



## **U.S. TREASURY DEPARTMENT OFFICE OF PUBLIC AFFAIRS**

**EMBARGOED UNTIL 1:00 p.m. (EDT), April 17, 2008**  
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**TESTIMONY BEFORE THE HOUSE COMMITTEE ON FOREIGN AFFAIRS**

**SUBCOMMITTEE ON THE MIDDLE EAST AND SOUTH ASIA AND THE  
SUBCOMMITTEE ON TERRORISM, NONPROLIFERATION AND TRADE**

**WASHINGTON** - Chairman Ackerman, Chairman Sherman, Representative Pence, Representative Royce and distinguished members of the Committee, thank you for the opportunity to speak with you today about the Treasury Department's efforts to counter Iran's nuclear program and its deliberate support of terrorism. I want to thank this Committee for its continued support and guidance in our efforts against an Iranian regime that continues to pursue threatening activities. Today, I will focus my remarks on the Treasury Department's strategy and actions to counter this threat and the impact we have achieved on Iranian financial institutions and businesses.

### **The Iranian Threat**

Iran poses significant threats to the international community. Chief among them is the regime's continued pursuit of a nuclear weapons capability in defiance of United Nations Security Council resolutions. Another paramount threat is Iran's provision of financial and material support to terrorist groups. The combination of these two threats presents a lethal challenge that is exacerbated by Iran's integration into the international financial system, and its deceptive financial practices.

#### *Threat of Iran's Nuclear Pursuits*

Iran's continued pursuit of sensitive nuclear technologies and missile programs present a deliberate and intolerable threat to the international community. Iran has ignored calls from the

international community to suspend its enrichment-related reprocessing and heavy water-related activities, and defied numerous U.N. Security Council resolutions including:

- Resolution 1696 (2006)
- Resolution 1737 (2006)
- Resolution 1747 (2007)
- Resolution 1803 (2008)

The international community reiterated its position on this issue most recently on March 3, 2008, when the U.N. Security Council adopted Resolution 1803, imposing further sanctions on Iran for its refusal to suspend its proliferation sensitive nuclear activities. Iran has thus far ignored this recent resolution, announcing that it would proceed forward in expanding its uranium enrichment activities. Iran's defiance and disregard for international concern adds to the gravity of the threat.

### *Threat of Iran's Support of Terrorism*

The threat we face from Iran is not limited to its pursuit of a nuclear capability. Another dynamic of Iran's threat is its provision of financial and material support to terrorist groups. Iran has long been a state sponsor of terrorism and continues to support an unparalleled range of terrorist activities. For example, Tehran arms, funds, and advises Hizballah, an organization that has killed more Americans than any terrorist network except for al-Qa'ida, and does so via the Qods Force, a branch of the Islamic Revolutionary Guard Corps. In addition, Iran provides extensive support to Palestinian terrorist organizations, including the Palestinian Islamic Jihad (PIJ) and Hamas. In the case of PIJ, Iran's financial support has been contingent upon the terrorist group carrying out attacks against Israel. And we are all familiar with Iran's funding, training, and equipping of select Shi'a extremist groups in Iraq, further destabilizing that country and resulting in deaths of Americans, Iraqis and others. Iran's Qods Force also provides weapons and financial support to the Taliban to support anti-U.S. and anti-Coalition activity in Afghanistan

Iran utilizes the international financial system as a vehicle to fund these terrorist organizations. As Under Secretary Levey has previously testified, the Iranian regime operates as the central banker of terrorism, spending hundreds of millions of dollars each year to fund terrorism.

### *Iran's Integration into the International Financial System*

Iran is deeply integrated in the international financial system. Iranian state-owned banks have dozens of branches located all over the world. Additionally, Iranian banks have correspondent accounts at foreign banks for an even broader reach into the international financial system. Moreover, Iranian individuals and entities maintain accounts at foreign financial institutions.

Iran's integration into the global economy and the international financial system gives the Iranian regime global financial capability to support its threatening activities and exposes the international financial system to illicit financing risks posed by the regime.

