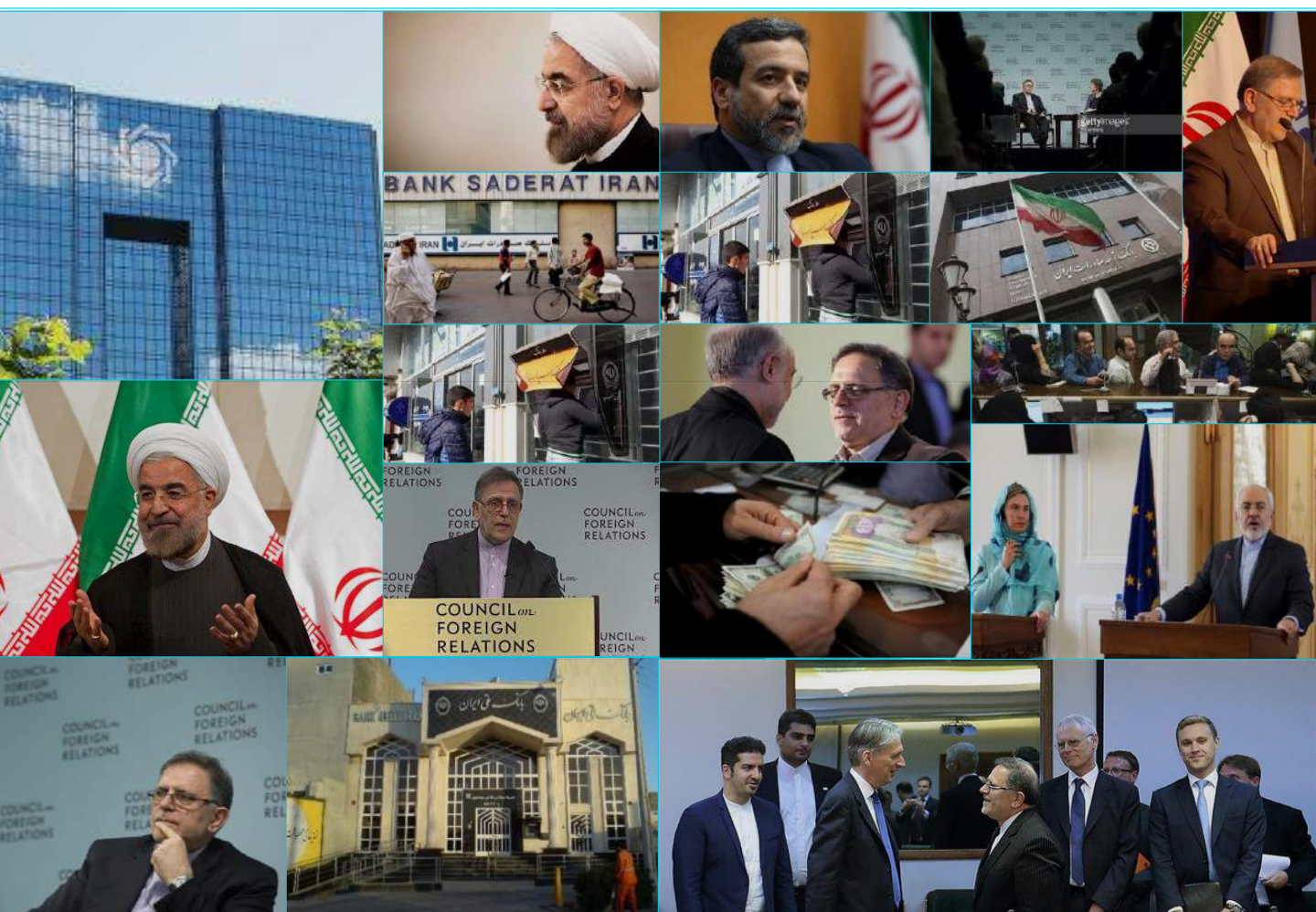


# Banking Industry Iran

current status, opportunities and threats



September 2016

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There are 30 banks and 5 financial/credit institutions active in Iran, where banks are the main source of funding for development plans and companies. The Iranian banking industry makes up for 2.5% of GDP and has the second highest penetration rate in the MENA region. Iran is the only Muslim country besides Sudan where the entire financial industry is obliged to be consistent with the principles of sharia law, accounting for more than 40% of the world's total Islamic banking assets.

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In 2001, 57 branches of private and governmental Iranian banks were active in foreign countries. The number fell to 49 in 2005, and following sanctions all overseas branches were closed. Post the implementation of the JCPOA, more than 50 branches of Iranian commercial banks are expected to restart their activities in foreign countries. Based on the Iran Foreign Investment Promotion Act, foreign banks are allowed to hold a 40% share of Iranian banks and according to the Iranian Central Bank, the necessary initial capital for foreign investors to establish a bank in Iran is at 5 million EUR.

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The Iranian Bank industry has a key role to play after the lifting of the sanctions. The opportunities created by the opening of Iran's domestic market combined with the government's desire to reform the banking system opens new development horizons for this sector.

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The lifting of sanctions will serve to substantially reconnect Iranian banks to the international financial market infrastructure and thereby reducing time and cost of doing business and trade. Improving the Banking Industry is the first and most important step for the Iranian government, in order to increase the impact of the JCPOA and achieving the 2025 vision throughout all industries.

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ILIA Corporation is a boutique management consultancy firm, focused solely on helping local and international organisations operate in Iran. ILIA empowers clients through every stage of the market entry process, from in-depth Market Insights, through to comprehensive Implementation Solutions and ultimately support during the Execution Process. Operating in Iran for nearly a decade, serving Fortune 500 companies, SME and government institutions alike, we provide clients an experienced consulting team and leverage an unrivalled network of local experts, to help you unlock the full potential of the Iranian market.

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# Recent Key Statements about Iran



The implementation of the JCPOA on January 16, 2016 is expected to help lift Iran's real GDP growth rate to 4.2 percent and 4.6 percent in 2016 and 2017, respectively. Key growth benefits include increased oil exports, the resumption of access to the SWIFT by the Central Bank of Iran and Iranian financial institutions, the provision of insurance and reinsurance, the financial support for trade with Iran, and commitments for grants, financial assistance and concessional loans to the Government of Iran.

*March 2016*



In recent years, the authorities have made considerable progress in restoring macroeconomic stability under difficult circumstances. Inflation has declined from 45 percent in 2013 to around 8 percent recently, the foreign exchange market has stabilized, and some key reforms have been implemented. The implementation of the JCPOA bodes well for the outlook. Higher oil exports, along with lower costs of trade and financial transactions, as Iranian banks reconnect to the international financial system, would help support the economy, with real GDP growth projected at 4 – 4.5 percent over the medium term.

*May 2016*



Iran will be one of the fastest growing economies in the region over the next five years as investment comes into the country following the removal of sanctions. Declining oil prices will force the government to cut current spending and investment in the country's infrastructure sector in 2016, which will result in slow expansion of private consumption and fixed investment. The removal of sanctions on Iran is a once in a decade opportunity for investors in emerging markets.

*March 2016*



Iran presents an important opportunity for multinational companies that operate in emerging markets. But managing expectations about the country's trajectory is crucial for building an effective strategy. A smart approach will find the sweet spot: advancing ahead of competitors while sidestepping first-mover mistakes that often plague companies in unfamiliar, rapidly changing, high-stakes business environments.

*May 2016*



Finally, lifting the sanctions will mean that Iran will regain access to the estimated \$90 billion assets that are currently held abroad. At a business level, sophisticated professional service firms based in the UAE, Iran's biggest source of imports, are well placed to help repatriate some of these assets. Iran also has a growing and cash-hungry tech sector, which could be a potential investment target. More importantly though, as the amounts involved are quite large, capital inflows could have wider macroeconomic effects including stabilizing the Iranian Rial in the medium-term, reducing the wedge between the official and parallel rates, and putting downward pressure on inflation. Some London-based asset managers have already teamed up with local Iranian firms to prepare for this.

*December 2015*



Currently Iran's Gross Domestic Product (GDP) is only USD 415 bn. Germany, which has a similar population size, has a GDP more than nine times higher. So there is a lot of ground to be made up. Iran is ideally suited to playing catch-up. Not only does it have an immense supply of natural resources – including the largest gas and the third largest oil reserves on the planet –, it also benefits from a relatively young, well-educated population. Iran's economy is predicted to grow between 4 and 5 per cent per year until 2020 – the end of sanctions represents a huge opportunity not only for "Made in Germany."

