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ASSET FREEZES, SANCTIONS, MONEY LAUNDERING

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The US International Banking Act states that in making its decision as to whether to approve a foreign bank’s establishment of a branch or an agency in the US the Federal Reserve Board shall “consider whether the foreign bank has adopted and implements procedures to combat money laundering” and “may also take into account whether the home country of the foreign bank is developing a legal regime to address money laundering or is participating in multilateral efforts to combat money laundering.” In addressing the financial crisis, the G20 countries agreed to work together to deal with money laundering. At the international level the Financial Action Task Force promulgates standards on money laundering. Since 9/11 these standards also address the financing of terrorism. Governments use asset freezes as ways of preventing terrorism or as sanctions against other Governments.² In recent years such asset freezes have often been co-ordinated at the international level through the United Nations Security Council. Financial institutions are required to implement anti-money-laundering (AML) measures and measures such as asset freezes as a condition of their licensing. Financial institutions are thus co-opted as components of regimes of crime control, public security, and international politics. But it is not clear how effective this co-option is. The Financial Action Task Force, which has adopted a set of recommendations for measures to prevent money laundering and terrorist financing,³ has also made a practice of evaluating which countries have implemented the recommendations. More recently the FATF has moved from focusing on formal adoption of the recommendations to a focus on the effectiveness of implementation of the

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² See generally, e.g., <http://europeansanctions.com/> .

³ International Standards On Combating Money Laundering And the Financing of Terrorism & Proliferation The FATF Recommendations (2012) at http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf

recommendations.⁴

Asset Freezes and the UN Security Council

In *Libyan Arab Foreign Bank v Bankers Trust* we saw that unilateral asset freezes can be problematic for banks required to implement them: a bank might find that the laws of one jurisdiction where it carries on business require it to act in ways which are inconsistent with the laws of another jurisdiction whose laws bind it. Multilateral freezes should be easier for banks with cross-border operations to manage, as they can avoid the problems Bankers Trust faced in the *Libyan Arab Foreign Bank* case. Multilateral sanctions are adopted by the United Nations Security Council.⁵ To the extent that multilateral freezes can be made effective they also operate more effectively as sanctions or to inhibit the financing of terrorism. Some multilateral sanctions target countries, and others target named individuals. But individuals and firms have no standing to challenge a decision by the Security Council to impose an asset freeze. The Security Council adopted resolution 1730 (2006)⁶ to ask the UN Secretary-General to establish a “focal point” to consider requests for de-listing.⁷

Where the Security Council adopts sanctions, individual states may adopt unilateral sanctions as well. For example, the Security Council adopted sanctions with respect to Iran including embargos with respect to nuclear and conventional weapons and materiel and a travel ban and assets freeze for designated persons and entities.⁸ The US imposed additional unilateral sanctions with respect to Iran.⁹

⁴ See, e.g., FATF Press Release, Many Countries Are Still Not Able to Freeze Terrorists’ Assets Effectively, Says FATF President Roger Wilkins, AO (Dec. 18, 2014) at <http://www.fatf-gafi.org/documents/news/many-countries-still-not-able-to-freeze-terrorist-assets-effectively.html>

⁵ See generally, e.g., <http://www.un.org/sc/committees/index.shtml>.

⁶ See http://www.un.org/ga/search/view_doc.asp?symbol=S/RES/1730%282006%29.

⁷ There is a guide to the delisting process at <http://www.un.org/sc/committees/pdf/De-listing%20process%20flowchart.pdf>.

⁸ See <http://www.un.org/sc/committees/1737/>.

⁹ See, e.g., National Defense Authorization Act FY 2013.

A 2012 Report by a Panel of Experts on the Multilateral Iran sanctions¹⁰ stated:

The sanctions measures specified in resolution 1929 (2010) and previous resolutions are part of a coordinated and intensive effort by the international community to persuade the Islamic Republic of Iran to resolve outstanding questions about the nature of its nuclear programme and demonstrate that it is for purely peaceful purposes. Sanctions remain one element of a dual-track approach to the country, which includes diplomatic efforts by China, France, Germany, the Russian Federation, the United Kingdom of Great Britain and Northern Ireland and the United States of America. These sanctions are targeted at specific activities, institutions, entities and individuals related to the Islamic Republic of Iran's prohibited proliferation-sensitive nuclear activities and development of a nuclear weapon delivery system, in addition to transfers of conventional weapons.

