

House Financial Services Committee  
*Subcommittee on Oversight and Investigations*

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# Fueling Terror: **The Dangers of Ransom Payments to Iran**

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## Introduction<sup>1</sup>

Chairman Duffy, Vice Chairman Fitzpatrick, Ranking Member Green, and distinguished members of the Committee on Financial Services, Subcommittee on Oversight and Investigations, I am honored to appear before you today to discuss the dangers of ransom payments to Iran.

In particular, I would like to focus my testimony on what we know about the \$1.7 billion payment to Iran, including the \$400 million cash payment that was tied to the release of U.S. hostages, the legality of such a payment, and most importantly, why such a payment was a missed opportunity by the Administration to limit Iran's ability to use these funds to support terrorism, weapons proliferation, and human rights abuses.

With the recent one-year anniversary of the signing of the Joint Comprehensive Plan of Action ("JCPOA") between Iran and the P5+1, it is as important as ever to carefully examine the consequences of that agreement and Iran's continued destabilizing activities in the region, and to remain vigilant in ensuring that Iran is limited in its ability to support terrorist forces and corrupt the international financial system.

While the JCPOA has arguably curbed Iran's nuclear activities in the short run, the Islamic Republic continues to send fighters to Syria, develop ballistic missiles in violation of United Nations Security Council Resolutions, and openly support Hezbollah, which is well known to have killed Americans and remains designated as a Specially Designated Global Terrorist, as well as other terrorist groups and militant proxies.<sup>2</sup> Iran has also continued to take American citizens hostage, in particular dual-citizens who have traveled to the country following the partial relaxation of U.S., EU, and UN sanctions on Implementation Day of the JCPOA. In short, Iran remains a threat to American citizens, our key allies such as Israel, and regional stability in the Middle East.

In addition—and of particular importance to this Committee—Iran poses a special threat to the global financial system. Beginning in the early 2000s, the United States and the international community more broadly recognized this threat and began actively cutting Iranian banks out of global financial markets and limiting Iran's ability to use the international financial system to finance its proliferation and terrorist activities.

Make no mistake: while Iran has signed the JCPOA and begun implementing it, Iran has not changed the underlying criminal activity that has led respectable financial institutions across the world to refuse to do business in Iran or with clients doing substantial business there. Indeed, one marked development in the past year has been the international financial community's unwillingness to re-enter the Iranian market, even if legally permitted to do so.

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<sup>1</sup> The views expressed in this testimony are my own and do not represent the views of any institution with which I am affiliated.

<sup>2</sup> For an overview of Iran's terrorism-related activities, see U.S. Department of State, Bureau of Counterterrorism, "Chapter 3: State Sponsors of Terrorism Overview," accessed Sept. 1, 2016, *available at* <http://www.state.gov/j/ct/rls/crt/2015/257520.htm>.

Iran's unwillingness to change its destabilizing conduct is one of the reasons the payment of the \$1.7 billion to the Islamic Republic raises serious concerns that this money will be—or already has been—used to support the Islamic Revolutionary Guard Corps (“IRGC”), the Iranian military, and its proxy terrorist forces throughout the region—and that any future payments will similarly go towards such activities. While those on both sides of the aisle will debate whether the \$400 million, paid upon the successful release of American hostages immediately following Implementation Day, amounted to a ransom, one thing is certain: The way in which the money was paid—in cash, in the middle-of-the-night, delivered to Iran Air (an entity formerly designated by the Office of Foreign Assets Control (“OFAC”) at the United States Department of the Treasury for supporting the IRGC and supplying goods and services to Hezbollah and Syrian President Bashar al-Assad)—was both troubling and a missed opportunity.

The \$1.7 billion payment was troubling in large part because, in providing funds to Iran—including cash—without controls on how Iran would use that money, we allowed the country to disburse these funds to the Iranian military and other nefarious actors. In addition, the very nature of the payment led Iranian officials to conclude that it amounted to a ransom payment; for example, on January 20, 2016, the commander of the IRGC paramilitary Basij unit reportedly said the reclaiming of \$1.7 billion in blocked Iranian assets “had nothing to do the [nuclear] negotiations and was the . . . price that America paid to free its spies.”<sup>3</sup> While the payment itself may not have been a ransom under U.S. law, Iran's perception of the payment matters; a principle purpose of the United States' no ransom policy is to deter hostage takers from compromising the safety of American citizens abroad—if terrorist groups and rogue countries do not think the U.S. will pay for hostages, those bad actors will be less likely to take hostages.<sup>4</sup> Because of the particular nature of this payment, Iran believed this to be a ransom and consequently may be more inclined to seize Americans in the future.

The payment is also a missed opportunity because the United States could have set up payments stemming from the settlement agreement struck between Iran and the United States related to outstanding legal issues in a way that conditioned providing the funds on ensuring they would not be used to support terrorism or be given to the Iranian military or other sanctioned parties. By releasing these funds in a way that limited Iran's ability to use them to support its destabilizing activities, the Administration could have out-manuevered the Islamic Republic.

I will focus my comments today on four main areas. First, I discuss the \$400 million and subsequent \$1.3 billion payments, including a factual narrative of what we know about the payments. Second, I assess the legal case concerning whether the Administration's actions violated any relevant sanctions regulations or underlying U.S. laws. Third, I detail why—while the Administration was on solid legal footing in facilitating these payments—the way these payments were sent to Iran raises serious concerns. Fourth and finally, I discuss why the Administration's approach was a missed opportunity and identify ways that this Committee can

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<sup>3</sup> Behnam Ben Taleblu and Annie Fixler, “Settling with Iran: \$1.7 Billion and U.S. Hostages,” *Foundation for Defense of Democracies*, Sept. 2016, available at [http://www.defenddemocracy.org/content/uploads/general/Settling\\_with\\_Iran.pdf](http://www.defenddemocracy.org/content/uploads/general/Settling_with_Iran.pdf).

