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Implementing the Iran Nuclear Deal

Balancing Proliferation Finance Risk and
Economic Opportunity

Emil Dall, Andrea Berger and Tom Keatinge



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Foreword

Despite having been implemented for just under a year, the Joint Comprehensive Plan of Action (JCPOA)'s existence has already been eventful. No development has been as important – or as unexpected – as Donald Trump's victory in the 2016 US presidential election, which took place after this paper was written. His win, together with the uncertainties around major cabinet appointments and the behaviour of a Republican-controlled Congress, place question marks over a large swathe of US foreign policy, including the JCPOA. The deal and wider US-Iranian relations appear to be headed for trouble. With perhaps the exception of the North American Free Trade Agreement, no agreement to which the US is party received as much attention from Trump during his campaign. The JCPOA, according to the next US president, is 'the worst deal ever negotiated'.¹ Trump has vowed to dismantle the agreement while on other occasions stating his intention to negotiate a better deal and 'police that contract so tough'.²

With this in mind, the JCPOA could follow one of several pathways in the months after Trump takes office on 20 January 2017. The new president may seek to swiftly deal it a death blow, as he has so frequently threatened to do, possibly with the support of a sizeable number of Republicans in Congress. Alternatively, the Trump administration could wilfully neglect the procedures needed to keep the US in compliance, by failing to continue to authorise the waivers required to keep certain US sanctions lifted, for example. He could make the continued lifting of US sanctions contingent on Iran's willingness to return to the table to renegotiate the agreement – a move which may not find a receptive audience in an Iran facing elections in May 2017 or in partner nations in Europe. Or he may simply deprioritise the deal and its upkeep, exacerbating the frictions that have already emerged and are described in this paper.

What is certain is that any of these potential trajectories are unlikely to involve active efforts by the Trump administration to encourage permitted trade and financial re-engagement with Iran, or to work through the implementation challenges that already exist. Both actions are critical to the success of the JCPOA, as described below. The dynamics outlined in this paper will thus remain an integral part of any discussion of the JCPOA's future – and of the broader counter-proliferation finance agenda – after Inauguration Day.

1. Yeganeh Torbati, 'Trump Election Puts Iran Nuclear Deal on Shaky Ground', *Reuters*, 9 November 2016.
2. *Ibid.*

Implementing the Iran Nuclear Deal: Balancing Proliferation Finance Risk and Economic Opportunity

In the past five years, sanctions have isolated Iran from much of the global economy, particularly the financial system. From a policy standpoint, this was done in service of an overarching non-proliferation objective. Financial sanctions put pressure on Iranian decision-makers by showing them that their nuclear development comes at a substantial cost. They also increased global vigilance over attempts by Iran to evade detection and process payments needed to access critical goods for its nuclear and missile programmes. It is not surprising that, if the application of financial sanctions against Iran affected the non-proliferation discussion, lifting them does as well.

The issue of Iran's access to the financial system is now proving to be a critical component of the overall health of the Joint Comprehensive Plan of Action (JCPOA), which was formally implemented on 16 January 2016. The JCPOA requires Iran to restrain its nuclear programme and increase international oversight of it, in return for the lifting of UN, EU and US sanctions that had been put in place over the nuclear issue. Almost a year after it came into effect, not all the aspects of the agreement (and the non-proliferation objective it serves) are fully operational. These dynamics have wider repercussions, including on the global discussion over counter-proliferation finance (CPF) initiatives.

A review of the relationship between the JCPOA and this CPF agenda is both timely and necessary. This paper considers how financial institutions have approached the lifting of specified Iran sanctions, and what this means for efforts to counter proliferation finance. It highlights that financial institutions of different sizes and with varying global reach have approached re-engagement with Iran in different ways, mostly as a result of their continued sensitivities to remaining US sanctions. This paper also identifies a concerning trend: with the majority of UN and EU sanctions against Iran now gone, as well as US secondary sanctions affecting non-US companies doing business with Iran, it is becoming more difficult to mobilise and direct a concerted global effort to counter proliferation financing. This challenge must be borne in mind as states seek to revive an international discussion over the future of CPF initiatives.

