Title: Financial Restrictions (Iran) Order 2011 **IA No:** **Lead department or agency:** HM Treasury **Other departments or agencies:**	**Impact Assessment (IA)** **Date:** 16/11/2011 **Stage:** FINAL **Source of intervention:** Domestic **Type of measure:** Secondary legislation **Contact for enquiries**: Bhavika Chauhan - 020 7270 5454

Summary: Intervention and Options

RPC Opinion: RPC Opinion Status

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, One-Out?**	**Measure qualifies as**
£m	£m	£m	No	NA

What is the problem under consideration? Why is government intervention necessary?

Iran's continued proliferation-sensitive activities pose significant risks to the national interests of the UK. The November 2011 Board Report of the International Atomic Energy Agency highlights the reasons for the Government's serious and ongoing concerns about Iran's nuclear activities. Iran continues to defy international calls to suspend its nuclear activities. This poses a serious threat to Middle East peace and security and could unravel the Non-Proliferation Treaty (the international system for preventing nuclear proliferation), which risks deepening further unrest and creating a nuclear arms race in the region. This would jeopardise UK interests in the region.

What are the policy objectives and the intended effects?

The policy objective is to minimise the threat to the UK's national interests posed by Iran's proliferation-sensitive activities.
The intended effect is to protect the UK financial sector from being unknowingly used to facilitate Iran's proliferation-related activities, thereby restricting options for international financial transactions available to Iran to support its activities of concern. Cutting Iranian banks off from a key financial centre will add wider pressure on Iran to engage with the international community and return to the negotiating table for further talks.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

1. Do nothing: this option fails to address the significant risks that Iran's proliferation-sensitive activities pose to the national interests of the UK, and Iranian banks' contribution to these risks.
2. To issue a direction to UK credit and financial institutions to undertake systematic reporting on transactions with Iranian banks. This would not be as effective in mitigating the risks and is likely to require the financial sector to introduce new systems in order to comply with the measure.
3. To issue a direction to UK credit and financial institutions to cease all transactions and business relationships with Iranian banks. This is the most effective option to tackle the risk available under the powers and it is the Government's preferred option.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** 11/2012

Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** Yes	**< 20** Yes	**Small** Yes	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:**	**Non-traded:**	

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible SELECT SIGNATORY: [signature] Date: 16/11/11

Summary: Analysis & Evidence

Policy Option 1

Description: Cease business with Iranian banks

FULL ECONOMIC ASSESSMENT

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	**High:** Optional	**Best Estimate:**

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate				

Description and scale of key monetised costs by 'main affected groups'

There are additional compliance requirements imposed on the financial sector. The financial sector has informed us that it is extremely difficult to single out the costs of these requirements as banks are required to comply with existing sanctions and money laundering controls. The Government is mindful of additional costs and seeks to ensure that financial restrictions are well targeted. Thorough guidance is provided to help financial and credit institutions comply with the restrictions.

Other key non-monetised costs by 'main affected groups'

UK exporters may experience difficulty securing trade finance arrangements for contracts with Iranian counterparts who have a business relationship with an Iranian bank.

UK exports to Iran declined by 46% in January to August 2011 compared to exports in the same period in 2010. The government does not encourage trade with Iran and does not provide any support for such trade.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate				

Description and scale of key monetised benefits by 'main affected groups'

Other key non-monetised benefits by 'main affected groups'

Iran's proliferation-sensitive activities are a significant threat to the UK's national interests. The aim of the direction is to protect the UK financial sector from being unknowingly used to facilitate Iran's proliferation activities and therefore making it more difficult for Iran to access a key financial centre. The benefit of this action will be its contribution to a reduction in risk to the UK's national interests. This is a highly significant foreign policy and national security benefit.

