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## Europe finally puts its payment mechanism where its mouth is

*Europe's long awaited Special Purpose Vehicle for facilitating trade with Iran has arrived. It is a small step on a long journey, but it does illuminate the way forward for Iranian businesses. With the US determined in its pursuit of sanctions, this is the platform that will define Iran's economic and financial relationship with the wider world. For that reason, Iran should embrace it and play its part in bringing the payment mechanism to life.*

**Almost eight months after the United States withdrew from the Iran Nuclear Deal, the European Union has taken its first major, tangible step to keep the deal alive.** France, Germany and the United Kingdom launched their long awaited special financial channel for reinstating Iranian trade on the 31<sup>st</sup> of January 2019. The vehicle is called INSTEX (short for Instrument for Supporting Trade Exchanges). It will be based in the French Finance Ministry, headed by a well-regarded German banking expert, Per Fischer, and with UK representatives heading the supervisory board.

In this month's Verity Iran newsletter, we provide a primer on the INSTEX, and what it means for Iranian businesses.

### How will the INSTEX work?

**When INSTEX is up and running, European and Iranian businesses wanting to engage in legitimate trade will be able to transact through a safe financial clearing mechanism with mirror entities in Paris and Tehran.** The mechanism will essentially operate as a barter system, enabling an Iranian company to *match* its purchases of European pharmaceuticals, for example, against the value of a European company's imports of Iranian crude. The INSTEX will create a legal shield around European companies that are making transactions that fall within the scope of the JCPOA nuclear agreement. These transactions would otherwise be subject to US extra-territorial sanctions, but the new entity acts as a blocking statue that nullifies the sanctions' power within the EU and allows EU businesses to recover damages incurred by them. It is important to note that numerous legal obstacles and complications are yet to be overcome before the channel is operational, so it is expected to take at least a further two or three months yet.

### How effective will the EU be in protecting firms from US sanctions?

**The INSTEX's strength in the face of US sanctions pressure is yet to be tested.** The US State Department immediately responded to the EU3's announcement by reiterating its stance on companies dealing with sanctioned Iranian entities; a loss of



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access to the US financial system, the US dollar and the US market. The European Union used a similar blocking statute with some success in the 1990s to guard European entities against the US' Cuban embargo. But the political context and legal force of the US extra-territorial sanctions are much more powerful now than they were then. The efficacy of the new European legislation may well be decided in the courts.

**European businesses will each have to weigh up the risks on a case by case basis and it is small and medium enterprises, with limited exposure to the US market, that are most likely to be the first movers.** Whilst large enterprises with an international footprint might be highly reticent to risk losing their access to the US market, EU officials hope that many small and medium-sized enterprises will see a different balance of risk and reward. Access to Iranian oil and other products, as well as opportunities to sell into the large Iranian market, particularly food, pharmaceuticals and medical equipment are compelling. These so called 'humanitarian' goods are in great demand and exempt from sanctions, so present immediate business opportunities.

### What will this mean for Iran's economy?

**There is a question mark over whether Europe's efforts will ever deliver sufficient value to Iranian businesses in the face of stern US financial pressure.** Europe's goal is to secure Iran's commitment to the JCPOA. To do that it aims to materially improve Iran's export revenues and access to finance, with positive implications for tax receipts, jobs and a generally stronger economic trajectory. But expectations are for the vehicle to facilitate only small volumes of humanitarian trade to begin with. Even that will depend on the level of engagement from European businesses and the political climate that surrounds the trade in Europe and Tehran.

**In time, if political will remains and Iranian compliance with the JCPOA continues, the new mechanism could grow and prove to be a vital channel for trade.** It provides a workable platform for legitimate payments outside the reach of the US dollar-dominated global financial system. This is something Iranian businesses currently do not have. Over time, Europe's ambition is for the mechanism to gain trust, grow the value of transactions and potentially even extend the function to non-European parties wishing to trade safely with Iran.

**The Trump administration has demonstrated its intention to maximise the sanctions pressure on Iran.** As long as this position holds, the options for Iranian businesses are limited. The worst case scenario is a withdrawal from the JCPOA terms, which would mean a sure return to isolation from the global economy and financial system, as well as an escalated risk of military conflict. Despite US antagonism, the INSTEX is a clear political statement that European partners want to preserve the JCPOA and deliver on its side of the bargain. It is a basis upon which to build.

### What must Iran do to make it work?

**Iran should seize the INSTEX opportunity for the sake of Iranian businesses and households.** That means developing the necessary financial infrastructure as quickly as possible, creating the political and legal conditions for Iranian businesses to engage and continuing its principled adherence to the terms of the JCPOA.

**Iran must match the INSTEX with a mirror-mechanism in Tehran; that means matching European compliance with UN trading standards, including anti-money laundering and anti-terrorist regulations.** Iran's parliament successfully passed the legislation required to bring Iran into line with the global financial rules established by the Financial Action Task Force (FATF) and to remove its name from the FATF black list. But the legislation has stalled controversially in Iran's Expediency Council. The extra financial transparency that the FATF related bills deliver has sparked fierce resistance from many of those stakeholders



that benefit most from informal, under-the-radar financial dealings. Further delays to the bills will also hold up progress towards the European financial trading mechanism.

**In the meantime, Iran can continue to build its trading relationship with non-EU partners.** Iran's new arrangement for processing Indian payments for Iranian oil exports is aligned with the INSTEX approach. Indian buyers deposit rupee denominated revenues in a state-owned Indian bank and the funds are made available for purchases or investments within the Indian market. Similar bilateral funding arrangements being developed with Turkey, China and Russia too.

