

Questions Related to the NDAA (Section 1245 of the National Defense Authorization Act for Fiscal Year 2012)

On December 31, 2011, the President signed into law the National Defense Authorization Act for Fiscal Year 2012, Public Law 112-81 ("NDAA"). Section 1245 of this statute requires the President to block the property and interests in property subject to U.S. jurisdiction of all Iranian financial institutions, including the Central Bank of Iran ("CBI"). It also aims to reduce Iranian oil revenues and discourage transactions with the CBI by providing for sanctions on foreign financial institutions that knowingly conduct or facilitate certain significant financial transactions with the CBI. Although the sanctions on foreign financial institutions authorized by section 1245 are similar to the financial sanctions under the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (22 U.S.C. 8513(c)) ("CISADA") (i.e., prohibiting and/or imposing strict conditions on opening or maintaining correspondent accounts or payable-through accounts in the United States), there are differences in the scope and operation of the two statutes.

What is the NDAA?

On December 31, 2011, the President signed into law the NDAA. Section 1245 of the NDAA requires the President to block the property and interests in property subject to U.S. jurisdiction of all Iranian financial institutions, including the CBI. It also aims to reduce Iranian oil revenues and discourage transactions with the CBI by providing for sanctions on foreign financial institutions that knowingly conduct or facilitate certain significant financial transactions with the CBI.

What activities can trigger sanctions on a foreign financial institution under the NDAA?

For private financial institutions, the Act mandates that the President sanction those institutions that are found to knowingly conduct or facilitate any significant transactions with a U.S.-designated Iranian financial institution or with the CBI – whether for the purchase of petroleum or otherwise – unless the transaction is for the sale of food, medicine, or medical devices to Iran. For all transactions with the CBI other than petroleum purchases, this provision takes effect on February 29, 2012, i.e., 60 days after the enactment of the Act. The timing of the petroleum purchase sanctions is discussed immediately below.

Private financial institutions and all other foreign financial institutions – including central banks or foreign state-owned or -controlled banks – potentially face sanctions under the NDAA if they knowingly conduct or facilitate significant financial transactions for the purchase of Iranian petroleum or petroleum products with a U.S.-designated Iranian financial institution or with the CBI after the provision takes effect as early as June 28, 2012, i.e., 180 days after enactment.* This NDAA provision may be held in abeyance beyond June 28, 2012, depending on the President's determination on the availability and price of alternative supplies. Foreign central and foreign state-owned or -controlled banks are also subject to these sanctions if the transactions are for the **sale** of petroleum or petroleum products to Iran and they occur after June 28, 2012.

All foreign financial institutions, including private and state-owned institutions, remain subject to section 104(c) of CISADA, which calls for sanctions on foreign financial institutions that are found to have knowingly engaged in facilitating significant transactions for specific Iranian-linked individuals and entities. (See CISADA: The New U.S. Sanctions on Iran, available at http://www.treasury.gov/resource-center/sanctions/Programs/Documents/CISADA_english.pdf .)

**Irrespective of the timeframes set forth in the NDAA, any foreign financial institution that knowingly facilitates significant transactions with any U.S.-designated Iranian financial institution would still be subject to CISADA.*

Does the NDAA repeal or amend Section 104(c) of CISADA?

No. Any foreign financial institution that knowingly facilitates significant transactions or provides significant financial services for a U.S.-designated, Iranian-linked financial institution can be sanctioned under section 104(c) of CISADA and section 561.201 of the Iranian Financial Sanctions Regulations ("IFSR") even if those transactions are not sanctionable under section 1245(d) of the NDAA. Though the NDAA imposes sanctions on foreign financial institutions similar to financial sanctions under CISADA and the IFSR (i.e., prohibiting and/or imposing strict conditions on opening or maintaining correspondent accounts or payable-through accounts in the United States), there are differences in the scope and operation of the statutes.

How does Executive Order 13599, "Blocking Property of the Government of Iran and Iranian Financial Institutions," and the blocking of all Iranian financial institutions affect the financial sanctions provisions in CISADA? Do CISADA sanctions now apply to financial transactions with any Iranian financial institution?