*January 2016*



# Iran's Banking Industry at a Glance

**2.5%**

GDP Share of Banking Industry

**100%**

Number of banks that are Sharia compliant

**5,063,954,900**

Number of transactions banking network - ATM (2015)

**20%**

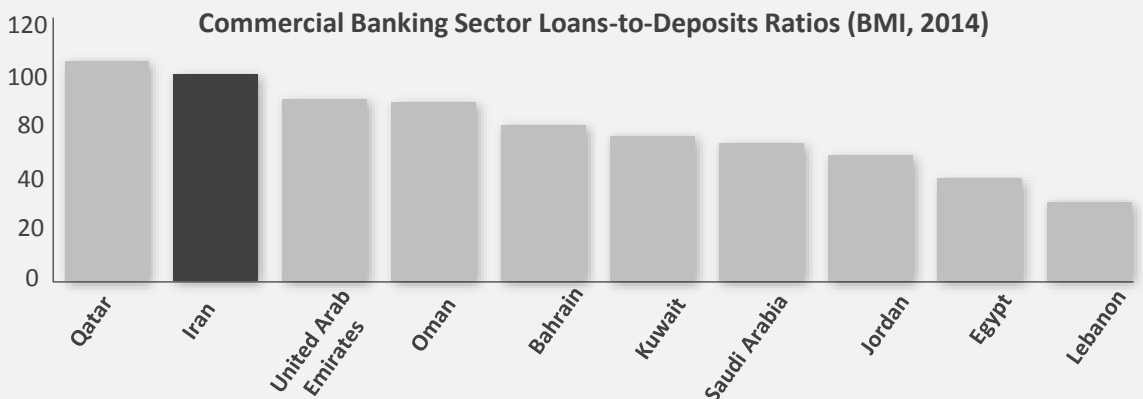
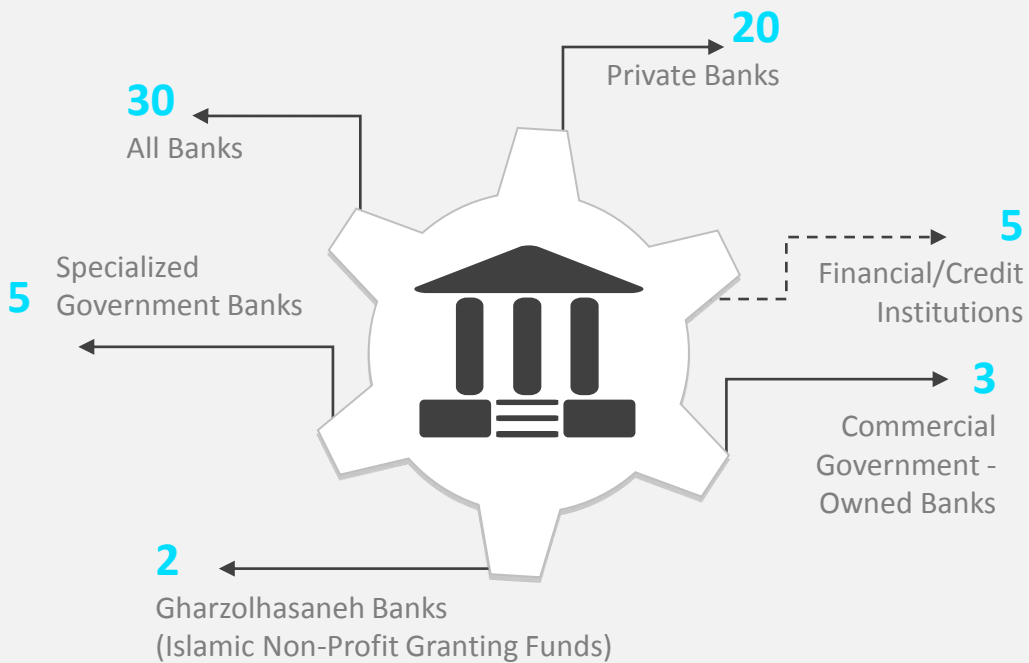
Maximum bank lending rate

**74%**

Iranians with a bank account at a formal institution

**281,407,717**

Number of transactions banking network-PIN PAD (2015)



# Iran's Economic Status & Intro to Banking

## Iran's Economic Environment & Policies in Recent Years

During the last three years, Iran's economic and political landscape has drastically changed under the influence of both endogenous and exogenous factors.

### [Sanctions in a Nutshell \(How we got here\)](#)

The United States has imposed sanctions against Iran in one form or another since the 1979 Iranian Revolution. **In 1995**, they expanded their sanctions to include non-Iranian firms which have dealings with the Iranian government, effectively preventing any company from engaging with Iran if they do business with or in the United States.

**In 2006** the United Nations, becoming increasingly concerned with Iran's nuclear enrichment program, passed progressively punitive sanctions, imposing travel bans on individuals, freezing offshore Iranian assets, blocking armament shipments and in conjunction with the EU **in 2012** disconnecting Iranian banks from SWIFT effectively cutting them out of the global financial system.

With Iran cut off from the financial world, the Rial significantly weakened and inflation accelerated, eventually peaking at 45.1% in June 2013. Access to capital in Iran was severely challenged forcing the government to intervene in Iranian banks credit allocation, effectively dictating which industries were to be prioritized for funding. During this period, Iranian banks access to liquidity as well as their profitability substantially fell and non-performing loans rose.

### [New Administration, New Strategy, New Deal](#)

Upon the new administration taking office in 2013, elected under a mandate of increasing economic growth and improving international relations, a more conservative fiscal policy and less accommodative monetary policy was adopted.

Further, on **14 July 2015** the Joint Comprehensive Plan of Action (JCPOA) was reached between Iran and the P5 + 1 (China, France, Russia, UK, US + Germany) and the EU regarding Iran's nuclear program. Under the agreement Iran accepted strict limits to reduce the capacity and proliferation risk of its nuclear infrastructure. In return, the UN, US and EU would halt the financial and economic sanctions which had been crippling the country for years. The agreement was formally adopted on 18 October 2016 and post Iran meeting the relevant requirements under the JCPOA, implemented on 16 January 2016.

### [Containment of Inflation and Expected Growth](#)

Post the adoption of the JCPOA and along with the Governments focused fiscal and monetary measures, **Iran's inflation rate has since fallen below 10% for the first time in nearly 25 years.** According to the World Bank, the implementation of the JCPOA is expected to help lift Iran's real GDP growth rate from 0.5% in 2015 to 4.2% in 2016 and 4.5% in 2017.

Although highly dependent on oil and gas, Iran has one of the most diversified economies amongst the OPEC producers and whilst we at ILIA Corporation believe that all sectors of the economy stand to benefit over the coming years, we expect progress to be slow, with many international institutions still weary of the political risk inherent in the country.

# Iran's Economic Status & Intro to Banking

## What is at Stake for Iran's Banking Sector?

Iran's banking sector is expected to benefit from the lifting of the sanctions, and lending growth should pick up towards the latter half of 2016.

Nevertheless, many sanctions on the banking sector still remain and will likely limit the short-term positive impacts. The first milestone to the stabilization of Iran's banking sector has been achieved, but a boom in the lending and deposit market is not expected for several years.

The main stabilization factor will be the access to the Society for Worldwide Interbank Financial Telecommunication (SWIFT) transactions. Ending the isolation of the Iranian banking sector from the global bank-to-bank transactions is a key issue in revitalizing the Iranian economy. Once this decisive step is taken, Iranian banks will be able to raise capital in the international markets and undertake international transactions.

Whilst the timing of this process is not precisely known, **Iranian banks should gain broad access to non-US dollar denominated SWIFT transactions during the second half of 2016 and to US dollar transactions in mid 2017.** It is important to note despite the lifting of the sanctions obstacles will remain. Logistical problems will have to be handled, including compliance issues for companies operating in both the US and the EU, since the timing of the lifting of the sanctions will be different for each region. Further we would highlight that many foreign financial institutions will be cautious of processing transactions in/with Iran, given the severe fines imposed during the previous sanctions era.

Ultimately, we believe the end of the sanctions and expected growth of Iran's economy will create the conditions for this sector's activity to flourish, both on a national and international scale, however remain cautious on timing given the infancy of the post JCPOA era.