### *Iran's Deceptive Financial Practices*

Iran uses its global financial ties to pursue both the threat of terrorism and nuclear program through an array of deceptive practices specifically designed to avoid suspicion and evade detection from the international financial community. Iran uses its state-owned banks for its nuclear and missile program and for financing terrorism. For example, Tehran uses front companies and intermediaries to engage in ostensibly legitimate commercial transactions that are actually related to its nuclear and missile programs. These front companies and intermediaries enable the regime to obtain dual-use technology and materials from countries that would typically prohibit such exports to Iran.

Another method Iranian banks use to evade controls is to ask other financial institutions to remove their names when processing transactions through the international financial system. This practice is intended to elude the controls put in place by responsible financial institutions and has the effect of potentially involving those institution in transactions they would never engage in if they knew who, or what, was really involved. This practice allows Iran's banks to remain undetected as they move money through the international financial system to pay for the Iranian regime's illicit and terrorist-related activities. This practice is even used by the Central Bank of Iran to facilitate transactions for sanctioned Iranian banks.

### *Fundamental Deficiencies in Iran's AML/CFT Regime*

In addition to Iran's deceptive financial conduct, substantial deficiencies in Iran's anti-money laundering and combating the financing of terrorism (AML/CFT) regime present a significant vulnerability to the international financial system. Iran lacks an acceptable system of laws and enforcement capabilities that would allow it to detect and prevent money laundering or terrorist financing. Although Iran adopted an anti-money laundering law this year, its content has been heavily criticized by both the Financial Action Task Force (FATF) and International Monetary Fund (IMF) for failing to meet international standards. Moreover, both the FATF and IMF have recognized broader deficiencies in Iran's AML/CFT regime to include:

1. Insufficient criminalization of money laundering.
2. Failure to criminalize terrorist financing.
3. Lack of AML/CFT supervision.
4. Lack of a financial intelligence unit.
5. Lack of sanctions implementation.
6. Lack of international cooperation in AML/CFT investigations.

As FATF has stated in its advisories to the international financial system, these core AML/CFT deficiencies present a substantial vulnerability to the international financial system. The FATF took unprecedented measures to warn the international financial system about the risks arising from the deficiencies in Iran's AML/CFT.

### **Treasury's Actions to Address the Threat**

Addressing this multifaceted threat – the threat of both proliferation and terrorism, reinforced by Iran's deceptive financial conduct and systemic AML/CFT deficiencies –requires a multifaceted strategy, including an essential financial component. In the years since September 11, we have substantially increased our understanding of vulnerabilities in the international financial system and how terrorist and other illicit financial networks exploit those vulnerabilities. Treasury's

strategy to combat the threat that Iran presents, and application of financial pressure to the Iranian regime, builds upon these experiences and consists of three inter-related initiatives:

- Developing and implementing targeted financial measures to combat Iran’s proliferation and terrorism support activities;
- Maximizing the impact of U.S. financial actions by securing international support; and
- Engaging in a strategic dialogue with the international private sector to explain the risks of doing business with Iran.

#### **A. Direct U.S. Action Utilizing Treasury Authorities**

The U.S. has maintained trade and financial-related sanctions program against Iran for almost 30 years. The current program prohibits virtually all commercial trade between the U.S. and Iran. Our efforts in recent years have focused on a conduct-based targeted financial action aimed at disrupting Iran’s proliferation and terrorism activities. We have shown that these types of targeted, conduct-based financial measures aimed at particular bad actors can be quite effective, in part because they unleash market forces by highlighting risks and encouraging prudent and responsible financial institutions to make the right decisions about the business in which they are engaged. They give us a concrete way in which to target directly those individuals and entities we know are bad actors and to strike at the heart of their operations.

##### *Executive Order 13382 – Targeting WMD Proliferators and Their Networks*

The Treasury Department relies on Executive Order 13382, a targeted financial sanctions authority, for imposing targeted financial sanctions against weapons of mass destruction (WMD) proliferators and their supporters to pressure Iran. Executive Order 13382 was issued by President Bush in 2005 and added a powerful tool to the array of options available to combat WMD proliferation. By prohibiting U.S. persons from engaging in transactions with entities and individuals targeted by the order, we can effectively deny proliferators and their supporters access to the U.S. financial and commercial systems, cutting them off from the benefits of our economy. These prohibitions have powerful and far-reaching effects, as the suppliers, financiers, transporters, and other facilitators of WMD networks tend to have commercial presences and accounts around the world that make them vulnerable to exactly this kind of financial action, particularly since so many of the transactions are denominated in dollars.

