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Iran's Vulnerabilities to U.S. Sanctions (Part 2): Working Smarter, Not Harder

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Pending policy decisions on reimposing sanctions will give Washington opportunities to calibrate its arsenal of measures against illicit Iranian financial activity.

This PolicyWatch is the second in a two-part series on renewing U.S. sanctions. Read Part 1, which explains why the banking sector is Iran's biggest weak spot.

Many of the details behind reimplementing nuclear sanctions on Iran have yet to be fully fleshed out. The U.S. government will likely issue additional guidance as key dates for certain sanctions—namely, August 6 and November 4—approach. In the meantime, a number of pending policy decisions could underpin this guidance.

As officials mull these decisions, they should keep in mind that sanctions need not be reimposed exactly how they were before the nuclear deal. This discretion gives Washington room to better exploit key Iranian vulnerabilities, work with foreign partners with the aim of galvanizing multilateral action, and prioritize U.S. efforts in the face of time and resource constraints.

ENERGY SANCTIONS

When targeting Iran's oil sector, policymakers should focus more on revenues than sales. That is, even as they take steps to reduce the volume of Iran's oil sales, their priority should be ensuring that revenues from those sales are locked up.

The relevant legislation allows for a waiver of certain financial sanctions as long as countries (1) continue to meet a purchase reduction requirement, and (2) agree to hold Iranian revenues in the purchasing country while restricting their use to financing bilateral trade. This so-called "bilateral trade restriction" barring the repatriation of Iranian oil revenues was introduced one year after the "significant reduction waiver," which spared Iran's oil customers from sanctions if they reduced their purchases over time. Both provisions aim to reduce the amount of oil revenues—a key source of hard currency—available to Iran.

Since both measures will be implemented simultaneously, policymakers may want to consider greater flexibility on the reduction requirement in exchange for stronger commitments to refrain from repatriating Iranian revenues. Doing so would mean that the funds are kept in the country to which the oil is exported and are only available for use in that country. Countries such as Turkey and India may also be induced to comply based on the benefit to their trade balance, given the advantage this arrangement would confer on their exports to Iran.

In addition, the Trump administration has a great deal of flexibility in determining what constitutes a "significant reduction" of oil imports from Iran. Speaking to a *Wall Street Journal* reporter in Brussels last week, Deputy Assistant Secretary of State Andrew Peek declined to cite specific numbers, saying that the required reduction "needs to be significant but will probably vary from country to country." The State Department administers the reduction waiver and is allowed by statue to consider a number of factors when deciding whether a country will receive it, including reductions in the quantity and percentage of oil they purchase from Iran, termination of contracts for future delivery of Iranian crude, and "other actions that demonstrate a commitment to decrease substantially such purchases." Iranian oil exports fell sharply in the first half of June, according to ship-tracking data compiled by Bloomberg, which called it the biggest drop for a similar period since December 2016.

NO SILVER BULLETS

Another measure set to be reimposed in November is sanctions on the provision of specialized financial messaging services to the Central Bank of Iran and other designated banks. Yet cutting off access to the top provider of such services—the Society for Worldwide Interbank Financial Telecommunication (SWIFT)—is neither necessary nor sufficient to minimize Iran's access to the global financial system.

Leading up to implementation of the Joint Comprehensive Plan of Action (JCPOA), many observers conflated reestablishing Iranian access to SWIFT with reestablishing Iranian access to foreign banks. Most of these banks declined to reestablish ties with Iranian banks despite their renewed access to SWIFT. Likewise, many foreign institutions had stopped doing business with Iranian banks even before they were barred from SWIFT in 2012. Iranian use of SWIFT declined more than 30 percent between 2006 and 2012 (the only years for which the organization provides such data), a telling drop during a period in which the overall global volume of SWIFT transactions grew by nearly 40 percent. Iran's decline included a 22 percent drop in 2008—the same year the country was banned from using dollarized "U-turn transactions," not long after the UN had called for "vigilance" in dealing with Iranian banks as part of UN Security Council Resolution 1803.

Since the United States announced its withdrawal from the JCPOA in May, many foreign banks that had resumed ties with Iran have said they will wind down business, among them major financial institutions such as Belgium's KBC, Switzerland's Banque de Commerce et de Placements (BCP), and Germany's DZ Bank, as well as smaller banks with less exposure to the United States (e.g., Austria's Oberbank). Undoubtedly, access to SWIFT makes it easier to conduct cross-border transactions and foreign currency exchange, but financial institutions have other ways of exchanging messages related to transactions. Thus, pushing to cut Iran off now may have only a limited impact, and would also come with downsides.