**BNP** agreed to pay almost \$8.9 billion in penalties and pled guilty to settle charges it concealed roughly \$8.8 billion of transactions with countries like Sudan, Iran and Cuba.

**HSBC** was accused of conducting transactions on behalf of customers in Cuba, Iran, Libya, Sudan and Burma, all of which were on the sanctions list, and paid nearly \$1.3 billion.

**ING** was assessed with a \$619 million penalty for allegedly moving billions of dollars on behalf of sanctioned Cuban and Iranian entities.

**Credit Suisse** paid \$536 million for transactions on behalf of customers from Iran and the Sudan.

**Lloyds TSB Bank** was hit with a \$350 million fine in January 2009 related to transactions with Iranian customers.

**Barclays** paid \$298 million in August 2010 for allegedly stripping wire transfers for customers in Cuba, Iran and elsewhere.

[www.americanbanker.com](http://www.americanbanker.com)

# 1. Iran Banking Industry

Islamic banking is based on the principle of profit-earning on equity participation, the earning of interest being forbidden.

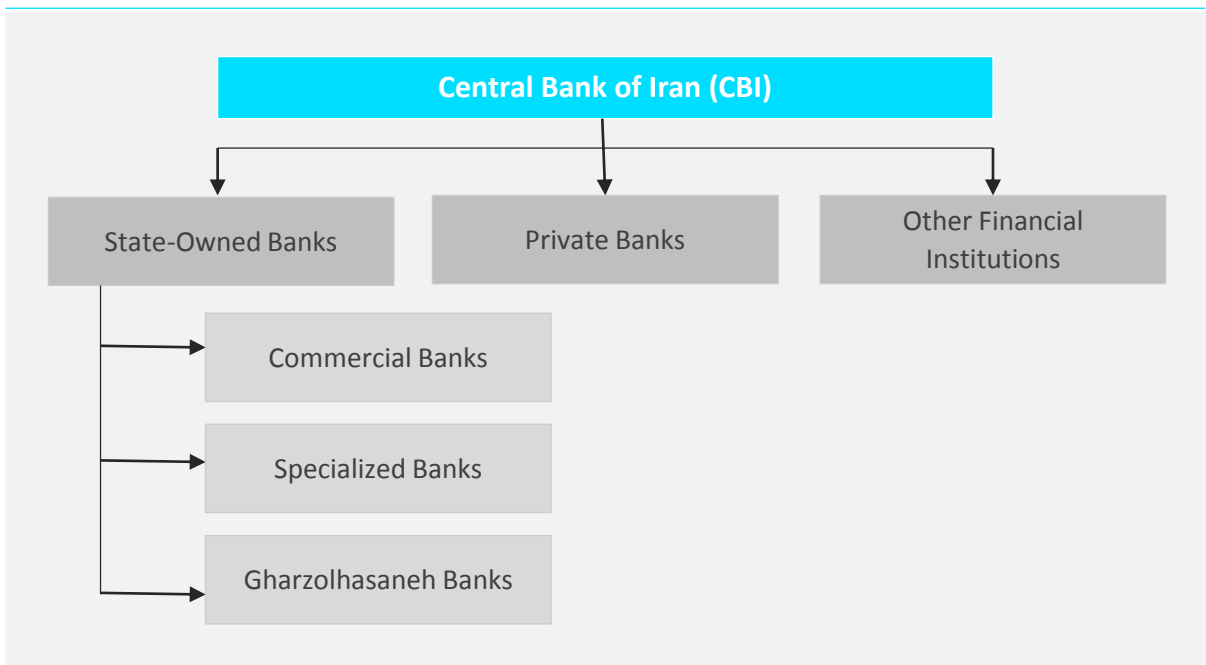
Iran's modern banking industry has a 95-year history. Modern banking in Iran was introduced and dominated by foreign banks up to the late 1920s. The foreign banks, despite their early contribution in introducing many financial innovations, did little to foster indigenous economic development. In 1960 the Iran central bank was established. Later legislation further defined its powers and responsibilities. The banking laws limited foreign participation to 40 percent in any bank operating in Iran (except the Soviet bank, which had been founded much earlier). Subsequently, the Central Bank limited foreign ownership in new banks to 35 percent.

In 1979, after the Iranian Islamic revolution, all banks along with a number of other financial and industrial establishments were nationalized, and the governor of the central bank was inaugurated. The nationalization and the subsequent consolidation of the banks paved the way for the launch of Islamic banking. Nowadays, **Iran's banking system is 100% Sharia compliant** (The highest of any country), far exceeding that of Saudi Arabia, Kuwait and Brunei, which are all less than 50%.

Currently, there are 30 banks and 5 financial/credit institutions active in Iran, where banks are the main source of funding for development plans and companies. The Iranian banking industry makes up for 2.5% of GDP and has the second highest penetration rate in the MENA region.

20 Iranian banks have been listed on the Tehran Stock Exchange. Currently the government plans to expand the use of online banking and to modernize the banking systems that are at the moment far from international standards.

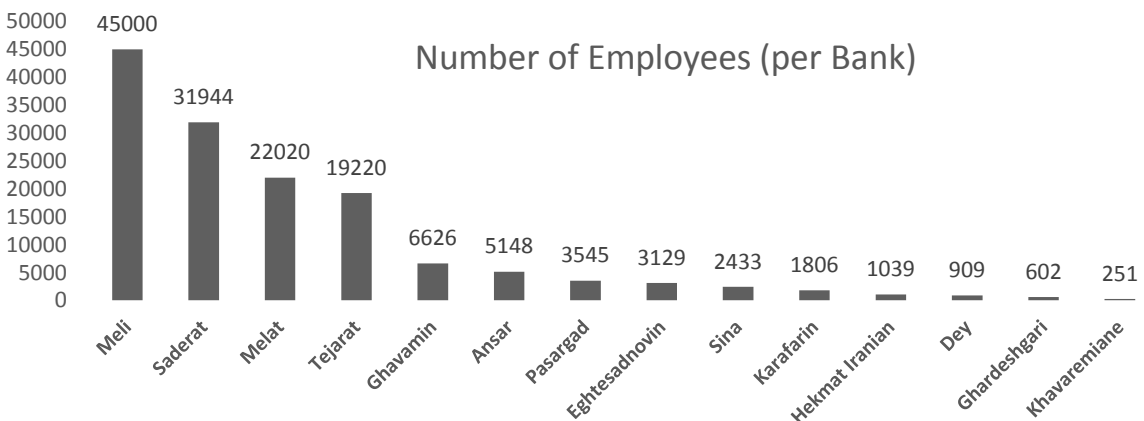
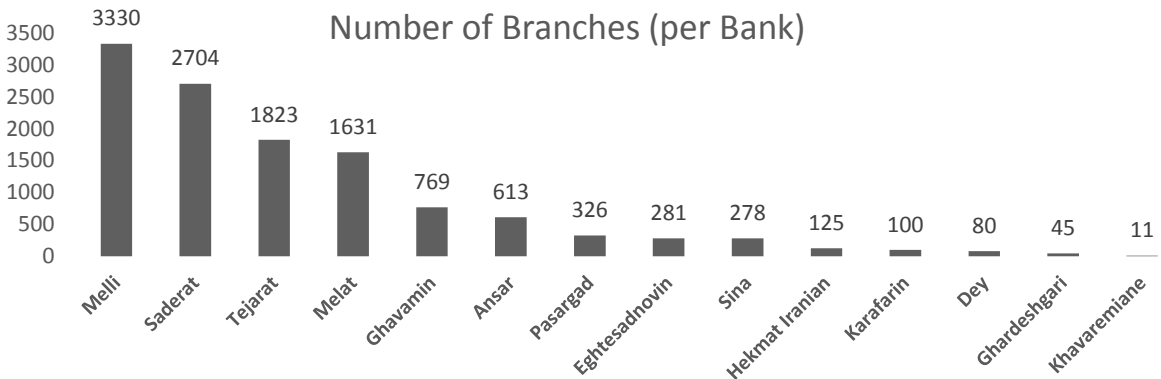
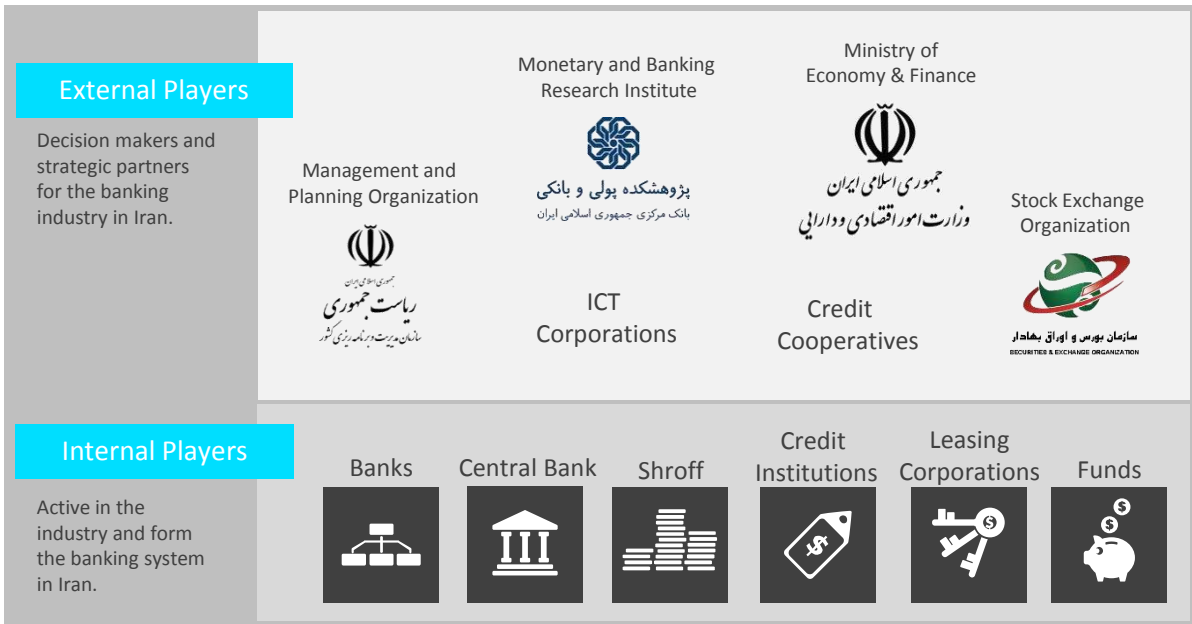
The following figure illustrates the hierarchical structure of Iran's banking sector. As it is depicted, there are 3 different types of banks in Iran, and all of them are under the rule of the central bank.





