



IRAN'S NEW YEAR

Causes for Optimism?

Reformists' gains in Iran's recent elections show the extent of Iranian public optimism regarding the potential for economic improvement through President Rouhani's policy of engagement with the West.

As Iran seeks to end its political and economic isolation, the foreign investment community is monitoring what liberalisation measures Rouhani will now take to create opportunities, and in which sectors there will continue to be constraints on FDI as a result of military dominance. This article examines the political developments, resulting changes in the business climate and areas of potential risk of which potential investors should be aware.

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Post-JCPOA Iran: Sufficient Progress?

On 20 March 2016, Iran's Supreme Leader Ayatollah Ali Khamenei delivered a speech to mark the beginning of Nowruz, Iran's New Year festival, in which he took the economy as his theme. Khamenei's speech is likely to set the tone for the political year ahead in Iran. Despite stating his approval of the nuclear agreement and his ongoing support for President Rouhani, Khamenei emphasised that remaining banking sanctions were still acting as a deterrent for foreign investors in Iran. He warned that if Iran does not see sufficient economic benefit and foreign investment from the suspension of its nuclear programme, it may be forced to rethink its position.

Khamenei also emphasised that Iran would not bow to US pressure to halt backing 'resistance' activities overseas. These are led by Iran's Islamic Revolutionary Guard Corps (IRGC), a military body with extensive business interests which remains under sanctions related to its alleged support for terrorism.

Khamenei's speech highlights the challenges for foreign investors seeking to take advantage of business opportunities in Iran. Though many Iranian banks were removed from the US Treasury's Office of Foreign Assets Control (OFAC)'s Specially Designated Nationals (SDN) list on 22 January 2016 as part of the Joint Comprehensive Plan of Action (JCPOA), others remain, while dollar transactions involving Iran are still largely prohibited.

Major international banks are still wary of facilitating Iran-based transactions or financing projects given the incomplete removal of US-imposed banking sanctions. Meanwhile, Khamenei's reiteration of his support for the IRGC's overseas activities, namely backing Shia militias in Syria, Iraq, Lebanon and elsewhere, suggests the US and EU are unlikely to have cause to lift IRGC-related sanctions any time soon.

On the US side, the picture is also uncertain once President Barack Obama leaves office in January 2017, given that leading Republican candidates Donald Trump and Ted Cruz are opposed to the nuclear agreement.

Positive Signs of Change

So what cause is there for optimism on Iran? Firstly, the sheer potential of Iran's market. With a population of over 76 million, it has the second largest proven gas reserves in the world as well as the fourth largest oil reserves and significant other natural resources. Urbanisation, modernisation and the country's young demographic are creating burgeoning consumer demand, especially focusing on technological products.

Despite anti-Western attitudes in official political rhetoric, most Iranians do not share such attitudes at a personal level; indeed there is a clear appetite for things western, in particular for products considered American.

Secondly, the strong showing for President Hassan Rouhani and his 'List of Hope' in Iran's parliamentary elections in February 2016 is a positive sign. In the capital Tehran, for instance, all 30 seats were won by 'List of Hope' candidates. The results demonstrate the extent to which ordinary Iranians are pinning their expectations on President Rouhani and the nuclear deal to open up their economy and end years of under-investment and isolation under sanctions. Significantly, 'List of Hope' also secured victories in the Assembly of Experts, which will choose Iran's next Supreme Leader, the ultimate arbiter of policy. This heightens the likelihood of a pro-integration policy being pursued by whoever succeeds Khamenei, aged 76.

Thirdly, there are signals from Western powers that they are willing to help make the nuclear agreement stick, by assisting Rouhani to demonstrate concrete improvements in economic performance ahead of his presidential re-election campaign in spring 2017. Already, the Obama administration is considering easing restrictions on the use of dollars in currency exchanges with Iran, though any such relaxation faces significant domestic political opposition within the US Congress.

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Potential Risk Issues

Companies considering investment in Iran will do well to consider several risk factors. One of these is the need to avoid accidental engagement with IRGC front companies. In the sanctions era, the IRGC and its engineering company Khatam al-Anbia became the only domestic entity with the capabilities to conduct large strategic projects such as expansion of the South Pars gas field. From 2005-2011, the Iranian government granted it more than USD25bn worth of projects. The IRGC is unlikely to surrender its market dominance easily, and Rouhani will probably be forced to protect its involvement in the most strategic sectors including ports, airports, telecommunications, national infrastructure projects and defence. Targeted due diligence, including discreet interviews with knowledgeable sources, is one way to mitigate the risk of partnering with IRGC-related entities.

Another issue is the opacity of corporate ownership structures in Iran. Companies not listed on the Tehran Stock Exchange are not required to declare their shareholders, though corporate registry checks on their boards of directors can sometimes give an indication of ownership. Further muddying the waters is the fact that privatization since 2006 in Iran has often involved sale of assets to other quasi-state bodies, some of which are connected to sanctioned entities, rather than truly private investors. On-the-ground source enquiries can help identify any concealed shareholders and establish an understanding of the true ownership of private companies.

Lastly, the current pro-integration political climate in Iran may change. At present, some politicians most supportive of Rouhani's liberalization programme are those, like former President Akbar Hashemi Rafsanjani or Speaker Ali Larijani, whose personal business interests mean they stand to gain the most. But investors should watch for indications of shifts in the political climate – for instance if Rouhani fails to be re-elected as President next year, or if a change in the US political leadership prompts more hardline attitudes on both sides. This could lead to Rouhani allies falling out of favour and even becoming subject to politically-motivated corruption investigations under a future Iranian administration. A thorough understanding of the business and political context, and an awareness of political and business rivalries between different camps, will therefore be key for new entrants into the Iranian market.



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