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The View from Tehran's Twilight Zone: Iran's Continued Illicit Finance Activities and Their Implications

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THE VIEW FROM TEHRAN'S TWILIGHT ZONE: Iran's Continued Illicit Finance Activities and Their Implications

A day after meeting with Treasury Secretary Jack Lew, the Governor of Iran's Central Bank, Valiollah Seif, spoke at the Council on Foreign Relations where he warned that failure to do more to integrate Iranian banks into the international economy could jeopardize the Iran deal.¹ The onus, he stressed, is on Washington and its allies to reassure banks that doing business in Iran is fine.

But it's not, and that is entirely Iran's own fault.

If Seif it to be believed, Iran has no menacing intentions toward any other countries, never pursued a nuclear weapon, was not driven to the negotiation table by the power of biting sanctions, and has every right to expect Washington to go well beyond the terms of the Iran deal to ensure Iran's full reintegration into the international economy.

But, Seif complained, that reintegration is not happening. In his words: "Let me give you a snapshot of what has happened since three months ago, the date of implementation of the [Iran deal]: almost nothing."² And, without discounting Treasury's efforts to help Iranian banks to date, he insisted these efforts have proved to be insufficient. "Unless serious efforts are made by our partners to make the [Iran deal] work, in my view, they have not honored their obligations."³

Just two days earlier, senior Treasury official Adam Szubin reiterated in the most uncertain terms that Washington is not standing in the way of permissible business activities involving Iran.⁴ But according to Seif, the reason Iran has not seen the benefits it expected under the deal is not due to the risks that remain to doing business in Iran such as rampant corruption⁵ and a banking sector that is out of step with international banking norms, it is the result of the administration not honoring its obligations under the deal.⁶ Under Iran's reading of the deal, Seif stressed, "effective implementation of the agreement [must be done] in such a way that Iran's economic and business activities will be facilitated." If not, he warned the deal "breaks up on its own terms."⁷

In fact, Seif made clear Iran expects the administration to provide benefits well beyond what is offered in the Iran deal itself, including access to the U.S. financial system and the ability to dollarize foreign currency transactions through U.S.-based banks in what is called "U-turn transactions." U.S. officials explicitly insist neither of these demands will be met, but that has not stopped Seif from demanding that the U.S. even go so far as to change its laws, if necessary, to make them happen.⁸

¹ "A Conversation with Valiollah Seif", *Council on Foreign Relations*, 15 April 2016, available at: <http://www.cfr.org/global/conversation-valiollah-seif/p37733>, last visited: 11 May 2016.

² Ibid.

³ Ibid.

⁴ "Remarks by Acting Under Secretary Adam Szubin at the Foundation for Defense of Democracies Annual Forum", *US Treasury*, 13 April 2016, available at: <https://www.treasury.gov/press-center/press-releases/Pages/jl0419.aspx>, last visited: 11 May 2016.

⁵ "Poll: Banks Most Corrupt Institutions in Iran", *United States Institute of Peace*, 21 January 2016, available at:

<http://iranprimer.usip.org/blog/2016/jan/21/poll-banks-most-corrupt-institutions-iran>, last visited: 11 May 2016

⁶ Clawson, P., "Iran Locks Itself Out of the International Financial System While Blaming Washington", *The Washington Institute*, 5 April 2016, available at: <http://www.washingtoninstitute.org/policy-analysis/view/iran-locks-itself-out-of-the-international-financial-system-while-blaming-w>, last visited: 11 May 2016.

⁷ "A Conversation with Valiollah Seif", *Council on Foreign Relations*, 15 April 2016, available at: <http://www.cfr.org/global/conversation-valiollah-seif/p37733>, last visited: 11 May 2016.

⁸ "Remarks by Acting Under Secretary Adam Szubin at the Foundation for Defense of Democracies Annual Forum", *US Treasury*, 13 April 2016, available at: <https://www.treasury.gov/press-center/press-releases/Pages/jl0419.aspx>, last visited: 11 May 2016.