The CPF Conversation after the Iran Deal

Since 2008, the Financial Action Task Force (FATF), the global standard-setter for countering financial crime, has pursued initiatives to counter proliferation finance. Its decision to add this new element to its portfolio was governed by the view that proliferation finance was an issue warranting continued and coordinated international attention and leadership. Based on this understanding, FATF members undertook a series of studies designed to address the repeated successes of proliferators such as Iran and North Korea in finding finance to facilitate their trade in sensitive goods. Honing in on the financial aspect of procurement was seen as vital in unravelling the complex global networks through which proliferators operated.

In 2012, FATF adopted recommendations that encouraged its members to counter proliferation finance in addition to countering terrorist financing and money laundering, which members were already expected to do. The inclusion of proliferation finance as a threat in its own right raised awareness of the issue among governments and the financial institutions on the front line of efforts to counter financial crime.

Rather than focusing on proliferation financing activity more broadly, which was the original objective of some FATF member states, FATF agreed to adopt Recommendation 7, which is concerned only with the implementation of proliferation-related targeted financial sanctions at UN level¹. This definition was arrived at as a result of some FATF member states arguing stridently that activity-based requirements would be impossible to implement in practice.² Between 2012 and January 2016, when the Iran deal was implemented, this was generally understood to include the targeted financial sanctions regimes imposed against Iran and North Korea, which FATF members were already obliged to comply with as members of the UN. Proliferation-related sanctions on Iran at the US and EU level were much broader, and sought to address Iran's nuclear programme by cutting off Tehran's access to critical financial services and closing its European markets for energy products, among other things.

In reaction largely to actions by the US and EU, financial institutions with an interest in preserving their connectivity to Western markets adopted a risk-based view of the Iranian situation after

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1. Countering proliferation finance (CPF) was also added to Recommendation 2 focusing on developing 'effective mechanisms' for government units to cooperate and coordinate policies and activities to counter a number of financial crime risks, including proliferation finance.
 2. RUSI's research found that the debate over what CPF requirements should be pursued in the FATF context was divided in two camps: 'those who believe that in order to be countered effectively, proliferation finance must be addressed on an activity basis rather than an individual entity, country or goods basis; and those who are sceptical that this is possible for financial institutions'. RUSI's interviews identified the US as being clearly in the former group: 'Washington recognises that only screening against sanctions lists for Iran and North Korea ... will never sufficiently cover the extent of contemporary proliferation threats'. In the other camp is Germany, which argued against activity-based requirements: 'As a country with a large manufacturing base and extensive trade, it was reluctant to condone onerous CPF obligations on top of those already in place for other forms of financial crime, which could as a whole hamper the global competitiveness of the German export community'. See Emil Dall, Andrea Berger and Tom Keatinge, 'Out of Sight, Out of Mind?', *Whitehall Report*, 3-16 (June 2016), pp. 6-7.

2012. Given the sanctions landscape, particularly the large fines with which the US government was enforcing its regulations, most of these financial institutions opted to completely sever ties with Iran. They were at the same time alert to the prospect that Iranian individuals and entities would seek to circumvent restrictions by accessing their services in other ways, such as by establishing front companies outside Iran. It was these general evasive attempts – not proliferation finance specifically – that banks and insurance firms directed their compliance teams to identify and root out in relation to Iran. Consequently, most financial institutions in Europe and elsewhere did not devote energy to honing their understanding of, and ability to detect, proliferation finance. Indeed, consistent with FATF Recommendation 7, they believe they are countering proliferation financing by focusing on the implementation of sanctions. While sanction evasion and proliferation finance are overlapping risks, they are not synonymous. The majority of global proliferation networks are not formally sanctioned, instead employing deceptive practices designed to avoid any obvious connection to sanctioned parties, as such links are likely to result in impediments to their illicit business.

