

FINANCIAL CHANNELS AND INTERNATIONAL SANCTIONS

Gist of the news

According to *Zawya.com* on December 20, 2014:

Iran-China Joint Chamber of Commerce Chairman Asadollah Asgaroladi said that China has financed several Iranian projects.

"We agreed to receive our money in the form of goods and finance," the official explained, Iran's Mizan News Agency reported on Dec. 16.

"The country has no debt to us anymore, except for the goods," he said.

"Bank of Industry and Mine, Parsian, and Pasargad banks are currently working in this regard," the official explained.

In November 2013, Iran announced that about \$30 billion of its oil revenues have been blocked by Chinese banks due to the sanctions imposed on Tehran's banking system.

The two countries agreed over Chinese companies' financing of Iranian projects as an approach to return the blocked assets.

Another piece of information concerning the financial channels used by Iran is reported by *The Economic Times* on November 5, 2014:

India today paid Iran USD 500 million to clear a part of its past dues for crude oil it buys from the Persian Gulf nation.

The payment made today was in addition to USD 400 million India paid on October 21, industry sources said.

Mangalore Refinery and Petrochemicals Ltd (MRPL) paid about USD 217 million and almost an equal amount was paid by private sector Essar Oil. The remaining amount was mostly paid by Indian Oil Corp (IOC)...

Since February 2013, when the US blocked payment channels to Iran for its nuclear programme, India has been paying 45 per cent of its Iran oil bill in rupees through a UCO Bank branch in Kolkata. For the remainder, it had been waiting for a way to make the payment...

Rupee payments equivalent to USD 500 million was deposited by Indian refiners in the UCO Bank account, which will now be transferred to the Reserve Bank of India for onward credit to the central bank of the United Arab Emirates, which will make payments in dirhams to Iran.

Since July 2011, India had been paying in euros for 55 per cent of its purchases of Iranian oil through Ankara-based Halkbank. The remaining 45 per cent was remitted in rupees through UCO Bank.

In this News & Analysis report we will look into the following two issues:

- 1) How the UCO and the central banks of India, UAE and Iran collaborate in channeling payments to Iran?
- 2) What are the advantages and disadvantages of debt reimbursement arrangement made with Chinese banks for financing of projects in Iran?

Financial channels of Iran and foreign banks involved in it

According to the above report of the Economic Times, at least four banks have been involved in transfer of money from India or Turkey to Iran: 1) UCO Bank branch in Kolkata; 2) Reserve Bank of India; 3) Central Bank of the United Arab Emirates; and 4) Ankara-based Halkbank.

To understand more about the payment mechanisms used to transfer money to Iran, it is indispensable to have a closer look at each of the above banks' activities in this respect.

UCO Bank (and other Indian banks)

The payment mechanism used on the Indian side, according to *Reuters.com* on June 19, 2014, includes the following steps:

In a first step, India's petroleum ministry would instruct oil refiners to remit funds in rupees to the account of an Iranian bank with India's state-run UCO Bank.

UCO would then transfer the sum to the RBI for crediting to a new rupee account held by the UAE central bank.

Once this step is completed, the UAE central bank would make a payment in dhirams to the Iranian central bank. On receipt of payment confirmation, the RBI would credit the UAE account at the Fed with an equivalent sum in dollars.

Simultaneously, the RBI would settle its dollar purchases with the funds on the UAE rupee account at the Indian central bank...

India has been settling 45 percent of Iranian oil payments by transferring rupees into Iran's account with UCO Bank, while the refiners hold the remainder. Tehran is using the funds in UCO Bank to import goods from India.

Simply put, 45% of the debt-payment is through a payment channel that starts with the UCO bank in India, and then goes through the Reserve Bank of India (RBI), the UAE Central Bank, and finally the Central Bank of Iran (CBI). In other words, three central banks of India, UAE and Iran are involved in this money transfer.

Such a humongous operation needs careful legal planning in which the central banks of three countries need to get into detailed arrangements that should respect the

requirements of international sanctions imposed on Iran. The process of establishing the legal and banking connections to carry out the above financing project is not divulged to the public.

Another interesting issue in this process is that the UCO Bank is only involved in oil-related transactions of Iran. In January 2014, Iran started negotiations with the RBI and the Indian government to open bank accounts in other Indian banks, as reported on the website of *livemint.com* on January 16, 2014:

Iran has requested the ministry of finance and the Reserve Bank of India to allow it open accounts in multiple banks to facilitate better non-oil trade between the two nations.

At present, only UCO Bank facilitates transactions with Iran and those are oil related. According to Iranian ambassador to India Gholam Reza Ansari, as the UCO Bank account deals with only oil transactions, the Persian Gulf nation needs to open accounts in different banks for better non-oil trade between the two countries.

The process for the financial channeling of the remaining 45% used to go through the Halkbank until February 2013. This issue will be discussed later in this report.

Reserve Bank of India

We have already explained the role that RBI plays in making arrangements for oil trade payments. But this is just part of the financial relationship between Iran and India. The website of *in.rbth.com* reported on October 24, 2014 on a new arrangement made between India and Russia concerning payment for Iranian oil:

As a way of skirting global sanctions on Iran, India may use Russia as an intermediary to make payments for Iranian oil, the Indian Express reported on its website. Under an oil swap mechanism, India would pay Russia for Iranian oil with the Russian Government assuming the risk of routing the funds to Iran, the paper said.