To date, under Executive Order 13382 the Departments of Treasury and State have designated 52 Iran-related individuals and entities as supporting Iran’s and missile programs. Targeted entities could range from those under the direct control of the Government of Iran to facilitators in the support network that act as conduits. Some prominent examples include:

- **Aerospace Industries Organization** - The Aerospace Industries Organization (AIO), a subsidiary of the Iranian Ministry of Defense and Armed Forces Logistics, is the overall manager and coordinator of Iran's missile program. AIO oversees all of Iran's missile industries and was designated in 2005 when the Executive Order 13382 was first issued. AIO was also identified by the UNSC Resolution 1737 the following year in 2006 and subject to target sanctions for its involvement in Iran’s nuclear program.
  - Treasury has designated numerous related AIO organizations, including, **Sanam Industrial Group** and **Ya Mahdi Industries Group**, both designated for their ties to

AIO. Sanam Industrial Group has purchased millions of dollars worth of equipment on behalf of the AIO from entities associated with missile proliferation. Ya Mahdi Industries Group is subordinate to AIO and has been involved in international purchase of missile-related technology and goods on behalf of the AIO. These entities were also identified and sanctioned under UNSCR 1747.

- **Atomic Energy Organization of Iran** - The Atomic Energy Organization of Iran (AEOI) is the main Iranian organization for research and development activities in the field of nuclear technology, including Iran's centrifuge enrichment program. Treasury also designated AEOI in 2005, which was then followed by its designation under UNSC Resolution 1737. Treasury has designated numerous subsidiaries of AEOI network including:
  - Kalaye Electric Company, Kavoshyar Company, and Pioneer Energy Industries Company are owned or controlled by the AEOI or acting for or on its behalf. Kalaye Electric Company has been linked to Iran's centrifuge research and development efforts. Kalaye is also listed in the Annex to UN Security Council Resolution 1737 as subject to targeted sanctions because of its involvement in Iran's nuclear program. Kavoshyar Company's sole shareholder is AEOI. Pioneer Energy Industries Company provides services to AEOI, including technological support.
  - Pars Tarash and Farayand Technique are owned or controlled by, or act or purport to act for or on behalf of the AEOI. Pars Tarash and Farayand Technique were also listed in the Annex to UNSCR 1737 as subject to targeted sanctions for their involvement in Iran's centrifuge program and were identified in reports of the International Atomic Energy Organization (IAEA).

Treasury has also used this authority to designate several state-owned Iranian banks, including:

- **Bank Sepah** – Bank Sepah is the fifth largest Iranian state-owned bank, designated in January 2007 for providing extensive financial services to Iranian entities responsible for developing missiles capable of carrying weapons of mass destruction. Bank Sepah was sanctioned by UNSCR 1747 in March that same year. Since at least 2000, Bank Sepah has also provided a variety of critical financial services to Iran's missile industry, arranging financing and processing dozens of multi-million dollar transactions for AIO, which has been designated by the U.S. for its role in overseeing all of Iran's missile industries. By cutting off Sepah from the U.S. and the international financial system, we have made it more difficult for Iran to finance some of its proliferation-related activities.
- **Bank Melli** – Bank Melli is Iran's largest bank and provides banking services to entities involved in Iran's nuclear and ballistic missile programs, including entities listed by the UN for their involvement in those programs. Through its role as a financial conduit, Bank Melli has facilitated numerous purchases of sensitive materials for Iran's nuclear and missile programs. This includes handling transactions in recent months for Bank Sepah, Defense Industries Organization, and Shahid Hemmat Industrial Group. Following the designation of Bank Sepah under UNSCR 1747, Bank Melli took precautions not to identify Sepah in transactions. Entities owned or controlled by the IRGC or the Qods Force use Bank Melli for a variety of financial services. From 2002 to 2006, Bank Melli was used to send at least \$100 million to the Qods Force. When handling financial transactions on behalf of the IRGC, Bank Melli has employed

deceptive banking practices to obscure its involvement from the international banking system. For example, Bank Mellat has requested that its name be removed from financial transactions.