Since the conclusion of the JCPOA, the Iran-related policies of financial institutions have started to diverge, as will be discussed in greater detail below. Some have re-engaged with Iranian business, while others have refused, much to the chagrin of the Iranian and Western leaders who recognise that the JCPOA must yield economic dividends if Tehran is to remain committed to it. The picture is consistent in one sense, however: the majority of financial institutions globally have yet to make efforts to develop measures to counter proliferation finance as a distinct form of financial crime.

In fact, interviews with financial institutions show that the JCPOA promoted the misleading conclusion that Iran no longer poses a proliferation threat, and has thus made it more difficult to engage in conversations with financial institutions over proliferation financing risks. However, Iran is still prohibited from procuring missile-related goods, and from buying sensitive nuclear technology outside an agreed procurement and licensing channel. Should Iran engage in either of these activities, it is likely to do so using sophisticated evasion techniques that allow it to access the global financial system and circumvent the policies of banks that still refuse to engage with it. Banks that are willing to process Iranian business may not be as vigilant as necessary because of the apparently widespread belief among many banks that the Iranian proliferation threat has been neutralised. From a financial crime compliance perspective, it is a much more daunting task to mitigate risk under a policy that supports engagement with Iran than one that rejects it. Now, more than ever, these institutions need to understand and focus on the specific proliferation financing activities that are still prohibited.

Rather than ignoring past global experiences with Iranian proliferation financing, now is the time to discuss them in order to better counter any future illicit proliferation financing activity should it happen. In recent years, many proliferation financing cases involving Iran have been identified by financial institutions, acted upon by governments and prosecuted in the courts. Learning from these cases could help to build knowledge on the specific signatures of proliferation finance that make it different from other forms of financial crime, and what can be done to combat it specifically. This presents an opportunity to ensure that international attention on

proliferation financing does not disappear in the slipstream of the Iran agreement, especially at a time when proliferation remains a significant threat, particularly in relation to North Korea.

Another challenge that has been brought to light since the JCPOA was implemented concerns the international standards on CPF, which are now in urgent need of updating. As previously mentioned, FATF's standard focused only on the implementation of targeted financial sanctions imposed at the UN-level against Iran and North Korea, and not proliferation financing activity more generally. The standard also excluded other proliferation finance requirements contained in other resolutions (namely UN Security Council Resolution (UNSCR) 1540, which concerns proliferation threats from all non-state actors) despite proliferation finance activity going well beyond the few entities and individuals designated in UN sanctions lists. Moreover, when new entities or individuals become designated, they alter their practices to conceal their involvement. Most banks have already been implementing UN targeted financial sanctions, and FATF-directed requirements on CPF have done little to alter the practices of financial institutions in relation to the wider activity-based aspect of proliferation finance.

UNSCR 2231 implemented the terms of the JCPOA on a universal scale. It terminated all prior UN sanctions resolutions relating to Iran's nuclear programme and replaced them with new restrictions on the development of ballistic missile and conventional weapons trade, which Iran is still prohibited from pursuing for another seven years under the JCPOA. At Iran's insistence, the restrictions encompassed in UNSCR 2231 are not imposed under Chapter 7 of the UN Charter, and therefore do not constitute 'sanctions' as traditionally understood. As a result of this departure from standard practice, confusion over the scope of the FATF Recommendations relating to proliferation finance has emerged. Some assume that the change in UN legal authority in UNSCR 2231 means that FATF Recommendations covering 'targeted financial sanctions' no longer include that resolution. This should not be the case, and this assumption demands swift clarification by FATF. FATF should update its guidance relating to its proliferation financing requirements to specify that UNSCR 2231, and the missile and conventional weapons restrictions it covers, falls within its scope. In the absence of such a change, it will become progressively more difficult to use the FATF standards as the basis for any useful conversation about what CPF measures should look like in practice.

Divergent Approaches to CPF

In the global financial sector there is now a spectrum of policies on the issue of Iranian engagement. All approaches have important implications for efforts to advance international non-proliferation objectives in relation to Iran.

