

How Europe Can Pressure Iran

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Articles & Testimony

Executive Summary

1. Britain finds itself in a unique position to place tremendous pressure on Iran to desist from its nuclear activities due to the central role that the City of London along with New York plays in the international financial system.
2. Realizing the leverage that the U.S. financial markets give Washington, the U.S. Treasury Department has in the last couple years been pressing Iran hard on the financial front.
3. The British government should complement the activities of the U.S. Treasury in actively discouraging financial institutions from conducting business with Iran. This could take the form of a joint U.S.-U.K. outreach effort that would threaten to cut off from the New York and London financial markets companies that persist in their business dealings with Iran. It would be beneficial to include other European countries in this endeavor to increase the potential for desirable results.

On October 25, the U.S. took a major step in ratcheting up the financial pressure against Tehran, unilaterally designating Iran's powerful Islamic Revolutionary Guard Corp, three State-owned banks, and a number of key officials for their involvement in the regime's terrorist financing and WMD-related activities. Nicholas Burns, State Department's number three ranking official, called the moves the "most significant actions" the U.S. has taken against Iran since the 1979 revolution.

Britain's Prime Minister Gordon Brown immediately released a statement backing the U.S., noting that "we endorse the U.S. administration's efforts to apply further pressure on the Iranian regime." While public support from the U.S.'s closest ally will undoubtedly help bolster the impact of the unilateral actions, Britain is in a unique position to do far more -- primarily due to the central role that the City of London plays in the international financial system.

Although Europe has several important financial centers including Paris and Frankfurt, London is in altogether different category, being one of the world's two leading financial capitals. London and New York offer unmatched access to capital, skilled personnel, state of the art technology, and reasonable regulatory environments. More than 550 international banks and 170 global security houses have a presence in London. London is a key financial center for businesses from many countries for instance, Russian companies raised approximately 7.5 billion pounds in 2006 in initial public offerings. Peter Weinberg, the former CEO of Goldman Sachs International, estimates that between \$50 and \$100 billion of Middle Eastern money will enter London in the next few years.

U.S. Outreach Campaign

Realizing the leverage that the U.S. financial markets give Washington, the U.S. Treasury Department has in the last couple years been pressing Iran hard on the financial front. Senior U.S. Treasury officials have traveled the world, highlighting for global financial institutions the risk to their reputation from doing business with Iran, given Tehran's deceptive financial practices.

This includes: Iran's use of front companies frequent requests by Iranian state-owned banks to remove their names from financial transactions and the involvement of these same banks in Iran's nuclear and missile programs and

terrorist financing. For example, in January 2007, the U.S. Treasury designated Bank Sepah a large state-owned bank -- for providing "extensive" financial services to Iranian entities involved in WMD proliferation. Illustrating the risks to the international financial system, the U.S. Treasury noted that Sepah had also engaged in "a range of deceptive financial practices in an effort to avoid detection," which included asking other financial institutions to remove Sepah's name from international transactions. Sepah was subsequently blacklisted by the UN, in Security Council Resolution 1747.

In light of Iran's behavior in this arena, the U.S. Treasury Department has argued that doing business with Iran is a risky endeavor, and could ultimately cause great harm to the reputations of those associated with the regime. Treasury Secretary Henry Paulson emphasized this message again after the recent designations, arguing that "in dealing with Iran, it is nearly impossible to know one's customer and be assured that one is not unwittingly facilitating the regime's reckless conduct."

Major international financial institutions have been responsive to the Treasury pitch. A number of global institutions including Switzerland's UBS and Credit Suisse and Germany's Commerzbank and Deutsche Bank have either terminated or dramatically reduced business with Iran, presumably due both to the potential risk to their reputations and the prospect of facing severe complications in the U.S. market.

What Britain Could Do

A complimentary outreach effort by the British government emphasizing to banks a similar message to that of the U.S. Treasury could dramatically increase the financial pressure on the Iranian government. Coordinated visits by top U.S. and UK officials to major financial institutions could be a particularly effective way to get the message across that business with Iran is risky so long as Tehran persists in ignoring the UN Security Council orders about its nuclear program.

