In Expected Iran Sanctions Lift, an Opportunity for Russian Sanctions Dodgers

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Should Iranian companies rejoin global markets next year under the terms of last month's intergovernmental accord, sanctioned Russian businesses could be discreetly riding on their coattails.

Starting on the agreement's "Implementation Day"—a stage of the deal contingent on confirmation that Iran has scaled back its nuclear activities—banks outside of the United States would again be free to provide services for Iranian clients without fear of losing their American correspondent and payable-through accounts.

Unlike their American counterparts, EU banks would be able to offer direct services to Iran's government and all of the country's financial institutions, which would once more have access to the global messaging protocol managed by the Society for Worldwide Interbank Financial Telecommunication (Swift).

The expected opening of Iran's economy has drawn commercial interest from Russia, a nation currently subject to hundreds of U.S. and EU restrictions, including so-called "sectoral" sanctions prohibiting the issuance of long-term debt to companies that are owned or otherwise controlled by designated Russian entities.

The nations have scheduled trade talks while oil giant Gazprom and other blacklisted Russian entities have expressed interest in joint ventures with Iranian companies still subject to sanctions, according to reports by pro-governmental news agencies, including *RIA Novosti*.

The economic alliance could prove challenging for Western banks cleared to transact with Iran, particularly when conducting trade financing, according to a former U.S. State Department official who asked not to be named. Russian companies could use proxies to hide their stakes or otherwise exercise control in joint ventures with Iranian partners, the person said.

Since 2014, U.S. officials have restricted loans to four Russian energy companies—OAO Novatek, Rosneft, Gazprom Neft and AK Transneft OAO—and to Rostec, a defense firm. Six Russian banks—Gazprombank OAO, VEB, Bank of Moscow, Russian Agricultural Bank, VTB Bank OAO and Sberbank—face similar restrictions.

Over the same timeframe, the EU has imposed conventional sanctions on 151 individuals and 37 companies deemed responsible for violating Ukraine's territorial integrity. The bloc has also imposed sectoral restrictions on five state-owned Russian banks, three Russian energy firms and three defense firms.

3-D chess

The degree that Western banks are still engaging with their sanctioned Russian counterparts likely depends on their commercial relationships before the sectoral prohibitions took effect, according to Dan Newcomb, a New York-based attorney with Shearman & Sterling LLP.

"If they engaged in significant business pre-sanctions, they probably wouldn't want to paint with a broad brush and cut all ties. They'll want to continue business, and also continue being very diligent and scrupulous about compliance," said Newcomb.

But the potential challenge of complying with sectoral restrictions against Russia while navigating the nuances of Iran sanctions relief "basically creates a three-dimensional chess game," he said.

Some of the difficulties stem from perceived ambiguities with the EU sectoral sanctions that many industry and government officials believe subsequent guidance failed to clarify.

In February, Rosneft petitioned a U.K. court to determine whether the EU's ban on the provision of "financial assistance" covers the processing of payments and other funds transfers for designated parties.

In a report published Wednesday, British officials said the economic bloc has not specified whether extending repayment terms on a pre-sanctions loan to a designated entity is tantamount to approving a new loan—a violation of the prohibitions.

"Further, there are likely to be instances where it is unclear whether bank guarantees and letters of credit issued at the request of a sanctioned entity in favor of a third party, or any deferred payment terms extended to a sanctioned entity fall within the scope" of the sectoral sanctions, according to the report.

The EU guidance states that correspondent banks should reject payments when information on a sanctions breach is "available," but "does not explain what is covered by this term" nor clarify how far banks "must look along a chain of payments" and "beyond their own customer" for compliance purposes, the report said.

Assuming that Iran complies with the terms of the accord and is subsequently reconnected to Swift and other financial messaging services, the answer is likely "quite far" for banks involved in long-term ventures with foreign investors, according to Jasper Helder, a customers and trade attorney with Baker & McKenzie in Amsterdam.

“Large projects entice external financing, [and] then you are talking about business transactions over several years, for which any regulator will expect you to do more than just a basic check of the parties you know are involved,” said Helder.

Pledges and plans

Some of the long-term projects may be taking shape today.

In addition to cooperating on energy development and associated pipeline projects, Russia and Iran may establish a joint venture to manufacture cars and road construction equipment, the Russian Ministry of Industry and Trade said last month. The federation also expects to build eight new civilian nuclear power stations in Iran, *Sputnik* reported.

The most likely Russian beneficiaries of Iran’s potential sanctions lift are energy firms, defense contractors and independent investors, according to John Wood, an Atlanta-based anti-money laundering consultant and author of *Russia, the Asymmetric Threat to the United States*.

Western restrictions have already left Russian firms vulnerable to unforeseen market shifts, scaring off investment, he said.

“Russian multinationals can use foreign opportunities in Iran to move some of their liquid holdings out of the ruble. It won’t always be the case, but they still need dollars and euros” until alternative sources of financing are secured in Asia or through other means, said Wood.

The boost in bilateral trade would likely mean an uptick in opportunity for more conventional financial crimes.

Criminals in both countries can exploit commodity swaps and the exchange of goods with negotiable prices, said David Buxton, chief executive officer of Arachnys, a global consultancy based in London.

Repeat violators?

Western officials suspect Iran and Russia have previously worked together to circumvent sanctions.

At the start of nuclear negotiations last year, the countries allegedly tried to negotiate an oil-for-goods bartering arrangement worth $18 billion annually. U.S. officials warned that Western sanctions prohibited the deal, which never materialized.

Shortly after, the U.S. Treasury Department designated a financial institution in Moscow for providing services to the Central Bank of Iran. Asia Bank, formerly known as Chemeximbank, exchanged $13 million of U.S. banknotes and arranged the currency's shipment to Iranian officials.

Asia Bank also attempted to open correspondent accounts for the benefit of Bank Tejarat and the Export Development Bank of Iran, U.S. officials said.

The designations followed the 2012 blacklisting of Moscow-based Mir Business Bank CJSC, which U.S. officials said served as a payment channel for Iran-Russia bilateral trade in the face of international restrictions on Iran's financial system.