

Iran Faces Challenges in Implementing Its FATF Action Plan

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Brief Analysis

Despite agreeing on an action plan, Tehran has far to go to meet international standards aimed at countering money laundering and terror financing.

At the conclusion of its regular plenary meeting in Paris last week, the Financial Action Task Force (FATF) released its "public statement" on "high-risk and noncooperative jurisdictions" -- a category that continues to include Iran. It was the first meeting of the international standard-setter for anti-money laundering and counter-terrorist financing (AML/CFT) since the group **suspended so-called countermeasures (<http://www.fatf-gafi.org/publications/high-riskandnon-cooperativejurisdictions/documents/public-statement-june-2016.html>)** against Iran for a year while Tehran works to implement an "action plan" to address AML/CFT deficiencies. In its October 21 statement, the FATF **urged members (<http://www.fatf-gafi.org/countries/d-i/iran/documents/public-statement-october-2016.html>)** to "continue to advise their financial institutions to apply enhanced due diligence to business relationships and transactions with natural and legal persons from Iran." The organization also reiterated that Iran would remain on the public statement until it completes the full action plan.

The FATF statement did not mention any Iranian progress in implementing the plan, which has faced strong domestic political opposition. As of mid-October, a special working group of the Iranian Majlis set up to review the plan had yet to determine whether the required measures conflicted with national interests.

OBJECTIONS TO THE ACTION PLAN

The FATF releases a "public statement" on jurisdictions with strategic AML/CFT deficiencies following its plenary meetings in February, June, and October of each year. Iran has been named in these statements since 2008, when the organization revised its processes for dealing with "high-risk and noncooperative jurisdictions."

In this year's June and October statements, the FATF recognized that Iran has agreed to -- and in fact made a high-level political commitment to -- implement an action plan to address its strategic AML/CFT deficiencies. In return,

the organization announced that it would suspend its call for additional restrictions and due-diligence measures designed to protect the financial sector against risks emanating from Iran. Despite the suspension of these countermeasures, however, there are few signs that national regulators have modified their guidance to financial institutions regarding Iran, which they still see as a high-risk jurisdiction.

Although Iran's FATF action plan has not been publicly released, hardliners in Tehran have focused their objections on three areas: (1) amending the legal definition of terrorist financing to bring it in line with international standards, (2) recognition and implementation of international sanctions, and (3) international cooperation and information sharing.

CRIMINALIZING TERRORIST FINANCING

The FATF statement continued to call attention to Iran's failure to address terror finance-related deficiencies, noting that until the country addresses these issues, "the FATF will remain concerned with the terrorist financing risk emanating from Iran and the threat this poses to the international financial system." In prompting Tehran to amend its 2015 Counterterrorist Financing Law to fully criminalize terror financing and develop implementing regulations, one of the key issues for the FATF is a clause in the legislation that exempts the following activities from the definition of terrorism: "actions taken by nations, groups, or liberation organizations for the purpose of putting an end to foreign occupation, colonialism, and racism." Populating this supposed "whitelist" of terrorist organizations means that financing such entities would not be considered illegal. Iran will need to get rid of the clause in order to be considered in compliance with the FATF's call for countries to criminalize terrorism per the [UN Terrorist Financing Convention \(http://www.un.org/law/cod/finterr.htm\)](http://www.un.org/law/cod/finterr.htm).

Although hardliners in Tehran oppose such changes, viewing them as an effort to cut off or reduce funding to Iran's terrorist proxies, the FATF is unlikely to back down on this point. During remarks at The Washington Institute's Stein Counterterrorism Lecture Series on October 13, Assistant Secretary Daniel Glaser of the U.S. Treasury Department [noted that \(http://www.washingtoninstitute.org/policy-analysis/view/the-evolution-of-terrorism-financing-disrupting-the-islamic-state\)](http://www.washingtoninstitute.org/policy-analysis/view/the-evolution-of-terrorism-financing-disrupting-the-islamic-state) "terrorist financing laws that make exceptions for national liberation movements or other types of movements have not been acceptable to FATF in the past, and I don't expect them to be acceptable to FATF in the future." Previous cases of this sort have arisen primarily in Latin America and Africa, where countries with a colonial legacy have sought to make exceptions for freedom fighters, anti-apartheid groups, and similar factions. As the world's most active state sponsor of terrorism, Iran represents a qualitatively different threat, so it is important that the FATF hold the line.