Key assumptions/sensitivities/risks — **Discount rate (%)**

Key risks are: (1) That financial and credit institutions in other countries will provide financial services to Iranian banks, including in support of Iran's proliferation-sensitive activities, and so the benefits of the measure will be reduced. The Government will raise this risk with international partners. (2) That affected parties could bring legal challenges, which could give rise to litigation costs.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs:	**Benefits:**	**Net:**	No	IN/OUT/Zero net cost

Evidence Base (for summary sheets)

International Context

Iran continues to develop its nuclear programme. The November 2011 Board Report of the International Atomic Energy Agency (IAEA) contains serious concerns about possible military dimensions to Iran's nuclear programme. The information in the report indicates that Iran has carried out the following activities that are relevant to the development of a nuclear explosive device:

- Efforts, some successful, to procure nuclear related and dual use equipment and materials by military related individuals and entities

- Efforts to develop undeclared pathways for the production of nuclear material;

- The acquisition of nuclear weapons development information and documentation from a clandestine nuclear supply network; and

- Work on the development of an indigenous design of a nuclear weapon including the testing of components.

While some of the activities identified have civilian as well as military applications, others are specific to nuclear weapons. The information indicates that prior to the end of 2003 the above activities took place under a structured programme. There are also indications that some activities relevant to the development of a nuclear explosive device continued after 2003, and that some may still be ongoing.

The international community has expressed ongoing concerns about Iran's proliferation-sensitive activities and have indicated the need to impose further restrictive measures. The case for action is underlined by the recent calls from the Financial Action Task Force for countries to apply effective counter-measures to protect their financial sectors from money laundering and financing of terrorism risks emanating from Iran. The FATF (the global standard setting body for anti-money laundering and combating the financing of terrorism) renewed these calls with urgency on 28th October 2011 and noted its particular and exceptional concern about Iran's failure to address the risk of terrorist financing and the serious threat this poses to the integrity of the international financial system.

These activities are in breach of Iran's obligations to the IAEA as a signatory to the Treaty on the Non-Proliferation of Nuclear Weapons (the international system for preventing nuclear proliferation). Iran has claimed that its nuclear activities are for the production of a civil power generation programme, but the international community shares concerns that the same technology could be used to produce nuclear weapons. This is deeply concerning for the following reasons:

- Implications for deepening unrest in the Middle East
- Risk of nuclear arms race causing further instability in the region
- The Nuclear Non-Proliferation Treaty (NPT), the international agreement to limit the proliferation of nuclear weapons, may collapse.

The actions of the Government of Iran undermine the existence of an international system designed to prevent the proliferation of nuclear weapons and their means of delivery. The United Nations Security Council has affirmed that this is of itself a threat to international peace and security. The stance of the Iranian Government since 2003 has undermined international confidence that the intentions that underlie Iran's nuclear programme are exclusively peaceful. This may encourage other states, in the region or elsewhere, to seek to acquire nuclear weapons or their means of delivery or to pursue a destabilising policy of accumulation of conventional arms.

The UN Security Council has repeatedly called upon Iran to suspend all enrichment-related activities, and has imposed incremental sanctions on individuals and entities involved in Iran's nuclear programme. Over recent years, the UN Security Council has adopted several resolutions requiring mandatory suspension of Iran's sensitive nuclear technologies, to answer questions about their nuclear programme and co-operate with the IAEA. As a result of non-compliance from Iran, the UN have increased pressure on Iran by strengthening restrictions on individuals and entities closely associated with Iran's proliferation sensitive activities, increasing vigilance over the activities of Iranian banks and imposing export controls on items of concern.

Iran's failure to comply with these resolutions poses a major test of international resolve and one of the greatest threats to the peace of the wider world. Iran's actions on the nuclear issue are deeply concerning – if they do not restore international confidence in their ultimate nuclear intentions, there is a serious risk others will choose to develop their own nuclear capability, and/or that regional powers will decide to take military action.

The UK Government has raised these concerns with its international partners and seeks to take internationally coordinated action where possible.

Domestic Policy Context

The UK Government is seeking a lasting solution to this issue through diplomacy and negotiations. A dual track strategy of engagement and pressure has slowed progress on the nuclear programme. The UK and its international partners stand ready to meet Iran for meaningful negotiations on the nuclear issue.