<sup>4</sup> See, e.g., David S. Cohen, “Why the U.S. Does Not Pay Ransoms for Americans Kidnapped by Terrorists,” *Newsweek*, Aug. 23, 2014, <http://www.newsweek.com/why-us-does-not-pay-ransoms-americans-kidnapped-terrorists-266315>.

help ensure that, in the case of any future payments made to Iran—either by the United States or the private sector—we are able to reduce the risks that Iran uses the funds to support terrorism and other destabilizing activities.

## **I. The \$400 Million and Subsequent \$1.3 Billion Payments to Iran**

On January 16, 2016, otherwise known as Implementation Day, the U.S., European Union, and United Nations lifted a number of key economic sanctions against Iran pursuant to the JCPOA.<sup>5</sup> On January 17, the Obama Administration also announced an agreement for the release of five American hostages held in Iran.<sup>6</sup> In exchange for the hostages' release, the U.S. pardoned or commuted the sentences of seven Iranians charged with a number of sanctions-related violations of U.S. law, including sanctions evasion.<sup>7</sup> The Administration also dropped the charges and withdrew Interpol detention requests against a number of Iranians abroad.<sup>8</sup>

Also on January 17, the Obama Administration announced a \$1.7 billion settlement with the Islamic Republic regarding an outstanding claim against the Foreign Military Sales (“FMS”) Trust Fund.<sup>9</sup>

Iran's claim dated to the period before the 1979 revolution, when Iran was a significant recipient of U.S. military equipment. As part of the FMS program, which was designed to provide Iran with a mechanism for purchasing U.S. military equipment, Tehran deposited funds in an account held by the United States Department of Defense.<sup>10</sup> When Iranians stormed the U.S. embassy and took Americans hostage at the time of the Islamic Revolution, the United States cut off military sales and froze the funds in the account—funds that Iran had placed there in anticipation of purchasing American military equipment.

As part of the Algiers Accord of 1981 that resolved the Iranian hostage crisis, the United States and Iran agreed to create the Iran-United States Claims Tribunal (“the Tribunal”) to resolve certain legal issues related to, *inter alia*, these claims. According to Secretary of State John Kerry, the January 17 settlement for \$1.7 billion, divided into \$400 million in principal and \$1.3

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<sup>5</sup> See, e.g., “Remarks on Implementation Day,” *U.S. Department of State*, Jan. 16, 2016, available at <http://www.state.gov/secretary/remarks/2016/01/251336.htm>.

<sup>6</sup> See, e.g., Jay Solomon and Asa Fitch, “Iran Releases Americans in Prisoner Swap,” *The Wall Street Journal*, Jan. 16, 2016, available at <http://www.wsj.com/articles/iran-releases-four-unnamed-american-prisoners-state-tv-says-1452955793>.

<sup>7</sup> U.S. Department of Justice, Press Release, “List of Individuals Receiving Pardons/Commutations,” Jan. 17, 2016, available at <https://www.justice.gov/opa/pr/list-individuals-receiving-pardonscommutations>.

<sup>8</sup> Joel Schectman and Yeganeh Torbati, “Factbox - Iranians granted clemency by Obama in prisoner exchange,” *Reuters*, Jan. 17, 2016, available at <http://www.reuters.com/article/uk-iran-nuclear-prisoners-usa-idUSKCN0UV11G>.

<sup>9</sup> John Kerry, Press Statement, “Hague Claims Tribunal Settlement,” *U.S. Department of State*, Jan. 17, 2016, available at <http://www.state.gov/secretary/remarks/2016/01/251338.htm>.

<sup>10</sup> Letter to Committee on Foreign Affairs Chairman Edward R. Royce from Assistant Secretary of State for Legislative Affairs Julia Frifield, Mar. 17, 2016, available at <https://foreignaffairs.house.gov/wp-content/uploads/2016/08/03.17.16-DOS-Response-Concerns-re-1.7-Billion-Payout-to-Iran.pdf>.

billion in interest that had accrued in the years since the Iranian revolution, addressed the final case related to foreign military sales.<sup>11</sup>

The Obama Administration settled the case in part because it was reportedly concerned that the Tribunal would reach a decision in the coming weeks and months that would be unfavorable to the United States and require the United States to pay a significantly greater amount of money than the \$1.7 billion it ended up providing to Iran.<sup>12</sup> At the time of the announcement of the settlement agreement, the mechanism of the payment was not made public.

In early August, however, *The Wall Street Journal* broke the story that the \$400 million principal payment was provided to Iran in cash.<sup>13</sup> In particular, Swiss and Dutch central banks, at Washington's request, loaded \$400 million in euros, Swiss francs, and other currencies onto an Iran Air plane in Geneva that then flew to Iran.<sup>14</sup> Notably and according to follow up reporting by *The Wall Street Journal*, the cash was only permitted to leave Geneva until after a Swiss Air Force plane carrying the five American hostages had taken off from Iran.<sup>15</sup> In defending the decision to send this cash to the Islamic Republic, President Obama noted that “[t]he reason that we had to give them cash is precisely because we are so strict in maintaining sanctions and we do not have a banking relationship with Iran that we couldn't send them a check and we could not wire the money.”<sup>16</sup>

The Administration has denied any connection between the legal settlement and the release of these American hostages. However, State Department Spokesman John Kirby did assert that “[i]t would have been foolish, imprudent, irresponsible, for us not to try to maintain maximum leverage [once it was decided that the hostages were going to be released around the same time as the first settlement payment would be sent to Iran]. So if you're asking me was there a connection in that regard at the endgame, I'm not going to deny that.”<sup>17</sup> In effect, the Administration has argued that while the settlement and the release of the hostages were not linked, the Administration did link the actual transport of the payment with the physical release of the hostages to ensure that if Iran did not allow the hostages to go, it would not provide them with the first settlement payment.

In addition to the \$400 million dollars in cash, the United States also paid Iran the remaining \$1.3 billion from the Judgment Fund, which is a permanent appropriation created by Congress to

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<sup>11</sup> John Kerry, Press Statement, “Hague Claims Tribunal Settlement,” *U.S. Department of State*, Jan. 17, 2016, available at <http://www.state.gov/secretary/remarks/2016/01/251338.htm>.

