

## U.S. government announces enhanced due diligence process for humanitarian trade with Iran and identifies Iran as a jurisdiction of primary money laundering concern

6 November 2019

On 25 October the U.S. Departments of the Treasury and State [announced the establishment of a new channel](#) for conducting due diligence on humanitarian trade with Iran. Foreign governments and foreign financial institutions that choose to participate in this enhanced due diligence process must report to the U.S. Treasury Department a significant volume of information on a monthly basis. Foreign financial institutions that choose not to participate in this process could face exposure under U.S. "secondary" sanctions if Specially Designated Nationals targeted by other sanctions programs (beyond the Iran sanctions program), such as the Central Bank of Iran (CBI), which is designated under global terrorism sanctions, are involved in their payment process, or the transaction does not otherwise meet the requirements of applicable general or specific licenses.

Therefore, there is a strong incentive for foreign financial institutions to use the new process, but the enhanced diligence required raises the question of whether such institutions will decide to cease support for any further humanitarian trade with Iran as part of a de-risking strategy. Both U.S. persons and U.S.-owned or -controlled foreign entities, as well as non-U.S. entities, may use this mechanism in the commercial export of humanitarian goods to Iran.

The establishment of this new channel to regulate humanitarian trade with Iran is not intended to displace the U.S. Treasury Department's Office of Foreign Assets Control's (OFAC) [General License for commercial sales, exportation, and reexportation of agricultural commodities, medicine, medical devices, and certain related software and services](#). However, the burdensome nature of the new process raises questions about whether foreign financial institutions will continue to process payments involving Iranian entities, even if such transactions are otherwise authorized under the humanitarian general license.

Concurrently with this announcement, the U.S. Treasury Department's Financial Crimes Enforcement Network (FinCEN) identified Iran as a jurisdiction of primary money laundering concern under Section 311 of the Patriot Act. Under FinCEN's order pursuant to Section 311, foreign financial institutions' correspondent accounts at covered U.S. financial institutions are prohibited from processing transactions involving Iranian financial institutions. While any direct

or indirect financial transactions between Iranian and U.S. financial institutions have been prohibited under economic sanctions laws (except where such transactions were subject to an express authorization), U.S. financial institutions must now apply enhanced due diligence to their correspondent accounts to prevent their improper indirect use by Iranian financial institutions. Similarly, covered financial institutions must notify those foreign correspondent account holders that those accounts may not be used to provide access to Iranian financial institutions to process prohibited transactions.

## **Enhanced due diligence process for humanitarian transactions**

### **The enhanced due diligence process imposes significant reporting requirements**

The purpose of this new due diligence mechanism is to ensure that sanctioned Iranian entities do not divert funds associated with permissible humanitarian trade to finance malign activities, including supporting terrorism. Iran has long been designated by the United States as a state sponsor of terrorism, and has consistently failed to implement important anti-money laundering and countering the financing of terror (AML/CFT) safeguards.

On 20 September 2019 OFAC designated the CBI for its involvement in facilitating the transfer of funds to designated terrorist organizations, including Iran's Islamic Revolutionary Guards Corps Qods Force, as well as Hezbollah and Hamas.

Following this designation, on 15 October 2019 the U.S. Department of Justice [indicted state-owned Turkish bank Halkbank](#) for fraud, money laundering, and sanctions offenses related to its participation in a scheme to evade U.S. sanctions on Iran.

Finally, in October 2019, global AML/CFT standard-setting body the Financial Action Task Force [urged all jurisdictions to implement enhanced due diligence](#) of financial transactions involving Iran, including requiring increased supervision of Iran-based subsidiaries of financial institutions.

While the CBI designation and the new channel for humanitarian trade are intended to be separate actions, the new channel is meant to prevent sanctioned Iranian entities from appropriating funds to support terrorist organizations and engage in other prohibited activities.

Foreign governments and foreign financial institutions applying this due diligence framework must collect, maintain, and report to the U.S. Treasury Department a significant volume of information on a monthly basis. The types of documentation the U.S. government may require include, but are not limited to:

- The information used to identify Iranian customers, and to verify their identities and beneficial ownership.
- The information used by both the foreign financial institutions and any involved Iranian financial institution to understand the purpose and intended nature of the business relationship between the seller of the humanitarian goods and the Iranian customer.
- Monthly statement balances with the value, currency, and balance date of any account of an Iranian financial institution held at the foreign financial institutions that is being used for humanitarian transactions.
- A list of designated Iranian individuals or entities with which the Iranian customers indicate they currently have business relationships.
- Detailed information regarding the commercial elements and logistics of the transaction.

- A written commitment from any Iranian distributors involved that they will not allow the goods to be sold or resold to designated Iranian individuals or entities, and that the Iranian distributor will impose this obligation on downstream customers.