## Key Players in Iran's Banking Industry

There are many players in the Iranian banking industry, which can be categorized into 2 major groups, namely internal and external. The first group contains the direct players and the second is constituted of businesses related to the industry. Melli and Saderat are the banks with the largest number of branches and employees. According to the Industry Management Institute IMI100 2015 ranking (top one-hundred companies list announced by IMI every year), Melli Bank is the most valuable holding in the banking industry and the third among all industries in Iran.



# Islamic Banking Aspects In Iran

*“Iran banks try to operate Islamic banking considering banking without Riba (usury). Although banks in Iran are based on Islamic banking, monitoring the system is a necessary action.”*

*CEO of the Central Bank of Iran*

Islamic banks are those banks that follow Islamic Sharia (the body of Islamic law) in their business transactions. Among other things, **Sharia prohibits dealing in interest and undertaking transactions with unknown fate**, while it requires transactions to be lawful (halal). Abolishing interest from their dealings is the fundamental principle on which Islamic banks are based. Use of Riba (usury) violates the principle of social justice, which is very important in Islam, because it leads to rewarding people without them making an effort. Those who lend money on interest do not make an effort, nor do they participate in the risks of the projects financed, and such behavior is rejected by the teachings of Islam. Interest-based transactions allow lenders to receive the advantages associated with lending their money, while avoiding the risks and losses attached to ownership.\*

## Difference between Conventional and Islamic banking

Conventional Banking	Islamic Banking
❖ Money is a commodity besides medium of exchange and store of value. Therefore, it can be sold at a price higher than its face value and it can also be rented out.	❖ Money is not a commodity though it is used as a medium of exchange and store of value. Therefore, it cannot be sold at a price higher than its face value or rented out.
❖ Time value is the basis for charging interest on capital.	❖ Profit on trade of goods or charging on providing service is the basis for earning profit.
❖ Interest is charged even in case the organization suffers losses; Therefore, it is not based on profit and loss sharing.	❖ Islamic bank operates on the basis of profit and loss sharing. In case, the businessman has suffered losses, the bank will share these losses based on the mode of finance used.
❖ While disbursing cash finance, running finance or working capital finance, no agreement for exchange of goods & services is made.	❖ The execution of agreements for the exchange of goods & services is a must. Islamic banking tends to create link with the real sectors of the economic system by using trade related activities.
❖ Conventional banks use money as a commodity which leads to inflation.	❖ Islamic banking tends to create link with the real sectors of the economic system by using trade related activities. Since, the money is linked with the real assets therefore it contributes directly in the economic development.

Since 1983 Iran adopted the non interest banking system and applies Islamic principals to the financial industry. While there are differing views about its performance in Iran, all are agree that the industry needs improvement.

\* Based on Sharia law (resulting from Quran and the life of Prophet Mohammad) certain financial methods/tools are prohibited: e.g. riba (interest), gharar (uncertainty), and maisir (gambling).

# Classification of Iranian Banks



## Financial/Credit Institutions

1. Tosee Credit Institute
2. Kosar Credit Institute
3. Askariye Credit Institute
4. Noor Credit Institute
5. Caspian Credit Institute

## Governmental Banks

- Specialized Government Banks\*
1. Export Development Bank of Iran
  2. Bank of Industry & Mine
  3. Bank Keshavarzi
  4. Bank Maskan
  5. Cooperative Development Bank
- Commercial Government-Owned Banks\*\*
1. Bank Sepah
  2. Bank Mellat
  3. Post Bank
- Gharz-al-Hasaneh Banks\*\*\*
1. Bank Qarzol-Hasaneh Mehr Iran
  2. Qarzol-Hasaneh Resalat

## Private Banks

1. Bank Mellat
2. Bank Pasargad
3. Bank Saderat Iran
4. Bank Tejarat
5. Bank Parsian
6. Eghtesad Novin
7. Sina
8. Karafarin
9. Ansar
10. Ayandeh
11. Saman
12. Sarmayeh
13. Ghavamin
14. Hekmat Iranian
15. Middle east
16. Iranzamin
17. Tourism Bank
18. Dey Bank
19. Refah Bank
20. Shahr-bank

## Tehran Stock Exchange Listed Banks

1. Bank Mellat
2. Bank Pasargad
3. Bank Saderat Iran
4. Bank Tejarat
5. Bank Parsian
6. Eghtesad Novin
7. Sina
8. Karafarin
9. Ansar
10. Ayandeh
11. Saman
12. Sarmayeh
13. Ghavamin
14. Hekmat Iranian
15. Middle east
16. Iranzamin
17. Tourism Bank
18. Dey Bank
19. Mehr Eghtesad
20. Post Bank

\* Banks specializing in financing specific economic sectors.

\*\* Banks which can lend to both government and non-government customers in any industry.

\*\*\* Islamic non-profit, typically borrow and lend to customers at lower interest rates.

# Iran Central Bank



CENTRAL BANK OF THE  
ISLAMIC REPUBLIC OF IRAN



## Governor Profile:

**Valiollah Seif**

In 2014 he was nominated as the Governor of the Central Bank of Iran by the Bank's Board of Directors and was accepted by President Hassan Rouhani.