<sup>12</sup> The White House, “Press Briefing by Press Secretary Josh Earnest, 1/19/2016,” Jan. 19, 2016, available at <https://www.whitehouse.gov/the-press-office/2016/01/19/press-briefing-press-secretary-josh-earnest-1192016>.

<sup>13</sup> Jay Solomon and Carol E. Lee, “U.S. Sent Cash to Iran as Americans Were Freed,” *The Wall Street Journal*, Aug. 3, 2016, available at <http://www.wsj.com/articles/u-s-sent-cash-to-iran-as-americans-were-freed-1470181874?mod=ST1>. The cash payment has been confirmed by Administration officials.

<sup>14</sup> *Id.*

<sup>15</sup> Jay Solomon and Carol E. Lee, “U.S. Held Cash Until Iran Freed Prisoners,” *The Wall Street Journal*, Aug. 18, 2016, available at <http://www.wsj.com/articles/u-s-held-cash-until-iran-freed-prisoners-1471469256?mod=ST1>.

<sup>16</sup> Barack Obama, “Press Conference by the President After Meeting with National Security Officials,” *The White House*, Aug. 4, 2016, available at <https://www.whitehouse.gov/the-press-office/2016/08/04/press-conference-president-after-meeting-national-security-officials>.

<sup>17</sup> John Kirby, “Daily Press Briefing,” *U.S. Department of State*, Aug. 18, 2016, available at <http://www.state.gov/r/pa/prs/dpb/2016/08/261128.htm>.

pay Judgments against the United States which otherwise lack a funding source.<sup>18</sup> According to journalist Claudia Rosett and research by analysts at the Foundation for Defense of Democracies, 13 payments—each approximately \$100 million and totally \$1.3 billion—were made to the State Department out of the Judgment Fund on January 19.<sup>19</sup> The State Department has since confirmed that these payments from the Judgment Fund were part of the \$1.7 billion settlement with Iran.<sup>20</sup> Senior Administration officials have told the press that the remaining roughly \$1.3 billion was transferred to Iran in an “above-board way” through an unnamed foreign bank, however the exact mechanism of transmission, and whether it was done in cash, remains unknown.<sup>21</sup>

## II. The Legal Bases for the Payments

Given the broad prohibitions on U.S. persons conducting transactions with Iran or Iranian persons after Implementation Day, Senators and Representatives have rightly questioned whether the \$400 million cash payment to Iran, as well as the subsequent \$1.3 billion payments, violated U.S. law. In short, such violations appear unlikely, either under the International Emergency Economic Powers Act (“IEEPA”) and the regulations promulgated pursuant to IEEPA, as well as criminal provisions related to material support for terrorism.

First, under U.S. law, it is generally prohibited for U.S. persons to export goods or services, directly or indirectly, to Iran or the Government of Iran.<sup>22</sup> Likewise, pursuant to IEEPA, U.S. persons may not facilitate transactions by third parties that would be prohibited if the U.S. person engaged in such activity.<sup>23</sup> These prohibitions, contained in the Iranian Transactions and Sanctions Regulations (“ITSR”), make it illegal for a U.S. person—including a U.S. Government official—to send good or services—including cash or financial services—directly or indirectly to Iran or the Government of Iran. Likewise, if a U.S. Government official facilitates such a transaction, for example by asking a foreign financial institution engage in such activity, such facilitation would be prohibited.

Despite this blanket prohibition, however, the ITSR contains a number of regulatory carve-outs, known as General Licenses, that permit certain classes of transactions that would otherwise be prohibited. For example, U.S. law permits U.S. persons to send certain humanitarian goods to Iran. In this case, a particular General License codified at 31 C.F.R. § 560.510(d)(2) explicitly authorizes “all transactions necessary to . . . payments pursuant to settlement agreements entered into by the United States Government in [] a legal proceeding [involving Iran].” Because

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<sup>18</sup> @Price44, “@Kredo0 @sremkusrenner The payment was provided out of the Judgment Fund, which previous Administrations have used for similar settlements,” *Twitter*, Jan. 20, 2016. <https://twitter.com/Price44/status/689859745088278529>.

<sup>19</sup> Behnam Ben Taleblu and Annie Fixler, “Settling with Iran: \$1.7 Billion and U.S. Hostages,” *Foundation for Defense of Democracies*, Sept. 2016, available at [http://www.defenddemocracy.org/content/uploads/general/Settling\\_with\\_Iran.pdf](http://www.defenddemocracy.org/content/uploads/general/Settling_with_Iran.pdf).

<sup>20</sup> Bradley Klapper, “2 days after cash delivery, US paid \$1.3 billion to Iran,” *Associated Press*, Aug. 24, 2016, available at <http://bigstory.ap.org/article/360619286aeb4e3dbafd5eb29388d93a/2-days-after-cash-delivery-us-paid-13-billion-iran>.

<sup>21</sup> *Id.*

<sup>22</sup> 31 C.F.R. § 560.204.

<sup>23</sup> 31 C.F.R. § 560.208.

sending Iran the \$1.7 billion was arguably necessary to the payment of the settlement agreement entered into by the United States and Iran to settle a claim before the U.S.-Iran Claims Tribunal in The Hague, the \$400 million and subsequent \$1.3 billion payments likely fall under this carve-out and are therefore permitted under U.S. law.

It is worth noting here, however, that 31 C.F.R. § 560.510(d)(2) is a broad allowance for both the type and form of transactions related to settlement payments. For example, if the United States wired the money to a European Central Bank, which in turn wired the funds to a small European bank (or a Russian or Chinese bank for that matter) that subsequently wired the funds to Iran, all entities in that transactional chain would likely be insulated from liability under U.S. law. In other words, U.S. law likely permits payment mechanisms other than providing the Islamic Republic with \$400 million in pallets of cash.

