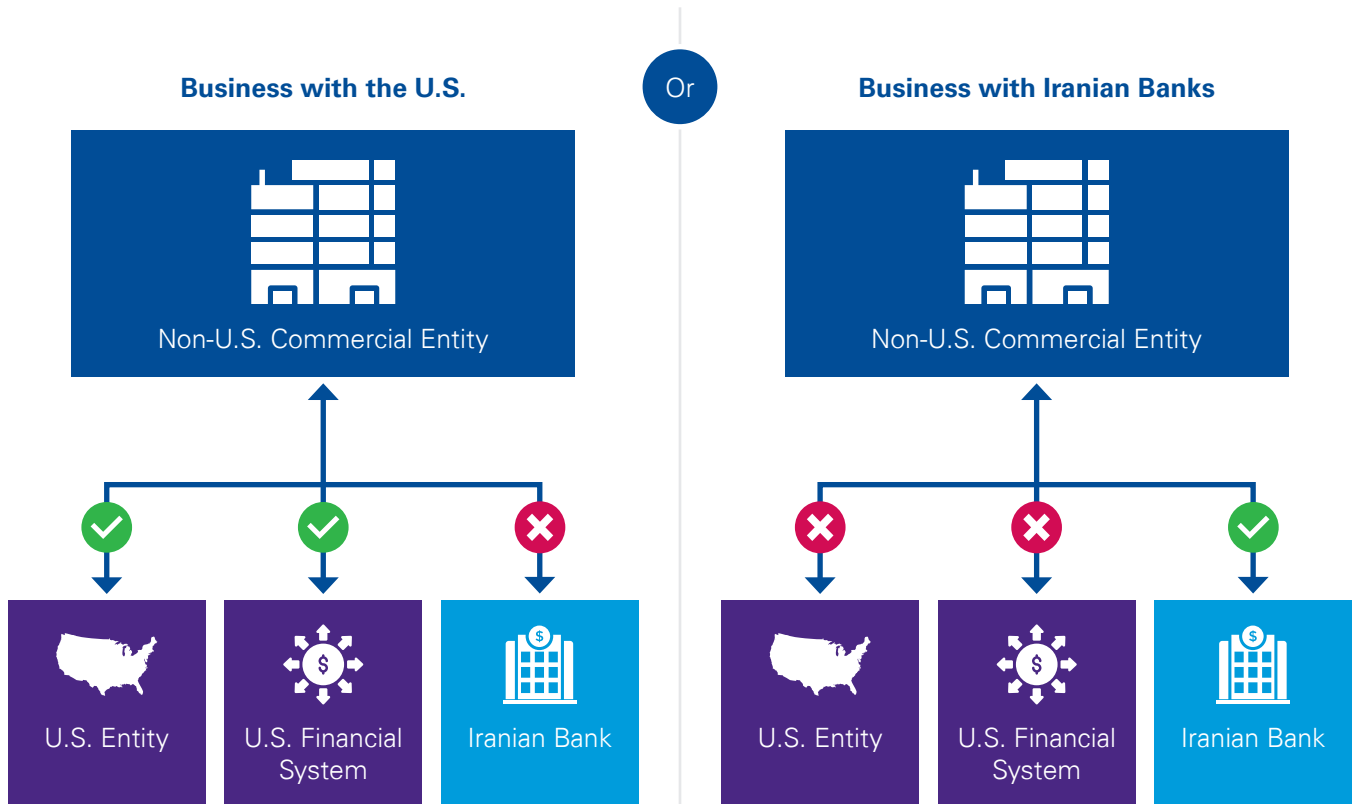
For most U.S. persons and entities, the increased risk may be minimal since these same banks were previously designated as SDNs, meaning that U.S. persons were prohibited from doing business with them. However, the intent of these designations is to reach non-U.S. persons and entities using secondary sanctions.

Understanding the impact of this new designation requires knowing how secondary sanctions work. OFAC does not have the jurisdiction to directly

limit non-U.S. entity interactions with these banks. However, secondary sanctions supplement other sanctions programs by targeting non-U.S. entities who do business with these Iranian banks. As just one example, additional possibilities described below, a high volume of transactions between a non-U.S. entity and these Iranian banks could increase the risk that the non-U.S. entity is itself designated under secondary sanctions. Once this occurs, sanctions can prohibit or impose limitations on the non-U.S. entity’s access to the U.S. financial system. Prior to this recent designation, non-U.S. entities could conduct business with these banks with no legal repercussions on their U.S. interests. However, following this designation, OFAC may designate a non-U.S. entity who conducts business with these Iranian banks as an SDN. Should that occur, the designated entity could lose access to U.S. markets.

