

Iran's "Trojan Horse" Bank

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The Kingdom of Bahrain recently filed its statement of defence in an ongoing [UNCITRAL](#) arbitration in the Permanent Court of Arbitration ("PCA") in The Hague against Iranian financial institutions Bank Melli and Bank Saderat. The statement of defence cites a Bahraini government audit evidencing a multibillion-dollar corruption scheme perpetrated by Bank Melli and Bank Saderat on Bahraini soil.

U.S. sanctions against Iran

U.S. sanctions against Iran date as far back as 1979, when Iranian students stormed the U.S. Embassy in Tehran and held 52 American diplomats and citizens hostage for 444 days, from November 4, 1979, to January 20, 1981. This remains the longest hostage crisis in recorded history. Since 1979, the U.S. has imposed a raft of sanctions against Iran.

- On March 15, 1995, President Clinton [prohibited](#) U.S. involvement in Iranian petroleum development, before then [imposing](#) a comprehensive U.S. embargo against Iran on May 6, 1995.
- On August 19, 1997, Clinton clarified the March 16 and May 6, 1995, actions as [prohibiting](#) virtually all trade and investment activities with Iran by U.S. persons, wherever located.
- On November 6, 2008, the U.S. Treasury [revoked](#) the "U-turn" license for Iran, further restricting Iran's access to the U.S. financial system by prohibiting U.S. financial institutions from continuing to process transfers involving Iran that originate and end with a non-Iranian, non-U.S. bank.
- On July 1, 2010, U.S. Congress [extended](#) U.S. economic sanctions against Iran by prohibiting U.S. persons from exporting goods or services (including financial services) to Iran or, in general, to a third country knowing those goods or services are ultimately intended for Iran.
- On February 5, 2012, President Obama then [blocked](#) the property of the Government of Iran and Iranian financial institutions.

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- Iran provisionally returned to the international fold on July 14, 2015, after agreeing a [nuclear deal](#) with international parties. The agreement provided, in return for verifiably abiding by its commitments under the deal, that U.S. and other international nuclear-related economic sanctions against Iran would be scaled back.
 - However, President Trump has [recently threatened](#) to [tear up the deal](#), which would revive the threat of secondary sanctions (exclusion from the U.S. financial system) to non-Iranian, non-U.S. banks facilitating transactions related to the import/export of Iranian petroleum.
 - Gulf States have also markedly increased their rhetoric against Iran in recent times.

Banks Melli and Saderat

Bank Melli was founded in 1927 and is Iran's first national bank. Bank Saderat was founded in 1952 and has grown to be Iran's largest bank.

The U.S. [designated](#) Bank Melli on June 28, 2005 for providing financial support to entities involved in Iran's nuclear and missile programs, including the Islamic Revolutionary Guard Corps.

The U.S. [designated](#) Bank Saderat on September 8, 2006 for providing financial support to terrorist organizations, including Hamas and Hizballah.

Future Bank

Future Bank B.S.C. was established in Bahrain in 2004 as a joint venture between Bahrain's Ahli United Bank (with a 34% stake) and Iran's Banks Melli and Saderat (with an aggregate 66% stake). Culturally, the joint venture was viewed as a positive for Bahrain, which has been ruled since 1783 by the Sunni House of Khalifa but which has a majority-Shiite population with religious ties to Iran.

However, by 2015, Bahraini regulators had placed Future Bank into administration and, by 2016, had closed the bank, on suspicions of money laundering. These acts prompted Banks Melli and Saderat to bring an action in The Hague, claiming breach of the 2002 Bahrain-Iran Bilateral Investment Treaty for the Promotion and Protection of Investments. They also sought the return of assets they allege were misappropriated by Bahrain. Banks Melli and Saderat also contend that Bahrain's closure of Future Bank was attributable to political pressure from the Kingdom of Saudi Arabia.

“Trojan Horse” inside Bahrain, facilitating more than USD 7 billion of Iranian business

According to Bahrain's defence, a lookback into the bank's historic business shows that it was used by Iran as a “Trojan horse” inside Bahrain, affording Iran “secret access” to the international monetary system in defiance of U.S. and other international sanctions intended to isolate Tehran.

Specifically, the bank is alleged to have avoided sanctions against Iran, to the tune of at least USD 7 billion, by deliberately removing or changing certain identifying information when transferring money between banks—a practice known as “wire-stripping.” Bahrain asserts that the auditors detected more than 4,500 instances of wire-stripping by Future Bank officials designed to conceal Iran's role as the sender or recipient of funds.

As a result, Future Bank may have facilitated business for purposes of organized crime, arms proliferation and terrorism. The audit apparently identified “hundreds of bank accounts tied to individuals convicted of crimes including money laundering and terrorism financing, as well as phantom loans provided to companies that operate as fronts for Iran’s Islamic Revolutionary Guard Corps.”

The Washington Post obtained and [reported](#) the confidential PCA filing as well as a statement from Bahraini Foreign Minister Khalid bin Ahmed Al Khalifa, who summarized the audit as “reveal[ing] crimes and violations of Bahraini and international law of massive proportions.”

Additional Considerations

This case demonstrates the enormous compliance challenges facing banks and regulators in a region geographically proximate to sanctioned countries intent on operating non-transparently. Perhaps more than ever before, financial institutions in locations like the United Arab Emirates, the Kingdom of Saudi Arabia, the State of Kuwait, and the Sultanate of Oman must be rigorous in efforts to detect and prevent similar sanctions-defying criminality.

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National Law Review, Volume VIII, Number 116

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