

Sanctions busting – an Iranian imperative

Iran is an international outcast for its nuclear ambitions but ranks as high in the geographic risk league over its long-standing refusal to cooperate in the fight against money laundering (let alone terrorist financing). There may though be signs, albeit mixed, of movement in Tehran, writes Paul Cochrane.

Iran has been under international financial and other trading scrutiny since the Islamic revolution 30 years ago, with sanctions by the United States tightened under the Clinton administration through the *Iran-Libya Sanctions Act*. After the Iranian decision to embark on a nuclear programme, US sanctions intensified but

in the face of such restrictions Iranian banks and individuals are increasingly using joint venture banks in the Middle East and South America to bypass scrutiny. In a further series of complications, the Central Bank of Iran denies that money laundering exists in the country even whilst implementing a new Anti-Money Laundering Law.

The Islamic Republic has been at the hard end of recent Financial Action Task Force (FATF) statements, which warned in October 2007 that "Iran's lack of a comprehensive anti-money laundering/counter-terrorist finance regime represents a significant vulnerability within the international financial system."

Since then FATF has issued three additional statements: the last, in October 2008, reiterating the risk of terrorist financing and urging all jurisdictions to "strengthen preventive measures to protect their financial sectors."

FATF's statements appear to have been taken seriously by Iran, which has now applied for membership of the Paris-based body, an interesting development given the belligerent tone often adopted by the current government of President Mahmoud Ahmadinejad. "At the same time that the Ahmadinejad government was dismissive of US and UN sanctions, it was concerned about FATF – sending a lobby group to Paris to stop a second warning," said Michael Jacobson, senior fellow at the Washington Institute for Near East Policy.

Last year, the Iranian parliament did pass an Anti-Money Laundering (AML) law and sent it to the country's Guardian Council for final ratification. Enacted in April 2009, the law created a High Council on Anti-Money Laundering, chaired by the Minister of Economic Affairs and Finance; its members include the governor of the Central Bank of Iran (CBI). However, a financial intelligence unit (FIU), which is a requirement of the FATF, has yet to be established.

Jay Jhaveri, Head of Asia at World-Check, a British company that maintains a database on high and heightened risk individuals and entities, said the AML legislation is "pretty standard, the key buzzwords are there. It's almost a standard cut and paste from FATF guidelines." But lacking a financial intelligence unit, he said Iranian "banks and financial institutions don't have anyone to whom to report suspicious activity."

A further area where the legislation falls short is in addressing terrorist financing, a particularly charged area given the political animosity between the United States and Iran. The US State Department designated Iran an international sponsor of terrorism in 1984, accusing it of funding the Palestinian organisation Hamas, the Lebanese militant group Hezbollah and, since 2003, militias in Iraq such as *Asa'ib Ahl al-Haq* and *Kata'ib Hizbullah*. The US has directly linked Iran's Islamic Revolutionary Guard Corps Quds Force (IRGC-QF) – a paramilitary wing of the government that is also heavily involved in business in Iran – to financing, arming and training such groups. The IRGC-QF has been singled out by the US Department of the Treasury under UN Executive Order 13224 for providing material support to terrorists; it claims that the IRGC is funnelling money to Hamas, and between US\$100-US\$200 million a

year to Hezbollah, through Iranian banks, notably state-owned Bank Saderat and Bank Melli.

Khaled Meshal, leader of the Hamas political bureau in Syria, confirmed Iranian backing during a visit to Tehran in 2007, when he stated that the country had been providing financial support since Hamas was voted into office in the Palestinian territories in 2006. Meshal did not give any figures but added that funding would continue.

Unlike in Lebanon, where Iranian banks operate freely, Israel strictly monitors Palestinian financial transactions, meaning funding from Iran has to enter the Palestinian territories through other channels. "A lot of the money is bulk cashing smuggling, particularly into Gaza through tunnels, with people travelling from Iran and bringing huge amounts, some in the millions of dollars," said Jacobson.

Iran does support these groups: all are listed on the US Treasury Office of Foreign Assets Control (OFAC) list and deemed terrorist groups by the American government, but Tehran does not consider the likes of Hamas and Hezbollah as terrorist organisations.

"There is an element of politicisation in the OFAC list, with a few years ago Libya as the bad boy, and since removed. There is always a grey area between terrorist and freedom fighters; Hamas was elected, so what do you say?" said Jhaveri.

But Tehran's inability to tackle terrorist financing remains a concern of FATF: "The Plus 9 [the FATF 9 Special Recommendations on Terrorist Financing] have largely been ignored in Iran, which probably comes down to the definition of terrorism," added Jhaveri, "I believe FATF will address that in their next report, that legislation doesn't address the Plus 9 properly."

Iran's definition of money laundering is a further area where Tehran and the international community are not seeing eye-to-eye, with the Central Bank primarily focused on criminal proceeds and the narcotics trade. "Like a lot of countries in the beginning [of implementing legislation], money laundering is considered proceeds of narcotics. So in a lot of reports, when Iran talks of money laundering, the predicate crime is narcotics-related," said Jhaveri.

According to the United Nations Office on Drugs and Crime (UNODC), approximately 60% of Afghanistan's opium is trafficked across Iran's border, supplying an estimated three million Iranian drug addicts as well as being transported on to Turkey and Europe. According to a study carried out by Dr Bijan Bidabad, an economic consultant in Tehran, "revenues

from drug sales and transportation in some years is equal to Iran's oil revenue." Iran's oil and gas revenues were US\$80 billion in 2007-2008, according to the central bank.

