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Those Three Little Words: OFAC’s Subtle Language Shift Could Create Sweeping Change on Iran Investment

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Article Highlights:

- Non-U.S. banks can do business with Iran and continue their relationships with U.S. banks.
- Non-U.S. companies may use proceeds from Iran transactions more freely, including in the United States.
- OFAC draws a clearer line with respect to the use of Iran-related funds.

After the Iran nuclear agreement, as non-U.S. companies entered into newly-permitted business in Iran, they faced the difficult question of where they could put the money from their Iran business. U.S. law still prohibits U.S. persons (including U.S. banks) from conducting most business with Iran. Among other rules, OFAC regulations and guidance provided that “Iran-related” funds could not transit the U.S. financial system. But the guidance did not state clearly what constituted “Iran-related” funds. For that reason, foreign financial institutions (FFIs) hesitated, even feared, to process Iran-related transactions because of the risks of sending Iran-related funds into the U.S. financial system in violation of U.S. sanctions. However, a new clarification in the OFAC guidance could change all of that (and change it in the way we proposed right here in this blog[1]).

The Change

On October 7, 2016, OFAC amended one phrase in FAQ C-15 of its Frequently Asked Questions on the implementation of the Iran nuclear agreement. Previously, the FAQ read as follows:

> It remains prohibited, however, for non-U.S. financial institutions to route Iran-related transactions through U.S. financial institutions or involve U.S. persons in such transactions, unless the transactions are exempt from regulation or authorized by OFAC.

As of October 7, 2016, that sentence has been revised to read as follows:

> It remains prohibited, however, for non-U.S. financial institutions to route ***transactions involving Iran*** to or through the U.S. financial system, or involve U.S. persons in such transactions, unless the transactions are exempt from regulation or authorized by OFAC.

[Emphasis definitely added by us.]

Did you see what they did there?[2] By changing the phrase "Iran-related transactions" to "transactions involving Iran," OFAC has established a much brighter line by which FFIs and non-U.S. companies can determine whether Iran-related funds are permitted enter the U.S. system. The elegant simplicity with which OFAC has drawn that line (only three little words!) merits the admiration of legal drafters everywhere.

The Implications

Prior to the OFAC guidance change, an FFI holding an account containing proceeds from a transaction in Iran could not be certain whether it could process those funds through the U.S. system. Additionally, it was unclear whether the Iran-related proceeds would taint the rest of the funds in the account so that no funds in that account could transit the U.S. banking system.

Under the new guidance, it is clear that where a transaction does not involve Iran or persons in Iran, OFAC's policy is that the funds involved in that transaction may transit the U.S. system. Thus, in our view, if a transaction is complete and the only connection to Iran is that funds in an account were derived from an Iranian transaction, it is permissible for those funds to transit the U.S. financial system. The funds can be exchanged for U.S. dollars, spent on U.S. goods, or paid to U.S. persons for goods and services, so long as those goods or services are not intended for Iran.

We caution that the transaction must *legitimately* not involve Iran, so the Bank must have systems in place to prevent transactions actually involving Iran from transiting the U.S. system. Of course, the United States can be expected to investigate and strongly penalize activity in which a transaction is set up to appear as if it does not involve Iran, but effectively permits Iran or persons in Iran to make use of the U.S. system.

The Next Steps

If your business involves Iran, this is your first agenda item at the next meeting with your bank. If you have lawful business in Iran and you hold the proceeds of that business in an account with an FFI, you may now provide comfort to your bank that those funds are yours to spend as you please. The transactions you undertake with those funds that do not involve Iran may involve U.S. persons and may use the U.S. banking system. Iran is still effectively barred from using the U.S. banking system, but you are not.

If you are an FFI, you have the opportunity to support and finance all the non-U.S. companies that are champing at the bit to lawfully enter an untapped market of more than 77 million people. You will, of course, need to undertake due diligence measures to ensure that fraudulent transactions do not put you at risk of routing “transactions involving Iran” through the United States. However, we believe FFIs can take these three little words from OFAC as an invitation to join the effort to open business in Iran and open Iran for business.

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[1] With the readers’ permission, we will go on and, as the poet suggests, brush our shoulders off.

[2] Well, yeah, probably so. That’s why we added the emphasis. In fact, in every instance in the FAQ of the phrase “Iran-related transaction,” it has been changed to “transaction involving Iran.”

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