Citing sources, the paper said the arrangement could be part of a package deal on the defence and energy sectors. At the moment Indian oil refiners deposit the payments for Iran in an Indian bank account and then Iran appropriates the money in back to back transactions in different currencies channeled through the Reserve Bank of India, according to the report. Indian oil refiners owe Iran around \$6 billion at the moment.

Central Bank of the United Arab Emirates

Iran has established very strong ties with the Central Bank of the UAE during the last two decades. Further, the Central Bank of Iran has a bank account in the UAE. For this reason, the 13th and 14th instalments of the Iranian frozen assets were paid to this CBI account.

The relationship between the Central Bank of the UAE and the Iranian banks is becoming even warmer and closer. According to *trend.az* on December 22, 2014:

Bank Melli of Iran and the Central Bank of the United Arab Emirates (UAE) have agreed to boost bilateral ties.

The agreement was reached during a meeting between the Managing Director of BMI Abdolnaser Hemmati and UAE Central Bank Governor Mubarak Al Mansouri in Abu Dhabi, Iran's Fars news agency reported on Dec. 22...

Hemmati, for his part, said that despite international sanctions on Iran's banking sector over its nuclear program, BMI has managed to provide significant services to its customers, especially Iranian businessmen and companies in the UAE.

Ankara-based Halkbank

Livemint.com reported on January 16, 2014 that:

India had since July 2011 paid in Euros to clear 55% of its purchases of Iranian oil through Ankara-based Halkbank. The remaining 45% due amount was remitted in rupees in accounts Iranian Oil Company opened in Kolkata-based UCO Bank. Tougher sanctions blocked the payments in euro through Turkey from 6 February last year but the rupee payments for 45% of the purchases continued through UCO Bank.

Reuters.com sheds more light on the sanctions imposed on Turkey by reporting on February 15, 2013 that:

A provision of U.S. sanctions, made law last summer and implemented from February 6, effectively tightens control on sales of precious metals to Iran and prevents Halkbank from processing oil payments by other countries back to Tehran, bankers said.

"Halkbank can only accept payments for Turkish oil and gas purchases and Iran is only allowed to buy food, medicine and industrial products with that money," one senior Turkish banker told Reuters.

Role of the Halkbank in financial channeling to Iran needs to be considered and analyzed in a separate report. Recent developments have taken the Turkey-Iran relationship to a different level that adds to the complexity of the financial channeling issues as far as these two neighboring countries are concerned.

Debt payment through financing of projects

According to Financial Tribune on November 25, 2014, the project financing carried out through an arrangement between Chinese and Iranian banks is a mega-project:

The upper limit of the Chinese finance would be between \$40-44 billion, said Asgaroladi, "which is twice the \$22 billion debt China owes Iran for previous oil and gas deliveries."

The two sides have agreed that the Chinese side finances the Iranian projects to clear its debts. Currently, two Iranian banks are examining other projects that have also applied for funding from the East Asians financiers, said Asgaroladi, who added that the process might be time-

consuming, as there are some ambiguities and deficiencies in the projects which need to be addressed before the projects are approved.

As previously mentioned, three Iranian banks are involved in this project financing, namely Bank of Industry and Mine, Parsian Bank, and Bank Pasargad. No information is available about the Chinese bank(s) involved in this project or about the agreement signed between the parties.

The question that needs to be answered is about the advantages and disadvantages of project financing when it replaces debt reimbursement. It is clear that all depends on the context of two sides of this project. Unfortunately, due to lack of information on both, we cannot get into detailed analysis of this matter. However, we can at least look into ups and downs of project financing in general.

Bruce Comer in his article titled *Project Finance Teaching Note* explains that project financing has the following disadvantages:

- 1) **Long term:** The tenor for project financings can easily reach 15 to 20 years.
- 2) **Costly:** Raising capital through project finance is generally more costly than through typical corporate finance avenues.
- 3) **Huge size of financing:** Might require critical mass to cover high transaction Costs.

The advantages of debt reimbursement through project financing according to the same author are:

- 1) **Financial structures:** Highly-tailored structures which cannot generally be re-used;
- 2) **Type of capital:** Finite - time horizon matches life of project; and
- 3) **Financing vehicle:** Single-purpose entity.

The questions that remain to be answered are:

- a. What are the terms of the project financing arranged with the Chinese banks?
- b. Which Iranian projects have benefitted or will benefit from this financing?
- c. How long would be the period of the project financing?
- d. What are the principal and ancillary costs of the projects and how will they affect the total amount to be financed by the Chinese side?

Unbiased evaluation of the project financing arrangements depends heavily on the answers to be provided to the above questions. These answers need to cover both economic and legal aspects of the project, as well as the impacts that they will have on the future Iran-China, Iran-Russia and Iran-India relationships.

Conclusion

One of the major barriers to the economic collaboration between the Iranian and the foreign private or public entities is the severe difficulty that latter parties face in obtaining financial support for their projects in Iran. The sanctions are still in full force and will remain so, as long as Iran and the P5+1 have not settled their differences. In the meantime, both sides seek other financial channels to go ahead with their projects. In this report we tried to shed some light on few of these channels. We will continue our analysis of this fascinating subject in our other N&A reports in the near future.

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