The World Bank meanwhile has claimed that an estimated 19% of Iran's GDP stems from unofficial economic activities, while, according to the US State Department, "a prominent Iranian banking official has estimated that money laundering encompasses an estimated 20% of Iran's economy. Other reports have found that approximately US\$12 billion is laundered annually via smuggling commodities in Iran and another US\$6 billion laundered by international criminal networks."

Money is typically laundered through unofficial banks, said Bidabad, known as *Qarzol Hassaneh Funds*, which "belong to pressure groups and the Ministry of Defence and Armed Forces Logistics (MODAFI)." State-run banks and businesses are further areas of concern. Jhaveri noted that as they are state-controlled, enforcement of AML regulations was unlikely since it would directly hurt the government.

Real estate is another area where funds are laundered, according to the State Department, with settlements and payments often made overseas. Dubai in the United Arab Emirates has been singled out as a major hub for Iranians to launder money, acquire real estate and re-export Iranian-made goods. "A lot of bypassing of Iranian semi-governmental agencies is done via Dubai, while a lot of private activity is also carried out there," said Bidabad.

The Central Bank, however, came out in April to say that US claims regarding money laundering are baseless. "[Iran's] banking laws and regulations do not allow those kinds of illegal activities," the CBI governor, Mahmoud Bahmani, was quoted as saying in the Iranian press. "The money laundering law approved by the Guardian Council is now being enforced in the banks throughout the country," he added.

The *Iran Sanctions Act* (ISA), originally called the *Iran-Libya Sanctions Act* (ILSA), was issued in 1995 under Executive Order 12959 in response to Iran's nuclear programme and support for Palestinian and Lebanese terrorist organisations. The ISA banned US trade and investment in Iran, while, in July 2006, the United Nations Security Council passed five resolutions related to nuclear proliferation, with three calling for financial restrictions on Iran.

In the years since, the US Treasury Department has named four Iranian banks – Bank Sepah, Melli, Mellat and the Export Development Bank of Iran – for

proliferation under UN Executive Order 13382, while Bank Saderat was designated under a separate order for funding Hezbollah and Hamas. The international clamp-down on Iran was tightened last year when the European Union in June 2008 imposed sanctions on Iran's largest bank, Bank Melli, freezing assets and preventing the bank from doing business in the European Union.

The effect of such sanctions on Iran has been mixed. "Are they having an economic impact and raising the cost of business? Yes. But curtailing the nuclear programme? No," said Jacobson.

Indeed, international banks took notice of the stepped-up US sanctions and executive orders, with Treasury officials in 2007 saying that over 40 international banks and financial institutions had either cut off or stepped back from business with Iran. The seriousness with which Washington takes such sanctions was highlighted in January this year, in a landmark case by the Manhattan District Attorney and the Justice Department against LloydsTSB. The British bank was fined US\$350 million for falsifying outgoing US wire transfers from Sudan and Iran, with over US\$300 million transferred up to 2004 for Iranian banks Melli, Sepah and Saderat. A further nine EU banks are currently being investigated.

"There is now a fear factor of a heavy or perhaps even crippling fine," said Jhaveri. "But as long as banks are trading in non-US\$ currencies like Euros, they seem to believe that they are OK."

Jhaveri added that Asian banks, particularly in Malaysia and India, "deal with Iran with kid gloves." He said banks have separate units that deal with Iran, making sure transactions are not carried out in US dollars or via a US institution. "There is a fear that if money comes via the US, and Iran is mentioned, the money will be frozen. So they have specialists to make sure no mistakes take place," he said.

While such policies are required for banks and businesses dealing with Iran, the state-owned banks that are blacklisted by OFAC are resorting to other means to get around restrictions.

In April this year, OFAC-listed state banks, the Commercial Bank of Syria (CBS) and Bank Saderat formed a joint venture in Damascus to create "Banki", ostensibly to act as a conduit for bilateral trade. However, a source close to the deal said that the motivation was "wholly political," with CBS pushed into the deal by the Iranian and Syrian governments. Iranian banks Melli and Saderat had carried out a similar policy in 2004, joining to form a private bank,

Future Bank, in Bahrain. It was able to operate outside of the OFAC list until March last year. A senior source at a Middle Eastern Central Bank said it would be logical for Banki to be put under the same US sanctions as the parent institutions.

It is a similar story in Venezuela, said Douglas Farah, senior fellow for the International Assessment and Strategy Center in Washington DC. "Wholly owned Iranian banks have been established that are supposedly joint ventures, with Venezuela saying they put in half of the money, but it is usually Iran. The clearest case is Banco Internacional Desarrollo CSA, founded as part of the Saderat group in 2007. Everyone on the board is Iranian and it is a 100% Saderat subsidiary," said Farah.

"It is an area of concern because it is constituted in Venezuela and acting out of Venezuela, so not facing sanctions like Saderat, which allows them to evade sanctions with relative ease," he added. A second bank of concern is Banesco, the second largest commercial bank in Venezuela. "They have some suspicious characters on the board and have opened a large office in Panama, handling a great deal of Iranian money that comes from Saderat via branches in Dubai," said Farah. And while these banks may face scrutiny from international regulators and the US Treasury, "they don't come under the same scrutiny as Iranian banks. It's the same in Europe, so a nice way to ensure a free flow of money," he added.