On Implementation Day, many of the on-paper impediments to Iran's formal reconnection to the international financial system disappeared, especially in jurisdictions outside the US. The continuation of the US trade embargo introduced decades ago means that US banks are still prohibited from conducting Iranian business. Elsewhere, most formal restrictions, including sanctions on Iranian access to the Society for Worldwide Interbank Financial Telecommunications

(SWIFT) payment messaging system, no longer exist.³ The change was greeted with the assessment that Iran would be the 'largest economy to re-enter international markets since the fall of the Soviet Union'.⁴ In the three months immediately following Implementation Day, it was reported that '64 trade delegations comprised of 837 foreign businessmen and officials from 28 countries visited Iran' to scope out potential business deals.⁵ President Hassan Rouhani himself led a delegation of 120 Iranian officials and business leaders on visits to Italy and France in January 2016, resulting in the signing of several billion dollars-worth of deals.⁶ Central to the feasibility of any deal, however, is finance.

Nearly one year since the JCPOA was formally implemented, the landscape of financial re-engagement with Iran is extremely uneven, both along geographic lines and – within Europe especially – in terms of the size and international reach of the financial institutions in question.

Financial linkages are being most actively rebuilt or expanded outside the US and Europe, including with the endorsement and assistance of host governments. South Korea, in an attempt to help companies send and receive now-legal payments to and from Iran, has established a payment channel for all such transactions. The payment channel is euro-denominated and all transactions enter and leave South Korea through a specified bank.⁷ India used to have a similar arrangement whereby a designated bank would handle limited Iranian oil transactions that took place under sanctions, but since the JCPOA the government has encouraged involvement from the wider Indian financial sector.⁸ Japan has also recently encouraged cooperation between its domestic banks and Iranian counterparts.⁹ Banks in these jurisdictions have not been as frequent a target of penalties imposed by the US Office of Foreign Assets Control as European banks. Paired with the clear and public support of their host governments, who have created dedicated channels to mitigate risk, this fact has meant that Iranian business is within the risk appetite of financial institutions in many non-Western countries. Partly as a result of such initiatives, it was recently reported that the volume of foreign investments in Iran was expected to increase sixfold during the first year of implementation of the JCPOA.¹⁰

Though these developments are significant, Tehran's eye remains fixed on Europe. Its interest in trade ties with the continent is longstanding; among other things, Europe has been a major customer of Iranian energy products and a source of important manufactured goods. Yet,

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3. While Iran was reconnected to the international messaging service for processing financial transfers between financial institutions (SWIFT), a few Iranian financial institutions continue to be sanctioned under non-nuclear sanctions regimes.
 4. Hannah Murphy, 'Iran is Back in Business', *Financial Times*, 29 January 2016.
 5. *Tehran Times*, '16 Trade Delegations Visit Iran in First 3 Post-Sanction Months', 3 May 2016.
 6. Antonella Cinelli and Crispian Balmer, 'Deals and Warm Words Flow as Iran President Visits Europe', *Reuters*, 26 January 2016.
 7. *Iran Daily*, 'Seoul to Launch Euro-Based Payment Framework Trade with Iran', 12 July 2016.
 8. Pradipta Mukherjee and Anto Antony, 'End of Iran Sanctions Signals Tougher Times for India's UCO', *Bloomberg*, 19 September 2016.
 9. *Press TV*, 'Iran, Japan Banks Cooperating by Using Yen', 5 October 2016.
 10. *Press TV*, 'Iran Expects \$12bn in Foreign Investments', 13 November 2016.

despite Iran's keen interest in reviving business with Europe, the European financial sector is divided over the proposition.¹¹

Domestic or Regional European Financial Institutions

European banks with most of their operations in Europe have gradually been willing to undertake business relationships with their Iranian counterparts. However, their often smaller size means they are unable to support the big-ticket or more complex and comprehensive financial arrangements Tehran seeks.¹² Some have limited themselves strictly to smaller transactions in and out of Iran in support of facilitating trade, while others have committed to short-term, small credit lines. Some are processing Iranian transactions only for existing clients, while others are taking on new clients interested in Iran as long as those clients agree to host their non-Iran business with the financial institution as well.

