



ONPOINT / A legal update from Dechert's International Trade Practice

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Non-U.S. Financial Institutions Face Increased U.S. Sanctions Risks

With the U.S. entering a new phase of sanctions implementation with respect to Iran and Russia, financial institutions located outside of the United States (foreign financial institutions, or “FFIs”) face new U.S. sanctions risks. The risks stem from the U.S. government’s use of sanctions against transactions that have no nexus to the United States. The use of these measures, referred to as “secondary sanctions,” is on the rise.

Many FFIs long ago treated themselves as “U.S. persons” and tailored their compliance programs around U.S. “primary sanctions,” which apply to transactions that have a U.S. nexus. However, others adopted a risk-based approach, especially following the Iran nuclear deal (“JCPOA”) in 2016. The imminent re-imposition of the full suite of Iran-related U.S. secondary sanctions, and the Trump Administration’s recent steps toward implementation of Russia-related secondary sanctions in the Countering America’s Adversaries Through Sanctions Act (“CAATSA”), are now putting those risk-based models under increased strain.

Iran

On November 5, 2018, the second and final set of U.S. secondary sanctions that had been lifted pursuant to the JCPOA will come back into effect. These secondary sanctions principally aim to restrict Iran’s ability to produce, sell, and export oil and gas. They do so in many instances by directly threatening FFIs with secondary sanctions for facilitating such transactions. Specifically, FFIs will be restricted from opening or maintaining correspondent and payable-through accounts in the United States if OFAC finds that they knowingly conducted or facilitated any significant financial transaction¹ that is:

- For the sale, supply, or transfer to Iran of significant goods or services used in connection with the automotive sector of Iran;
- On behalf of Iranian persons on the Office of Foreign Assets Control’s (“OFAC”) List of Specially Designated Nationals and Blocked Persons (“SDN List”), except for Iranian depository institutions sanctioned *solely* because they are Government of Iran entities;
- With the National Iranian Oil Company (NIOC) or Naftiran Intertrade Company (NIOC), subject to limited exceptions;
- For the purchase, acquisition, sale, transport, or marketing of petroleum or petroleum products from Iran, subject to certain conditions and waivers; or
- For the purchase, acquisition, sale, transport, or marketing of petrochemical products from Iran, subject to certain exceptions.

The above sanctions *directly* target FFIs and their ability to access the U.S. financial sector.² As a consequence, FFIs should assume that U.S. authorities will be looking squarely at their role in such transactions and should calibrate their risk appetite accordingly.

For EU FFIs, the picture is complicated by the updating of the EU Blocking Regulation (changes effective August 6, 2018).³ Broadly, this has the effect of prohibiting EU persons (including FFIs) from complying with

the re-imposed U.S. secondary sanctions on Iran, and exposes EU FFIs who refuse to support sanctionable Iran-related activities of their EU customers to the risk of a damages claim. However, the blocking regulation contains many ambiguities such that the scope of the prohibition remains unclear. In addition, there are real doubts as to the appetite of EU Member State regulatory authorities to enforce the blocking regulation. The extent of the damages risk remains to be seen. Indications so far are that, where the demands of U.S. secondary sanctions and the Blocking Regulation conflict, EU FFIs are more concerned about U.S. secondary sanctions.

The EU has recently announced a further measure aimed to support the JCPOA and to counter the effects of the U.S. secondary sanctions by removing FFIs from certain transactions entirely, through the establishment of a “Special Purpose Vehicle” to effect payments between EU and Iranian businesses, including facilitating oil trades. The details of how this scheme will operate have not been released. In general, major oil traders and other global businesses have been unenthusiastic about the SPV. This is not surprising since the value of their U.S. operations likely dwarfs the value of any prospective Iran business.

Russia

On September 20, 2018, the Trump Administration signaled that it was entering a new stage of CAATSA implementation by issuing Executive Order (E.O.) 13849.⁴ The Executive Order delegates some Presidential powers and defines the specific sanctions that will apply to entities targeted under certain provisions of CAATSA. CAATSA significantly increased the divergence between EU sanctions in relation to Russia (which have changed little since 2014) and the U.S. measures.⁵ Most prominently, the CAATSA combined with the E.O. introduces secondary sanctions measures targeting FFIs.