After Iranian financial institution designation

You can only pick one



⁵ Imposing Sanctions with Respect to Additional Sectors of Iran, 85 Fed. Reg. No. 9, dated Jan. 1, 2020 at 2003.

For many companies, losing access to the U.S. could have serious financial ramifications, potentially jeopardizing their overall viability. Companies conducting business with any of the designated Iranian banks must now carefully assess the benefit and return of their involvement with these Iranian banks versus that of their U.S. transactions.

However, OFAC does not appear to be interested in punishing all transactions with these financial institutions, rather, it seems focused on “significant” activity. The language of E.O. 13902 speaks to individuals who have “knowingly engaged in... a significant transaction for the sale, supply, or transfer to or from Iran of significant goods or services[.]”⁶ However, the natural question is “what is ‘significant’”? In a Frequently Asked Question (“FAQ”), OFAC offers a broad definition of transactions that may potentially be considered “significant” under E.O. 13902. Noting that OFAC will evaluate the totality of the circumstances, it will generally consider the following factors:

- a. The value and number of goods or value and frequency of services;
- b. The nature of the good or services, including their type, complexity, and commercial purpose;
- c. The level of awareness of management and whether the provision of goods or services is part of conduct;
- d. The involvement of designated persons in transactions involving goods and services defined [elsewhere];
- e. The impact of the provision of goods or services on the objectives of E.O. 13902
- f. Whether the provision of the goods or services involved deceptive practices; and
- g. Other relevant factors that the Secretary of the Treasury deems relevant.⁷

While this FAQ sheds some light on the standards for assessing the significance of a transaction or a series of transactions, it is not clear-cut. The challenge for many non-U.S. companies will be applying this high-level guidance to their day-to-day operations and in the context of their overall sanctions risk profile. We anticipate that in many instances, companies will be unwilling to accept the risk of a designation should their interactions with the Iranian financial institutions be considered “significant.” This will likely result in non-U.S. entities suspending their operations with these banks to avoid the possibility of a designation.

⁶ Id.

⁷ U.S. Department of the Treasury’s Office of Foreign Assets Control Frequently Asked Question #833.

In sum, through the designation of these Iranian financial institutions, a renewed sanctions risk not seen since before the implementation of the Joint Comprehensive Plan of Action (JCPOA) has emerged for non-U.S. entities. This risk must be assessed in light of the company’s current operations and E.O. 13902’s provisions.

Important actions to take now

For companies who believe their interests will be impacted by this action, it will be critical to develop a plan for each affected transaction. This will mean conducting thorough, individual risk analyses and validating them against OFAC’s restrictions. Once stakeholders are aligned on a course of action, well controlled processes and written procedures should be developed to support compliance. This should include periodic risk assessments, key control identification and testing of automated and manual solutions.

Areas to evaluate include:

? Does your organization potentially transact with a listed bank?

- Even if there are no current dealings, do you have proper controls in place to guard against no future dealings?

? Is it significant?

One of the most difficult exercises related to secondary sanctions is determining whether a transaction or series of transactions might be considered “significant.” If OFAC could potentially consider it significant then your company may be at risk for secondary sanctions.

? Can you get a license?

A license or existing exemption may be available to authorize the transactions, though it is critical that, before relying on such authorizations, an analysis is undertaken to confirm that you have the necessary internal controls in place to comply with the specific requirements for using the authorization.

? Do you understand your risks?

Risk assessments are the cornerstone of effective and sustainable sanctions compliance programs. A company cannot manage its risks if it does not know what or where they are. By conducting a risk assessment, your company can identify and anticipate the unique touchpoints that might lead to compliance challenges and develop a process for mitigating them. You should also periodically validate your current sanctions program by independently testing processes and procedures and uncovering the key controls that are the foundation to your company’s program.

? Are your written policies and procedures adequate?

Assess your sanctions compliance program against applicable regulatory standards and industry standards. Then identify potential gaps in current processes and controls and develop plans for any needed enhancements.

? What if your company has been designated as a result of secondary sanctions?

If your company is facing possible designation, it is much easier to implement changes to stave off designation than to request delisting afterwards. Be proactive in communicating with OFAC on ways to remove your designation risks.

How we can help

KPMG’s Export Controls & Sanctions and Financial Crimes & Analytics practices have deep technical knowledge of U.S. and global sanctions regimes, as well as the practical experience to understand how to implement or review compliance measures in a business-friendly way. We can help your company navigate the complex export controls and sanctions landscape, from assessing your current risk profile to implementing compliance procedures to limit those potential pitfalls. Our webcast series, [Export Compliance Smart Practice](#), guides exporters through recent regulatory changes and identifies ways to enhance existing programs. If you are ready for a more in-depth analysis, we can team with you to validate your compliance position to help your company prevent costly violations. As your trusted advisors, we will help you carve a compliant path forward.



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