Iran's central bank has acknowledged that smaller, regional banks are more willing to engage, and claims it has started relationships with 'two hundred small and medium-sized international banks' since the implementation of the JCPOA.¹³ These reportedly include financial institutions in Germany (Europäisch-Iranische Handelsbank, DZ Bank), Belgium (KBC), Austria (Oberbank, Erste Bank, Raiffeisen Bank) and Italy (Mediobanca, Banca Popolare di Sondrio).¹⁴ Some of these banks have been encouraged by their governments to seek such engagement. For example, in September 2016, the then Italian Prime Minister Matteo Renzi announced that the state export credit agency, Sace, would begin issuing assurances and guarantees to all Italian banks doing business with Iran in order to offset potential risks.¹⁵

As domestic and regional banks seek to re-engage with the Iranian business and financial sectors, proliferation financing risks should remain a consideration. Most have not experienced the multi-billion dollar, US-imposed fines or restrictions on operations visited on their larger, globally operating European counterparts for past sanctions transgressions. They are not encumbered by necessary remedial action or continued operational restrictions imposed by regulators and are therefore free to develop engagement strategies for dealing with Iranian business. Furthermore, in contrast to the banks operating on a global scale, for whom US banking licences are key to their business models and profitability, domestic banks feel far less existential pressure on their actions.

11. European companies will generally stick to their preferred financial institution in their preferred home jurisdiction to process transactions. For European companies to process their Iran-related business through financial institutions located outside Europe would prove a burdensome and costly operation.

12. Smaller banks do not have the same capital available as larger banks, and are therefore unable to offer financing or credit lines for extended periods of time or for substantial amounts.

13. Tom Arnold and Bozorgmehr Sharafedin, 'Small Banks Help Iran Slowly Restore Foreign Financial Ties', *Reuters*, 15 June 2016.

14. Information obtained via BBC Monitoring using search perimeters of "'COUNTRY X' and 'IRAN' and 'BANK'".

15. Najmeh Bozorgmehr and James Politi, 'Italy Extends \$5bn Credit Line and Export Guarantees to Iran', *Financial Times*, 12 April 2016.

Their size also means they are unlikely to have the resources to commit to a large compliance operation that might take them beyond the mandatory screening for entities and individuals found on sanctions lists, and instead engage in broader measures to counter proliferation financing activity. As previously mentioned, proliferation financing is carried out by more individuals and entities than appear on sanctions lists. These financial institutions will thus need to ensure that, as they re-engage with Iran, they develop sufficient knowledge of the continued risks (such as Iranian missile-related trade) and how they might affect their business in practice.

Specifically, it will be crucial for financial institutions to explore what procedures and documentation will be associated with the designated procurement channel that has been set up under the JCPOA to facilitate sales to Iran of sensitive nuclear goods. Under this channel, certain dual goods and sensitive technology, which may now be legally procured by Iran, will have to go through a designated procurement process and be accompanied by appropriate documentation. Currently, most banks providing trade finance services already look for export licences for sensitive and dual-use materials, including those related to the nuclear industry. However, banks now need to consider whether their current approaches and checks meet the requirements of this new procurement channel. This is something that has yet to play out in practice: bureaucratic delays have meant that the procurement channel has only recently been fully established, and only one licence application has so far been submitted (it was subsequently withdrawn).¹⁶ The system has therefore yet to be tested by the financial institutions that will ultimately facilitate the transactions in support of the procurement channel. Governments should thus consider outreach to financial institutions to discuss what the procurement channel might mean for their trade finance compliance procedures (even if there is no significant change).