- **Bank Mellat** - Bank Mellat provides banking services in support of Iran's nuclear entities, namely the Atomic Energy Organization of Iran (AEOI) and Novin Energy Company. Both AEOI and Novin Energy have been designated by the United States under E.O. 13382 and by the UN Security Council under UNSCRs 1737 and 1747 respectively. Bank Mellat services and maintains AEOI accounts, mainly through AEOI's financial conduit, Novin Energy. Bank Mellat has facilitated the movement of millions of dollars for Iran's nuclear program since at least 2003. Transfers from Bank Mellat to Iranian nuclear-related companies have occurred as recently as this year.

#### *Executive Order 13224 - Targeting Entities that Commit, or Support Terrorism*

The Treasury Department targets Iran's support for terrorism utilizing Executive Order 13224. This Executive Order, issued immediately after the September 11 attacks, allows Treasury to designate and block the assets of individuals and entities controlled by, acting on behalf of, or providing support to named terrorist organizations. This has the effect of freezing the target's assets that are held by U.S. persons and preventing U.S. persons from having any future dealings with them.

Using this terrorism authority, we have been able to expose Iran's terrorist support infrastructure. Two examples include:

- **Bank Saderat Iran** – In 2006, the Treasury Department initially took action against one of Iran's largest state-owned banks under the country sanctions program, cutting the bank from indirect access to the U.S. financial system revoking its authority to conduct U-turn transactions. In 2007, we intensified the action against Bank Saderat and officially designated it under E.O. 13224 as a supporter of terrorism.
  - Government of Iran uses Bank Saderat to transfer money to terrorist organizations, most notably Hizballah and Hamas. From 2001 to 2006, Bank Saderat transferred \$50 million from the Central Bank of Iran through its subsidiary in London to its branch in Beirut for the benefit of Hizballah fronts in Lebanon that support acts of violence.
- **Qods Force (IRGC Qods Force)** - The Qods Force, a branch of the IRGC, provides material support to the Taliban, Lebanese Hizballah, Hamas, Palestinian Islamic Jihad, and the Popular Front for the Liberation of Palestine-General Command (PFLP-GC).
  - The organization is the regime's primary instrument for providing lethal support to the Taliban. It provides weapons and financial support to the Taliban to support to anti-U.S. and anti-Coalition activity in Afghanistan. The Qods Force has also funded Hizballah with \$100 to \$200 million and has assisted Hizballah in rearming in violation of UN Security Council Resolution 1701.

## **B. Securing International Action**

The effectiveness of targeted financial sanctions and other measures is significantly enhanced when other countries take similar actions. Accordingly, a significant part of the Treasury Department's efforts related to Iran has been devoted to a broader U.S. government campaign to facilitate international action against Iran's support of terrorism and nuclear program.

#### *Facilitating International Action to Combat Iran's Support of Terrorism*

The FATF is the premier standard-setting body for AML/CFT (anti-money laundering and combating financing of terrorism) and provides a unique opportunity for Treasury to engage our international counterparts regarding the risks posed by Iran's AML/CFT regime deficiencies. Treasury leads the U.S. delegation to the FATF. Taken as a whole, the FATF's AML/CFT standards are recognized by more than 175 countries and have been endorsed by the United Nations, the World Bank and the International Monetary Fund.

In addition to setting the AML/CFT international standards, the FATF also identifies jurisdictions with serious vulnerabilities in their AML/CFT framework. In early 2007, Iran was identified by FATF as having significant deficiencies in its AML/CFT regime. As a result, the FATF issued a public statement in October 2007 expressing its concern that Iran's lack of a comprehensive AML/CFT regime represents a significant vulnerability within the international financial system. Iran subsequently adopted an anti-money laundering law and met with FATF to discuss its legal framework for AML/CFT. The FATF, however, concluded that the deficiencies in Iran's AML/CFT regime warranted the issuance of another statement that reiterated previous concerns. The latest FATF advisory issued on February 2008, called on all members and non-members alike to advise their financial institutions about the risks posed by Iran's AML/CFT regime. In response many countries – including the UK, Canada, France, Germany, Japan and Malaysia - have advised their financial institutions of the risks inherent in doing business with Iran.