Sanctions are slowing the procurement by the Islamic Republic of Iran of some critical items required for its prohibited nuclear programme. At the same time, prohibited activities, including uranium enrichment, are continuing. The Islamic Republic of Iran has still not complied with the requests of the International Atomic Energy Agency for information to clarify the possible military dimensions of its programme. In the present report, the Panel identifies the acquisition of high-grade carbon fibre as one of a number of critical items that the Islamic Republic of Iran requires for the development of more advanced centrifuges. The report also contains an analysis of the country's requirements for uranium ore in the context of its current and future planned activities, while noting that no procurement attempts have been reported to the Security Council Committee established pursuant to resolution 1737 (2006).

The Iranian ballistic missile programme continues to develop, as demonstrated by additional launches, their prohibition under resolution 1929 (2010) notwithstanding. In the present report, the Panel provides the conclusions of its investigation into the June 2011 launch of the Rasad satellite, which was reported to the Committee.

The Panel takes note of the recent designations by the Security Council Committee established pursuant to resolution 1718 (2006) concerning the Democratic People's Republic of Korea of two Democratic People's Republic of Korea entities and their links to the Iranian ballistic missile programme...

The Panel concludes that financial sanctions have been implemented by many Member States with rigour and welcomes the new Financial Action Task Force standard on financing of proliferation...

Security Council resolutions are targeted at specific activities, institutions, entities and individuals related to the Islamic Republic of Iran's prohibited nuclear and missile activities, and conventional arms imports and exports. It is difficult to assess their impact, in particular measured against stronger and more comprehensive sanctions imposed by Member States unilaterally.

Unilateral sanctions are an issue that Member States raise regularly with the Panel in the context of their implementation of targeted Security Council sanctions. A number of Member States, which implement

¹⁰ Final Report of the Panel of Experts submitted in accordance with resolution 1984 (2011) at http://www.un.org/ga/search/view_doc.asp?symbol=S/2012/395.

only these sanctions, have expressed concern to the Panel that unilateral sanctions have a negative impact on legitimate economic activities allowed under United Nations sanctions...

Financial and business restrictions

The relevant Security Council resolutions contain two categories of financial restrictions. The first, targeted financial sanctions, require freezing of funds and other assets of designated entities and individuals (resolution 1737 (2006), paras. 12-15; resolution 1747 (2007), para. 6; resolution 1803 (2008), para. 7; and resolution 1929 (2010), paras. 11, 12 and 19). The designated individuals and entities are listed in the annex to resolution 1737 (2006), annex I to resolution 1747 (2007), annexes I and III to resolution 1803 (2008) and annexes I to III of resolution 1929 (2010). Two Iranian financial institutions are designated: Bank Sepah and Bank Sepah International (resolution 1747 (2007)) and First East Export Bank (resolution 1929 (2010)).

The second category of restriction is activity-based sanctions, which impose restrictions on financial or business dealings with the Islamic Republic of Iran under specific conditions. The restrictions are as follows:

- (a) Preventing the transfer of financial resources or services related to the supply, sale, transfer, manufacture or use of the prohibited items (resolution 1737 (2006), para. 6; and resolution 1929 (2010), paras. 8 and 13);
- (b) Preventing the provision of financial services and transfer of financial assets or resources that could contribute to the Islamic Republic of Iran's proliferation-sensitive nuclear activities or the development of nuclear weapon delivery systems (resolution 1929 (2010), para. 21);
- (c) Prohibiting Iranian banks from initiating new business activities in Member States if related to the Islamic Republic of Iran's proliferation-sensitive nuclear activities or the development of nuclear weapon delivery systems (resolution 1929 (2010), para. 23);
- (d) Prohibiting financial institutions of Member States from initiating new business in the Islamic Republic of Iran if related to the Islamic Republic of Iran's proliferation-sensitive nuclear activities, or the development of nuclear weapon delivery systems (resolution 1929 (2010), para. 24).