Indeed, recent U.S. sanctions history makes clear that the United States has developed financial workarounds that do not require the large-scale distribution of cash. In a well-known recent example, the United States designated Banco Delta Asia (“BDA”)—a Macau-based bank known to hold significant assets of the North Korean leadership—as a jurisdiction of primary money laundering concern under Section 311 of the USA PATRIOT Act.<sup>24</sup> As in the case of Iran from 2008-2016, North Korea was almost completely cut off from the international financial system, with just a handful of banks in China and Russia providing the country and its leadership banking services outside of the peninsula. The BDA 311 designation—in addition to carrying a risk of serious penalties for any legitimate financial institutions that continued to do business with the bank—also carried a heavy reputational taint; few financial institutions wanted to do any business with BDA for fear of being seen as cooperating with a bank that was well-known to engage in illicit activity.

This taint created a particular challenge when the United States and its negotiating partners decided to facilitate the release of the North Korean leadership’s funds held by BDA—approximately \$25 million—as a carrot to restart the stalled Six-Party Talks over the Hermit Kingdom’s nuclear weapons program in 2007. The problem was that—like Iran prior to and immediately following Implementation Day—no legitimate bank wanted to facilitate the transfer from BDA to accounts in North Korea, for fear of sanctions and reputational liability. As a result, the United States Federal Reserve stepped in to assist. In the end, BDA transferred the \$25 million to the Macau Monetary Authority (Macau’s central bank), which in turn transferred it to the United States Federal Reserve. The Federal Reserve then sent it along to the Russian Central Bank, which passed it to Far Eastern Bank, a Russian bank in Vladivostok that held accounts on behalf of the North Korean Foreign Trade Bank.<sup>25</sup> Through this system, the United States was able to facilitate the delivery of North Korean funds back to the regime through legitimate financial channels.

This transmission chain shows that, when necessary, the United States Government has found ways to return funds to sanctioned countries where almost no banking ties to the legitimate financial system exist. In the case of Iran and as mentioned above—particularly given the General License legal cover for transactions necessary for the payment of settlements—it seems

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<sup>24</sup> Juan Zarate, *Treasury’s War* (New York: Public Affairs, 2013), pp. 249-254.

<sup>25</sup> *Id.* at 264.

likely that the United States could have found a way to provide these funds to Iran other than in \$400 million in cash. Indeed, the Administration has hinted that such pathways do exist when senior officials have reported that the remaining \$1.3 billion was transferred to Iran in an “above-board way.”<sup>26</sup>

Second, Administration officials likely did not violate other criminal offenses related to money laundering, support for terrorism, and paying ransoms. As former U.S. Attorney General and federal judge Michael Mukasey has recently noted, while it is prohibited for a U.S. person to transfer monetary instruments (such as cash) with the intent to promote specified unlawful activity pursuant to 18 U.S.C. § 1956, in this circumstance it would be difficult to prove that Administration officials intended to promote specified unlawful activity.<sup>27</sup> In particular, because it is unclear whether the Administration knew where the funds were going—or whether they were going directly for specific unlawful activity such as support for a designated terrorist organization—it would be difficult to make a legal case that the requisite intent existed.

Similarly, and as Judge Mukasey points out, because U.S. officials were acting in their official capacity, they are likely insulated from criminal prosecution.<sup>28</sup> This doctrine—combined with the lack of intent—also undercuts arguments that these officials could be culpable under 18 U.S.C. § 2339, which prohibits knowingly providing material support for a foreign terrorist organization.<sup>29</sup> Likewise, under U.S. law, it is prohibited to receive, possess, or dispose of any money or property that has been delivered as ransom or reward in connection with certain kidnappings.<sup>30</sup> In this case, it does not appear that U.S. officials are receiving, possessing, or disposing of money that has been delivered as a ransom, and therefore very likely did not run afoul of 18 U.S.C. § 1202.

### III. Concerns Raised by the Payments

Though the payments to Iran may have been legal, they raise serious policy concerns and questions about whether the United States could have found a better way to ensure that these funds did not end up in the hands of the Iranian military and sanctioned parties. The primary risks raised by these payments are twofold. First, giving the Government of Iran \$1.7 billion (\$400 million of which was provided in untraceable assets) assisted a state sponsor of terror to promote destabilizing activities. Second, the nature of this transaction, i.e. cash delivered in the middle-of-the-night to a formerly-designated airline known to fly routes in support of the IRGC, Hezbollah, and Syrian President Bashar al-Assad’s regime (Iran Air),<sup>31</sup> for all intents and

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<sup>26</sup> Bradley Klapper, “2 days after cash delivery, US paid \$1.3 billion to Iran,” *Associated Press*, Aug. 24, 2016, available at <http://bigstory.ap.org/article/360619286aeb4e3dbafd5eb29388d93a/2-days-after-cash-delivery-us-paid-13-billion-iran>.

<sup>27</sup> Michael Mukasey, “The \$400 Million: Legal but not Right,” *The Wall Street Journal*, Aug. 4, 2016, available at <http://www.wsj.com/articles/the-400-million-legal-but-not-right-1470353025>.

<sup>28</sup> *Id.*

<sup>29</sup> 18 U.S.C. § 2339A-B.

<sup>30</sup> 18 U.S.C. § 1202.

<sup>31</sup> “Fact Sheet: Treasury Targets Commercial Infrastructure of IRGC, Exposes Continued IRGC Support for Terrorism,” United States Department of the Treasury Press Release, June 23, 2011. Available at <https://www.treasury.gov/press-center/press-releases/Pages/tg1217.aspx>. See also Emanuele Ottolenghi, “The Risks of The Iran-Boeing Deal,” *The Hill*, June 21, 2016. <http://www.defenddemocracy.org/media-hit/emanuele-ottolenghi-the-risks-of-the-iran-boeing-deal/>.



purposes looked like a ransom payment.