OTHER CHALLENGES AHEAD

Reacting to the action plan, Ayatollah Ahmad Jannati, secretary of Iran's powerful Guardian Council, told a Friday prayer gathering on September 9: "I do not understand how they could sign this confidential document. I've studied both the Persian and English versions and I soon came to the conclusion that they want to give our financial and banking information to the enemy. They want us to sanction ourselves. They want us to sanction the individuals and institutions that the enemy disagrees with. They want us to sanction the [Islamic Revolutionary Guard Corps (IRGC)], revolutionary institutions, and individuals."

Iran's FATF action plan likely emphasizes full criminalization of terrorist financing and development of mechanisms to facilitate international cooperation. Yet it is unclear if development of a "targeted financial sanctions" capability is one of the first-line issues identified by the FATF -- at least not in the manner Jannati and other Iranian critics have characterized it. The FATF requires countries to develop such a capability so that they can implement UN sanctions related to terrorism, terrorist financing, and the proliferation of weapons of mass destruction. Furthermore, countries are required to put in place a legal, regulatory, and administrative structure to

implement targeted sanctions on entities involved in such activity, whether on their own or based on another country's request.

Despite this general intent, critics have connected implementation of the FATF action plan with implementation of specific Western sanctions on Iranian entities. Some of this concern likely stems from reports that two Iranian banks sent letters to subsidiaries of the IRGC-affiliated construction conglomerate Khatam al-Anbia, which remains subject to U.S. secondary sanctions even after implementation of the 2015 nuclear deal. The letters, which were leaked to the Iranian press, stated that banks would not process foreign exchange transactions on behalf of the subsidiaries due to Western sanctions. The resultant uproar prompted Iranian officials to assert that the letters were not related to the FATF plan and to reject compliance with international sanctions.

Yet adopting and implementing FATF requirements related to transparency of legal persons could expose commercial interests affiliated with the IRGC, quasi-governmental organizations, and other vested Iranian interests who have benefited from lax or murky ownership requirements. The difficulty in determining complete ownership of Iranian counterparties has been one factor deterring Western financial institutions from reengaging with Iran. Banks are concerned about the commercial risk involved in dealing with institutions of uncertain ownership, something frowned upon by regulators. Add to this the risk that banks might unwittingly do business with an entity fully or partially owned by the IRGC, which remains subject to U.S. and EU sanctions, or another Iranian entity that the bank perceives to be a reputational or other risk.

Although updates made to the Treasury Department's Office of Foreign Asset Control (OFAC) "Frequently Asked Questions" on October 7 state that some activity with subsidiaries of sanctioned entities "is not necessarily sanctionable," the many cautionary notes in Treasury's guidance will likely lead banks to decide that doing business with Iran continues to carry great risks, especially since the penalty for violation could be losing access to the U.S. financial system: "It is not necessarily sanctionable for a non-U.S. person to engage in transactions with an entity that is not on the [Specially Designated Nationals List] but that is minority owned, or that is controlled in whole or in part, by an Iranian or Iran-related person on the SDN List. However, OFAC recommends exercising caution...Non-U.S. persons should consult with their local regulators regarding due diligence expectations in their domestic jurisdictions. In particular, the non-U.S. person should ensure that its due diligence procedures conform to its internal risk-assessment and overall compliance policies."

IMPLICATIONS

In an effort to quell debate in the Majlis, Minister of Economy and Finance Ali Tayebnia told a parliamentary session last month that Iran is not obliged to accept all conditions put forward by the FATF. According to a September 27 report by Agence France-Presse, he declared: "We will not allow any international body to access our intelligence. We will not accept definition and examples of terrorism from any authority other than the UN Security Council." But what is perhaps more concerning was his rejoinder that Tehran does not recognize "international sanctions on revolutionary individuals and institutions," which implied that Iran will not necessarily implement UN-mandated restrictions. So long as it continues to view itself as being above international norms, Iran will struggle to convince financial counterparties of its seriousness in abiding by international standards.

Looking ahead, Iran will need to find a way to implement the action plan before June 2017, at which time the FATF has said it will reimpose countermeasures. Even if Tehran succeeds on that front, it would still need to address the many other concerns that wary banks have about doing business with the Islamic Republic; indeed, it would still be far from full compliance with FATF standards, much less with the many other international regulatory requirements adopted over the decade since the global financial crisis. Yet failure to take even this first small step would be a significant setback in Iran's efforts to court global banks.

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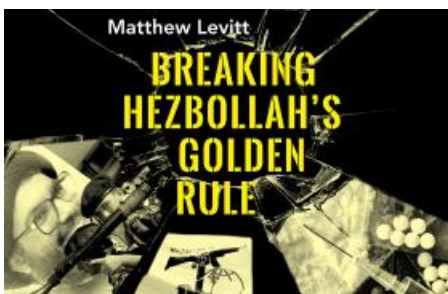
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