The activity-based sanctions of resolution 1929 (2010) build on those set out in resolutions 1737 (2006) and 1803 (2008). Two Iranian financial institutions are named in paragraph 10 of resolution 1803 (2008), in which the Security Council calls upon States to exercise vigilance over the activities of financial institutions in their territories with all banks domiciled in the Islamic Republic of Iran, in particular with Bank Mellī and Bank Saderat, and their branches and subsidiaries abroad. Vigilance over transactions involving Iranian banks, including the Central Bank of Iran, was also called for in the sixteenth preambular paragraph of resolution 1929 (2010).

Member States are also obliged to require their nationals, persons subject to their jurisdiction and firms incorporated in their territory or subject to their jurisdiction to exercise vigilance when doing business with entities in the Islamic Republic of Iran, including those of the Islamic Revolutionary Guards Corps and the Islamic Republic of Iran Shipping Lines (resolution 1929 (2010), para. 22).

To implement financial sanctions, Member States require mechanisms to identify and freeze assets of

designated entities and individuals, and to monitor and regulate financial and business transactions with the Islamic Republic of Iran. A high standard of communication and coordination between regulatory authorities and the private sector is needed.

While many Member States noted that they had such systems in place, only a few shared information regarding suspicious transaction reports, violations or attempted violations. For example: (a) One State bordering the Islamic Republic of Iran said that it had revoked the licence of a money transfer company in 2008; (b) One State informed the Panel that its financial intelligence unit had received and investigated several suspicious transaction reports in connection with transactions involving Bank Saderat during the period 2006-2007. It could not be ascertained that those were relevant to United Nations resolutions. The financial intelligence unit had also carried out checks on the basis of information received from other Member States during 2007, but no information had been found related to United Nations sanctions; (c) One State said that on-site inspections of Bank Mellat had identified two examples of failure to follow proper procedures; (d) One State noted that transactions from banks in one Middle Eastern State with Iranian shareholders had been blocked based on intelligence received from foreign sources...

There is no general understanding of the definition of “vigilance” in the context of paragraph 22 of resolution 1929 (2010). Member States reported various mechanisms to comply with this requirement, such as: (a) Some regulatory authorities closely supervised business with the Islamic Republic of Iran; (b) Some authorities required notification or authorization in advance for transfers of funds involving an Iranian person or entity over specific thresholds. One State reported a requirement for non-personal financial transactions to be licensed on a case-by-case basis. Other Member States had systems in place to license individual financial transactions, or to license a class of financial transactions; (c) Some Member States reported that they simply generally supervised business to ensure that no prohibited activities took place...

The Panel received no reports that the Islamic Republic of Iran had successfully developed significant new channels for transactions following the adoption of resolution 1929 (2010), although some Member States shared information that it remained interested in doing so. One State noted that monitoring Iranian-related transactions through banks in some third countries was difficult. One State bordering the Islamic Republic of Iran informed the Panel of Iranian requests to open new financial institutions. Those requests were not pursued, apparently because of that State’s burdensome legislation. Another State, on another continent, disclosed similar requests. Another State said that the Islamic Republic of Iran had requested information about procedures for opening financial institutions using Iranian or mixed capital. In most cases, the Islamic Republic of Iran did not pursue these enquiries.

The compliance department of one large international financial institution stated that the Islamic Republic of Iran was known to be seeking to develop covert relationships with existing institutions, and new relationships in jurisdictions with weak regulations. A representative of another large international financial entity also noted that Iranian banks were creative in seeking to circumvent sanctions, including by opening new branches...

The Financial Action Task Force issued revised standards in February 2012, including a new standard on

implementation of targeted financial sanctions related to proliferation. Member States may need to put in place mechanisms to meet this standard. The inclusion of this standard in future mutual evaluation reviews could provide the Panel with useful information regarding the implementation of United Nations targeted financial sanctions.