Treasury also issued such advisories to the U.S. financial sector following FATF's advisories, warning them of the general risks of Iranian business and providing specific information about areas of concern related to Iran, including Iran's deceptive financial conduct. The most recent Treasury advisory identified Iranian state-owned and private banks and their branches and subsidiaries abroad. Significantly, it also warned financial institutions about the conduct of the Central Bank of Iran, both in obscuring the true parties to transactions and facilitating transactions for sanctioned Iranian banks.

#### *Facilitating International Action to Combat Iran's Nuclear Pursuits*

The U.S. has worked within both the United Nations and the FATF to reinforce our targeted financial actions to counter Iran's proliferation activities. Indeed, the international community is working to establish a global framework that addresses the threats posed by Iran and develops effective financial measures. These efforts have focused on increasing multilateral implementation of both targeted financial measures and other financial prohibitions against entities involved in Iranian nuclear and missile proliferation. We have worked with the FATF to provide guidance on the effective implementation of those obligations.

##### (i) UN Obligations

The State Department has led important U.S. efforts at the UN in the adoption of three Chapter VII resolutions related to Iran's nuclear and missile programs that include significant financial components:

- **Targeted financial sanctions:** UN Security Council Resolution 1737, adopted December 23, 2006, requires the worldwide freezing of the assets of designated key actors associated with Iran's nuclear and missile programs. The Resolution targeted Iran's proliferation infrastructure, requiring all States to freeze the assets of identified individuals and entities and effectively deny them access to the international financial system. The adoption of the resolution and its successor resolution, 1747, also globalizes Treasury's action against Iran's proliferation infrastructure. Many of the individuals and entities identified in the UN Security Council resolutions were already publicly designated by Treasury and State under E.O. 13382.
- **Activity-based financial prohibitions:** UNSCR 1737 also requires states to prevent the provision to Iran of any financial assistance, or the transfer of any financial resources or services, related to the supply, sale, transfer, manufacture, or use of prohibited items associated with Iran's nuclear and missile programs. This measure effectively prohibits the provision of financial services that would allow Iran to procure the prohibited items needed for nuclear or missile programs. It places strong responsibilities on states to press financial institutions to make efforts to ensure they do not provide those financial services. This is a daunting task for financial institutions, and we have worked with the FATF to provide guidance that would assist financial institutions in this preventative effort.
- **Exercising vigilance over financial institutions' activities with Iranian banks:** With the most recent adoption of UNSCR 1803, the Security Council calls upon UN member states to exercise vigilance over the activities of financial institutions in their territories with all financial institutions domiciled in Iran, and their branches and subsidiaries abroad. This provision makes special mention of the risks posed by Bank Melli and Bank Saderat. This measure has critical importance to us, as it significantly reinforces the concerns Treasury has expressed for many months regarding some Iranian financial institutions' deceptive financial conduct and terrorism and proliferation support activities.

#### (ii) Working with the FATF to Implement UN Obligations

Treasury is working within the FATF to ensure effective implementation of the financial provisions contained in the UN Security Council resolutions. This guidance by the FATF works in conjunction with the UN's effort to develop international commitment and create a framework for countries to counter Iranian financial threat.

- In June 2007, the FATF issued initial guidance on the implementation of sanctions and finance-related provisions of UN Security Council resolutions related to proliferation activities in Iran, as well as the threat from other states and non-state actors.
- In September 2007, the FATF issued an annex intended to provide guidance on implementing targeted financial sanctions against financial institution, in particular, Bank Sepah, named in UNSCR 1747.



- In October 2007, FATF issued additional guidance on implementing activity-based financial sanctions identifying categories of high-risk customers and transactions on which financial institutions could focus their efforts. Risk factors include Iran-related customers or transactions, as well as transactions involving sectors that potentially produce the prohibited goods, among other factors.