Globally Operating European Financial Institutions

European financial institutions with global operations have generally refused to re-engage with Iranian businesses and banks since Implementation Day. Informal conversations suggest that some have considered processing limited transactions with Iran for longstanding, trusted customers. However, the general picture is that these so-called Tier 1 banks feel the potential risks of engaging with Iran currently offset any perceived potential economic benefits, particularly when weighed against the value these banks place on continued access to the US market. In contrast to domestic and regional European financial institutions, global institutions have significant operations in the US and fear remaining US sanctions, which have previously resulted in substantial penalties for globally operating European banks deemed to be non-compliant with US regulations.¹⁷ As part of these settlements, some banks are subject to Deferred Prosecution Agreements with US authorities, under which they are strictly monitored

16. Bureaucratic delays have occurred on both sides in identifying the relevant entities responsible for leading activities under the procurement channel process, as well as ensuring that all such arrangements were in place prior to the first applications being submitted.

17. RUSI's previous research found that 'any impetus among FIs [financial institutions] to do more on CPF or related sanctions evasion, where it exists at all, was found to be largely motivated by fear of incurring penalties from vocal US enforcement agencies wielding large sticks', while governments 'around the world have been forced to grapple with the tangled web of incentives and disincentives created by the global reach of US secondary sanctions and enforcement

to ensure that standards are raised and no further transgressions occur. As a result, global banks continue to avoid Iran-related business.

Under the JCPOA, financial transactions to and from Iran may still not involve US persons or entities. Until recently, transacting in US dollars was also believed to be off limits. However, in October 2016, the US Treasury clarified that foreign financial institutions would be able to process US dollar transactions for Iranian clients – although such transactions may not, at any point, enter the US financial system. This is a difficult task for many globally oriented European financial institutions with a significant presence in New York that they would not want to jeopardise. It is standard custom among most banks to route all payments in US dollars through US-based correspondent accounts, even if the transaction does not involve US persons or clients. Even when transactions are not conducted in US dollars, most major European financial institutions still employ many US persons, or have interests that are owned by US parent companies. Those US persons may also not conduct business with Iranian entities, in line with US primary sanctions. However, the US Treasury has advised that it does allow those institutions to conduct business with Iran as long as the US persons or interests are ringfenced from the Iran-related part of the business. Such requirements are almost impossible for multinational banks to implement. Rather than instilling confidence, the clarification makes institutions so sensitive to the point that they choose not to re-engage.

Adding to the risk-aversion of European financial institutions with a global outlook is the fact that a number of Iranian entities and individuals remain sanctioned under the JCPOA, and under US and EU authorities addressing other issues (such as Iran's support for terrorism). One of the major concerns is the Iranian Revolutionary Guards Corps (IRGC), which remains sanctioned for its role in other prohibited activities. The IRGC maintains a significant presence throughout the Iranian economy, and controls or part-owns many Iranian businesses, particularly in the construction and infrastructure industries.¹⁸ Banks choosing to engage with Iran must ensure that these sanctioned parties are not involved in, and do not benefit from, the transaction. In light of the complexity of this task, the US recently issued further guidance, stating that non-US financial institutions are not prohibited from conducting transactions with entities that are minority owned or controlled 'in whole or in part' by a still-designated organisation, such as the IRGC. However, the guidance also states that the US 'recommends exercising caution when engaging in transactions with such entities' and warns that 'screening the names of Iranian counterparties against [sanctions lists] ... would generally be expected, but that is not necessarily sufficient'.¹⁹ The situation has gone from one of simplicity and clarity before the JCPOA, to one of mixed and often contradictory messages, leaving banks uncertain about what exactly is expected of them, and most importantly, what they are not allowed to do as sanctions have been unwound.

action, which continue to affect the behaviour of local financial institutions'. See Dall, Berger and Keatinge, 'Out of Sight, Out of Mind?', pp. 12, 14.

18. Robert D Hormats, 'Post-Sanctions Economic Opportunities and Risks in Iran', Atlantic Council, February 2016.

19. 'Frequently Asked Questions Relating to the Lifting of Certain U.S. Sanctions Under the Joint Comprehensive Plan of Action (JCPOA) on Implementation Day', OFAC, issued on 16 January 2016, updated 7 October 2016.