Responses to financial sanctions

Member States informed the Panel that Iranian entities and citizens not designated under sanctions were deploying measures to deal with the effects of sanctions, in particular unilateral ones, some of which might be intended only to protect legitimate transactions, such as: (a) An increasing number of Iranian-related financial transactions involved non-sanctioned Iranian banks with correspondent accounts with foreign banks, or money transfer businesses based in the Islamic Republic of Iran with access to foreign banks. Some of those transactions might have been initiated by sanctioned banks; (b) An increase in cash transfers between Iranians resident overseas and their friends and relatives inside the Islamic Republic of Iran, which was notable in Member States with many Iranian residents. One State, which monitors all cross-border financial transactions, reported a several-fold increase over the past two years in cash transfers to the Islamic Republic of Iran. The State suggested that sanctions had made electronic transfers more difficult. Another factor was the increasing regulation of money transfer businesses, which were now required to register as financial institutions. The media also reported an increase in cash transactions; (c) One State said that hawala transactions had increased in recent years in inverse proportion to the reduction of bank transactions with the Islamic Republic of Iran; (d) One border State reported that barter transactions were a growing component of trade with the Islamic Republic of Iran. Barter arrangements were also reported by the media; (e) Some Member States reported cases of companies set up for the purpose of transferring funds to or from the Islamic Republic of Iran. For example, the Panel was informed of the case of a small non-financial firm led by an expatriate Iranian that had transformed itself into a company involved in transferring funds received from a non-sanctioned Iranian bank to recipients throughout the world. Some \$11 billion had been processed over 18 months. Understanding whether and how the above-described methods could be used for financing procurement for sanctioned nuclear and ballistic programmes is challenging. These programmes are industrial in scale and require sources of financing for procurement that are large and reliable.

Practices of financial entities

The Panel held discussions with representatives of several international financial institutions, insurers, banking associations and legal entities in Europe, Asia and North America.

For the purposes of implementing United Nations targeted sanctions, many large financial institutions said that they relied on commercial software providers for systems to screen transactions. Screening against individuals designated by the United Nations was often complicated by a lack of sufficient identifying detail.

Most institutions required screening to be able to identify possible non-compliance under all relevant

jurisdictions in which they operated. Some providers offered screening services against additional, proprietary criteria. Most institutions said that they deployed many staff and expended significant resources to ensure that adequate due diligence was carried out.

The Panel was informed by many institutions and regulatory authorities that they took a highly risk-averse approach to compliance with sanctions on the Islamic Republic of Iran. Many regarded possible penalties for violating unilateral sanctions (in addition to negative publicity and reputational damage) as of greater concern than possible violations of United Nations sanctions, and formulated corporate compliance procedures accordingly. Some entities reported that they had decided that resources needed for adequate compliance with all relevant sanctions regimes were too costly where business was connected with the Islamic Republic of Iran and had decided to do no such business at all.

Channels for transactions with some Iranian banks have been blocked following the termination of financial messaging services to these banks in response to unilateral financial sanctions.

The Panel observed that the practices of many financial institutions were widening the scope of United Nations financial sanctions. For example, two large insurance entities informed the Panel that company policy was to turn down almost all business connected with the Islamic Republic of Iran because of the burdensome nature of necessary due diligence and potential complexities should a claim arise. Many protection and indemnity clubs have terminated third-party liability cover for Iranian vessels because of unilateral sanctions. The Panel was informed that Iranian insurance companies might provide alternative cover. It is unclear whether the compliance policies of international banks would allow transactions to be processed should Iranian insurance companies pay out against a claim.

Challenges

Asset freezes

Only a few Member States reported that assets had been frozen in response to Security Council resolutions. Most Member States informed the Panel that no assets had been frozen because no relevant assets had been present. Two said that business related to the Islamic Republic of Iran had already scaled back significantly by the time that United Nations asset freezes were put in place.

There are several possible reasons for the lack of reports of assets frozen under the relevant United Nations resolutions. Some Member States may lack mechanisms to freeze assets in connection with the resolutions, or may have failed to take action swiftly to ensure that no funds were removed from their jurisdiction before such freezes took effect. Some Member States may require assistance or advice in the implementation of asset freezes. For example, one State enquired about procedures followed elsewhere with regard to property subject to asset freezes.

A banking association reported to the Panel in writing that its members were concerned about the ability of the competent authorities to respond to enquiries and licensing requests in a timely manner. Many competent authorities struggled with the lack of precision in the language of United Nations resolutions (such as the definition of “acting on their behalf”).