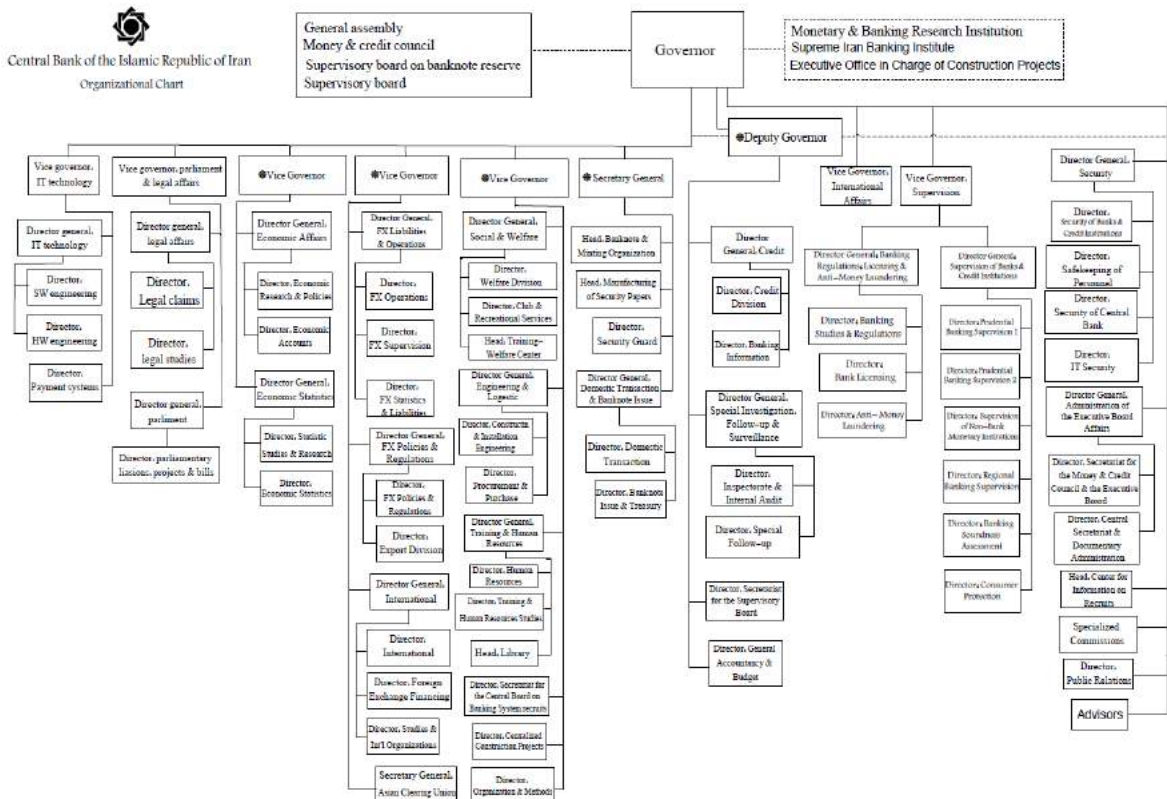
## Central Bank Description:

"BANK MARKAZI JOMHOURI ISLAMI IRAN" is the Central Bank of the Islamic Republic of Iran. The Central Bank of Iran (CBI) was established in 1960. The CBI is responsible for the design and implementation of the monetary and credit policies with due regard to the general economic policy of the country. The four major objectives of the CBI as stated in the Monetary and Banking Act of Iran (MBAI) are:

- Maintaining the value of national currency
- Maintaining the equilibrium in the balance of payments
- Facilitating trade-related transactions
- Improving the growth potential of the country

However, **the CBI does not independently set monetary policy nor can it conduct proactive monetary policy.** For example, the government, which is the main consumer of money, is in almost full control of the CBI – the main producer of money, with approval from the Majlis (The Iranian Parliament) required before the CBI can issue participation bonds.

Under the new administration, there is an acknowledgement of the need to reform the financial sector, including improving the independence of the CBI. However progress is likely to be slow, with disagreements between the administration and the Guardians Council on the level of independence necessary.



## Key Points on Monetary Policy and the Financial Sector

- The sanction period had major implications on Iran's foreign exchange rate and on its inflation rate
- The monetary policy framework has significantly improved under the Rouhani administration
- The stronger monetary policy environment, combined with the lifting of supply constraints following the JCPOA, have resulted in the easing of inflationary pressures on the economy
- The design of a flexible inflation-targeting framework is currently under consideration by the CBI, with underlying exchange rate and broad money growth anchor targets
- The ratio of non-performing loans (NPLs) in the banking system has improved in recent years but the high level remains a concern
- Bank profitability has sharply declined relative to the pre-sanction level
- Thanks to the lifting of the sanctions, the Tehran Stock Exchange (TSE) index has outperformed global indices
- Sinking oil prices have led to a further narrowing of Iran's current account surplus in 2015
- Foreign exchange reserves were estimated at USD 117.5 billion in 2015, which was equivalent to 19.4 months of imports
- In recent years, Iran has largely been unsuccessful in attracting foreign direct investment given the high level of idiosyncratic country risk and, most notably, because of sanctions
- While growth is projected to accelerate materially, a significant degree of uncertainty remains which, until resolved, will continue to hold down economic activity
- While diversified, Iran's economy remains critically dependent on its hydrocarbon sector, with a 10 percent increase in oil exports estimated to boost real GDP growth by 1.7 percent
- Economic growth is projected to accelerate in 2016-2017 partly on account of a surge in energy exports
- On the non-hydrocarbon side, consumption and investment are expected to increasingly contribute to growth
- With the economy rebounding, the associated reduction in the output gap is likely to exert inflationary pressures on the economy unless supply-side structural reforms are implemented
- The central government fiscal stance is forecasted to be slightly contractionary; visibility on the wider public sector stance is, however, limited
- The current account balance is projected to continue to deteriorate in 2016 – to post its first deficit since 2004 – but is projected to return to a surplus in subsequent years

## Currency In Iran & Exchange Rate

The currency in Iran is the Iranian Rial. Also Iranians commonly express amounts of money and prices of goods in "tomans" but it is not the official way.

10 Rial  
=  
1 Toman

The currency of Iran is the Iranian "Rial". Whilst prices of goods are virtually always written in Rials, Iranians commonly *verbally* express prices of goods in "Tomans", where one Toman equals 10 Rials. The Toman is not an official unit of Iranian currency.

**The symbol for IRR can be written RIs, and ﷼ .**

Iran has operated a multi-layered exchange rate system, as a way to manage and target the pain of sanctions over the last few decades. Historically, 7 distinct exchange rates were in operation, before being reduced to 3 in 1991 and eventually 1 in 1993. However, each time there has been pressure on the exchange rate, the government has reverted back to a multi-rate solution.

Currently there are two exchange rates in operation

- The official exchange rate (Set artificially by the CBI)
- The TSE/Parallel exchange rate (Set by the market)

The effect of the two different rates is to provide preferential access to Dollars - which due to sanctions are in short supply - to basic necessities. This allows goods to be imported at a more favorable exchange rate, reducing the cost to domestic consumers. The official exchange rate is typically applied to goods including food and medicines as these are mostly consumed by the poorer consumers in Iran. **The TSE/Parallel is applied to almost all other imports and exports and should be viewed by the international community as the key rate of exchange.**

### CBI and Market Exchange Rate (average) - USD/IRR (2011-2016)

Date	CBI Exchange Rate	Market Exchange Rate
March 2011	10,307	14,880
March 2012	12,260	16,000
March 2013	12,260	24,510
March 2014	24,891	29,490
March 2015	27,770	34,070
March 2016	30,200	34,650

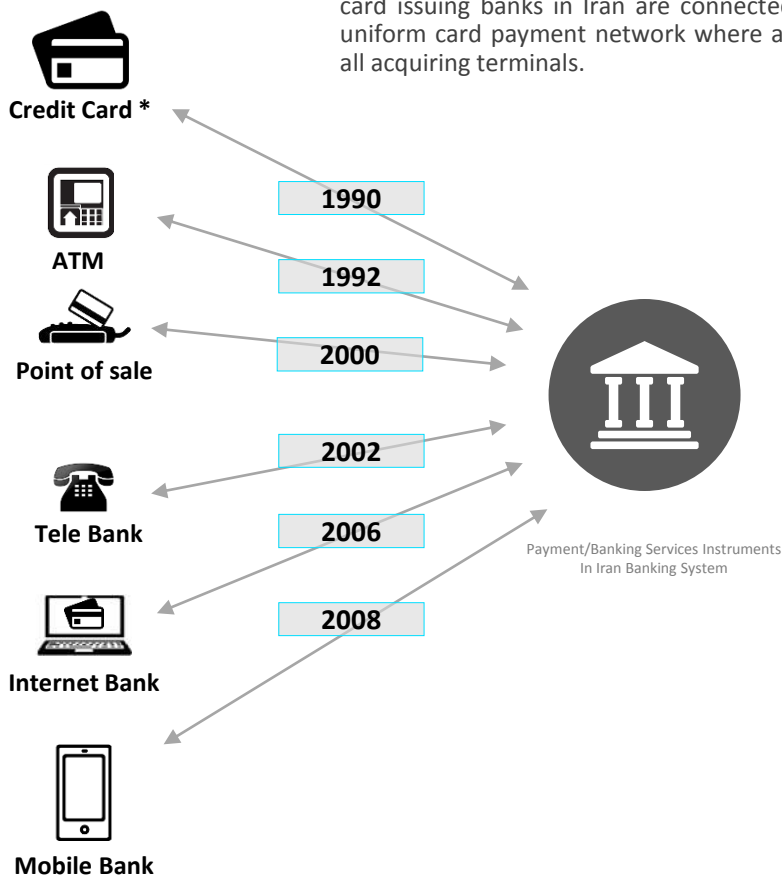
Source: Central Bank of Iran & sarafiroyal.com



# Banking Service Instruments In Iran

The introduction of modern payment instruments can be traced back to early 1990s where commercial bank of Sepah launched its Aber Bank (Debit Card) and ATM services. Since then almost all Iranian banks have provided their customers with the card payment services focusing on cards with debit function and ATM services to tackle the problem of heavy branch traffics.

