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Will Instex Save JCPOA?

Ain't Circumventin'

Germany, France, and the UK announced late last week a mechanism to continue trade with Iran despite renewal of US sanctions. Called the Instrument in Support of Trade Exchanges (Instex), it allows for the bartering of goods to bypass the need to use dollars.

The entity was announced last week at a European Union foreign ministers meeting in Bucharest.

The main object remains securing continued compliance by Iran in the Joint Comprehensive Plan of Action (JCPOA). This is the agreement by which Tehran agreed to cease development toward armament-grade enriched uranium in return for the phasing out of Western sanctions. After a multi-year negotiation process, the US, UK, Germany, France, Russia, China, the EU, and Iran signed the accord in 2015.

Trump pulled the US out of the treaty and instituted renewal of Iranian sanctions to begin the first week in November of 2018. However, at the eleventh hour, Washington provided 180-day exemptions to the eight largest importers of Iranian crude. Those exemptions are scheduled to expire at the beginning of May, and the US Administration has declared that no new continuances would be granted.

All of the other foreign signatories have stipulated that Iran has abided by the JCPOA dictates. This has been confirmed by the Vienna based International Atomic Energy Agency (IAEA) and, embarrassingly enough, by all of Trump's appointed US intel heads in recent Congressional testimony.

Instex is the latest indication of how livid erstwhile European US allies are with the Washington pull-out from JCPOA. The barter arrangement is the third major move made by London, Paris, and Berlin, with support from Brussels (the headquarters location for the EU).

The two earlier initiatives committed to central bank connections with Bank Markazi (the Iranian central bank) and a continuing banking exchange relationship. These two decisions also have Russian and Chinese agreement, as well as support from Turkey (not a JCPOA member).

Instex is registered as a special purpose vehicle (SPV) under French law with a physical location in Paris. Initial working capital will be provided by the UK, Germany, and France. Activities are expected to begin later this year, with Tehran setting up a parallel organization to orchestrate trade from its side.

Instex will be run by this fellow, Per Fischer.

Photo: *Global Banking & Finance Review*

He is a director of German Commerzbank, with primary responsibilities for Russia, the CIS (former USSR republics), Central Europe, the Baltics, and Turkey. Fischer likewise has experience in financial matters pertaining to the Organization for Security and Cooperation in Europe (OSCE). In addition, Per is also an international finance colleague of mine.

Instex will begin operations by facilitating a trade flow into Iran that is *not* currently subject to US sanctions. This will involve humanitarian supplies, medicines, pharmaceuticals, certain food products and consumer goods.

However, the activities will later expand into areas that would be subject to US sanctions. So long as the trade does not require access to dollars, it may well evade Washington's intent. Small to mid-size European companies having no assets in the US would certainly benefit from Instex.

Blocking & Tackling

But the import may well become bigger than simple barter. As an SPV, Instex could allow for significantly broader usage of assets, collateral transfers, and even credit swaps without requiring access to US dollar accounts.

Then again, contacts at the EU Secretariat in Brussels are telling me that there will be a "backdoor" channel established to plug Instex into central banking protection. A European commitment by the Continent's central banks to Iran was made at an EU meeting in Sofia last year. Instex is regarded by many in my circles as a formalizing of that commitment in the trade arena.

In this regard, it its noteworthy that the Europaeisch-Iranische Handelsbank (Iranian-European Bank, EIH), based in Hamburg, continues to operate. EIH was subject to sanctions in 2012. At that time, the sanction was American, but with the support of the EU. That is not the situation this time around.

Europaeisch-Iranische Handelsbank, Depenau 2, Hamburg Photo: EIH

EIH has the support of the German central bank. Of more than passing interest, EIH has its other offices in Tehran and on Kish Island – in the center of Iranian oil export trade.

In addition, late last year the Iranian (and German) licensed branch of Iranian commercial house Bank Melli (also located in Hamburg) received German court support against US secondary sanctions.

The issue at the time was suspension of Bank Melli telephone and communications services from Deutsche Telecom (DT). The German company argued that it had to suspend the services because of concerns that the US would apply secondary sanctions against the communications firm.

The court decision provided level cover for DT to put the phones back on. DT has assets in the US, making it an easy target for sanctions. On the other hand, Bank Melli does not operate in the US and has no bank accounts or assets there.

The EU has already telegraphed its intent to pass legislation insulating EU-member country companies from US sanctions. Such devices, known as “blocking statutes,” would increase European-US rancor to levels not seen in decades. But there remains strong support in Brussels for the defensive application of such legislation.

You BREXIT, We’ll Buy It

Meanwhile, the continuing BREXIT mess may actually strengthen EU resolve on the Iranian front. Several of my European banking contacts suggest that a departure of the UK from Europe is likely to intensify European decisions to establish a trading demeanor apart from what may be happening in London. As one succinctly put it to me last week, “[UK Prime Minister Theresa] May’s BREXIT difficulties may directly benefit Iran in developing separate European trading protections.”

On the other side, Iranian sources indicate that Tehran needs decisions like Instex to have formal overt European central government and banking support, with expansion into trade more directly confronting US sanctions.

I have suggested, and all of my contact network on the Continent and in the Middle East concur, that there are three triggers for this official recognition happening.

First, inclusion of government export and trade credit agencies would be a strong signal of European resolve to lessen risk. These would include the UK Export Credits Guarantee Department (aka, UK Export Finance); French Coface; German Hermes; and Italian SACE.

These could be connected to the Export Guarantee Fund of Iran (EGRI) to facilitate trade, in which the valuation of goods exchanged could be offset by guarantees not requiring access to either dollars or the US banking system.

Second, banking systems outside Europe have expressed interest. These include banking in Turkey, Russia, and China – three countries already on record as opposing the resumption of US sanctions. This has a more direct impact on oil trade, since it would allow primary importers to bypass dollar-dominated banking transactions.

Third, given that Instex is an SPV, the applications of such a vehicle can be expanded beyond per-trade bartering arrangements. One colleague has suggested that this could even encompass setting up “tradable asset units” (TAUs) that are then “bartered.” Such “units” would be both structured and valued independently. These is nothing in theory to prevent a TAU from being delineated in barrels or tons of crude oil.

All of these dynamics would introduce additional layers in and/or parties to transactions, thereby increasing the cost of transactions and the fluidity of trade. The extent to which they are pursued is a measure of the resolve on both sides.

Is this enough to save JCPOA?

Thus far, Tehran is taking a wait and see attitude. Meanwhile, the ball is in the European court (side of pitch?). If Instex is the first wave of a European longer-term commitment, and there emerge definitive expansions beyond the initial move, JCPOA may survive.

Regardless of what Trump tweets about it.

About the Author

Dr. Kent Moors is an internationally recognized expert in oil and natural gas policy, risk management, emerging market economic development, and market risk assessment.

He serves as an advisor to the highest levels of 27 countries, including the U.S., Russian, Kazakh, Chinese, Iraqi, and Kurdish governments, to the governors of several U.S. states, and to the premiers of two Canadian provinces. He's served as a consultant to private companies, financial institutions and law firms in 29 countries, and has appeared more than 2,300 times as a featured radio-and-television commentator. He appears regularly on ABC, BBC, Bloomberg TV, CBS, CNBC, CNN, NBC, Russian RTV, and the Fox Business Network.

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