In Seif's alternative reality, sanctions no longer exist so there is no risk to doing business in Iran. We now live in a "post-sanctions environment," he said, ignoring the terrorism, ballistic missile, and human rights sanctions that remain in place. As for the claim that it is Iran's own actions—executing minors,⁹ persecuting religious minorities,¹⁰ sponsoring terrorism,¹¹ testing ballistic missiles¹²—that create the kind of risk and uncertainty that keep banks from doing business with Iran, Seif argued that's nothing new. "If, according to our partners, it is our conduct which prevents international banks from engaging in business with us, they were fully aware of our conduct before signing the [Iran deal]. We have not changed [these actions]."¹³ Far from denying the illicit conduct, Seif argued it is old news. Arguing that Iran is responsible to change that behavior "is not correct. This is a misstatement of fact."¹⁴ Iranian misconduct notwithstanding, Tehran's Western negotiating partners need to do "whatever is needed to honor their commitments."¹⁵

Then, as if he had not just conceded that Iran's illicit conduct continues, he touted Iran's anti-money laundering (AML) and counter-terror finance (CFT) efforts. "We attach high priority to enhancing the AML/CFT framework, through improvement of KYC ["Know Your Customer"] policies and procedures to ensure prevention of financial crime and facilitate the reintegration of the Iranian banking system into the global economy."¹⁶ Noting Financial Action Task Force AML/CFT standards, he conveniently failed to note the group's repeated calls for Iran "to immediately and meaningfully address its AML/CFT deficiencies."¹⁷

Asked about the risks of unwittingly doing business with the still-sanctioned Islamic Revolutionary Guard Corps, Seif pointed to the ability of investors to utilize the services of Iranian companies who run checks so investors can try to know with whom they are truly doing business.¹⁸ But this not only neglects Iran's documented history of using front companies to hide the IRGC's business fingerprint,¹⁹ it also promotes a practice known to facilitate money laundering. The FATF, whose Eurasia body Iran hopes to join, warns that risk-mitigating efforts in high-risk jurisdictions like Iran should include a prohibition on using in-country third-parties to perform customer due diligence.²⁰

As governor of Iran's central bank, Mr. Seif is surely aware of the inconsistencies in his CFR lecture. But as the former head of no less than six Iranian banks that were hit by sanctions, he is no stranger to the intricacies of money laundering and illicit finance.²¹

⁹ Gladstone, R., 'Iran Still a Leading Executioner of Minors, Report Says', *The New York Times*, 25 January 2016, available at: http://www.nytimes.com/2016/01/26/world/middleeast/iran-still-a-leading-executioner-of-minors-report-says.html?_r=1, last visited: 11 May 2016.

¹⁰ 'Iranian Judiciary Took No Action despite Formal Complaint Detailing Torture of Baha'is in Prison', *International Campaign for Human Rights in Iran*, 27 March 2016, available at: <https://www.iranhumanrights.org/2016/03/twelve-bahais-allege-torture-in-detention/>, last visited: 11 May 2016.

¹¹ Levitt, M & Segawa, K., 'Findings from the State Department's Annual Terrorism Report (Part 1): Hezbollah and Iran', *The Washington Institute*, 19 June 2016, available at: <http://www.washingtoninstitute.org/policy-analysis/view/findings-from-the-state-departments-annual-terrorism-report-part-1-hezbollah>, last visited: 11 May 2016.

¹² 'Treasury Sanctions Those Involved in Ballistic Missile Procurement for Iran', *US Treasury*, 17 January 2016, available at: <https://www.treasury.gov/press-center/press-releases/Pages/j10322.aspx>, last visited: 11 May 2016.

¹³ 'A Conversation with Valiollah Seif', *Council on Foreign Relations*, 15 April 2016, available at: <http://www.cfr.org/global/conversation-valiollah-seif/p37733>, last visited: 11 May 2016.

¹⁴ Ibid.

¹⁵ Ibid.

¹⁶ Ibid.

¹⁷ Ibid.

¹⁸ Ibid.

¹⁹ 'Sanctions relief increases risk of IRGC front companies concealing illegal shipments in legitimate Iranian maritime cargo', *IHS Janes* 360, 17 March 2016, available at: <http://www.janes.com/article/58859/sanctions-relief-increases-risk-of-irgc-front-companies-concealing-illegal-shipments-in-legitimate-iranian-maritime-cargo>, last visited: 11 May 2016.

²⁰ Bauer, K., 'Iran's Long Road to Reintegrating With the World Financial System', *The Washington Institute*, 29 February 2016, available at: <http://www.washingtoninstitute.org/policy-analysis/view/irans-long-road-to-reintegrating-with-the-world-financial-system>, last visited: 11 May 2016.

