

# Little Change Expected in Upcoming FATF Statement on Iran

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## ABOUT THE AUTHORS



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Brief Analysis

**The organization's forthcoming statement will likely underline the fact that Iran's recent efforts are only the first steps toward complying with international standards.**

**A**s the Financial Action Task Force (FATF) gathers in South Korea this week for its regular plenary, many observers will be watching closely for the release of its public statement identifying jurisdictions that have strategic deficiencies related to anti-money laundering and counter-terrorist financing (AML/CFT). Iran and North Korea have been the sole members of that list since its creation in 2008.

In its February 2016 statement, the FATF -- whose thirty-seven member states include Russia and China -- reiterated its call for countermeasures regarding Iran's failure to address strategic AML/CFT deficiencies. Issued shortly after Tehran received sanctions relief under the nuclear deal, the statement also urged members to warn their banks about the risks of doing business in Iran. International banks have cited the FATF blacklist as one of the concerns preventing them from reestablishing ties with the Islamic Republic. Since the February statement, Iran has engaged the FATF and begun work on an action plan to address its deficiencies, according to press accounts and statements from U.S. officials. Yet the organization's forthcoming report will likely show that risks remain.

## WHAT TO LOOK FOR

**A**s the international standard-setting body for AML/CFT, the FATF publicly identifies jurisdictions that fail to address deficiencies in those areas via statements released following its plenary meetings in February, June, and October of each year. Iran has been named in these statements since 2008, when the organization revised its processes for dealing with "high-risk and non-cooperative jurisdictions."

The FATF maintains two separate lists of jurisdictions with strategic AML/CFT deficiencies. For those on the so-called "black" list, the organization calls on member states to apply countermeasures to protect the international financial system from AML/CFT risks related to these jurisdictions. Some have speculated that the "call for countermeasures" against Iran could be removed from the FATF's upcoming statement based on Tehran's recent steps, including amendments to its AML Law and ratification of its first CFT Law. In that scenario, Iran would likely remain on the FATF's so-called "grey" list, reserved for countries that have worked with the organization on developing an action plan to address their deficiencies and made a high-level political commitment to complete the plan. Since the FATF is a technical and apolitical organization, the high-level political commitment is a way to boost confidence that the government in question will actually commit adequate resources and take legislative actions needed to remediate deficiencies.

While neither of the two countries on the FATF's blacklist has been removed since its inception in 2008, North Korea's efforts to improve its standing offer some insight into how the FATF might proceed with Iran. Since 2014, Pyongyang has obtained observer status at the Asia/Pacific Group on Money Laundering, a FATF-style regional body; developed an action plan with the FATF; and expressed a commitment (albeit from the governor of the country's central bank, not the political leadership) to "sincerely implement the action plan." The latter announcement was made just weeks before the FATF's February plenary; although the organization recognized the move in its public statement that month, it also reiterated the call for countermeasures against North Korea.

Since Iran's remedial actions have been less substantial than Pyongyang's, the FATF's logical step would be to recognize Tehran's very recent efforts to seek removal from the blacklist, but defer the decision to rescind the call for countermeasures until further progress is made. A more lenient approach would be difficult to explain unless political considerations played a factor.

At the least, based on its recent direct engagements with the FATF, Iran will likely no longer be considered a "non-cooperative jurisdiction," which would be evidenced by language in the public statement noting the cooperation. Yet even this limited recognition could be caveated due to a problematic clause in Iran's new CFT Law, which exempts "actions taken by nations, groups, or liberation organizations for the purpose of putting an end to foreign occupation, colonialism, and racism" from its definition of terrorism. If Tehran insists on retaining a supposed "white list" of terrorist organizations engaged in national liberation efforts, it would give plenary participants a glaring reminder of why Iran is still considered one of the world's foremost state sponsors of terrorism.

