Worth its wait in gold? Frustration greets optimism for trade with Iran

Ibtissem Lassoued - Partner, Co-Head of White Collar Crime & Investigations - White Collar Crime & Investigations / Family Business

i.lassoued@tamimi.com - Dubai International Financial Centre

Almost two years after Implementation Day on 16 January 2016, time is beginning to tell a story of disappointment for the Joint Comprehensive Plan of Action (JCPOA) between the EU+3 Powers and Iran. Early promises of access to a market that had been locked away for the best part of a decade have failed to materialise; businesses are still unable to exploit the full potential of Iran's sizeable market, for various reasons. Trade opportunities continue to be an elusive reality as businesses face the dual obstacles of a complex compliance environment and volatile political conditions. Now more than ever, businesses are operating in a climate of confusion, and the initial optimism surrounding the deal's impact has given way to simmering frustration.

But in spite of the prevailing difficulties, there is still a tangible appetite to trade with Iran. For now, the key to reaping the benefits of Iran's market is to outlast the current difficulties; businesses must be willing to win the waiting game.

Global Derisking

In large part, the JCPOA's difficulties in facilitating trade lies in the complexity of the remaining regulatory framework. Various sanctions measures left in place, misalignment between US and EU approaches to trade, and onerous compliance standards form a convoluted web of considerations for any venture involving Iranian parties. In most instances, this nebulous regulatory environment is viewed as an insurmountable hurdle, and efforts to initiate trade agreements are stymied.

Under the terms of the JCPOA, Iran has not been granted complete relief from sanctions. The UN, EU and US still maintain differing lists of restricted individuals and entities, whilst US persons are still subject to a full range of primary sanctions unilaterally imposed by the Office of Foreign Assets Control (OFAC). The lack of alignment between US and EU regulations makes it particularly difficult for international companies to disentangle their compliance requirements. Moreover, attempts to conduct the necessary enhanced due diligence face additional difficulties in identifying Iranian beneficiary parties; well-known challenges include a lack of transparency and complex company ownership structures, as reported by the International Monetary Fund (IMF).1

Not only are the remaining prohibitions difficult to comply with, but parties face huge fines should any number of violations occur. Subject to the jurisdiction, the currency of transaction and the precise nature of the activity, previous fines have reached crippling sums. Though intended as a deterrent against illicit behaviour, the fines seem to have acted as a deterrent against all forms of trade.

Navigating regulations is made significantly harder by the limited extent of guidance available regarding the permissibility of trade. Even the Financial Action Task Force (FATF), which includes Iran as a high-risk jurisdiction for Anti-Money Laundering (AML) and Counter Terrorist Financing (CTF) deficiencies, provides broad brush advice to continue conducting enhanced due diligence. Whilst the inclusion of Iran's status on the FATF agenda provides limited insight to regulatory conditions, it remains challenging to predict how long the current situational stagnation will prevail.

Even in instances where trade appears to be permitted, the cost of compliance measures can outweigh the perceived benefit of trade. Due diligence and other administrative requirements can be costly and further mitigate the will to initiate business relationships.

These factors combine to create an effective blockade against trade; less of an obstacle and more a seemingly unassailable wall. Perhaps unsurprisingly, major banks now overwhelmingly defer to a derisking strategy, avoiding all ventures that expose them to the risks associated with Iranian parties, In essence, the viability of trade with Iran is fundamentally compromised by the very measures that are designed to protect and foster business relationships.

The impact of this trend is easily recognised in Iran's record of correspondent banking relationships (CBRs), which are a crucial mechanism for international financial inclusion. The IMF has identified the damage to Iran's CBRs as a significant impact of the sanctions measures over the past decade; between 2006 and 2014, the total number of CBRs reduced from 633 to 50. By the end of 2016 the total had reached 238; still a fraction of the total that existed before sanctions programs were initiated and absent the involvement of any major international banks.[2].

Right in the Middle of It – The Regional Perspective

At a regional level, businesses operating in the Middle East are subject to the same guidelines as many of their international counterparts outside of the US. The Middle East and North Africa Financial Action Task Force (MENAFATF is the regional mechanism for implementing FATF recommendations, so high-level guidance does not depart from the reserved position of the international body. With the UN Resolution 2231 (2015) endorsing the JCPOA and lifting measures previously imposed by the Security Council, businesses operating in local markets are only required to contend with the extraterritorial application of US sanctions and listed entities and/ or individuals.

Alignment in regulatory conditions means that the Middle East has not been immune to trends shaped at the international level. Derisking practices and confusion are as pervasive in regional markets, and the issues are often further compounded by the delicacy of regional political dynamics. The heightened difficulties are apparent in trade statistics; the UAE, for example, has experienced a reduction in foreign trade with Iran by more than 10% year on year since 2014.[3] Moreover, Middle East-based banks constitute a noticeably minor proportion of those engaging with Iranian financial institutions.

In the face of these challenges, there is some limited evidence of slow progress. These breakthroughs signify that trade is possible despite the difficulties, and help to preserve optimism regarding future trade.

Stirring the Political Pot

Escalatory rhetoric from President Trump has aggravated US relations with Iran and stirred speculation over the immediate future of the deal. Imminently possible outcomes range from conservative expectations of continued adherence to the deal by all parties; to more destructive moves including the US' unilateral withdrawal from the deal, re-imposition of "snap-back" sanctions and the subsequent collapse of all terms. Each possible scenario on the spectrum would have different implications for the permissibility of business involving Iran, and the state of political volatility has compounded a collective sense of intense uncertainty. Embarking on high risk ventures in the face of such instability is anathema to business, and opportunities to trade with Iran face further inhibition.

Conclusion

The limited instances of success that have surfaced since the signing of the JCPOA are insufficient to mitigate the overwhelming trend towards derisking. The confusion and frustration that characterise the current Iranian foreign investment climate will likely endure until there are substantive changes to the regulatory framework, or effective guidance is provided to businesses with an appetite for high risk ventures.

Impending developments regarding the status of the deal may play a significant role in redressing the balance between frustration and optimism for prospective investors. Recent events, including President Trump's announcement on 12th January 2018 that he would set a four month deadline on the deal, has cast the JCPOA's future into disquietude, as EU countries stand fast behind the agreement and the extent of the US' ability to effect unilateral change remains unclear. However, in the event that the deal is forced to undergo renegotiation or else collapse entirely, regulatory institutions should capitalise on the opportunity to clarify their position and issue substantive guidance for businesses and banks alike.

Iran's market is the second largest in the Middle East, behind only the Kingdom of Saudi Arabia, and has the potential to be a veritable gold mine for savvy investors. If businesses from the region and beyond can sustain their optimism for progress, they may well be rewarded with untapped opportunities that far eclipse the struggles of the current climate. This article was previously published in WorldECR; a specialist international journal covering sanctions and trade issues. *To view the original article or for more information on the journal, visit www.worldecr.com, or for any queries relating to sanctions please contact Ibtissem Lassoued at i.lassoued@tamimi.com*

1. https://www.imf.org/~/media/Files/Publications/PP/031617.ashx

2. https://www.imf.org/~/media/Files/Publications/PP/031617.ashx

3. http://www.economy.gov.ae/english/Knowledge-Section/TradeRelations/Pages/default.aspx