²¹ Dubowitz, M & Fixler, A., 'Iran's Center for Illicit Finance', *Foundation for Defense of Democracies*, 15 April 2016, available at: <http://www.defenddemocracy.org/media-hit/dubowitz-mark-irans-center-for-illicit-finance/>, last visited: 11 May 2016.

The bottom line, as Seif himself conceded, is that Iran has yet to alter the illicit conduct that makes it a pariah state and a financial risk. Passing a terror finance law does little to calm banks' fears when you continue to operate as the world's primary state sponsor of terrorism. Until those behaviors change, Seif knows full well that banks will continue to see in Iran the kind of business, reputation and regulatory risks the make doing business there prohibitive. The only country that can do anything about that is Iran.

1. Case Study: Iran Air

Just because an Iranian entity appears on no designation or prescription lists does not mean it is a safe investment or business partner. Consider the prominent case of Iran Air. According to the *Wall Street Journal*, the EU will be sending aviation experts to Iran next month to verify if Iran Air has resolved its safety issues and can be removed from the EU's blacklist.²² According to Jakub Adamowicz, a spokesman for the European Commission, "These are technical discussions, not a political decision. The safety of flights is not conditioned by the nationality of an airline."²³ That is true, of course, but safety issues are far from the only clouds hanging over Iran Air.

Iran Air was blacklisted by the EU in 2010 due to safety concerns but a year later, in June 2011, the U.S. Department of the Treasury sanctioned Iran Air under Executive Order 13382 for acting on behalf of the Islamic Revolutionary Guard Corps (IRGC) and Ministry of Defense and Armed Forces Logistics (MODAFL). Iran Air, which is the country's national air carrier, has on separate occasions transported military-related equipment for both MODAFL and the IRGC.²⁴

The treasury designation also notes that Iran Air passenger aircraft has been used to ship missile and rockets.²⁵ In certain instances, U.S. Treasury noted, "IRGC officers occasionally take control over Iran Air flights carrying special IRGC-related cargo. The IRGC is also known to disguise and manifest such shipments as medicine and generic spare parts, and IRGC officers have discouraged Iran Air pilots from inspecting potentially dangerous IRGC-related cargo being carried aboard a commercial Iran Air aircraft, including to Syria."²⁶

In fact, in September 2012, the U.S. Department of the Treasury identified 117 aircraft belonging to Iran Air, Mahan Air or Yas Air to further highlight Iran's ongoing effort to support the Assad regime's WMD programs and its brutal repression of the Syrian people.²⁷ It was discovered in the summer of 2012 that Tehran was sending both Iran Air and Mahan Air flights to Damascus to deliver military and crowd control equipment to the Assad regime.²⁸ It was common practice for Iran to use "deceptive measures when shipping such items to Syria, by using a combination of passenger and cargo flights and declaring illicit cargo as humanitarian and other licit goods."²⁹ An article by *Reuters* in September of 2012 claimed that "Planes are flying from Iran to Syria via Iraq

²² Pop, V., 'EU Looking to Remove Iran Air Sanctions', *Wall Street Journal*, 18 April 2016, available at: <http://www.wsj.com/articles/eu-looking-to-remove-iran-air-sanctions-1460979526>, last visited: 11 May 2016.

²³ Ibid.

²⁴ 'Fact Sheet: Treasury Sanctions Major Iranian Commercial Entities', *US Treasury*, 23 June 2011, available at: <https://www.treasury.gov/press-center/press-releases/Pages/tg1217.aspx>, last visited: 11 May 2016.

²⁵ Ibid.

²⁶ Ibid.

²⁷ 'Treasury Designates Syrian Entity, Others Involved in Arms and Communications Procurement Networks and Identifies Blocked Iranian Aircraft', *US Treasury*, 19 September 2012, available at: <https://www.treasury.gov/press-center/press-releases/Pages/tg1714.aspx>, last visited: 11 May 2016.

²⁸ Ibid.

