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Doing Business in Iran: the banking bottleneck

By Shahram Safai | 23 May 2016

Tensions in the Middle East have continued into 2016 as conflicts among global powers and regional powers play out in the region. But 2016 is also the year of hope – the year when peace may begin in Syria and Yemen. This is also the year that the UAE has appointed a Minister of Happiness, and even more relevantly, a Minister of Tolerance. Given such prospects of hope across the region, businesses should be considering whether previous challenges in the region can be transformed into opportunities. One such challenge and opportunity is Iran. The promise of the Iranian market is so alluring that a number of businesses from regional competitor nations are actively pursuing opportunities, despite geopolitical challenges.

Iran has one of the largest economies in the Middle East, and it has the second largest population in the region, with about 80 million people. Iran ranks second in the world in natural gas reserves, and fourth in crude oil reserves. The economy is dominated by direct and indirect revenues from the petroleum and natural gas sectors, although the agricultural manufacturing and service sectors in the country are active. The opportunities in oil, gas, retail, manufacturing, finance, automotive and many other sectors in Iran are vast.

Iran had been under sanctions for over three decades, which are now easing given the implementation earlier in the year of the Joint Comprehensive Plan of Action (JCPOA) between the P5 +1, the European Union and Iran. In the UAE, much of the previously applicable UN sanctions, which restricted business with Iran, are no longer applicable. As a result, individuals and entities are no longer generally restricted from dealings related to Iran, subject to certain limited remaining sanction regimes (such as those related to US persons, human rights breaches, terrorism and nuclear capable ballistic missiles).

The US Effect

Given the above opportunities and the lifting of sanctions, business in Iran should be prospering significantly since the lifting of such sanctions on 16 January 2016 (Implementation Day). However, this has not happened. The primary reason is that foreign banks are reluctant and nervous to conduct Iran related business. This remains true even after Iranian banks have reconnected to SWIFT (Society for Worldwide Interbank Financial Telecommunication) and stand ready to transfer funds internationally.ⁱ Such reluctance and nervousness on the part of foreign banks stems from warnings from certain US clearing banks in Europe, Asia and the Middle East that their US based dollar accounts would face close scrutiny if they did business with Iran. Such warnings were echoed by US Treasury officials in meetings in the Gulf earlier in the year.ⁱⁱ

Indeed, such warnings have been contrary to the spirit of the JCPOA, and also have little to no basis in law. The consequence has been a significant stifling of foreign direct investment and foreign business activity in Iran. Such stifling has been so significant as to cause outcries by not only the Iranians but also the Europeans and others who want to do business in Iran. The US administration's most recent reaction has been to publicly reconfirm that foreign companies could work with Tehran through European banks.ⁱⁱⁱ Also US officials have toured the world to host informal roadshows to help businesses (ironically, to help primarily non-US businesses) understand the maze of Iran related sanctions and how business may be conducted with Iran without penalties.^{iv}

Unfortunately, such measures have not alleviated the nervousness of foreign banks and they (including mostly European banks) continue to reject Iran related business, awaiting further clarity which may not be forthcoming until the US election in November 2016. To an extent such rejection is understandable - no bank wants to pay a fine of several billion dollars if indicted by the US government for dealings with Iran.^v

The consequence of such banking rejection is that some European and Asian companies pay up to ten percent of the value of a transaction to transfer money via exchange houses or via small developing economy banks.^{vi} There are glimmers of hope, however: smaller banks in Belgium, Germany, Austria, Turkey and India have chosen to step into the fray and handle transactions on behalf of certain customers doing business in Iran.^{vii}

Iranian Banking Standards

But there are other hurdles on the horizon: Iranian banking standards and risk management standards. Indeed, as of January 2016, four out of five Iranian banks had not published annual reports for the financial year up to March 2015 and only five out of nine Iranian banks provided an audit report as part of their annual financial statements.^{viii} Many of the banks do not comply with International Financial Reporting Standards (a globally accepted accounting standard). This means that the annual audited accounts of Iranian banks might not be on par with audited accounts of banks in other jurisdictions. In similar fashion, Iranian banks do not have adequate anti-money laundering procedures and Know-Your-Customer systems.

Exacerbating such issues is that the rules used by many Iranian banks for risk management and capital requirements are still only based on Basel I. Most US and European banks are already moving towards compliance with Basel III.

Such lack of standards will cause a wide disconnect between Iranian and foreign banks – a disconnect that can create significant operational hurdles for foreign banks in transacting with Iranian banks. Such transactions are the backbone of an emerging economy and critical to its growth.

The Trillion Toman Challenge

The hurdles to doing business in Iran have been significantly reduced due to the easing of sanctions earlier this year. However, obstacles remain: restrictions on US dollar transactions and restrictions regarding dealings with US persons, as well as certain lingering sanctions; reluctance and nervousness by foreign businesses and banks due to lack of clarity concerning the US Treasury's position on remaining sanctions; and inadequate accounting standards, risk management, and capital requirements at Iranian banks.

However, the opportunities in Iran are far too vast to pass up. The trillion toman challenge is whether and how to participate in such a potentially phenomenal market without taking undue risks. ■

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Shahram's practice consists of corporate law, real estate law, disputes, and advising on the legal aspects of doing business in Iran. He also advises on private equity and venture capital transactions. He heads the firm's Iran, real estate and venture capital teams and has been highly sought after by boards and shareholders for strategic legal advice. He is active in lobbying for, providing constructive feedback to and advising government organizations regarding regional laws and regulations pertaining to doing business, real estate and venture capital investment.

His Iran practice involves advising clients with respect to investments, joint ventures, as well as introduction to sector specific private and public entities in Iran. Such advice generally involves franchise and agency matters, build-operate-transfer transactions, regulatory compliance and strategies, foreign investment protection regimes, sanctions and anti-money laundering implications. Shahram is fluent in Farsi and he is a qualified solicitor in England and Wales and a member of the California State Bar. He is also a registered professional engineer.

Shahram's specific Iran related work has included advice relating to:

- Manufacturing sector joint ventures, commercial agency arrangements and local partner introduction.
- Onshore and Free zone entry advice, incorporation and liaison.
- Private equity transactions involving financial institutions.
- Build-operate-transfer arrangements related to the oil and gas sector.
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Shahram is described as “a cut above the rest with thorough knowledge, sharp analytical prowess, understanding of the industry, good relationships with government authorities and the best of communication skills” (Legal 500 EMEA). He is described as “quick, responsive and forthright” and a “Leader in [his] Field” (Chambers Global).

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ⁱ A. Mustafa, 'Iran's Nuclear Deal Emphasis has evaporated', *Gulf News* 11 April 2016.

ⁱⁱ M. Arnold, 'Iran eyes 'bad banks' to mop up toxic loans', *Financial Times* 9 March 2016.

ⁱⁱⁱ Presstv.com, "US not to give Iran access to its financial system: State Department, 5 April 2016.

^{iv} S. Kerr, G. Dyer, 'US roadshows aim to guide groups through Iran Sanctions maze', *Financial Times* 5 April 2016.

^v A. Mustafa, 'Iran's Nuclear Deal Emphasis has evaporated', *Gulf News* 11 April 2016.

^{vi} S. Kerr, G. Dyer, 'US Roadshows aim to guide groups through Iran Sanctions', *Financial Times* 5 April 2016.

^{vii} Presstv.com, 3 April 2016.

^{viii} M. Arnold, 'British regulations help Iranian banks come in from the cold', *Financial Times* 31 January 2016.