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Iranian banks take steps towards global financial order

The decision by two major Iranian banks to refuse business to IRGC entities has sparked a heated debate, with critics accusing the authorities of pandering to the international community and "self-sanctioning". Actually, the move is a bold and necessary step towards Iran's reintegration into the international financial system and should be applauded. It is good for the economy. The vested interests opposing change in Iran's broken financial sector pose the real risks to Iranian prosperity.

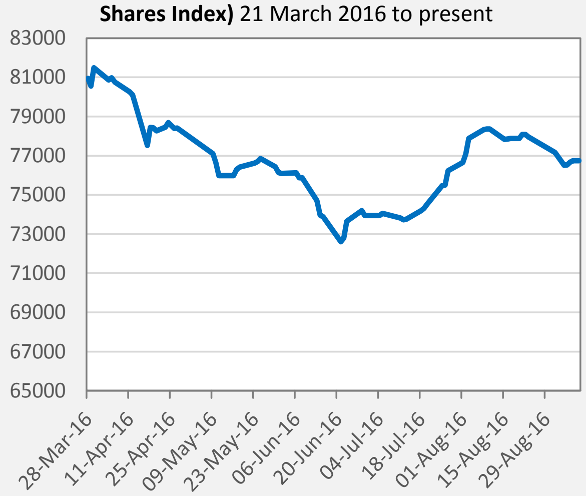
The refusal of two of Iran's largest banks to do business with the Islamic Revolutionary Guards Corps (IRGC) has caused considerable controversy in Iran. Bank Mellah and Bank Sepah turned away business from entities affiliated with the IRGC, including the giant construction company Khatam Al-Anbia, in order to comply with international rules on money laundering and terrorist financing, as stipulated by the Financial Action Task Force (FATF).

The Iranian authorities and the two banks should be applauded for taking concrete steps towards Iran's reintegration into the global financial system. The accusations of "self-sanctioning" from some quarters of the hard-line press are emotive and ludicrous**.** The main reason for the reticence of the international financial community to reengage with Iranian banks since the signing of the JCPOA has been the opaqueness of the Iranian business environment and the risk of falling foul of remaining sanctions. International banks look to institutions like the FATF for signals of risk and the fact that Iran is one of only two countries in the world "black-listed" by the FATF sends a very strong signal. Banks Mellah and Sepah are spearheading efforts to reassert the international reputation of Iranian banks, to the benefit of the entire Iranian economy. As the Economy Minister, Ali Tayebnia, sensibly said, the biggest act of "self-sanctioning" Iranian banks could engage in is to pursue a path that *keeps then on the "black-list"*.

What is the FATF?

The Financial Action Task Force (FATF) is an inter-governmental body, formed in 1989 to combat money laundering, terrorism financing and other threats to the integrity of the international financial system. The FATF sets international standards through a series of recommendations. It is integral to the international financial system. Iran became the second country in the world to be "black-listed" by the FATF (after North Korea) for lacking the means or will to combat money-laundering and terrorist financing, which means the FATF actively warned international banks from dealing with Iran. The government recently signed an agreement with the FATF to "white-list" its

Fig 1. Tehran Stock exchange (TEDPIX All Shares Index) 21 March 2016 to present

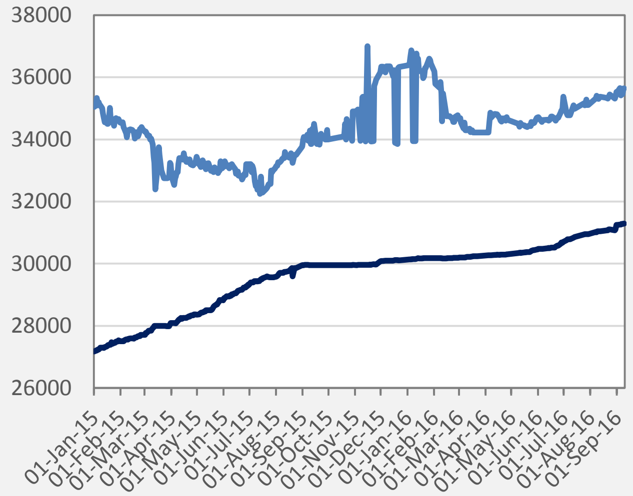


The toxicity of the dispute over FATF compliance reveals the scale of the challenge facing the Rouhani administration's