²⁹ Ibid.

on an almost daily basis, carrying IRGC (Iranian Revolutionary Guard Corps) personnel and tens of tons of weapons to arm the Syrian security forces and militias fighting against the rebels," and that Iraq denied the allegations.³⁰

To further combat the deceptive practices of Iran Air on behalf of groups like MODAFL and the IRGC the US government passed the Iran Threat Reduction and Syria Human Rights Act of 2012 (ITRSHRA) which implemented significant sanctions on any foreign financial institutions that knowingly do business with or assist persons connected to Iran's support for WMD proliferation or international terrorism. Any foreign financial institution caught in violation of the ITRSHRA risks losing access to the US financial system.³¹

In May 2013 the Department of Treasury targeted 20 individuals and entities for their involvement in Iran's continued attempts to evade sanctions and its nuclear and missile proliferation networks. Treasury specifically designated three Iranian based companies and two individuals affiliated with them for "actively assisting Iran Air by providing it with financial services, aviation related procurement and freight forwarding."³² This assistance included attempting to import sanctioned aviation parts by trying to falsify end-user certificates and airway bills, providing Iran Air pilots with non-Iranian pilot licenses, attempting to register Iran Air planes outside of Iran, and carrying cargo on behalf of Iran Air.³³

Beginning in 2006, the Treasury Department ratcheted up sanctions pressure on Tehran by proactively identifying Iranian individuals and entities engaged in a range of illicit conduct.³⁴ These investigations revealed that more often than not, Iranian entities were involved in more than one type of illicit activity and therefore qualified for designation under multiple executive orders, such as those for WMD proliferation, human rights abuses, and support for terrorism. However, only in rare cases were eligible Iranian entities designated under multiple authorities. Therefore, despite all the evidence above, Iran Air, like so many other entities that engaged in illicit Iranian activities beyond WMD proliferation, it was designated solely under authorities targeting Iran's proliferation activities and therefore was delisted under the Iran nuclear deal.

So regardless of whether or not Iran Air has resolved its safety issues, it chose to engage in deceptive business practices and facilitate the transfer of weapons and other cargo at the behest of the IRGC, MODAFL, and the Assad regime.³⁵ And it is exactly this kind of illicit activity that makes it very difficult for banks and other companies to gain full transparency into the activity underlying a financial or commercial transaction, which is a risk that cannot be ignored.

Furthermore, when it comes to doing business with Iran, people often get caught up in the official CISADA language, which exposes foreign financial institutions who knowingly engage in significant transactions with certain Iranian entities sanctioned for terrorism support, missile procurement or

³⁰ Charbonneau, L., Exclusive: Western report - Iran ships arms, personnel to Syria via Iraq', *Reuters*, 19 September 2012, available at: <http://www.reuters.com/article/us-syria-crisis-iran-iraq-idUSBRE88I17B20120919>, last visited: 11 May 2016.

³¹ 'To strengthen Iran sanctions laws for the purpose of compelling Iran to abandon its pursuit of nuclear weapons and other threatening activities, and for other purposes', *US Congress*, available at: https://www.treasury.gov/resource-center/sanctions/Documents/hr_1905_pl_112_158.pdf, last visited: 11 May 2016.

³² 'Treasury Announces New Sanctions Against Iran', *US Treasury*, 23 May 2013, available at: <https://www.treasury.gov/press-center/press-releases/Pages/jl1935.aspx>, last visited: 11 May 2016.

³³ *Ibid.*

³⁴ *Ibid.*

³⁵ *Ibid.*

human rights abuses, such as the IRGC, to the risk of being cut off from the U.S. financial system.³⁶ However, if CISADA were the only concern then doing business with Iran would have minimal risk; after all, there have only been two actions under CISADA ever, targeting Bank of Kunlun in China and Elaf Islamic Bank in Iraq.³⁷ But engaging in business with Iran is not that simple. According to former deputy industry minister Mohsen Safai Farahani, “more than half of Iran’s economy is run by pseudo-private entities linked to “parastatal organisations”, including the IRGC,”³⁸ which poses a significant challenge to Western business investors attempting to identify exactly with whom they are engaging in business.

2. Sanctions Evasion

Iran has relied upon an advanced and effective sanctions evasion network to both to obfuscate its illicit activity as well as to supplement its economy; and this continued reliance on sanctions evasion networks proves why Secretary Kerry’s strategy of instructing banks that “when in doubt, ask,” will not work.³⁹ Iranian officials have continued to blame the US for the lack of willingness from international banks to invest in Iran and claim that the United States “removed the sanctions in paper only,”⁴⁰ but this could not be farther from the truth.