Unilateral sanctions

The issue of unilateral financial sanctions is not within the Panel's mandate. The issue is, however, raised often by Member States in the course of the Panel's consultations regarding United Nations financial sanctions. In addition to United Nations sanctions on the Islamic Republic of Iran, a number of jurisdictions have imposed their own financial sanctions regimes (referred to here as "unilateral sanctions regimes"). Such regimes and sanctions have increased over the past year.

Some Member States reported that they sought to comply with both United Nations sanctions and unilateral regimes, and others that they complied only with United Nations sanctions.

One example of the difficulties imposed by unilateral sanctions on legitimate transactions is illustrated by an enquiry from an international humanitarian organization to the United Nations regarding the transfer of funds from the Islamic Republic of Iran. The Committee, assisted by the Panel, subsequently recommended that the humanitarian organization should seek advice from Member States that had jurisdiction over their activities regarding restrictions imposed by sanctions regimes, and, where necessary, request such Member States to seek an exemption from the Committee in connection with the transfer of items, financial resources or assets to or from the Islamic Republic of Iran.

One State reported that it had been approached by an international humanitarian organization for advice on transferring funds to the Islamic Republic of Iran following the imposition of unilateral sanctions. The State responded that it could not influence the policies of individual banks.

The media also reported difficulties with humanitarian transactions.

Conclusions

The Panel finds a high level of awareness among Member States and the private sector of United Nations financial sanctions. Many Member States are implementing sanctions through their financial regulatory bodies with rigour.

Understanding whether and how Iranian circumvention of United Nations financial sanctions could be used for financing procurement for sanctioned nuclear and ballistic missile programmes is challenging. These programmes are industrial in scale and require sources of procurement financing that are large and reliable.

Legitimate trade may be hindered by the practices for financial transactions followed by some entities in response to unilateral sanctions.

Individuals and firms who are designated as subject to asset freezes on the basis of Security Council resolutions have no right to challenge the designations directly in any tribunal: there is no individual standing to challenge acts of the UN Security Council. But the Security Council resolutions are implemented by means of domestic measures in UN Member States (and in the EU by EU institutions and the Member States). Courts in the EU have found that persons designated under UN sanctions regimes have rights to due process under EU law, which they can

invoke before EU courts and the domestic courts of EU Member States.¹¹ The EU courts use the language of fundamental rights rather than the term due process. These fundamental rights include the rights of the defence (“the right to be heard and the right to have access to the file, subject to legitimate interests in maintaining confidentiality”) and the right to effective judicial protection.¹² And the invocation of fundamental rights in the EU courts has meaning: in a number of cases individuals and firms have successfully invoked their EU due process rights to invalidate the EU measures which designated them as subject to sanctions.¹³ Rosneft is one of a number of Russian companies that is in the process of challenging EU sanctions aimed at Russia with respect to its actions in Ukraine.¹⁴ The prospect of legal challenges to sanctions measures affects the EU’s willingness to adopt sanctions.¹⁵

The US authorities have taken enforcement action against a number of banks with respect to sanctions-busting activities. For example, in December 2012 the Federal Reserve announced “the issuance of a consent order to cease and desist and a civil money penalty assessment of \$100 million against **Standard Chartered PLC**, London, Standard Chartered Bank, London, and the

¹¹ See, e.g. Commission v Yassim Abdullah Kadi Joined Cases C-584/10 P, C-593/10 P and C-595/10 P (Jul. 18, 2013) at <http://www.bailii.org/eu/cases/EUECJ/2013/C58410.html>. See also, e.g. Clemens A Feinäugle, Commission v Kadi, 107 Am. J. Int’l L 878 (2013); Original citation: Conor Gearty, In praise of awkwardness: Kadi in the CJEU, 10. European Constitutional Law Review 15-27 (2014), Peter Margulies, Aftermath of an Unwise Decision: The U.N. Terrorist Sanctions Regime After Kadi II, 6 Amsterdam Law Forum 51 (2014).