The interbank card switch (SHETAB) was introduced in 2002 and now all card issuing banks in Iran are connected to the center; building up a uniform card payment network where all issued cards are accepted in all acquiring terminals.



Previously, debit and credit cards in the country can only be used on ATMs or POS machines that were provided by the issuer bank. Shetab changed this and now allows debit and credit cards to be accepted at any ATM or POS terminals in the country, and even in online payment portals. As a result, Iran is now one of the countries with the highest Debit Card penetration rate at 92%. Credit Card penetration however remains low, at only 3.1%. Further, online monthly transactions in the country have grown during the last years, as more customers use their debit and credit cards to pay online.



\*International credit and debit cards cannot be used in Iran since the US trade embargo on the country.

# SWIFT Network and Iran Banking System

*Iranian banks are reconnecting to the SWIFT payment system after a four-year break; however challenges still remain for international transactions between Iranian and foreign banks.*

SWIFT (the Society for Worldwide Interbank Financial Telecommunication) is used by nearly every bank around the world to send payment messages that lead to the transfer of money across international borders. It provides a wide range of services including transmitting letters of credit, payments and securities transactions among 9,700 banks across 209 countries.

However, in March 2012 Iranian banks were disconnected from the system after the implementation of the US-led sanctions against the country. Accordingly, all 30 Iranian banks were blocked from using SWIFT services, literally cutting Iran off from the global banking system. **The implication on the currency was significant, with the TSE/Parallel based Rial depreciating by more than half.**

A key part of the recent negotiations of the JCPOA, included the resumption of access by both the CBI and Iranian financial institutions to the SWIFT network.

Following its implementation in January 2016, most Iranian banks have been reconnected to the SWIFT network and can engage in international transactions. However foreign banks remain concerned about doing business with Iran, as the US still retains sanctions in place which predate the nuclear crisis and worry they could still be targeted by the United States.

Re-engagement with the banking world through the SWIFT system is vital for Iran's trade, particularly for the country's oil exports and broader stability of its currency. Whilst we expect progress to be slow at first, the signs are positive. Anecdotally, Germany's DZ Bank, Belgium's KBC and Austria's Erste Bank, Oberbank and Raiffeisen Bank International have already commenced cross boarder transactions for their clients in one form or another.

It is prudent to highlight that as long as the 1995 trade embargo by the US remains in place, no US Dollar transfers will be able to take place, as these transactions are required to be cleared in the US.





## 2. Iran Banking and Globalization

In 2001, 57 branches of private and governmental Iranian banks were active in foreign countries. The number fell to 49 in 2005, and following sanctions all overseas branches were closed. Post the implementation of the JCPOA, more than 50 branches of Iranian commercial banks are expected to restart their activities in foreign countries. Considering the capacity of current Iranian banks, it is anticipated that Saderat, Melli, Sepah, Mellat and Tejarat have the greatest potential to increase their international exposure with other global banks, regaining their position within international markets. Furthermore, Saderat, Mellat and Tejarat are among the private banks with the biggest potential at the global level.

The answer to whether Iran has really been readmitted to the SWIFT (Society for Worldwide Interbank Financial Telecommunication) system is complicated: The reconnection process to SWIFT has been physically established, however, few major foreign banks have decided to engage with Iran at this point. The banks that were actively trading even during the sanctions era continue to maintain their business, although nothing has so far changed for the bigger banks.

In fact, the nuclear deal says non-U.S. banks may resume trading with Iran, however because Washington retains sanctions against Iran that predate the nuclear crisis and were imposed over other issues such as human rights, bankers are uncertain of the legal basis for business and worry they could still be targeted by U.S. officials.



*Due to the uncertainty for European banks to engage in Iran, Iran has started turning away from the western-dominated World Bank towards alternatives. Iran is one of the founding members of the China-led Asian Infrastructure Investment Bank and is seeking to join the New Development Bank backed by the BRICS nations.*

Conversely, after sanction relief, many foreign banks are keen to operate in Iran. Before the sanctions banks had demanded to establish branches in Iran (especially in free zones), those demands were met with the allowance for limited operations of some joint branches between foreign and Iranian banks.

There are now several requests from European banks, including Austrian, Italian and Lebanese banks, to start official activities in Iran. Further, ICBC China, the largest bank in the world, has requested to establish several branches in Iran. Belgium's KBC and Germany's DZ Bank both confirmed that they have started handling transactions on behalf of European clients doing business in Iran. Austria's Erste Bank is also preparing to do so.

In theory, remaining sanctions (US sanctions applied for alleged terrorism and human rights violations) do not prevent international financial institutions from engaging with Iran, however there is still uncertainty for European banks that create unwanted ambiguity.

Despite these ambiguities, Iranian officials emphasize that there is no problem for international banks to receive permission for activity in Iran, and claim that it is not a time-consuming procedure.

On the other hand, Iranian banks are worried about the global competition. Most of them are far from the international standards and they have concerns on their ability to compete with big international banks in a global competitive atmosphere.

Based on the Iran Foreign Investment Promotion Act, foreign banks are allowed to hold a 40% share of Iranian banks and according to the Iranian Central Bank. The necessary initial capital for foreign investors to establish a bank in Iran is at 5 million EUR.

Iranian officials are trying to pass a number of laws to foster the establishment of foreign banks in Iran. As an example being that the Iranian government has prepared a bill that allows foreign banks to operate in Iran under 100% ownership.



*The Central Bank of Iran encourages foreign banks to be active in Iran. It is seen as an opportunity to enhance the Iranian banking infrastructure, management systems and investment in projects.*

## Foreign Banks in Iran

### Foreign Banks in Tehran

1. Europäisch-Iranische Handelsbank AG
2. Bank Ta'avon Eslami

### Foreign Banks in Kish Island

1. Europäisch-Iranische Handelsbank AG
2. Standard Chartered
3. Future Bank

The minimum capitalization for establishing a foreign bank branch in Iran is EUR 5 million. A handful of foreign bank branches and representative offices in the country were allowed to undertake administrative and coordination activities but were not permitted to open customer accounts inside the Iranian mainland territory, receive deposits or extend normative facilities.

In 2010, the Iranian government lifted a cap on the percentage ownership in Iranian banks that can be held by a foreign individual or company. The original law, which applied to both Iranians and foreigners, restricted the amount of shares in a bank that a single entity could own to 10% and an individual to 5%. According to the new rules, only the Iranian government has the authority to form joint banks with foreign entities.

According to the CBI, in 2016 five foreign banks have started operating in Tehran and Kish free trade zone.\*

#### Kish Free Trade Zone

Whilst still complying with Islamic Banking Laws, there are few other restrictions on activities of foreign banks in Iranian free economic zones. Additionally, the government has provided a number of incentive schemes to encourage investment including:

- 20 year tax-exemption
- Flexible employment regulations
- Extended legal guarantees and protections
- 100% foreign ownership

They may also open branches and representative offices in the mainland or hold 40% shares of an independent unit.

\* Free Trade Zones and Special Economic Zones are designed to promote investment in the country. Free Trade Zones have their own legal regime and aren't subject to the laws and regulations of mainland Iran.

According to CBI, as of May 2012 five offices of foreign banks operate in Tehran and Kish free trade zone.



