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Banks caught by EU-US Iran sanctions clash

President Trump's reinstatement of sanctions against Iran has caused the European Union to dust off its Blocking Statute, in order to salvage the 2015 nuclear deal. Now financial institutions in Europe face serious consequences whether they conduct business connected to Iran or do not; moreover, application of the EU provisions is as yet unclear. Ahmad Khonsari and Stefan Hoffmann report.

On 7 August 2018, the updated, so-called EU 'Blocking Statute' entered into force, prohibiting compliance with the United States secondary sanctions against Iran, the first tranche of which have already been re-imposed with the remainder to follow soon. The far-reaching implications for global banks of violating the sanctions are well known, not least from press coverage regarding billions already paid by them in fines. And now, serious liabilities may arise from the EU blocking statute as well. The following article takes a closer look at the conflict between EU and US law in the context of Iran sanctions and the resulting challenges for banks.

US exit from the JCPOA and US secondary sanctions

On 8 May 2018, US President Donald Trump announced that the US was exiting the existing nuclear deal with Iran, the Joint Comprehensive Plan of Action (JCPOA). The remaining parties to the JCPOA, including Germany, France, the United Kingdom and EU stated their regret regarding the US's decision to withdraw from the JCPOA and declared their continued adherence to the agreement. Pursuant to the JCPOA, Iran committed to reduce its uranium enrichment substantially. In return, the EU and the US suspended certain sanctions against Iran in January 2016.

The reinstated sanctions are of a secondary nature and relate to extraterritorial US regulations primarily targeting operations outside the US and not involving US persons. While the regulations in question cannot directly impose either prohibitions or mandatory legal requirements on non-US persons, the threat of sanctions will likely deter certain businesses from working with Iranian individuals and entities. For example, these measures could cut off UK banks from maintaining accounts with US correspondent banks or making payments via US financial institutions, or even result in them being listed on the Specially Designated Nationals and Blocked Persons List (SDN List), which, essentially, hinders US persons doing business with listed banks via primary sanctions and non-US-persons via secondary ones. The first stage of reinstatement of the US sanctions took place on 7 August 2018. It targets, *inter alia*, the purchase of US currency by the Iranian government and the country's automotive sector.

A mural on the wall of the former US Embassy in Tehran

EU Blocking Statute

Iran has announced that it will remain in the JCPOA if the EU and the other parties can secure for it the economic benefits of the agreement despite the US withdrawal. Against this background, the EU has extended the scope of a 1996 'Blocking Statute' regulation originally issued to protect European companies from extraterritorial US sanctions against Cuba, Iran and Libya, to cover the present situation as of 7 August 2018.

The essential provisions of the Blocking Statute can be summarised as follows:

- It prohibits compliance with the US sanctions listed in the regulation's annex. This prohibition is meant to be

broadly applied and covers both active measures and deliberate omissions, as well as indirect acts through representatives or intermediaries. In particular, it is prohibited to comply with any judgments of foreign courts or decisions of authorities giving effect to the relevant US sanction;
- EU persons are entitled to recover damages incurred as a result of the application of the relevant US sanctions from persons causing said damage (ie, likely meaning persons applying or giving effect to US sanctions);
- It obligates any person (natural persons or legal entities) whose economic or financial interests are affected directly or indirectly by the relevant sanctions to inform the EU Commission within 30 days. In the case of legal entities, the obligation applies to directors, managers and other persons with management responsibilities; and
- Is applicable, among others, to EU nationals and natural persons resident in a member state and to legal entities incorporated in the EU. It should be noted that, despite Brexit, the UK implementing legislation (SI 1996 No 3171) for the EU Blocking Statute is set to continue in UK law under section 2 of the European Union (Withdrawal) Act 2018.

General reluctance of banks to engage in Iran business

Generally, banks were reluctant to do business with Iran even before the US left the JCPOA. Despite the easing of sanctions, it was challenging to find UK-based banks processing payment transactions to or from Iran, or providing financing to Iranian entities. Most financial business with Iran was transacted by smaller banks with limited US exposure, in particular from Germany, Italy and France, as well as the European subsidiaries or branches of Iranian banks. There were various reasons for this. While secondary sanctions were eased in the wake of the JCPOA, the primary US sanctions applicable to US persons remained largely in force. Therefore, US banks remained prevented from processing USD payment transactions resulting from business with Iran. Also, not all persons on the SDN List were removed meaning that, generally speaking, neither US nor non-US persons were allowed to do business with said listed persons. Further, many UK banks have direct or indirect US shareholders and/or investors, all of whom tended to be very reluctant to do business with Iran. Moreover, UK banks with US personnel (including employees having permanent residency in the US) had to ensure they were ring-fenced from any Iran-related transactions.

The compliance costs for assessing whether or not an Iran-related transaction complies with either the primary or secondary sanctions, were usually disproportionate to the potential profits to be made from the deal. Even smaller banks did not want to put themselves at risk, as nowadays they too are expected to provide customer access to USD transactions and thus to US correspondent banks.

Therefore, many banks communicated to their customers that they would neither accept payments from Iranian business partners, or even from the European subsidiaries of Iranian banks. In case of justified suspicions that a customer was conducting business with Iran through their account, some banks made use of their right of ordinary termination of the relevant business relationship. This applied, for example, to companies based in the UK having Iranian shareholders or directors based in Iran, or UK exporters reaching out to their bank for letters of credit to secure payments for their exports to Iran.