UN Security Council Resolution 1803 welcomed the work of FATF and its efforts to provide guidance on how to implement targeted financial measure. Treasury will work with its counterparts within the FATF to continue these efforts.

### **C. Strategic Dialogue with the Private Sector**

We have also reached out to another important stakeholder: the international private sector. Since 2006, we have conducted an unprecedented, high-level strategic dialogue with the international financial private sector, meeting with more than 40 banks worldwide to discuss the threat Iran poses to the international financial system. Secretary Paulson initiated this effort in the fall of 2006 in Singapore during the annual IMF/World Bank meetings. Secretary Paulson met with executives from major banks throughout Europe, the Middle East, and Asia and discussed the various threats posed by Iran. Deputy Secretary Kimmitt, Under Secretary Stuart Levey and Assistant Secretary Patrick O'Brien continue to engage with these institutions abroad, as well as in Washington and New York. Through this outreach, Treasury has shared information about Iran's deceptive financial behavior and raised awareness about the high financial and reputational risk associated with doing business with Iran and the international financial institutions have taken action.

#### *Impact of U.S. Outreach Efforts to the Private Sector*

International financial institutions have responded to our message with action that reinforces governmental pressure on Iran. As evidence of Iran's deceptive practices has mounted, financial institutions and other companies worldwide have begun to reevaluate their business relationships with Tehran. Many leading financial institutions have either scaled back dramatically or even terminated their Iran-related business entirely. Many global financial institutions have limited their exposure to Iranian business by cutting off Iranian business in dollars but have not yet done so in other currencies. Regardless of the currency, the core risk with Iranian business – that you cannot be certain that the party with whom you are dealing is not connected to some form of illicit activity – remains the same.

#### *Importance of Private Sector and Targeted Financial Measure*

The private sector plays a central role in the implementation of our sanctions. Our ability to effectively communicate with the private sector about Iran has been essential to the success of Treasury's broader efforts. The private sector has been receptive in part due to Treasury's targeted financial strategy that we have increasingly used to combat Iranian threats as well as other threats to the U.S.

When we use reliable financial intelligence to build conduct-based cases, it is much easier to achieve a multilateral alignment of interests. It is difficult for another government, even one that is not a close political ally, to oppose isolating actors who are demonstrably engaged in conduct

that threatens global security or humanitarian interests. The private sector also reacts positively to the use of these targeted measures. Rather than comply with just the letter of the law, we have seen many in the banking industry voluntarily go beyond their legal requirements because they do not want to handle illicit business.

The private sector and Treasury share a common interest in protecting the international financial system from illicit conduct. Financial institutions want to identify and avoid dangerous or risky customers who could harm their reputations and business. And we want to isolate those actors and prevent them from abusing the financial system. Once some in the private sector decide to cut off companies or individuals we have targeted, it becomes an even greater reputational risk for others not to follow, and they often do. Such voluntary implementation in turn makes it even more palatable for foreign governments to impose similar measures because their financial institutions have already given up the business, thus creating a mutually-reinforcing cycle of public and private action.

By partnering with the private sector, including by sharing information and concerns with financial institutions, we are increasingly seeing less of a tendency to work around sanctions. In meetings with bank officials abroad, Treasury officials have learned that even those institutions that are not formally bound to follow U.S. law pay close attention to our targeted actions and often adjust their business activities accordingly.

## **Conclusion**

Financial measures are an integral component of U.S. and international efforts to counter Iran's threatening behavior. Through our authorities and our engagement with counterparts around the world, we are implementing a financial strategy that is having an impact. This impact will only be enhanced as the international community continues to crack down on Iran's illicit financial behavior through national action and through organizations such as the UN and FATF. The international financial system is becoming an increasingly challenging and unfriendly environment for Iran's illicit conduct. But it is important that we and our international partners keep up the pressure. This remains a top priority for the Treasury Department and we will continue to work closely with our colleagues in the State Department, foreign governments and international financial community to maximize the effectiveness of our efforts.

Thank you again for the opportunity to appear before you today. I look forward to any questions you have regarding my testimony.