The UK has implemented UN and EU financial sanctions against Iran in full. The most recent UN Security Council Resolution (UNSCR 1929) was adopted on 9 June 2010, and imposes further restrictive measures against Iran. The UN Security Council expressed deep concern over Iran's failure to suspend its nuclear activities. As a result, UNSCR 1929 imposed sanctions against Iran, including an arms embargo and restrictions on financial and shipping enterprises that have facilitated proliferation-sensitive activities.

On 26 July 2010, the European Union adopted Council Decision 2010/413/CFSP, which provided for measures intended to restrict Iran's proliferation-sensitive activities. These measures give effect to UNSCR 1929. The EU Council Decision binds Member States to implement restrictive measures as set out in UNSCR 1929 and additional sanctions introduced by the Union prohibiting future investment in or trade with Iranian or Iranian owned enterprises, even outside Iran, in the oil and gas sector. The EU Council Decision was implemented via Council Regulation (EU) 961/2010 on 27 October 2010, which includes:

- export controls on goods and technology which could contribute to the development of nuclear and ballistic missile weapons
- embargo on key equipment and technology for the oil and gas industries.
- restrictions on access to EU airports for certain cargo flights including certain services to vessels and aircraft
- prohibition on new commitments for grants, financial assistance and concessional loans to the Government of Iran or public financial support for trade with Iran

- prohibitions on transferring funds to and from an Iranian person, entity or body unless the transfer is notified to the Treasury if over €10,000 and submitted for prior authorisation if €40,000 or above (transactions in respect of foodstuffs, healthcare, medical equipment or for humanitarian purposes need only be notified regardless of the amount)
- prohibitions on providing new insurance and reinsurance to Iran
- asset freezing measures on additional entities, including certain banks;
- prohibitions on establishing new bank accounts, correspondent banking relationships or joint ventures with Iranian banks or their branches and subsidiaries wherever located, and from establishing new representative offices in Iran
- prohibitions on providing access to the EU bonds markets to Iran.

Schedule 7 to the Counter-Terrorism Act 2008 gives the Treasury powers to take action in response to risks to the UK's national interests posed by proliferation, terrorist financing or money laundering activities carried on in other countries. These powers range from directing the UK financial and credit institutions to cease business relationships and/or transactions with a person, entity or government of a country of concern to requiring systematic reporting of specified information and documents relating to transactions and business relationships with such persons.

Rationale for intervention

Attempts by the international community to persuade Iran to engage constructively on the issue of its proliferation-sensitive activities have not achieved this objective so far. UN and EU sanctions measures have brought significant pressure to bear on Iran's international procurement for its proliferation-sensitive activities and wider pressure on the Iranian economy. HM Government supports these efforts and continues to pursue multilateral action through international forums. However, the risk posed by Iran's nuclear activities to the UK's national interests remains. Further action is required.

Recent UN and EU sanctions have resulted in significant positive steps in encouraging Iran to participate in negotiations with the international community. Negotiations resumed in November 2010, but broke down at the second round of talks in January 2011. Iran was not willing to negotiate without a commitment from the E3+3 (UK, France, Germany, US, China and Russia) that Iran had a right to enrich uranium and that all sanctions would be lifted. These conditions were unacceptable. Iran has since failed to engage in further negotiations. HM Government believes further pressure is now required.

The Prime Minister and the Foreign Secretary have since outlined their intentions to focus efforts on a lasting solution through diplomacy and negotiations but failing that to increase further pressure on Iran to comply with international sanctions and draw them back to talks for meaningful negotiations on their nuclear programme.

It is the firm view of the Government that it is in the UK's national interest to stop Iran from developing a nuclear weapon and that there would be serious consequences for UK interests should this goal not be met. In particular, a nuclear-armed Iran could promote an arms race in the Middle East (nuclear or otherwise) which could have a significant destabilising effect on the region. This would jeopardise UK interests in the region, particularly UK military and diplomatic personnel and installations. Furthermore, the Middle East is a critical region for global oil and gas supplies. Disruption to these could have a detrimental effect not only on the UK's energy supply, but resultant price disruption could have a negative impact on global and UK economies. Finally, there is a risk of an attack on Iran to deny it a nuclear capability. That in turn could lead to a wider conflict situation which may have broader implications.