### *1. Concerns About Providing Funds to the Government of Iran*

First, it is well-documented that Iran is both a leading state sponsor of terrorism and continues to engage in such activities post-JCPOA.<sup>32</sup> In recent months, Iran has flouted international norms and threatened U.S. interests in a number of ways:

- Iran has conducted repeated ballistic missile tests in violation of United Nations sanctions;<sup>33</sup>
- Qassem Soleimani, the head of the Iranian Revolutionary Guard Corps' Qods Force ("IRGC-QF"), an entity designated by the United States for its support of—and direct engagement in—terrorism, traveled on multiple occasions to Moscow in contravention of international travel bans to coordinate military cooperation with the Russian government, including the delivery of the S-300 anti-aircraft missile system to Iran and defense of the Assad regime in Syria;<sup>34</sup>
- Iran remains the leading state sponsor of terror and has continued its direct support to terrorist proxies throughout the region, including Hezbollah's activities in Lebanon and Syria, as well as Iraqi Shi'ite militias who have been responsible for the deaths of hundreds of Americans and are now deployed in Syria to fight for the Assad regime. In some cases, this support is intended to destabilize governments allied with the United States. In recent months, international naval forces have interdicted Iranian arms shipments likely headed to Houthi rebels in Yemen;<sup>35</sup>
- Iran has deployed troops to Syria to fight for the Assad regime, with reports of thousands on the ground;<sup>36</sup>
- Iran has continued to engage in human rights abuses and restrict democratic norms. Iran has disqualified thousands of individuals from recent elections and continues to detain opposition leaders;<sup>37</sup>

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<sup>32</sup> See U.S. Department of State, Bureau of Counterterrorism, "Chapter 3: State Sponsors of Terrorism Overview," accessed Sept. 1, 2016, available at <http://www.state.gov/j/ct/rls/crt/2015/257520.htm>.

<sup>33</sup> "Iran Should Pay a Price for Its Ballistic Missile Tests," *The Washington Post*, Apr. 6, 2016, available at [https://www.washingtonpost.com/opinions/iran-should-pay-a-price-for-its-ballistic-missile-tests/2016/04/06/a85ef152-fc1c-11e5-80e4-c381214de1a3\\_story.html?utm\\_term=.1b2581ef50fe](https://www.washingtonpost.com/opinions/iran-should-pay-a-price-for-its-ballistic-missile-tests/2016/04/06/a85ef152-fc1c-11e5-80e4-c381214de1a3_story.html?utm_term=.1b2581ef50fe).

<sup>34</sup> Lidia Kelly and Parisa Hafezi, "Iran's Soleimani in Russia for Talks on Syria, Missiles," *Reuters*, Apr. 15, 2016, available at <http://www.reuters.com/article/us-russia-iran-soleimani-idUSKCN0XC0TR>.

<sup>35</sup> See, e.g., Matthew Levitt, "Iran's Support for Terrorism Under the JCPOA," *Washington Institute for Near East Policy Policywatch*, July 8, 2016, available at <http://www.washingtoninstitute.org/policy-analysis/view/irans-support-for-terrorism-under-the-jcpoa>.

<sup>36</sup> See, e.g., J. Matthew McInnis, "How Many Iranian Forces are Fighting and Dying in Syria?" *Newsweek*, Oct. 28, 2015, available at <http://www.newsweek.com/how-many-iranian-forces-are-fighting-and-dying-syria-388004>.

<sup>37</sup> Sam Wilkin, "Iran excludes most candidates in elite assembly election," *Reuters*, Jan. 26, 2016, available at <http://www.reuters.com/article/us-iran-election-candidates-idUSKCN0V419V>.

- Iran detained two Iranian-American citizens, a father and son, in October 2015 and February 2016, and continues to hold them. In addition, Robert Levinson remains missing after disappearing on Kish Island on March 9, 2007;<sup>38</sup>
- On January 12, 2016, Iranian naval forces arrested American sailors at gunpoint, broadcasting the video of their detention, and subsequently mocking the sailors through a reenactment at a rally commemorating the anniversary of the Iranian Revolution.<sup>39</sup>

Iran's support for such activities has not abated. The IRGC in particular remains committed to threatening American interests throughout the region. The IRGC is actively engaged in—and often times the driving force behind—Iran's most destabilizing activities, with responsibilities related to the development of weapons of mass destruction, missile systems, and overseas operations. It and its affiliates have been responsible for all the activities—weapons proliferation, terrorist support, and militant activity—for which Iran was sanctioned in the past.

Providing any funds to the Government of Iran raises serious risks that this money will be used to support these activities. Indeed, as Secretary of State John Kerry has suggested, some of the funds returned to Iran pursuant to the JCPOA will go to support terrorist and militant groups like Hezbollah, Hamas, Iraqi Shi'a militias, and the Houthis in Yemen.<sup>40</sup>

In this particular case, however, evidence suggests that the Government of Iran has already earmarked this \$1.7 billion for use by the Iranian military. According to research by analysts at the Foundation for Defense of Democracies, Tehran recently finalized its fiscal year budget and included the \$1.7 billion from the settlement of foreign legal disputes as an earmark for the Iranian military.<sup>41</sup> This episode illustrates the clear risks associated with providing funds directly to Iran, particularly when the release of those funds is not conditioned in any way on ensuring that they will not be used by the Iranian military or designated entities within Iran.

While in this case we know—largely because the Government of Iran made it clear in their annual budget—that the \$1.7 billion ended up in the coffers of the Iranian military, in general providing these types of payments in cash raises the risk that the United States will be unable to trace the ultimate beneficiaries of the cash. Indeed, in large part because of its fungibility, once the United States or European Central banks, working on behalf of the United States, loaded the \$400 million in cash pallets onto the Iran Air flight in January, we lost visibility into how those funds would be used by Iran. In addition, once we released the \$1.7 billion to Iran without conditions—such as specifying that we would only release the funds to parties without ties to the Iranian military or the IRGC—the U.S. gave up all leverage it had to ensure that the money

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<sup>38</sup> Barry Meier, "Seeking Robert Levinson, the C.I.A. Consultant Who Vanished," *New York Times*, May 13, 2016, available at <http://www.nytimes.com/2016/05/15/nyregion/seeking-robert-levinson-cia-consultant-who-vanished.html>.