For one, designating SWIFT is as likely to encumber U.S. banks as it is Iranian, since they would find it difficult to use the service if it was added to sanctions lists. Furthermore, certain transactions related to medicine, medical devices, and agricultural commodities will remain allowable even after nuclear sanctions are reimposed. It is in America's interest to allow, if not facilitate, such transactions.

Rather than picking a fight with Europe about SWIFT, the U.S. government has less contentious ways to counter illicit Iranian behavior. In a June 5 speech, Treasury Undersecretary Sigal Mandelker delivered an indictment of the Iranian banking sector, including the Central Bank, citing its "systemic efforts to undermine the international financial system." In that vein, Washington should not only warn banks that doing business with Iran could make them complicit in illegal activity, it should also urge partners to better enforce sanctions not eased by the JCPOA. In particular, the EU's Syria sanctions may be applicable to the Export Development Bank of Iran—the institution that Tehran has reportedly used to extend credit to the Assad regime via various Syrian state-owned banks, including at least one on the current EU sanctions list.

These and other actions could enable SWIFT to disconnect Iranian banks that flout international authority as a matter of "regulatory obligation." Notably, Bank Saderat Iran has not been able to reconnect to SWIFT, according to the Iranian daily the *Financial Tribune*. Saderat was removed from EU sanctions lists in October 2016, despite being one of the three Iranian banks that were to remain on those lists following implementation of the nuclear deal. Yet secondary sanctions continue to apply to the bank because it was sanctioned by the United States under counterterrorism authorities.

CONSIDERING EVASION

In the face of new sanctions pressure, Iran will no doubt see opportunities for evasion. For more than thirty years, the regime and individual institutions have developed sophisticated means of skirting U.S. and multilateral sanctions of varying intensity, and they apparently continued using these networks during the period of sanctions relief. In this sense, Iranian firms have faced a catch-22: they felt they could not move fully away from evasion networks as long as they were unable to establish relationships with global banks, yet it was such deceptive behavior that made banks reluctant to reengage with them in the first place.

For example, in November 2017, the accounts of Iranian businesses in China, Dubai, and Malaysia were blocked after petrochemical companies were discovered falsifying bills of lading to obscure the Iranian origin of goods in order to secure trade financing. "We still have to transfer our money through ways we did during the sanctions," explained one Iranian petrochemical official to the domestic press. In response, China has stepped up enforcement on its banks in preparation for its mid-2018 assessment by the international financial watchdog FATF.

This time around, Iran's traditional outlets for evasion may be less hospitable. Consider the joint action by Emirati regulators and the U.S. Treasury last month to disrupt an Islamic Revolutionary Guard Corps-Qods Force network that has been exploiting UAE exchange houses to procure U.S. dollars for regional proxy groups. The Turkish financial sector may also be less hospitable after a senior Turkish banking official was sentenced last month to thirty-two months in a U.S. jail. Halkbank executive Hakan Atilla had been involved in an Iranian evasion scheme aimed at laundering "billions of dollars worth of Iranian oil proceeds, ultimately creating a slush fund for Iran to use however it wished," according to U.S. law enforcement.

RESOURCE ISSUES

Since the JCPOA withdrawal announcement, the U.S. government has released seven sets of new sanctions targeting Iran's illicit non-nuclear activity. Clearly, then, the administration will continue to focus on Iran's destabilizing regional behavior, missile development/proliferation efforts, human rights abuses, support for terrorism, and other malign behavior even as it reimplements nuclear sanctions.

Most, if not all, of these recent actions took months to prepare. Accordingly, the sanctions team at the Treasury and State Departments will need to balance efforts to replenish the queue of additional actions with drafting new regulations, addressing frequently asked questions, and developing the evidentiary basis for relisting some of the 200 entities delisted under the JCPOA. In doing so, they should prioritize actions that will have the greatest impact while demonstrating a willingness to compromise on those that will only marginally affect Iran's access to financial services and oil revenues. This approach would maximize the U.S. government's finite resources while offering an olive branch to partners in Europe and elsewhere, making them more likely to help Washington call attention to Iran's most egregious violations of international norms.

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