reform agenda. The process of reintegration into the global economy will mean a long string of regulatory and legislative frameworks to adhere to, none of which were drafted with the sovereignty of the Islamic Republic in mind, rather the integrity of the global financial and trading system.

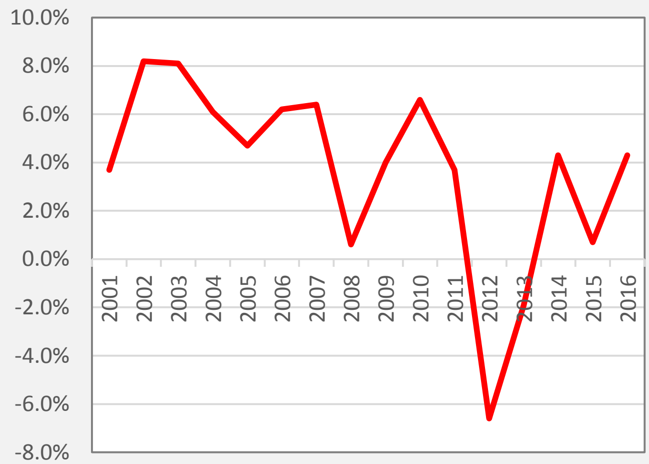
One high profile objection to FATF relates to Hezbollah's status as a terrorist organisation in the eyes of the international community, but apart from that there are powerful vested interests pushing against transparency in Iran's banks. Those individuals and organisations that benefit most from illegitimate transactions and money laundering have the most to lose from greater transparency. There is no rational economic argument against the cleaning up of the financial system through greater transparency and stricter regulation if it limits wastage and facilitates the efficient flow of funds to their most productive ends. Iran's long term economic trajectory will be dictated by its ability to overcome the trappings of vested interests.

Fig. 2 Iranian Rial to USD, dual exchange rates
1 January 2015 to present



On a more positive note, the Central Bank of Iran has taken constructive measures to strengthen the financial sector. The CBI took the economy one step closer to the unification of its dual exchange rates with a decree that banks could open letters of credit in foreign currencies at open-market rates (Fig 2). This follows the rule change in July, which enabled banks to trade in the parallel open market. The CBI also announced plans to establish a risk-based rating system for domestic banks as of next month. Banks will be classified according to their risk level, based on an evaluation of their financial statements and consultations between banks and government bank examiners.

Fig. 3 Real GDP growth per annum, Iran
2001 to present



The Iran Petroleum Contract (IPC) suffered further delays this month, leading to warnings from the National Iranian Oil Company (NIOC) that Iran is running out of time to reap the benefits. The new contract framework has been bogged down by legal disputes for two years, impeding production in Iran's joint fields, obstructing much needed foreign investment into Iran's ageing infrastructure. Large sections of Iran's oil fields are reportedly on the decline and without further investment will drop as much as 300kbpd from production in the coming years. NIOC announced its latest plan to unveil the IPC at a three day conference in Tehran in January 2017.

Finally, thirty percent of Iranians are hungry or do not have nightly bread, according to the Ministry of Health. In a speech to the Youth Affairs conference in Tehran, the Deputy Minister painted a bleak picture of social inequality and poverty in Iran. He claimed that seven hundred thousand people a year go bankrupt under the cost of healthcare and 25% of the urban population live in "shantytowns". It is a stark reminder of the real costs of *foot-dragging* over economic reforms.