<sup>39</sup> Helene Cooper and David Sanger, "Iran Seizes U.S. Sailors Amid Claims of Spying," *New York Times*, Jan. 12, 2016, available at <http://www.nytimes.com/2016/01/13/world/middleeast/iran-holds-us-navy-boats-crew.html>.

<sup>40</sup> Rebecca Kheel, "Kerry: Some Iran Sanctions Relief Will Go to Terrorists," *The Hill*, Jan. 21, 2016, available at <http://thehill.com/policy/defense/266619-kerry-some-iran-sanctions-relief-will-go-to-terrorists>.

<sup>41</sup> Saeed Ghasseminejad, "Iran Gives Green Light to Direct \$1.7 Billion from U.S. to Military," *Foundation for Defense of Democracies*, Sept. 1, 2016, available at <http://www.defenddemocracy.org/media-hit/saeed-ghasseminejad-iran-gives-green-light-to-direct-17-billion-from-us-to-military/>.

was not used to support terrorism or related activities, or would not go directly into the coffers of the Iranian military.

## 2. *Concerns About How the Funds Were Provided to the Government of Iran*

Second, the \$400 million cash payment to Iran that was timed in conjunction with the release of U.S. hostages—while unlikely to be a prohibited ransom payment under U.S. law—raises serious concerns about whether Iran will be more likely to take additional Americans hostage in the future. As a matter of policy, the United States Government does not pay kidnappers to secure the release of hostages.

The logic behind this policy is straightforward. According to Deputy Director of the Central Intelligence Agency (and at the time of these statements, Undersecretary of the Treasury for Terrorism and Financial Intelligence) David Cohen, “Ransom payments lead to future kidnappings, and future kidnappings lead to additional ransom payments. And it all builds the capacity of terrorist organizations to conduct attacks. Refusing to pay ransoms or to make other concessions to terrorists is, clearly, the surest way to break the cycle, because if kidnappers consistently fail to get what they want, they will have a strong incentive to stop taking hostages in the first place. There is empirical evidence to support this.”<sup>42</sup>

Key to breaking this cycle and deterring would-be hostage takers from seizing American citizens is making clear that the United States is not paying ransom for the release of hostages. In the case of the \$400 million payment, however, the Administration muddied these waters in order to maintain leverage and ensure the release of the five Americans. Indeed, as State Department Spokesman John Kirby noted, “[i]t would have been foolish, imprudent, irresponsible, for us not to try to maintain maximum leverage [once it was decided that the hostages were going to be released around the same time as the first settlement payment would be sent to Iran]. So if you’re asking me was there a connection in that regard at the endgame, I’m not going to deny that.”<sup>43</sup>

While the Administration’s contention that it wanted to maintain maximum leverage at the time of the prisoner release is understandable, it raises serious concerns that the resulting transfer of funds looked like a ransom payment to Iran. For example, on January 20, 2016, the commander of the IRGC paramilitary Basij unit reportedly said the reclaiming of \$1.7 billion in blocked Iranian assets “had nothing to do the [nuclear] negotiations and was the . . . price that America paid to free its spies.”<sup>44</sup> If Iranian military and IRGC commanders perceived the payment as ransom, they may be more likely to take Americans—particularly dual U.S.-Iranian citizens who travel to Iran frequently—hostage.

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<sup>42</sup> David S. Cohen, “Why the U.S. Does Not Pay Ransoms for Americans Kidnapped by Terrorists,” *Newsweek*, Aug. 23, 2014, <http://www.newsweek.com/why-us-does-not-pay-ransoms-americans-kidnapped-terrorists-266315>.

<sup>43</sup> John Kirby, “Daily Press Briefing,” *U.S. Department of State*, Aug. 18, 2016, available at <http://www.state.gov/r/pa/prs/dpb/2016/08/261128.htm>.

<sup>44</sup> Behnam Ben Taleblu and Annie Fixler, “Settling with Iran: \$1.7 Billion and U.S. Hostages,” *Foundation for Defense of Democracies*, Sept. 2016, available at [http://www.defenddemocracy.org/content/uploads/general/Settling\\_with\\_Iran.pdf](http://www.defenddemocracy.org/content/uploads/general/Settling_with_Iran.pdf).

Further, the nature of the payment likely exacerbated the Iranian perception that this was ransom. A middle-of-the-night, all cash payment in the amount of \$400 million loaded onto pallets and flown to Iran looks more like a ransom payment than does a wire transfer from an escrow account, held at a European Central Bank or another legitimate financial institution, that is going to an Iranian financial institution that has been vetted for any ties to illicit Iranian actors. This was likely why Assistant Attorney General for National Security John Carlin—along with other senior Justice Department officials—objected to the \$400 million payment on the grounds that Iranian officials were likely to view it as a ransom and thereby undercut the longstanding U.S. policy.<sup>45</sup>

#### **IV. Missed Opportunities and Policy Recommendations**

While the \$400 million cash payment and the subsequent \$1.3 billion transfers raise serious concerns that the money will be—or already has been—used to support the Iranian military, this episode also represents a missed opportunity to continue to pressure Iran to stop supporting terrorism and to clean up its financial act. These payments—and other related payments under the Joint Plan of Action (“JPOA”) in the lead-up to the JCPOA as well as many types of future payments—could have been structured in such a way that reduced Iran’s perception that they were a ransom and, more importantly, limited Iran’s ability to use these funds to support its destabilizing activities throughout the region.

If—instead of providing the funds in cash or in other ways where once the United States released the money it lost control of how the Islamic Republic would use the funds—we conditioned the release of these settlement agreement funds on a number of important triggers, the risks of Iran using this money for illicit purposes could have been mitigated. In particular, these risks could have been mitigated by using escrowed accounts for settlement funds or by requiring any funds transfers to pass through “white listed” banks deemed to present a low risk of funds being diverted to illicit.

##### *1. Escrowed Accounts for Settlement Funds*

Instead of providing \$400 million in cash to Iran, followed by sequential payments of approximately \$100 million, the United States could have put these funds into escrowed accounts, held by European financial institutions, including certain Central Banks. Once the settlement agreement was reached, the United States could have worked with these foreign financial institutions (and likely additional third party European or Asian banks that maintained ties to the Iranian financial system) to understand who the recipients of these funds would be within Iran.