## IMPLICATIONS

**T**he FATF's call for countermeasures has real implications for banks and regulators. The organization's standards specify time- and resource-intensive measures such as additional due diligence and reporting requirements, against which banks are examined for compliance by regulators, and regulators in turn by the FATF ([see PolicyWatch 2575, "Iran's Long Road to Reintegrating With the World Financial System" \(http://www.washingtoninstitute.org/policy-analysis/view/irans-long-road-to-reintegrating-with-the-world-financial-system\)](https://www.washingtoninstitute.org/policy-analysis/view/irans-long-road-to-reintegrating-with-the-world-financial-system)). Perhaps more important, however, is the impact that any change in FATF policy could have on banks' willingness to reengage with Iran. The attention that banks give to FATF determinations shows that their hesitation about doing business in Iran goes beyond sanctions risks, even though the latter are often the focus of Tehran's official complaints. When considering transactions with the Islamic Republic, banks face multiple, overlapping risks related to illicit finance, regulatory issues, sanctions, and reputational concerns.

For its part, Iran was quick to tout its April meeting with FATF officials, its first such engagement with the organization since being blacklisted. In an interview a few weeks afterward, the governor of the Central Bank of Iran, Valiollah Seif, told CNBC that FATF representatives "were surprised by the steps taken by the Iranian banks and financial institutions." He reportedly expressed confidence that Iranian banks would be removed from the blacklist,

though he did not give a timeframe. In a written response to CNBC, the FATF Secretariat confirmed the meeting and noted that the process it manages to ensure global compliance with AML/CFT standards is "a rigorous, apolitical, highly technical, and often lengthy process," adding that "Iran will be treated in the same impartial manner that all countries subject to similar reviews have been treated."

Meanwhile, in a statement issued at the conclusion of the most recent IMF mission to Iran in May, First Deputy Managing Director David Lipton acknowledged the "difficulties" that Iranian banks face in reintegrating with the international financial system, urging Tehran to "persevere with strengthening the framework for [AML/CFT], which should be critical to facilitate such reintegration." Last week, Seif announced that 200 small banks had reestablished correspondent banking relationships with Iran, but also admitted that "big banks are postponing normalization of relations." These small banks offer much-needed trade financing, which undoubtedly contributed to the 22 percent increase in trade between the EU and Iran during the first four months of this year, according to EU foreign policy chief Federica Mogherini. Yet their trade still remains well below its pre-sanctions level.

Indeed, while trade financing is easier to reestablish than project financing due to the short-term nature of such loans, it will not bring major economic dividends on its own. As Al-Monitor recently reported, a review of the volume and value of transactions on the Iran Mercantile Exchange indicated that demand was depressed significantly compared to the year prior, suggesting a lack of adequate capital. Although the report blamed this lack of investment on the diversion of government funding for development, David Lipton of the IMF also pointed to weakness in the banking sector during his May visit, noting its inability to channel credit to the private sector due to high levels of nonperforming loans, lack of bank capital, and poor risk-management systems.

## CONCLUSION

In recent remarks related to implementation of the nuclear deal, Assistant to the President Ben Rhodes noted the challenges Iran is having in reestablishing ties to the international financial system, but also reiterated the administration's commitment to "meeting our obligations under the deal." He added, "If anything, the limited nature of the relief so far makes some of the more hyperbolic claims of the deal's opponents look ridiculous." Focusing on the value of relief Iran has been able to access as a proxy for assessing whether or not the United States has met its obligations under the deal obscures what has prevented Iran from getting more relief: a wide variety of real, persistent risks of Tehran's own making. The modest steps Iran has taken so far come with huge caveats. As the wording of its new CFT law demonstrates, Tehran reserves what the State Department's 2015 Country Report on Terrorism describes as its ongoing "support for Hizballah, Palestinian groups in Gaza, and various groups in Iraq and throughout the Middle East."

The nuclear deal was exactly that: about nuclear matters. It did not excuse Iran from other regulations agreed to by the international community, including the FATF. What is deterring big banks from supporting investments in Iran is not just the "psychological remnants" of lifted sanctions, as claimed by Foreign Minister Javad Zarif, but Tehran's own failure to comply with internationally approved regulations. Getting Iran to bring its banking system into line with those regulations will be a long process -- one to which the United States and the international community are already contributing fully. The next steps are up to Tehran.

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