¹² “[T]he person concerned must be able to ascertain the reasons upon which the decision taken in relation to him is based, either by reading the decision itself or by requesting and obtaining disclosure of those reasons, without prejudice to the power of the court having jurisdiction to require the authority concerned to disclose that information, so as to make it possible for him to defend his rights in the best possible conditions and to decide, with full knowledge of the relevant facts, whether there is any point in his applying to the court having jurisdiction, and in order to put the latter fully in a position to review the lawfulness of the decision in question.” Kadi at ¶ 100.

¹³ See, e.g., Bank Tejarat v Council [2015] EUECJ T-176/12 (22 January 2015) at <http://www.bailii.org/eu/cases/EUECJ/2015/T17612.html>, Ocean Capital Administration GmbH v Council [2015] EUECJ T-420/11 (22 January 2015) at <http://www.bailii.org/eu/cases/EUECJ/2015/T42011.html>.

¹⁴ OJSC Rosneft Oil Company v HM Treasury [2014] EWHC 4002 (Admin) at <http://www.bailii.org/ew/cases/EWHC/Admin/2014/4002.html>. See also, e.g., Carol Matlack, Putin’s Response to EU Sanctions: See You in Court (Nov. 3, 2014) at <http://www.bloomberg.com/bw/articles/2014-11-03/putins-response-to-eu-sanctions-on-russian-firms-see-you-in-court>.

¹⁵ See, e.g., Gabriele Steinhauser & Benoît Faucon, EU Wary of Imposing Harsh Sanctions on Russians After Court Setbacks (Mar. 20, 2014) at <http://www.wsj.com/articles/SB10001424052702304026304579451603170136942>

bank's branch in New York.” The consent order related to Standard Chartered’s compliance failures with respect to economic sanctions and anti-money-laundering requirements and failures to respond to bank examiner questions.¹⁶ The order required the bank to improve its compliance program. At the same time, Standard Chartered entered into deferred prosecution agreements with the DOJ and the District Attorney for New York County,¹⁷ and a settlement agreement with the Treasury’s Office of Foreign Assets Control.¹⁸ Links to these materials are available on the course blog (together with material relating to RBS).

On 21 March 2013 John Peace, the Chairman of Standard Chartered made the following statement:

On 5 March 2013, I, together with Chief Executive Officer Peter Sands and Group Finance Director Richard Meddings, representing Standard Chartered Bank (the "Group"), held a press conference where certain questions were asked concerning individual employee conduct and compensation in light of the deferred prosecution agreements made with the US Department of Justice and the New York County District Attorney's Office in December 2012. During that press conference, which took place via phone, I made certain statements that I very much regret and that were at best inaccurate.

In particular, I made the following statements in reference to a question regarding the reduction of bonuses for SCB executives:

We had no willful act to avoid sanctions; you know, mistakes are made - clerical errors - and we talked about last year a number of transactions which clearly were clerical errors or mistakes that were made... My statement that SCB "had no willful act to avoid sanctions" was wrong, and directly contradicts SCB's acceptance of responsibility in the deferred prosecution agreement and accompanying factual statement. Standard Chartered Bank, together with me, Mr. Peter Sands and Mr. Richard Meddings, who jointly hosted the press conference, retract the comment I made as both legally and factually incorrect. To be clear, Standard Chartered Bank unequivocally acknowledges and accepts responsibility, on behalf of the Bank and its employees, for past knowing and willful criminal conduct in violating US economic sanctions laws and regulations, and related New York criminal laws, as set out in the deferred

¹⁶ Federal Reserve Press Release (Dec. 10, 2012) at <http://www.federalreserve.gov/newsevents/press/enforcement/20121210a.htm>.

¹⁷ Department of Justice, Standard Chartered Bank Agrees to Forfeit \$227 Million for Illegal Transactions with Iran, Sudan, Libya, and Burma (Dec. 10, 2012) at <http://www.justice.gov/opa/pr/2012/December/12-crm-1467.html> .

¹⁸ The settlement agreement is at http://www.treasury.gov/resource-center/sanctions/CivPen/Documents/121210_SCB_Settlement.pdf.

prosecution agreement. I, Mr. Sands, Mr. Meddings, and Standard Chartered Bank apologize for the statements I made to the contrary.¹⁹

¹⁹ See <http://investors.standardchartered.com/en/releasedetail.cfm?ReleaseID=750004>