Iranian proliferators have used Iranian banks to finance and procure equipment related to Iran's nuclear programme. Iranian banks play a crucial role in providing financial services to individuals and entities within Iran's nuclear and ballistic missile programmes as companies carrying out proliferation activities will typically require banking services. Any Iranian bank is exposed to the risk of being used by proliferators in Iran's nuclear and ballistic missile programmes. Experience under existing UN and EU financial sanctions against Iran demonstrates that targeting individual Iranian banks is not sufficient. Once one bank is targeted, a new one can step into its place.

Intervention is necessary to protect the UK financial sector from the risk of inadvertently facilitating proliferation-related activities. Although the EU sanctions make it considerably more difficult for Iran or Iranian entities to transact with the UK, there remains a risk that Iranian banks will use the UK to facilitate procurement for its proliferation-sensitive activities through routes still open to them.

Policy Objectives

The policy objective is to minimise the threat to the UK's national interests posed by Iran's proliferation-sensitive activities and reduce the risk of the UK financial sector being unwittingly used to facilitate Iran's proliferation-sensitive activities.

Policy Options

The Treasury has considered three options:

1. Do nothing: Existing restrictive measures against Iran and its proliferation-sensitive activities have brought pressure to bear which has encouraged Iran back to international negotiations, but they have not succeeded. Doing nothing will not mitigate the risk to the UK's national interests.

2. To issue a direction to UK credit and financial institutions to undertake systematic reporting on transactions with Iranian banks: the effect of directing UK financial and credit institutions to undertake systematic reporting on transactions with Iranian banks could provide useful information for investigative purposes. It could act as a deterrent to dissuade Iranian banks and other entities from undertaking activities in support of proliferation through the UK financial sector. However, this option would not be as effective in mitigating the risk to the UK's national interests. It would not make transactions more difficult for Iranian banks. The reporting burden would fall on the UK financial sector, which could be costly for them to implement, as there may be a need for new internal reporting systems to be set up. Reporting transactions would not provide a means to stop transactions of concern from going ahead, if they could be identified.

3. To issue a direction to UK credit and financial institutions to cease all transactions and business relationships with Iranian banks: directing UK financial and credit institutions to cease all business with Iranian banks, including the Central Bank of Iran, will be the most effective means to ensure that the UK financial sector is not being used by Iranian banks to facilitate proliferation related activities. We consider that this would be the most effective option to reduce the risk posed to the UK from Iran's proliferation-sensitive activities, and is the Government's preferred option.

Costs and benefits of each option

Option 1: Do nothing

Costs
This option will bear no direct costs for the UK financial sector and HM Government.
However, the policy cost of doing nothing could be significant, as it does not reduce the risk to the UK's national interests.

Benefits
UK businesses can continue to use UK credit and financial institutions to undertake transactions with Iranian banks.

Option 2: To issue a direction to UK credit and financial institutions to undertake systematic reporting on transactions with Iranian banks

Costs
Directing UK credit and financial institutions to undertake systematic reporting on transactions with Iranian banks will require institutions to submit reports to HM Government with details of relevant transactions. This may mean that credit and financial institutions have to put in place new systems to comply with the direction. Informal discussions with the sector on general implementation costs indicate that this could be a costly system to put in place.

Benefits

The benefits of issuing a direction to UK credit and financial institutions to undertake systematic reporting are negligible. While this measure may act to deter Iranian banks from using UK financial and credit institutions for transactions in support of proliferation-sensitive activities, we believe that this would not be an effective way of reducing the risk posed by Iran and ensuring that UK credit and financial institutions are not vulnerable to being used to facilitate proliferation-sensitive activities. Iranian banks have used deceptive practices to circumvent existing sanctions measures. This means it may be difficult or impossible for the UK financial sector or HM Government to identify where a reported transaction is related to activities of concern. Requiring transactions to be reported would not provide any additional means to prevent transactions of concern, if they are identifiable. This option also fails to increase pressure on Iran to comply with the UN Security Council resolutions and cooperate with the international community on seeking a peaceful resolution to its nuclear programme.