It is important to note that sanctions are not the only reason why European financial institutions have been cautious to re-engage with the Iranian economy. Dealing with Iran, even without sanctions, continues to carry exposure to general financial crime risks. Iran has long been identified as one of two (with North Korea) 'high-risk and non-cooperative' jurisdictions with actions put against them by FATF.²⁰ The country has also been ranked as the highest-risk country in the world for money laundering by the Basel Institute on Governance in 2016,²¹ and has ranked consistently low on Transparency International's Corruption Perceptions Index.²² FATF recently removed certain restrictions against Iran for one year to encourage financial institutions to re-engage with the country and to allow Iran the opportunity to improve upon its record.²³ However, it remains possible that when the temporary removal of restrictions expires in June 2017, Iran will again be classified as a high-risk jurisdiction under FATF, with all the restrictions this brings.²⁴ Furthermore, the structure of the Iranian economy makes it a challenging environment for doing business more generally – it is placed 120th on The World Bank's ranking of economies based on how business-friendly they are.²⁵ This is merely another layer of undesirable risk for financial institutions. These rankings all point to the lack of transparency in the Iranian economy, and Western businesses will enter an environment with poor property rights, intricate corporate structures and a legal framework that is generally not conducive to risk-free business.

Reluctance by some European financial institutions to engage in Iranian business affects the non-proliferation objectives that compelled the P5+1 (the five permanent members of the UN Security Council, plus Germany) to negotiate and conclude the JCPOA in two ways. First, as business between Iran and Europe is redirected through smaller institutions with narrower compliance capabilities, a greater portion of the proliferation finance risk associated with Iran is redirected as well. Second, the deal – and the non-proliferation achievements contained in it – may be in jeopardy if the Iranian leadership does not begin to see the economic revitalisation that is at the heart of the bargain. Access to finance to facilitate the large, multi-year trade deals that Iran is working hard to negotiate will be essential in that respect.

The Risk of Financial Engagement Failure

Thus Iran's return to the global market has been slow and Tehran has on several occasions expressed dismay at the lack of perceived benefit from the sanctions-lifting process. Since Implementation Day, Iran has been vocal in criticising the US and its European partners for failing to implement the deal 'in good faith' as promised. For Tehran, this means ensuring sanctions are lifted in a way that encourages European financial institutions to re-enter the Iranian market. In

20. FATF, 'High-Risk and Non-Cooperative Jurisdictions', <<http://www.fatf-gafi.org/countries/#high-risk>>, accessed 1 December 2016.

21. Basel Institute on Governance, 'Basel AML Index 2016', 27 July 2016.

22. Transparency International, 'Corruption Perceptions Index 2015'.

23. Tom Keatinge, 'Snapback, FATF-style: Counter-Measure Suspension Unlikely to Address Core Banking Issues', *RUSI Commentary*, 1 July 2016.

24. Aniseh Bassiri Tabrizi, Andrea Berger and Emil Dall, 'The Iran Deal One Year On: A Snapshot', *RUSI Commentary*, 15 July 2016.

25. The World Bank, Economy Ranking, <<http://www.doingbusiness.org/rankings>>, accessed 2 December 2016.

September 2016, Rouhani addressed the UN General Assembly, criticising the US for its 'failure to adhere to obligations under the agreement'.²⁶ He has previously threatened that the future of the Iran agreement hinges on the proper implementation of those obligations.

Many Western politicians fear that, if the economic benefits to Iran are not forthcoming, the deal may collapse. While Tehran continues to support the agreement, Rouhani is facing elections in May 2017 and is under domestic pressure to demonstrate that the deal is yielding tangible benefits for Iran. In July, Speaker of the Iranian Parliament, and a leading conservative in the country, Ali Larijani stated that 'if sanctions are not to be lifted and banking transactions are not done, there will be no reason to go on with the agreement'.²⁷

Leaders in the US and Europe have been fighting to ensure that this situation does not transpire. In February 2016, the then prime minister David Cameron wrote a personal letter to Barclays after the bank refused to process a payment on behalf of a British lubricant company wanting to sell its products in Iran. Cameron made it clear to the bank that its policies were 'in direct opposition to the policy of the EU and UN, as well as in opposition to the policy of the UK government'.²⁸