At the same time, the United States could have put conditions on the release of these funds to ensure that they were not being released to designated Iranian banks, or to actors within Iran who would use the funds for illicit purposes. As discussed below, such an approach would reduce the risk of precisely what happened; that the funds ended up in the coffers of the Iranian military.

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<sup>45</sup> Devlin Barrett, “Senior Justice Official Raised Objections to Iran Cash Payment,” *The Wall Street Journal*, August 12, 2016. ([http:// www.wsj.com/articles/senior-justice-official-raised-objections-to-iran-cash-payment-1470994380](http://www.wsj.com/articles/senior-justice-official-raised-objections-to-iran-cash-payment-1470994380))

While arbitrarily refusing to return the funds to Iran could be grounds for renegeing on a settlement agreement, it is reasonable for the United States to specify that it will not return funds to Iran that will go to designated parties or in support of terrorism or regional instability, in contravention of U.S. law. Such conditions could include provisions specifying that, among others:

- The funds cannot be directly provided to a designated person under U.S. or EU law;
- The end recipient of the funds must be identified; and
- The funds must be released in tranches, with a certification provided by the Secretary of the Treasury and relevant U.S. Government agencies that the prior released amount has not gone to designated parties or to entities engaged in a number of proscribed activities. If the Secretary of the Treasury cannot certify this information, the remaining payments must be suspended until such time as the Secretary can certify.

Moving forward, Congress could pass legislation that modifies 31 C.F.R. § 560.510(d) and requires that any funds to be sent to Iran pursuant to a settlement agreement between the United States and Iran be placed in an escrow account and released only upon meeting the conditions laid out above.

Another benefit of this approach would be that, even if funds were returned to Iran at approximately the same time that the Islamic Republic was set to release hostages, such a payment looks far less like ransom. Providing Iran funds out of an escrowed account with conditions on the end-recipient is far less likely to be perceived as ransom than \$400 million in cash pallets loaded onto Iran Air in the middle-of-the-night and time to ensure the release of U.S. hostages. While we cannot fully control Iran's perceptions of whether such payment would constitute ransom, this mechanism would certainly reduce that risk.

## 2. *“White List” of Vetted, Approved Iranian Banks*

More broadly, Congress could take steps to ensure that any payments made to Iran—either by the United States or by the private sector in accord with U.S. and EU law—would present reduced risks of diversion. For example, if the United States set up a halfway house system where a limited number of legitimate Western banks (likely European, given the broad remaining restrictions on U.S. banks doing business in Iran) with robust anti-money laundering (“AML”) and countering the financing of terrorism (“CFT”) policies, procedures, and programs could process legally permissible transactions to Iran (including the payment of settlement agreements), and the United States and its Western partners heavily monitored transactions and receiving parties to ensure these funds were not used for illicit purposes, this would limit Iran's ability to use these funds (and other funds) to support terrorism.

In particular, the United States and its partners could select a small number of Iranian banks that could serve as monitored-and-approved counterparties to facilitate these settlement and other payments. Requirements for joining the group of approved Iranian banks would include, among others:

- Banks would be subjected to enhanced due diligence (“EDD”) requirements, with the Financial Action Task Force (“FATF”) Recommendations for high-risk counterparties, clients, and services acting as a floor for ensuring that the Iranian banks were not engaging in any illicit activity and had no ties to illicit actors;<sup>46</sup>
- Banks would be subjected to frequent and updated EDD checks to ensure adherence to proper rules and regulations, and EDD would be conducted on each transaction and customer;
- Banks could not have been designated by OFAC for any activities related to Iran’s support for terrorism, ballistic missile development, human rights abuses, or fomenting regional instability;
- Banks could not have any current ties to Specially Designated Nationals (“SDNs”), including members of the IRGC;
- Banks have no record of engaging in deceptive financial practices; and
- Banks must submit upon request information about their clients to Western financial institutions using this “white list” (i.e., Know Your Customer’s Customer, (“KYCC”).

In addition, and related to particular transactions, “white list” Iranian banks would need to provide information about the ultimate end recipient of the funds, including whether the recipients were Government of Iran entities. In the case where such funds would end up in the coffers of the Iranian military or other actors engaged in specified destabilizing activity, the transactions would be prohibited. Further, any bank on the “white list” that returns to illicit activity should face harsh penalties, including a permanent ban from SWIFT access, permanent designation by OFAC, and, for any foreign banks continuing to do business with that bank, secondary sanctions.

This type of specific financial channel has precedent; during the JPOA and as a way to facilitate the purchase of, and payment for, the export of food, medicine, and medical devices to Iran, the P5+1 and Iran established a specific banking channel between Iran and foreign financial institutions. This channel was reportedly limited to this humanitarian function, however.<sup>47</sup>

Such a broader “white list” would create a specified channel for processing transactions—including settlement agreement transfers—in a way that would limit Iran’s ability to channel the funds to the IRGC and designated parties. Such a channel would also address one of the most intractable issues encountered following Implementation Day: the unwillingness of reputable financial institutions to return to Iranian markets and begin banking Iranian clients in ways that are permissible under U.S. and EU law.

This unwillingness is understandable and justified; while the JCPOA has relaxed certain sanctions related to the development of Iran’s nuclear program, the underlying risks of illicit conduct remain. In particular, the nature of the Iranian economy and the role of the government within the economy present serious risks related to bribery and corruption, money laundering,

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<sup>46</sup> Financial Action Task Force, *The FATF Recommendations* (2012), available at [http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF\\_Recommendations.pdf](http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf)

<sup>47</sup> See, “Frequently Asked Questions Relating to the Continuation of Certain Temporary Sanctions Relief Pursuant to the JPOA Prior to Implementation of the JCPOA,” *Office of Foreign Assets Control*, Aug. 7, 2015, available at [https://www.treasury.gov/resource-center/sanctions/Programs/Documents/jpoa\\_ext\\_faq\\_20150807.pdf](https://www.treasury.gov/resource-center/sanctions/Programs/Documents/jpoa_ext_faq_20150807.pdf).

and illicit financing. Iran ranked 130 of 175 countries in Transparency International's Corruption Perceptions Index as of 2015.