Existing EU sanctions contain requirements to report certain transfers of funds to or from Iranian persons, entities or bodies to HM Treasury. This option would not add any significant benefit beyond this existing requirement.

Option 3: To issue a direction to UK credit and financial institutions to cease transactions and business relationships with Iranian banks

Costs

The costs of directing UK financial institutions to cease all business between the UK financial sector and Iranian banks, including the Central Bank of Iran may be significant for the few UK banks who have significant dealings and business relationships with Iranian banks. It will mean that those business relationships will have to wind down and it is unlikely we will license significant further exemptions for businesses as this would risk undermining the purpose of the measure (although all licence applications will be assessed on a case-by-case basis).

Discussions with the British Bankers' Association, individual financial institutions and the Financial Services Authority, indicate that only a small number of UK credit and financial institutions undertake any significant business with Iranian banks, including the Central Bank of Iran. These industry representatives have informed us that it is not possible to estimate the costs of compliance with this type of measure. This is because all financial and credit institutions will already be undertaking due diligence practices to comply with their obligations under the Money Laundering Regulations and financial sanctions regimes, as well as risk analysis normally undertaken as part of commercial practices. It is not possible to identify additional costs arising from further financial restrictions as existing compliance mechanisms will be used to implement them.

Financial and credit institutions are obliged to have systems and controls in place to counter the risk they might be used to further financial crime. Sanctions breaches would be one type of financial crime risk financial institutions should guard against.

The FSA is responsible for overseeing the adequacy of the measures taken by financial firms it supervises; this forms one aspect of the FSA's supervision of financial firms, alongside, for example, overseeing the adequacy of firms' financial resources and the steps they take to ensure they treat customers fairly. In addition, supervisors (the FSA, HM Revenue and Customs, the Office of Fair Trading and the Department of Enterprise, Trade and Investment (Northern Ireland)) have a statutory responsibility for monitoring firms' compliance with directions made under the Counter-Terrorism Act.

Supervisory staff can explore the adequacy of banks' measures as part of their wider supervisory work. The costs of undertaking supervision and compliance build on existing anti-money laundering and counter-terrorist financing enforcement and supervision arrangements, which would be integrated into supervisors' current enforcement activities and systems concerning anti-money laundering and counter-terrorism financing. It is not likely supervisors would incur significant additional costs as a result of the introduction of a ban on business with all Iranian banks, although opportunity costs may be incurred: other work may be deprioritised if the attention of supervisory staff becomes focused on banks' compliance with sanctions against Iran.

Added administrative costs for HM Treasury in relation to responding to public queries and operating a licensing regime will be met from existing Treasury resources.

There will be no additional costs for Iranian banks in the UK as they have been designated for an asset freeze under UN and EU sanctions, which means they are not able to carry out any business except under Treasury licence.

UK financial and credit institutions will be prohibited from continuing or entering into business relationships and transactions with Iranian banks, including the Central Bank of Iran, which will have a knock-on impact on their UK customers who have financial links with Iran. Schedule 7 to the Counter-Terrorism Act 2008 contains licensing provisions which enable the Treasury to exempt certain activities from the restrictions. The Treasury intends to minimise disruption to innocent third parties, including companies who may have prior contracts with Iranian companies that rely on transactions with Iranian banks. The Treasury will consider all applications for licences of exemption on a case-by-case basis and is particularly mindful of the potential adverse impacts on companies who have entered into a contract before the restrictions were imposed in good faith and individuals who wish to make personal remittances to relatives in Iran who hold bank accounts with Iranian banks. The Treasury will issue general licences exempting certain low risk transactions from the restrictions.