The withdrawal of the United States from the JCPOA and the reinstatement of the first tranche of sanctions has increased the reluctance of banks to conduct business with Iran. Even the limited number of banks that had previously been willing to process Iranian business and establish correspondent relationships with Iranian banks, have seemed to pull out from doing so now.

Given that further US sanctions will come into effect on 5 November 2018, this trend will likely only increase. Iranian banks that were removed from the SDN List under the JCPOA are to be listed again as part of the second tranche of sanctions to be reinstituted. In particular, the sanctions will affect the messaging service SWIFT, with the aim of excluding Iranian banks from the international banking system.

New requirements due to the EU Blocking Statute

The EU Blocking Statute poses a major challenge to banks based in the UK and other EU member states. Refusing customer requests to process payment orders from or to Iran, or letters of credit in connection with Iranian business, legally violates the prohibition under the EU Blocking Statute to follow US secondary sanctions. Indeed, as the EU Blocking Statute is likely to be implemented in the UK, breaching its provisions could potentially lead to criminal charges. In addition, a bank might become exposed to claims for damages by its customers.

The conflict between EU and US law is most obvious in cross-border financings, such as in cases of syndicated loans granted by UK and US banks. While US banks will request provisions that the borrower complies with US sanctions, a UK bank would likely wish to refrain from such a contractual undertaking in light of the EU Blocking Statute.

Deciding not to do business with Iran for commercial reasons such as lacking the requisite resources, little or no local market knowledge or likely insufficient profitability from any transaction, remains unaffected by the regulation. Banks might wish to justify their decision with the fact that they are not able to or do not have the necessary resources to run a check to see if an Iranian transaction complies with the US sanctions. It remains unclear whether such motives are prohibited under the EU Blocking Statute. One could argue, especially in light of the EU Blocking Statute's broad

remit, that such decisions already imply recognition of the relevant US sanction laws and are therefore a violation of the EU Blocking Statute. Making things even harder, except for some very limited and rather outdated case law available in other EU member states, no current court precedents can be referred to as guidance.

One should also bear in mind that business decisions can be made and justified by various (other) considerations such as credit risks, money laundering regulations, lack of profitability and relevant US sanctions. It is as yet unclear if the EU Blocking Statute applies where complying with US sanctions is one motive among others.

The compliance requirements under the EU Blocking Statute include the obligation of banks to inform the EU Commission when their economic and/or financial interests are affected, directly or indirectly, by the relevant US sanction laws. Again, UK implementing legislation criminalises any breach of said obligation. In view of missing precedents and further specification by the EU Commission, it is still unclear how far this obligation extends. For example, does it only cover existing business or also specific requests from customers? Given the broad formulation of the provision, it is likely that the duty to inform is required at the earliest instance possible.

Possibility of authorisation

It is possible under the EU Blocking Statute to request from the Commission an authorisation to comply fully or partially with the relevant US sanctions, providing non-compliance would seriously damage the interests of the bank or the EU itself. According to the implementing regulation for the assessment of such applications, among others, the following non-cumulative criteria shall be considered where appropriate:

i. whether the protected interest is likely to be specifically at risk;
ii. the existence of an ongoing US administrative or judicial investigation against the applicant;
iii. the existence of a substantial connecting link with the US, for example the US subsidiary of a bank;
iv. whether measures could reasonably be taken by the applicant to avoid or mitigate the damages; and
v. the adverse effect on the conduct of economic activity, in particular whether the applicant would face significant economic losses, which could, for example, threaten its viability or pose a serious risk of bankruptcy.

The above criteria indicate that the Commission will set high standards for granting any such authorisation. In practice, these criteria will not frequently be met, especially by banks with little US exposure. Occasional requests by private customers, such as students who want to receive financial support from their parents in Iran, or small UK companies for handling their Iranian business, are not capable of establishing serious damages or even a substantial risk of insolvency. This is especially true where US authorities have not yet threatened or carried out investigations against a bank.

Conclusion

Complying with the EU Blocking Statute is essentially unknown territory and represents a real challenge to UK banks' compliance departments. While EU law does not recognise the relevant US secondary sanctions against Iran and prohibits complying with them, banks face a largely US-dominated international financial system and significant risks if they do not do so (which if based on US court judgments could also be open to enforcement in the UK). On the other hand, banks are exposed to the risk of potential fines and additionally claims for damages from their clients as well as other business partners (including other banks, such as subsidiaries of Iranian banks) if they comply. Many issues are as yet unclear due to the lack of existing precedents for the application of the EU Blocking Statute in practice. This includes, for example, the question of in which cases an authorisation from the prohibition may be obtained, and when the obligation of banks to inform the EU Commission is triggered. Therefore, it is advised to consider the EU provisions carefully in every individual case and closely monitor any further developments in this area.

Watson Farley & Williams partner **Ahmad Khonsari** leads the firm's Iran practice, while partner **Stefan Hoffmann**, who has expertise relating to cross-border sanctions and enforcement disputes, belongs to the Dispute Resolution Group. Contact them on akhonsari@wfw.com and shoffmann@wfw.com.