In 2011, the U.S. identified Iran as a state of primary money laundering concern pursuant to Section 311 of the USA PATRIOT Act. The Financial Action Task Force first raised concerns over Iran's lack of a comprehensive anti-money laundering/countering the financing of terrorism framework in 2007, and it still urges Iran to meaningfully address AML/CFT deficiencies. For example, as recently as February 19, 2016, the FATF issued a statement warning that Iran's "failure to address the risk of terrorist financing" poses a "serious threat ... to the integrity of the international financial system."<sup>48</sup> The international community continues to recognize that Iran—regardless of the status of its nuclear program—poses a real and serious threat to the integrity of the global financial system. Indeed, the FATF, while suspending the imposition of mandatory countermeasures for one year to try to coax Iran into reforming its decrepit jurisdictional AML and CFT controls, recently decided to keep Iran on its so-called "Black List" to ensure that financial institutions around the world understand the serious risks that exist with doing business in Iran.<sup>49</sup> This concern is justified: in the past week Iranian revolutionary and military forces have pushed back on any attempts to reform Iran's corrupt financial system.<sup>50</sup> OFAC also has made it clear that activity inconsistent with a wide range of Executive Orders imposing sanctions on Iran (including for providing support to terrorism, undermining the stability of Yemen, and other behaviors) could still subject U.S. and non-U.S. persons to sanctions.

In short, Iran has not changed the underlying criminal activity that has led respectable financial institutions across the world to refuse to do business in Iran or with clients doing substantial business there. Indeed, one marked development in the past year has been the international financial community's unwillingness to re-enter the Iranian market, even if legally permitted to do so. At the same time, smaller financial institutions, including some in Eastern Europe and Asia, have begun to fill the void.<sup>51</sup> These institutions often lack proper AML/CFT controls and the capabilities and will to ensure robust compliance when dealing with Iranian counterparties. As a result, Iran is slowly regaining access to Western financial markets, but in a way that may not effectively force its compliance with global standards prohibiting money laundering, terrorist financing, and illicit activity.

Establishing a "white list" would help remedy this situation. By specifying which Iranian banks present reduced risks, the United States could achieve a number of goals. First, it would force any Iranian financial institutions wanting to be part of the "white list" to clean up their financial crimes compliance ("FCC") act. While corruption and FCC risk permeate Iran's financial sector,

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<sup>48</sup> "FATF Public Statement," *Financial Action Task Force*, Feb. 19, 2016, available at <http://www.fatf-gafi.org/publications/high-riskandnon-cooperativejurisdictions/documents/public-statement-february-2016.html>.

<sup>49</sup> Mark Dubowitz and Toby Dershowitz, "Risky Business in Iran," *Forbes*, June 28, 2016, available at <http://www.forbes.com/sites/realspin/2016/06/28/risky-business-in-iran/#95318072a37d>.

<sup>50</sup> Golnar Motevalli, "Top Iran Banks Dragged into Rouhani Tussle with Hardline Rivals," *Bloomberg*, Sept. 5, 2016, available at <http://www.bloomberg.com/news/articles/2016-09-05/top-iran-banks-dragged-into-rouhani-tussle-with-hardline-rivals>.

<sup>51</sup> See, e.g., Tom Arnold and Bozorgmehr Sharafedin, "Small Banks Help Iran Slowly Restore Foreign Financial Ties," *Reuters*, June 15, 2016, available at <http://in.reuters.com/article/iran-banks-idINKCNOZ115J>.

incentivizing Iranian banks to come back in from the cold and cease their intentional and unintentional FCC-related activities would be a significant step in the right direction.

Second, it would reduce Iran's ability to access Western financial markets and services in a less-than-complaint way. As discussed, Iran is currently using banks that often lack effective FCC controls. By creating a "white list" whereby reputable European financial institutions could provide banking services to Iran, the United States and its partners could introduce a higher degree of due diligence and compliance into the financial relationship with Iran. In addition, any such banks doing business outside of this channel would immediately be viewed by the private sector as suspect, and would therefore have a more difficult time conducting business both in Iran and elsewhere. As a result, the "white list" approach would have a powerful market impact that would nudge financial relationships to more legitimate channels.

Third and finally, if Iran balked at allowing its banks to join such a "white list", it would expose the regime as recalcitrant and unwilling to live up to global standards for anti-money laundering and countering the financing of terrorism. Such a refusal would further strengthen the argument both to the private sector and our international partners that Iran remains a rogue regime that presents serious risk, even in the post-JCPOA context.

To be clear, both of these approaches will not totally eliminate risk. It would be very difficult to be certain that no funds provided to Iran—even if done through this "white list" mechanism—end up helping the regime fund terrorism and regional adventurism. Likewise, even conditioning the release of settlement funds from an escrow account on verified certification that they not be provided to any sanctioned parties or other actors engaged in illicit activity is not foolproof. At the same time, however, these mechanisms would certainly be less risky than providing Iran with money without strings attached, particularly in cash.

## **V. Moving Forward**

This episode illustrates the need for more sophisticated thinking on how to effectively use economic pressure to limit our adversaries' abilities to threaten our interests, even in the context of sanctions unwinding. In this case, the United States gave up much of its ability to ensure that this \$1.7 billion was not used for illicit or nefarious purposes.

Moving forward, Congress should consider ways, including legislative changes, to limit Iran's ability to access future settlement funds without condition as well as to establish specific and authorized channels for legitimate and legal financial transactions. Such solutions would have limited Iran's ability to use the \$1.7 billion in settlement funds for its defense budget and the Islamic Republic's ability to use much of the funds it was granted access to under the JPOA and the JCPOA to support terrorist activities. While Iran now has access to much of this money, Congress should still act to ensure that United States maintains its ability to pressure the regime over its continued illicit conduct.

Thank you for your time. I look forward to your questions.