Benefits

The Government's policy objective is to minimise the threat to UK national interests posed by Iran's proliferation-sensitive activities. The direction will make it more difficult for Iranian proliferators to carry out transactions of concern through the international financial system by blocking off Iranian banks' access to the UK financial sector. They will not be able to make transactions involving UK financial institutions, which will narrow the choices available to them, and it is likely other countries will also be more cautious about dealing with Iranian banks as a result of the UK's action. This will reduce the risk of the UK financial sector being unknowingly used to facilitate Iran's proliferation-sensitive activities. This will protect the UK financial sector thereby maintaining the integrity and credibility of the UK financial services industry as a world leading financial centre.

Offences and penalties provision

Criminal offences and civil penalties apply in relation to non-compliance with, or knowing and intentional circumvention of, the requirements of the direction. The penalty for a breach of this direction could be a fine, imprisonment for a maximum of two years, or both a fine and imprisonment. These penalties are the same as those that enforcement authorities and courts may impose for non-compliance with the requirements of the Money Laundering Regulations 2007.

Failure to comply with the terms of a licence of exemption from the requirements of a direction is subject to civil penalties.

Risks and assumptions

There is a risk that the measure will be weakened by financial institutions in other countries providing financial services to Iranian banks, including in support of Iran's proliferation-sensitive activities. The Government will raise this risk with international partners and push for further international action.

There is a risk that affected parties will bring legal challenges against the Government as a result of the measure, which will give rise to litigation costs, and, if the challenge is successful, to adverse costs and potentially damages.

Human Rights impacts

The direction strikes an appropriate balance between the requirements of the public interest and the requirements of the protection of an individual's rights, and provision of a fair hearing and respect for privacy, and is therefore compatible with Article 1 of Protocol 1 to, and Article 6 of the European Convention of Human Rights (ECHR), as set out below:

Article 1 of Protocol 1

In requiring the cessation of a person's business or transactions with persons in a third country, the direction may interfere with the peaceful enjoyment of possessions and thus engage Article 1 of Protocol 1 to the

ECHR. We consider such interference is justified in the public interest, given the risk posed to the UK's national interest by activity in Iran. The Treasury's power to grant licences to exempt certain acts from the restrictions potentially mitigates any interference, and enables the Treasury to ensure that a fair balance is struck in any particular case.

Article 6

Supervisory authorities can impose civil penalties for breaches of the requirements of a direction. This is subject to a right of appeal to an independent tribunal, thus satisfying the requirements of Article 6.

Persons affected by a direction can challenge the direction in the High Court under the procedure in Part 5 of the Counter-Terrorism Act 2008.

Summary and preferred option with description of implementation plan.

Iran continues to fail to meet UN calls for it to suspend its nuclear programme and return to peaceful negotiations with the international community. Most notably, its nuclear programme presents an immediate challenge to the global non-proliferation regime and to the long-term stability of Middle East peace and security.

Government intervention is necessary to address the risks posed by Iranian proliferation to the UK's national interests. Iranian banks play a crucial role in providing financial services to individuals and entities within Iran's nuclear and ballistic missile programmes as companies carrying out proliferation activities will typically require banking services.

The policy objective is to minimise threat to UK national interests by reducing the risk of the UK financial sector being unwittingly used to facilitate Iran's proliferation-sensitive activities.

Cutting Iran off from a key financial centre will add wider pressure on Iran to engage with the international community and encourage Iran to change its behaviour. To issue a direction to credit and financial institutions to cease business relationships and transactions with Iranian banks using powers under the CT Act is the most effective means of achieving the UK's objectives in this area and is the Government's preferred option.

Implementation

Following the direction coming into force, HM Treasury will publish detailed guidance on its website, alongside general licences of exemption for certain low risk categories of business and application forms for other licences. The guidance and any associated literature will be emailed to a wide distribution of stakeholders that will be affected by the direction.

In addition, there will be a dedicated outreach programme that will focus on engaging with stakeholders so that we are able to outline what is required under the direction and an opportunity to pose questions and provide clarity, where needed. There will also be a dedicated public queries helpline and an email inbox for queries and licence applications.