CISADA applies to transactions with only those Iranian financial institutions that are designated in connection with Iran's WMD or terrorism activities and are denoted on OFAC's List of Specially Designated Nationals and Blocked Persons (the SDN list) with the [IFSR] tag. While E.O. 13599 does block the property of all Iranian financial institutions, that action is not grounded in the authorities that relate to counterproliferation or counterterrorism, and therefore does not implicate CISADA.

Are there any exceptions to the sanctions provisions in the NDAA?

Yes. The NDAA includes an exception that prohibits the President from imposing sanctions "with respect to any person for conducting or facilitating a transaction for the sale of food, medicine, or medical devices to Iran."

What are definitions for the following NDAA terms: "significant financial transaction," "knowingly," "owned or controlled by the government of a foreign country," "food, medicine, and medical devices," "foreign financial institution," "Iranian financial institution," "significantly reduced," and "whether the price and supply of petroleum and petroleum products produced in countries other than Iran is sufficient"?

"significant financial transaction"

The IFSR, which implement section 104(c) of CISADA, identify factors to be used in determining what is significant (as it relates to transactions) in 31 C.F.R. § 561.404, which allows the Secretary of the Treasury to consider the "totality of the facts and circumstances" while providing a list of seven broad factors that can play a role in the determination, including: (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) such other factors that the Secretary deems relevant on a case-by-case basis. Treasury anticipates closely modeling the definition of "significant" for NDAA purposes on the IFSR.

We anticipate utilizing a broad definition of "financial transaction" that encompasses "any transfer of value involving a financial institution." The term "transaction" includes, but is not limited to, the following:

The holding of nostro, vostro, or loro accounts for or with the Central Bank of Iran or designated banks, such as Bank Melli Iran and/or Bank Saderat Iran, including any of their branches or

subsidiaries worldwide (collectively the "Listed Parties");

The provision of trade finance and/or letter of credit services for or with Listed Parties;

The provision of guarantees or similar instruments for or with Listed Parties;

The provision of investment products or instruments for Listed Parties and/or the participation with Listed Parties in investments;

The receipt or origination of wire transfers on behalf of or involving Listed Parties;

The acceptance of commercial paper (both retail and wholesale) drawn on Listed Parties, and the clearance of such paper (including, but not limited to, checks and similar drafts);

The receipt or origination of ACH or ATM transactions with Listed Parties; and/or

Any other transactions for or on behalf of, directly or indirectly, Listed Parties and/or with Listed Parties serving as correspondents, respondents, or beneficiaries. That would include transactions where the Listed Parties do not appear on the face of the transaction but where the transaction is undertaken with knowledge of the involvement of a Listed Party based on a relationship that exists through a third party such as a money exchange or trading house.

"knowingly"

The IFSR defines "knowingly" with respect to conduct, a circumstance, or a result, to mean that an entity or individual had actual knowledge, or should have known, about the conduct, the circumstance, or the result. 31 C.F.R. § 561.314. Treasury anticipates closely modeling the definition of this term on the IFSR.

"owned or controlled by the government of a foreign country"

The Iranian Transactions Regulations ("ITR") define "an entity owned or controlled by the Government of Iran" in section 560.313. Borrowing from that definition, a financial institution "owned or controlled by the government of a foreign country" would be deemed to include a financial institution in which a foreign government owns a 50% or greater interest or which is otherwise controlled by a foreign government. Treasury anticipates closely modeling the definition of this term under the NDAA on the ITR definition.

"food, medicine, and medical devices"

"Food": The October 2011 general license for the ITR and the Sudanese Sanctions Regulations ("SSR") authorizing certain food exports to Iran and Sudan defines "food" as "items that are intended to be consumed by and provide nutrition to humans or animals in Iran – including vitamins and minerals, food additives and supplements, and bottled drinking water – and seeds that germinate into items that are intended to be consumed by and provide nutrition to humans or animals in Iran." The regulations also specify that food does not include alcoholic beverages, cigarettes, gum, or fertilizer. Treasury anticipates closely modeling the definition of this term under the NDAA on this license definition.

"Medicine": ITR section 560.530(e)(2) states that: "For the purposes of this part, the term medicine has the same meaning given the term 'drug' in section 201 of the Federal Food, Drug, and Cosmetic Act (21 U.S.C. 321) but does not include any item listed on the Commerce Control List in the Export Administration Regulations, 15 CFR part 774, supplement no. 1 (excluding items classified as EAR 99)." Similarly, under the Trade Sanctions Reform and Export Act ("TSRA"), 22 U.S.C. 7201(5), "[t]he term 'medicine' has the meaning given the term 'drug' in section 321 of title 21." Treasury anticipates closely modeling the definition of this term under the NDAA on the ITR and TSRA.