In addition to the above reporting requirements, foreign governments or foreign financial institutions participating in this process that detect potential abuse of the process by Iranian entities, or involvement of designated individuals or entities, are required to restrict suspicious transactions and report pertinent information to the U.S. Treasury Department.

OFAC's announcement of the humanitarian channel sets forth a framework for the channel, but does not establish formal mechanisms. To the extent foreign financial institutions decide to move forward with the channel, it may take some time for such entities to work with OFAC to establish the actual mechanisms to implement OFAC's framework.

**Foreign financial institutions are not required by law to adopt the enhanced due diligence process, but are heavily incentivized to use this channel to review humanitarian transactions with Iran**

The establishment of this new mechanism for screening humanitarian trade with Iran does not require foreign financial institutions to use it in facilitating such transactions. Rather, financial institutions may elect to use this channel in lieu of the traditional risk-based approach to customer due diligence.

However, foreign financial institutions are heavily incentivized to use this process. Financial institutions that commit to implementing this enhanced due diligence process may seek written confirmation from the U.S. Treasury Department that the proposed transactions "[will not be exposed to U.S. sanctions.](#)"

Conversely, financial institutions that choose to conduct their due diligence differently (i.e., by using the traditional risk-based approach) and are found to have facilitated a transaction with a designated entity (other than those with only the [IRAN] tag) may be subject to penalties for those transactions. Due to possible involvement of the CBI in approving or processing payments involving humanitarian trade with Iran, and absent further guidance from OFAC regarding CBI's role, there is a risk for those institutions that choose to use the traditional approach.

Therefore, foreign financial institutions that do not use this new channel run the risk of exposure to adverse action under U.S. sanctions. For that reason, some foreign financial institutions may make the calculation that the risks of operating outside this due diligence channel are too great, and the burdens of operating within the channel too onerous, to continue participating in humanitarian trade with Iran.

**Prohibition on using correspondent accounts to process Iran-related transactions**

**As the result of its finding that Iran is a jurisdiction of primary money laundering concern, FinCEN may require U.S. financial institutions to take special safeguard measures for Iran-related transactions**

Pursuant to its authority under Section 311 of the Patriot Act, FinCEN has concluded that Iran is a jurisdiction of primary money laundering concern. Under Section 311, upon making such a finding, FinCEN may require U.S. financial institutions to employ certain safeguards to defend the U.S. financial system against money laundering and terrorist financing. Among other requirements, FinCEN may impose various recordkeeping, information collection, and reporting obligations.

In this action, FinCEN imposed the most severe special measure, prohibiting the opening or maintaining of correspondent accounts in the United States for, or on behalf of, Iranian financial institutions, and the use of foreign financial institutions' correspondent accounts at covered U.S.

financial institutions to process transactions involving Iranian financial institutions. As OFAC sanctions already broadly prohibit U.S. financial institutions from opening or maintaining correspondent accounts for, or on behalf of, Iranian financial institutions, and generally prohibit even processing U.S. dollar payments for Iran-related trade, FinCEN's directive regarding the use of foreign financial institutions' U.S. correspondent accounts to process Iran-related transactions is the novel section of this final agency rule.

**As a corollary to the restrictions on the use of foreign financial institutions' U.S. correspondent accounts, covered U.S. financial institutions must apply enhanced due diligence to all of their foreign correspondent accounts**

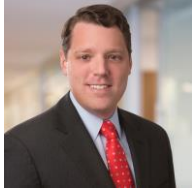
Covered U.S. financial institutions must apply to their foreign correspondent accounts due diligence that is reasonably designed to guard against such accounts being used to process prohibited transactions involving Iranian financial institutions. Part of that special due diligence process requires covered financial institutions to implement risk-based procedures designed to identify any use of correspondent accounts to process transactions involving Iranian financial institutions. This special due diligence also includes notifying those foreign correspondent account holders that the covered financial institutions know, or have reason to believe, provide services to Iranian financial institutions, that such correspondent institutions may not provide the Iranian financial institutions with access to the correspondent accounts maintained at the covered financial institutions to process prohibited transactions.

**Next steps**

Businesses should remain alert to additional actions, whether under forthcoming executive orders, agency regulations or guidance, or legislation from Congress. Businesses should also review their current humanitarian activities involving Iran and confirm whether foreign financial institutions will continue to facilitate humanitarian trade with Iran, either through the new enhanced due diligence process or otherwise.

For further information or assistance, please contact any of the Hogan Lovells lawyers identified below.

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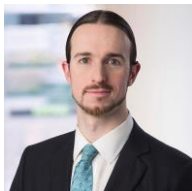


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