There are companies and financial institutions which do not do business in the United States and may be willing to ignore the U.S. government's warnings about Iran. Being cut off from both New York and London financial markets, however, might be a risk that many of these entities are not willing to take. From a business perspective, it would not necessarily be a realistic option for many companies to relocate to smaller financial centers so that they can continue to do business with Iran. Regional financial centers outside Europe such as Hong Kong do not have the depth to replace London and New York.

A joint U.S.-UK outreach effort might carry particular weight coming on the heels of the Financial Action Task Force's (FATF) October 11 statement on Iran. The 34 member body, launched by the G7 in 1989 and based in Paris, seeks to set global standards on combating money laundering and terrorism financing. FATF warned that "Iran's lack of a comprehensive anti-money laundering/combating the financing of terrorism regime represents a significant vulnerability within the international financial system." FATF noted that, as a result of this finding, its members would be advising their financial institutions to use "enhanced due diligence" in evaluating the risk of transactions with Iran.

Assuming that the FATF members follow through and issue alerts to their financial sector about the risks of doing business with Iran, this could have a significant impact on the Iranian economy. As the sitting president of FATF, Britain undoubtedly deserves significant credit for this recent action, but there is still much more that London could do.

Britain's Regulatory Practices

The irony of the recent U.S. Treasury actions against Iran is that they have been more on the model of how the UK government has traditionally related to financial firms through guidance than along the lines of the usual American model of detailed formal regulation.

Financial firms in Britain are regulated by the Financial Services Authority (FSA), an independent quasi-judicial body created in 1997 under Gordon Brown's leadership in his former position as the Chancellor of the Exchequer. FSA champions its "principles-based regulations" as compared to the rules-based regulations used by U.S. authorities such as the Security and Exchanges Commission or the Federal Reserve. FSA argues that rather than issuing highly detailed regulations, FSA can be more efficient and less burdensome on financial firms by working closely with firms to implement the broad principles it lays down. FSA describes this as emphasizing supervision over enforcement, preventing breaches in the first place.

This approach fits well with the decades-long practice of the Bank of England, the previous British de facto bank regulator, which argued that its informal guidance to senior bank management was much superior to the Federal Reserves' regulations, because it left to the banks how to accomplish the regulators' aims without providing them the wiggle room to evade the regulators' intentions by complying with the letter but not the spirit of the written rules.

And in the rest of Europe . . .

While the UK wields particularly powerful tools, there may also be other European countries now willing and ready to ramp up financial pressure against Iran. Ideally, this would be done at the European Union level -- something that the Sarkozy government has been pushing for several months. The European Union has already taken some strong steps against Iran in conjunction with, but separate from, the sanctions ordered by the UN Security Council. For example, in addition to freezing the assets of the fifty individuals and entities listed in the UN's two Iran resolutions, the EU has added more than twenty others to its own list. The EU has also enacted a more comprehensive arms embargo and travel ban against Iran and its officials than required by the UN. At this time, however, the EU appears reluctant to bring its own additional sanctions against Tehran, in the absence of a 3rd UN Security Council resolution.

In this situation, the French have suggested that individual European countries do not have to wait for Brussels to act. In fact, France has already announced that it is pressing large French companies to refrain from investing in Iran. A joint outreach effort to the financial sector by the U.S., the UK and perhaps other European countries would have an even greater impact.

A combined initiative to press Iran by the U.S. and the Europeans would also be a good way to show China, Russia and laggard European countries that with them or without them, action will be taken against Iran. If they are dissatisfied with this approach, they should be invited to propose and launch their own robust initiatives to bring Iran into compliance with the order that it suspend its enrichment program.

In addition, if the Islamic Republic sees that economic pressure will increase steadily so long as the nuclear impasse continues, that may strengthen the hand of those in Tehran arguing for an accommodation.

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A **version** (<http://www.washingtoninstitute.org/templateC06.php?CID=1103>) of this article appeared in Wall Street Journal Europe. ❖

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