"Medical Devices": ITR section 560.530(e)(3) states that: "For the purposes of this part, the term medical device has the meaning given the term 'device' in section 201 of the Federal Food, Drug, and Cosmetic Act (21 U.S.C. § 321) but does not include any item listed on the Commerce Control List in the Export Administration Regulations, 15 CFR part 774, supplement no. 1 (excluding items classified as EAR 99)." Similarly, under TSRA, 22 U.S.C. 7201(4), "[t]he term 'medical device' has the meaning given the term 'device' in section 321 of title 21." Treasury anticipates closely modeling the definition of this term under the NDAA on the ITR and TSRA.

"foreign financial institution"

"Foreign financial institution" is defined in section 1245 of the NDAA with reference to section 104(i) of CISADA (22 U.S.C. § 8513(i)). As further defined in the IFSR, a "foreign financial institution" is "any foreign entity that is engaged in the business of accepting deposits, making, granting, transferring, holding, or brokering loans or credits, or purchasing or selling foreign exchange, securities, commodity futures or options, or procuring purchasers and sellers thereof, as principal or agent. It includes but is not limited to depository institutions, banks, savings banks, money service businesses, trust companies, securities brokers and dealers, commodity futures and options brokers and dealers, forward contract and foreign exchange merchants, securities and commodities exchanges, clearing corporations, investment companies, employee benefit plans, and holding companies, affiliates, or subsidiaries of any of the foregoing." 31 C.F.R. § 561.308. It does not include "the international financial institutions identified in 22 U.S.C. 262r(c)(2), the International Fund for Agricultural Development, or the North American Development Bank." 31 C.F.R. § 561.308. Treasury anticipates closely modeling the definition of this term under the NDAA on the IFSR.

"Iranian financial institution"

This term is defined in E.O. 13599 as: "a financial institution organized under the laws of Iran or any jurisdiction within Iran (including foreign branches), any financial institution in Iran, any financial institution, wherever located, owned or controlled by the Government of Iran, and any financial institution, wherever located, owned or controlled by any of the foregoing." Such financial institutions include, but are not limited to, any foreign entity that is engaged in the business of accepting deposits, making, granting, transferring, holding, or brokering loans or credits, or purchasing or selling foreign exchange, securities, or commodity futures or options, or procuring purchasers and sellers thereof, as principal or agent. It includes but is not limited to depository institutions, banks, savings banks, money service businesses, trust companies, insurance companies, securities brokers and dealers, commodity futures and options brokers and dealers, forward contract and foreign exchange merchants, securities and commodities exchanges, clearing corporations, investment companies, employee benefit plans, and holding companies, affiliates, or subsidiaries of any of the foregoing.

"significantly reduced"

The Secretary of State, in consultation with the Secretary of the Treasury, the Secretary of Energy, and the Director of National Intelligence, will make determinations as to whether any country has significantly reduced the volume of Iranian crude oil purchases. Any determinations will be preceded by a process of rigorous due diligence. The Secretary of State intends to consider relevant evidence in assessing each country's efforts to reduce the volume of crude oil imported from Iran, including the quantity and percentage of the reduction in purchases of Iranian crude oil over the relevant period, termination of contracts for future delivery of Iranian crude oil, and other actions that demonstrate a commitment to substantially decrease such purchases.

"whether the price and supply of petroleum and petroleum products produced in countries other than Iran is

sufficient”

The President will make a determination, based on the reports required by subparagraph (A) of Section 1245(d)(4) of the NDAA, as to whether the price and supply of petroleum and petroleum products produced in countries other than Iran is sufficient to permit purchasers of petroleum and petroleum products from Iran to reduce significantly in volume their purchases from Iran.

What is the scope of “petroleum products” under the law?