Similarly, US Secretary of State John Kerry met representatives from European financial institutions in May 2016 in an effort to persuade them 'that doing Iran-related business is not only permitted ... but is actually encouraged'.²⁹ In a response to Kerry's outreach efforts, HSBC Chief Legal Officer Stuart Levey argued that it was an irony for Washington to be 'pushing non-US banks to do what it is still illegal for American banks to do' while at the same time producing 'no assurances as to how such activity would subsequently be viewed by US regulatory and law-enforcement authorities'.³⁰ For the bank, there is an apparent disconnect between the rhetoric of Western officials championing a foreign policy objective, and the enforcement actions of US regulators which shape the thinking on the risks of financial re-engagement with Iran.

The diplomatic aim is clear: by fostering new business and trade relationships with Iran, it will be opened up to the world and, over time, the risks of partnering Tehran will be reduced. However, for financial institutions, this equation works in reverse: as long as Iran continues to be considered risky territory, they prefer to disengage. Only when the risk reduces or disappears does engagement make sense. The business perspective, therefore, directly discourages and conflicts with the process of engagement sought by diplomats. It should thus come as no surprise that both HSBC and Barclays publicly stated that they have no intention of opening up business relationships with Iranian counterparts now or in the near future.

26. Rick Gladstone and Thomas Erdbrink, 'Iran's President Accuses U.S. of "Lack of Compliance" on Nuclear Deal', *New York Times*, 21 September 2016.

27. *Islamic Republic News Agency*, 'Larijani: JCPOA Not Needed Without Sanctions Removal', 19 July 2016, <<http://www7.es.irna.ir/en/News/82154757/>>, accessed 13 December 2016.

28. Martin Arnold, 'Europe's Banks Begin Tentative Return to Iran', *Financial Times*, 3 April 2016.

29. Stuart Levey, 'Kerry's Peculiar Message About Iran for European Banks', *Wall Street Journal*, 12 May 2016.

30. *Ibid.*

Conclusion

The JCPOA with Iran is a landmark agreement that has instilled confidence in the international community that Iran's nuclear programme will no longer contain military objectives. It is, therefore, a laudable deal that carries important non-proliferation objectives, and governments around the world should do all they can to uphold it. However, finance is currently a critical part of making the agreement work for all parties, and Tehran will expect to see tangible economic benefits if it is to stick to its side of the bargain.

Currently, the landscape of financial re-engagement is uneven. On the whole, many financial institutions outside Europe have been forthcoming in re-engaging with Iran, particularly when they are supported by the governments that regulate them. Within Europe, smaller banks appear to have the same appetite for limited re-engagement, while larger banks have stubbornly refused to engage. They maintain a global footprint and strong links to the US market, and are wary of remaining US sanctions and the general risk Iran presents from a business perspective. They have vocally ignored political pleas from US and European leaders, who know that engagement by large European financial institutions is the critical component in keeping the Iran deal alive.

This part of the post-sanctions puzzle is threatening to undermine the implicit bargain made in the JCPOA: that nuclear concessions by Iran will revitalise the Iranian economy through trade. Without access to sufficient finance, that may be impossible, especially since the EU is the partner with which Iran would most like to restore economic ties.

Finally, although finance affects the survival of the deal, the JCPOA itself has affected wider initiatives on countering proliferation finance. The deal has caused many to forget about the risk posed by proliferation financing, and to no longer consider it a risk to their business. This is complicated by the continued poor understanding of proliferation finance, among financial institutions on the front line of defence and the governments that regulate them. Financial institutions do not know what to look for, and thus are unaware that risks remain. Governments need to ensure that international standards, particularly those of the Financial Action Task Force, are up to date, relevant and issue sound guidance to financial institutions. Financial institutions need to ensure they are devoting the attention and consideration that the proliferation finance threat deserves, especially if they face higher risk by virtue of engagement in Iranian business.

Now is the time to reinvigorate international momentum and focus on crafting practical and realistic approaches to detecting and combating proliferation finance. Both governments and their financial sectors need to be part of that effort.

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