# ILIA Corporation Expertise on the Iranian Banking Sector

Interview with Mr. S. Hossein Nabavi,  
Managing and Founding Partner of ILIA Corporation

**Q: How has the Iranian banking sector evolved during the past decades?**

**SHN:** Since the Islamic Republic came into power, Iran's banking industry has developed significantly from a local perspective. Around 15 years ago, private banks started operating and the quality of services steadily increased. Ever since, the nature of customer service has gotten a true meaning here locally. In the private banks, the customers are the kings – they can easily choose another service provider, for free, without limitations. This makes the competition between the banks tough, and customer service the key differentiating factor.

**Q: How big was the impact of the sanctions on the Iranian banking sector? What is the situation like now in regards to the Iran Banking sanctions?**

**SHN:** Sanctions on both the Iranian Central Bank and the banking sector more broadly had some notable impacts on the entirety of Iran's banking industry. Whilst some argue the sanctions acted as a positive force (conveying many lessons towards self-sufficiency, which is also correct), in actuality it should be acknowledged that the main damage was caused to the banking infrastructure, mainly by cutting it off from the international banking network.

Whilst SWIFT was officially connected after the landmark nuclear deal (JCPOA), realistically the international services of Iranian banks are not functional and big international players are yet to enter the market. Some exceptions exist, however progress has been, and will be slow.

From a legal perspective, under the JCPOA, Iran is again linked and connected to the international banking system with the exception of the United States. This means all transactions between Iranian banks and international banks are allowed except through the US system or with US banks. All financial sanctions imposed by the EU and the UN on the financial systems of Iran have been lifted however some legacy US sanctions from a trade embargo in 1995 remain in place.

**Q: In that case, what is preventing international banks from operating in Iran?**

**SHN:** It is true that after the lifting of the sanctions one can wonder why international banks are so reluctant to set foot in Iran. Anecdotally we hear "you can work with Iranian banks; opening accounts for Iranian banks is ok", "transferring and handling Iranian orders/transactions is fine", and "opening LC's for Iranian clients is possible." These are statements that American authorities have been repeating in recent weeks. They emphasize that under the JCPOA framework, collaborations with Iranian banks are allowed and also encouraged.



ILIA Corporation Office Tehran

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Notwithstanding this, we believe there are several key reasons why foreign banks are not rushing to Iran:

As I mentioned one of the issues facing banks post the lifting of the sanctions, is that the US still has restrictions and sanctions on Iran, dating back to the 1990's which are yet to be lifted. Therefore, **before any non-US bank - which has a subsidiary on US soil - can facilitate any financial transaction, they must ensure that the Iranian person or company is not directly or indirectly working with an entity remaining on the US sanctions list.**

This of course can be clarified, via Customer Due Diligence (CDD). However, getting this wrong can be costly. There is a long history of significant and punitive fines enforced by the US Justice Department for "illegal" dealings with Iranian entities, which will keep banks cautious in the near term as they continue to clarify the United States intentions and expectations going forward.

By way of example, in 2014, BNP agreed to pay nearly USD9bn in fines for violating US sanctions involving Iran (as well as Cuba and Sudan).

**Q: So the main problem is not with the UN, but with the US authorities?**

**SHN:** Well, even after the JCPOA has been signed US citizens and entities are still prohibited from directly or indirectly providing services to Iran. Therefore the key question becomes what does "providing indirect services" actually mean? In the JCPOA and its clarification manual the terminology is not defined. The American authorities have stated that any questions around this ambiguity can be clarified with them. International banks will not start working with Iran until such matters are clearer as the risks of misinterpretation remains too great. They need to know definitively what they can and cannot do. Even more importantly, in the event they fail to comply, what risks are they exposing themselves to? This too is not clear or defined. We would not expect any international bank with a subsidiary on US soil to start working with Iran until both these issues are resolved.

Moreover and as mentioned, despite the lifting of the sanctions against Iran's nuclear program, there are other US claims and some established sanctions are still in place, such as those against alleged human rights violations and terrorism support. This creates an ambiguous environment and grey zones for big banks, thus Iran remains as a sensitive area on their banking system radar.

**Q: What are potential solutions to those issues?**

**SHN:** First of all, keeping good diplomatic relations is another step to further improvements of Iran's ties with the global economy.

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One potential solution would be to have US and EU authorities establish a publicly available Q&A checklist on the Iranian banking sanctions status, and whenever an issue is raised and clarified the answer would apply to all other banks as well, which could then be the basis for further steps. This checklist could be maintained and updated until the status is clarified. It would encourage knowledge sharing amongst other banks, enabling them to work with Iran.

A second solution would be to request from banks that when an Iranian person or organization comes to them requesting financial services they would be asked if they are working with sanction listed individuals or companies. If the verbal and written answer is “no”, then it would not be the banks responsibility to investigate the matter further anymore. A similar approach was taken by the EU on Russian banking sanctions, and there is no reason that the same cannot be applied to Iran’s case.

To complete this it would also be suitable to have a publicly available list of the people and entities who are still on the sanction list, clearly mentioning that these people are not to be worked with – any other person or entity would then be considered a reliable business partner.

**Q: Are there any other issues you are seeing at the moment?**

**SHN:** Yes. There is another bottleneck between the Iranian and the international banking system, namely the conversion non-floating currencies vs the Iranian Rial. This is related to the U-turn sanction still in place for Iran. Let me clarify this as follows:

A U-turn transaction, generally speaking, is a banned financial transaction done by a bank in country A (example: USA) for the benefit of a bank in country B (example: Iran) through an offshore bank (example: Switzerland). This loophole is used by Iranian banks to avoid U.S. sanctions for their US dollar based transactions. The phrase "U-turn" applies because the funds are transferred to a U.S. bank and instantly turned back as dollars to a European bank.

Many of the transactions internationally are done in USD. However, most of Iran’s assets outside the country as well as their reserves in Iran are in non-USD currencies. This is the result of sanctions on Iran, where Iran has had to exchange its assets into non-USD currencies (mostly into Chinese and other Asian currencies). Many of these currencies are not actively traded, as compared to the Euro or USD, and therefore when Iran needs to exchange its local currency or any of the non-floating currencies, it has to wait until it finds a buyer and negotiate an exchange rate (i.e. the market for Rial/Renminbi is extremely illiquid). The pricing and additional charges create a significant issue.



Therefore, even after the implementation of the JCPOA, many challenges remain for the Iranian Banking industry. It is our strong belief that come the beginning of 2017, this situation will be normalized. Some European and Asian banks will be offering full services to their Iranian customers and some of the governmental and private Iranian banks will be open and operational in Europe and Asia. The banking industry of Iran is going to grow at a fast pace, but certain challenges need to be dealt with.

# Special Attention: Iran FinTech Overview

Iran's FinTech scene is receiving a lot of attention lately because of Iran's large FinTech friendly market and low-competitive business environment. Strong local banking infrastructure, high debit card and smartphone penetration rates, combined with Iran's young and well educated population of nearly 80m people, make this market an attractive prospect for FinTech entrepreneurs.

Iran's FinTech ecosystem is still very much in a grassroots stage, however it has the potential to become one of the Middle East's leading hubs in the near future.

The number of FinTech startups operating in Iran is currently at just under 50 (August 2016), with many new start-ups emerging every few weeks across a variety of platforms. FinTech offerings currently cover online payments, mobile wallets, financial management applications and p2p payment systems.

## Investment

- **Finnova**, Iran's first FinTech VC, has started operations in recent months with its FinTech startup accelerator to be launched soon.
- **Saman Bank** and **Fanap** opened an investment arm to invest in FinTech startups throughout Iran.

## FinTech Stakeholders & Key Players

- **Saman Bank** and **Pasargard Bank** (of which **Tosan** is a subsidiary) have been the most active among banks in empowering the FinTech scene along with the privately held **Tosan**.
- **Zarinpal** and **JahanPay** are the most used payment portals for SME's and unauthorized E-commerce platforms to sell products online.
- **PayPing** is Iran's first p2p payment solution that works through the unified Shaparak network.
- **Jiring** and **AsanPardakht** are the two most utilized digital wallets, used by consumers to pay utilities and mobile credits which have a high volume of Iran's online transactions annually.

## FinTech International Presence

For international payments, the European VC-backed Turkish payment startup **Iyzico** has signed contracts with one of **Parsian Banks'** subsidiaries to provide services to Iranian debit card holders. This will enable Iranians to use local debit cards in Turkey. San Francisco based **Paymentwall** is also partnering with CBI's Shetab network.