As defined by the U.S. Energy Information Administration (EIA), petroleum products include unfinished oils, liquefied petroleum gases, pentanes plus, aviation gasoline, motor gasoline, naphtha-type jet fuel, kerosene-type jet fuel, kerosene, distillate fuel oil, residual fuel oil, petrochemical feedstocks, special naphthas, lubricants, waxes, petroleum coke, asphalt, road oil, still gas, and miscellaneous products obtained from the processing of crude oil (including lease condensate), natural gas, and other hydrocarbon compounds. In keeping with the EIA’s standard definition, petroleum products do not include natural gas, liquefied natural gas, biofuels, methanol, and other non-petroleum fuels.

If oil is being provided as payment for an outstanding debt, is such a transfer considered a “financial transaction”?

If a transfer involves a financial institution it would likely be considered a financial transaction.

If the CBI is involved in providing settlement services for a transaction, or is otherwise acting solely as an intermediary in a transaction between a non-designated Iranian bank and a foreign financial institution, is the foreign financial institution deemed to be engaging in a transaction with the CBI?

Section 1245 targets any significant transactions “with” the CBI; a transaction involving the CBI in an intermediary role would likely be viewed as a transaction “with” the CBI.

Are barter trades involving the CBI considered “financial transactions” under Section 1245?

If a transfer involves a financial institution it would likely be considered a financial transaction.

Does the definition of “significant financial transaction” exclude the passive holding of CBI reserves? Is the U.S. willing to give assurances that this will not be a basis for sanctions?

This will be a case-by-case determination and will require specifics on what “passive holding” entails. As a general matter, we would likely not view the holding of reserves as sanctionable in the following circumstances: the accounts are frozen or restricted, under which the CBI would be allowed to maintain accounts that it had already opened as of December 31, 2011, but would otherwise be unable to direct the disposition of those funds, with ordinary commercial interest payments and routine roll-overs of time deposits under pre-existing instructions being the only new transactions.

Are payments made under contracts existing prior to the date of enactment of the NDAA statute (December 31, 2011) exempted from the definition of “significant transactions”?

No general exception will be provided for payments arising out of pre-existing contracts. The assessment of whether such payments are “significant” will be done on a case-by-case basis in line with the criteria discussed above.

Will the U.S. refrain from sanctioning foreign financial institutions that receive funds from the CBI to repay loans? What if these loans were granted for projects that might be subject to the food, medicine, and medical device exemptions under the NDAA?

As noted, no general exception will be provided for payments arising out of pre-existing contracts. The assessment of whether such payments are “significant” will be done on a case-by-case basis in line with the criteria discussed above. Regarding payments for food, medicine, and medical devices, the NDAA does not allow sanctions based on transactions for the sale of food, medicine, or medical devices to Iran. Payments related to the export of broader humanitarian items would be dealt with in our analysis of what constitutes a “significant financial transaction” and would be considered on a case-by-case basis.

Is there a difference between entities that have been designated by the United States Government for illicit conduct, such as proliferation of weapons of mass destruction or support for terrorism, and those that are being blocked under E.O. 13599? How can I tell which entities appear on the SDN List for which reasons?

Both blocked and designated entities appear on the SDN List.

“Blocked” persons, in the context of E.O. 13599, appear on the SDN List due to the United States Government’s identification of these entities as the Government of Iran and/or as an Iranian financial institution. Such entities are identified on the SDN List with the tag [IRAN]. For example, Bank Keshavarzi is a Government of Iran owned Iranian financial institution and is identified with the [IRAN] tag. Additionally, the National Iranian Oil Company (NIOC) is a non-financial institution that has been identified as the Government of Iran and bears the [IRAN] tag.

“Designated” persons appear on the SDN List due to the United States Government’s having determined that they meet the criteria set forth in any of a number of other Executive Orders concerning, for example, assisting Iran’s weapons of mass destruction development, or aiding international terrorism and designating them for such activities. Such entities are identified on the SDN List with various tags other than [IRAN], such as [NPWMD] or [SDGT]. For example, Islamic Republic of Iran Shipping Lines is listed as: “[IRISL [NPWMD]].”

Note that many entries on the SDN List have more than one tag. For example: Bank Saderat Iran has three tags: [SDGT], indicating that it has been sanctioned for providing services to terrorism; [IRAN], indicating that it is the Government of Iran; and [IFSR], referring to the Iranian Financial Sanctions Regulations to signal to third country financial institutions that engage with entities with this tag that they risk sanctions under CISADA.