According to an economist close to Rouhani’s government, “between 5,000-10,000 people worked in the network, handling deals worth between \$300 billion and \$400 billion over the past decade.”⁴¹ The government of Iran will be in no great hurry to leave such a profitable sanctions sustainable for their economy. Therefore, in order to fully reintegrate into the financial world Iran will need to distance itself from the thousands of sanction evasion networks it has relied on for at least the past decade. It is because of sanctions evasion schemes and deceptive banking practices those banks and businesses alike are wary of engaging with Iran. But, insiders and economists agree, “Enough sanctions remain in place that the Iranian economy still cannot function without the network.”⁴²

Iran’s hesitation in parting ways with these illicit financial networks only solidifies the public statement FATF made in February 2016, “The FATF remains particularly and exceptionally concerned about Iran’s failure to address the risk of terrorist financing and the serious threat this poses to the integrity of the international financial system,” and “continues to urge jurisdictions to protect against correspondent relationships being used to bypass or evade counter-measures and risk mitigation practices.”⁴³

³⁶ ‘CISADA The New US Sanctions on Iran’, *US Treasury*, available at: https://www.treasury.gov/resource-center/sanctions/Programs/Documents/CISADA_english.pdf, last visited: 11 May 2016.

³⁷ ‘Treasury Sanctions Kunlun Bank in China and Elaf Bank in Iraq for Business with Designated Iranian Banks’, *US Treasury*, 31 July 2012, available at: <https://www.treasury.gov/press-center/press-releases/Pages/tg1661.aspx>, last visited: 11 May 2016.

³⁸ Hulpachova, M., ‘Untangling Iran’s web of sanctions of the nuclear deal’, *The Guardian*, 13 April 2016, available at: <http://www.theguardian.com/world/iran-blog/2016/apr/13/untangling-irans-web-of-sanctions-after-the-nuclear-deal>, last visited: 11 May 2016.

³⁹ Kerry, J., ‘Remarks Before Meeting with Iranian Foreign Minister Javad Zarif’, *US State Department*, 22 April 2016, available at: <http://www.state.gov/secretary/remarks/2016/04/256536.htm>, last visited: 11 May 2016.

⁴⁰ Stancati, M., ‘Iran’s Supreme Leader Says Sanctions Still Affecting Country’s Economy’, *The Wall Street Journal*, 20 March 2016, available at: <http://www.wsj.com/articles/irans-supreme-leader-says-sanctions-still-affecting-countrys-economy-1458502695>, last visited: 11 May 2016.

⁴¹ Erdbrink, T., ‘Sanctions Eased, Iran Sends Black Market a Strategic Warning’, *The New York Times*, 19 March 2016, available at: http://www.nytimes.com/2016/03/20/world/middleeast/sanctions-eased-iran-sends-black-market-a-strategic-warning.html?_r=0, last visited: 11 May 2016.

⁴² Ibid.

⁴³ ‘FATF Public Statement’, *The Financial Action Task Force*, 19 February 2016, available at: <http://www.fatf-gafi.org/publications/high-riskandnon-cooperativejurisdictions/documents/public-statement-february-2016.html>, last visited: 11 May 2016.

The United States has even become an excuse for business executives who are hesitant to engage in business with Iran, but as Secretary Kerry stated on Tuesday, “If they don’t see a good business deal, they shouldn’t say, ‘Oh, we can’t do it because of the United States.’ That’s just not fair. That’s not accurate.”⁴⁴ Indeed, the United States should not be blamed for the reluctance of international businessmen to participate in the Iranian economy, but neither should businesses see Iran as a new frontier just waiting for investors, the risks beyond just US sanctions are of real concern.

⁴⁴ Schwartz, F., ‘Kerry Tries to Drum up Some Business in Europe for Iran’, *The Wall Street Journal*, 10 May 2016, available at: <http://www.wsj.com/articles/kerry-tries-to-drum-up-some-business-in-europe-for-iran-1462902185>, lasted visited: 11 May 2016.

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Dr Matthew Levitt is an Associate Fellow of The Henry Jackson Society and Senior Fellow and Director of the Washington Institute's Stein Program on Counterterrorism and Intelligence. From 2005 to early 2007, he served as Deputy Assistant Secretary for Intelligence and Analysis at the U.S. Department of the Treasury. In that capacity, he worked both as a senior official within the department's Terrorism and Financial Intelligence branch, and as Deputy Chief of the Office of Intelligence and Analysis, one of sixteen U.S. intelligence agencies coordinated under the Office of the Director of National Intelligence. During his tenure at Treasury, Dr Levitt played a central role in efforts to protect the U.S. financial system from abuse, and to deny terrorists, weapons proliferators, and other rogue actors the ability to finance threats to U.S. national security. In 2008-2009, he served as a State Department counterterrorism advisor to the special envoy for Middle East regional security (SEMERS), General James L. Jones.



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