## A Global FinTech leader in Islamic Banking

According to the Digital Finance Institute, a Canadian Fintech Think-Tank, the opportunity for FinTech in Iran are enormous:

"Iran, the only Muslim country besides Sudan where the entire financial industry is obliged to be consistent with the principles of sharia law, accounts for more than 40% of the world's total Islamic banking assets. Trailing far behind is Saudi Arabia with 18.5%, Malaysia with 9.56%, and the UAE with 7.36%. As a result, **FinTech in Iran means that it will be poised to lead in Islamic FinTech globally and this has implications for the rest of the world's banks that are far behind in understanding and catering to Islamic finance customers.**"

**NOTE:** ILIA Corporation has recently successfully facilitated one of the largest (if not the largest ever) seed financing round of an emerging startup in the FinTech arena of Iran.

# 3. Industry SWOT Analysis

The Iranian Banking industry has a key role to play after the lifting of the sanctions. The opportunities created by the opening of Iran's domestic market combined with the government's desire to reform the banking system opens new development horizons for this sector.

## Strengths

- The industry has the potential size for major players to realize economies of scale
- Most of the larger banks have significant experience in international trade
- The public sector banks have the full backing of the Iranian government
- The access to the SWIFT system will infuse a new dynamic in Iran's banking sector
- Iran is the only Muslim country besides Sudan where the entire financial industry is obliged to be consistent with the principles of sharia law, accounting for more than 40% of the world's total Islamic banking assets.

## Weaknesses

- Theoretically, Iranian banks are Islamic institutions but Iranian banks are not generally regarded as Islamic institutions by the rest of the Islamic world
- Government fiscal policies are unfriendly to the development of commercial banking
- Disclosure practices are limited vs international standards and it is difficult to get a complete picture of the health of the industry
- Banks' profitability has sharply declined relative to the pre-sanctions levels

## Opportunities

- Reconnection to the global banking system amid removal of sanctions
- Lifting of international sanctions
- Lower transaction costs for Iranian businessmen
- New regional business opportunities related to trade finance, letters of credit and new investments and infrastructure projects
- Whilst Iran's FinTech ecosystem is still very much in a grassroots stage, it has the potential to become one of the Middle East's leading hubs in the near future.

## Threats

- Non-performing loan ratios are dangerously high
- Leverage ratios are very high by international standards, threatening to impact banking sector stability
- Uncertainty surrounding the implementation of sanctions from the U.S is leaving many large foreign banks cautious of re-engaging with Iranian institutions
- The potential for policy missteps, which may see the reintroduction of sanctions



## 4. Conclusion & Outlook

*Iran's Banking and Financial Sector is critical to propel Iran's economy towards the high, sustained and inclusive growth targeted in the country's sixth five-year development plan.*

This white paper gives a brief introduction to Iran's Banking Industry. Key figures and facts in regards to the industry include:

- The Iranian banking system is large, with total assets of near 150 percent of GDP in 2010
- The banking industry is one of the Iran's major industries, contributing 2.5% of GDP, and will play a vital role in enabling local businesses with international economies
- Iran has the second highest banking penetration rate in the MENA region
- Banks' market share (or percentage of total system assets) have changed considerably in recent years owing largely to a series of partial privatizations launched by the Government
- Iran is the only Muslim country besides Sudan where the entire financial industry is obliged to be consistent with the principles of sharia law, accounting for more than 40% of the world's total Islamic banking assets
- Through the central bank's Monetary and Credit Committee (MCC) the Government determines deposit rates, interest equivalent borrowing charges and intervenes through key banks' credit allocations for specific sectors
- Strong local banking infrastructure, high debit card and smartphone penetration rates, combined with Iran's young and well educated population of nearly 80m people, make this market an attractive prospect for FinTech entrepreneurs

**Improving the Banking Industry is the first and most important step for the Iranian government to increase the impact of the JCPOA and achieve the goals set forth in the 2025 Vision\* throughout all industries.** The sector is expected to benefit from the lifting of the sanctions enforced from 2012, most notably via the reconnection to the SWIFT network and lending growth should pick up towards the latter half of 2016. Nevertheless, other historic US led sanctions remain and will likely limit the short-term positive impacts. The first milestone to the stabilization of Iran's banking sector has been achieved, but a boom in the lending and deposit market is not expected for several years.

In conclusion, even after the implementation of the JCPOA, many challenges remain for the Iranian Banking industry. It is our strong belief that come the beginning of 2017, this situation will be normalized. Some European and Asian banks will be offering full services to their Iranian customers and some of the governmental and private Iranian banks will be open and operational in Europe and Asia. The banking industry of Iran is going to grow at a fast pace, but certain challenges need to be dealt with.

\* Iranian authorities have adopted a comprehensive strategy encompassing market-based reforms as reflected in the government's 20-year vision document (up to 2025) and the recently issued sixth five-year development plan for the 2016-2021 period.

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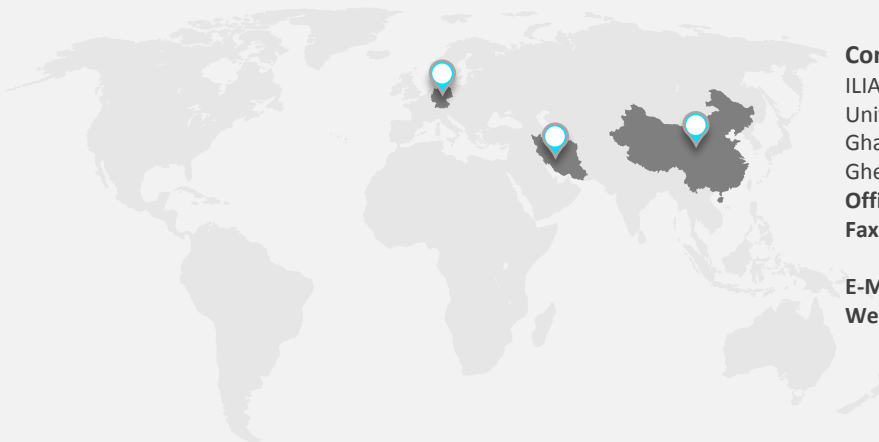
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## About ILIA Corporation

ILIA Corporation is a boutique management consultancy firm, focused solely on helping local and international organisations operate in Iran.

ILIA empowers clients through every stage of the market entry process, from in-depth **Market Insights**, through to comprehensive **Implementation Solutions** and ultimately support during the **Execution Process**.

Operating in Iran for nearly a decade, serving Fortune 500 companies, SME and government institutions alike, we provide clients an experienced consulting team and leverage an unrivalled network of local experts, to help you unlock the full potential of the Iranian market.

## ILIA Corporation Belief & Mission

After many years in relative economic isolation, we believe **Iran is entering a transformational phase** in its development. The Joint Comprehensive Plan of Action reached in 2015 reintroduces Iran to the global market place, opening significant opportunities to local and international businesses.

Unlocking Iran's full potential requires a deep understanding of the business environment, political system and religious and cultural practices. Operating in Iran for nearly a decade, **ILIA's local knowledge, experience and network is unrivalled**. With access to, and experience working with, local business leaders, elite families, political figures and cultural and religious lobby groups, ILIA is the perfect partner for clients as they navigate this complex market.

ILIA's mission is to be the preeminent Market Entry specialist in Iran, supporting clients through every stage of the process, from in-depth **Market Insights**, through to comprehensive **Implementation Solutions** and ultimately support during the **Execution Process**.

## ILIA Corporation Services



### Market Insights

Iran is a complex economy, presenting unique challenges to new entrants. ILIA empowers clients via high level **industry scans**, in-depth **market research** and comprehensive **feasibility studies** to increase decision making accuracy when considering an entrance into the Iranian Market.



### Implementation Solutions

Employing skilled local talent, complemented by internationally experienced and qualified senior personnel, we partner with clients in the **business modelling and planning** stages. We help **define and develop corporate strategy** and leverage our vast network to ensure everything is in order for a smooth market entry.



### Execution Process

From the moment a Go-Decision has been made, ILIA is there with you through every step. Whether proceeding with **incorporation, employment, operation or registration** of your business, we provide the contacts and know how required to facilitate this. Issue management is our expertise – we get things done in an ambiguous operating environment.