The FFI sanctions include barring FFIs from opening or maintaining correspondent and payable-through accounts in the United States if they are determined to have knowingly facilitated any significant financial transaction⁶ that:

- Is on behalf of any Russian person on the SDN List pursuant to Russia sanctions authorities;
- Involves an entity that is owned or controlled by the Russian government or Russian nationals and which knowingly manufactures, sells, transfers, or brokers or assists the transfer of defense articles into Syria or into the territory of a specified country without the consent of that country’s recognized government; or
- Involves any foreign person sanctioned for having knowingly made a significant investment in a “special Russian crude oil project.”

As with the Iran sanctions, a range of other activities are generally sanctionable under CAATSA (whether performed by an FFI or another person), which we do not detail here.⁷

The issuance of E.O. 13849 is a sign that further CAATSA-related sanctions are likely forthcoming. As a harbinger of what to expect, on the same day E.O. 13849 was issued the State Department sanctioned a unit of the Chinese military and its director for weapons procurements from the Russian defense sector. The Administration can be expected to further use this muscular approach against Russia, particularly if doing so would forestall additional Russia-focused sanctions legislation⁸ currently pending before Congress. The bills that could force the Administration to take preemptive action include:

- The Defending American Security from Kremlin Aggression Act of 2018 (“DASKAA”). If passed, this legislation mandates secondary sanctions against financial institutions engaging in significant transactions with certain Russian parastatal entities, senior political figures, oligarchs, and their family members in Russia. In its current form, it also requires the addition of one or more named Russian banks to the SDN List, and prohibits dealings in newly issued Russian sovereign debt.
- The Defending Elections from Threats by Establishing Redlines Act (“DETER”). If triggered by a report on Russian election interference, this legislation would require the addition of three or more named Russian banks to the SDN List. It also prohibits dealings in newly issued Russian sovereign debt or that of state owned or controlled enterprises.

While some of these sanctions are so harsh that they are viewed as unlikely to pass in their current form, there is a real possibility that some legislation could be forthcoming after the U.S. elections on November 6.

Conclusion

U.S. sanctions have long been predicated on leveraging the dollar’s privileged role in international trade and finance to apply pressure on sanctioned parties and countries. Because SDNs and other entities in comprehensively sanctioned countries are already prohibited from directly accessing the U.S. financial system, the U.S. has deployed the secondary sanctions model to inhibit their access to the financial system

more broadly, which has placed FFIs in the crosshairs. For FFIs that rely principally upon access to the U.S. market and correspondent banks, the potential exposure to U.S. secondary sanctions may be an unacceptable risk. FFIs that rely less upon the U.S. financial system – either because of the modest size of their international business, or because of the nature of that business – should carefully balance the risks. That balance must be continually re-assessed and weighed against the current U.S. government position (and in the case of Iran, the EU authorities under the Blocking Regulation). FFIs are navigating in a difficult risk environment.

Footnotes

- 1) OFAC has stated that it will consider the “totality of the facts and circumstances” in determining what constitutes a “significant financial transaction,” but factors will include (1) the size, number, and frequency of transactions; (2) the nature of the transaction(s); (3) the level of awareness of management and whether the transaction(s) are part of a pattern of conduct; (4) the nexus between the transaction(s) and a blocked person; (5) the impact of the transaction(s) on statutory objectives; (6) whether the transaction(s) involve deceptive practices; and (7) other factors that may be deemed relevant on a case-by-case basis.
- 2) Non-U.S. persons already are subject to sanctions for acts such as providing financial support or services in support of Iran’s acquisition of U.S. bank notes.
- 3) See our OnPoint: [EU Seeks to Contain the Impacts of U.S. Reimposition of Extra-Territorial Sanctions on Iran](#).
- 4) E.O. 13849 did not itself impose any new sanctions. It was a necessary procedural step to allow OFAC and the State Department to take future action under specific provisions of CAATSA.
- 5) The EU is also rumoured to be considering new measures in response to Russia poisoning and hacking activity.
- 6) See Footnote 1.
- 7) For instance, any person who makes an investment of \$10,000,000 or more, or facilitates such an investment, can be sanctioned if the investment directly and significantly contributes to the privatization of Russian state-owned assets in a manner that unjustly benefits Russian government officials or their family members.
- 8) See our OnPoint: [U.S. Moves Cautiously to Impose Mandated Sanctions Against Russia, While Congress Mulls Further Measures](#).

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