

INTERNATIONAL JOINT BANKS OF IRAN, A LEGAL REPORT

Gist of the news

According to *wantchinatimes.com* on January 28, 2015:

Iran and Russia are mulling a joint bank to settle their mutual trade payments, said Iran's ambassador Tuesday on Press TV.

"Both sides plan to create a mutual bank or a mutual account to make payments in (Iranian) rials and (Russian) rubles," ambassador Mehdi Sanaei said.

Sanaei's remarks came two days after Gholamali Kamyab, the deputy governor of the Central Bank of Iran (CBI), announced Iran's plans to sign "bilateral monetary treaties" with some countries.

Iran is not using the dollar "in its transactions with different countries," Gholamali Kamyab said, adding that "Iran is using other currencies like China's renminbi, Turkey's lira, Russia's ruble and South Korea's won in its trade transactions with the countries."

On October 13, 2014, the website of *globalresearch.ca* had already reported that:

Head of the Iran-Russia Joint Chamber of Commerce Asadollah Asgaroladi said that Tehran and Moscow are studying the possibilities of opening a new chapter in trade relations that could break the domination of Western currencies over bilateral exchanges.

"Since Russian banks fear the implications of working with Iran due to sanctions, we want to establish the joint Iran-Russia bank with the help of our central banks and private sectors," Asgaroladi said.

"Such a bank would be able to exchange money between the two sides using rials and rubles and put aside dollars, euros and pounds," he added.

Unilateral sanctions imposed on Iran's banking sector by the US and the European Union over Tehran's nuclear energy program and the recent Western bans against Russia over Ukraine have prompted the two countries' trade officials to boost economic cooperation.

In this first bi-monthly report of 2015, we will analyse the following issues:

- 1) What is the role of international joint banks of Iran, especially in the context of banking sanctions imposed on the country?
- 2) Would this role be and remain limited to using currencies other than Dollar, Pound and Euro in international transactions of Iran with its trade partners?

3) What would be the role of bilateral monetary treaties that Iran is going to sign with Russia, China and probably India?

4) What is the legal basis of this new development?

Role(s) of international joint banks of Iran

By putting the information explained in the first section of this report into perspective, it can be observed that the joint Iran-Russia bank is a small piece of a bigger plan for strengthening and deepening the politico-economic ties between Iran and Russia. Under this plan, the following actions will be taken:

1) According to Iran's ambassador to Russia, Mehdi Sanaei, as reported on *rt.com* on January 28, 2015:

- Noting high tariffs on the exports of Iranian goods to Russia, ...Tehran expects to sign an initial agreement with the Eurasian Economic Union in 2015.
- Iranian producers, according to the ambassador, hope to gain approval to export dairy and meat products within the next two months. "I hope that this happens because it's very important. We were promised that this would be resolved in the first quarter, by the end of March," the ambassador said.
- The ambassador also announced that Moscow and Tehran are considering the possibility of creating a visa-free regime by signing a memorandum of understanding in 2015.
- But Iran, Russia, China, and several Latin American countries are not the only ones looking to ditch the US dollar in their trade. The Eurasian Economic Union, which also includes Belarus and Kazakhstan, is planning to create a single market for financial services by 2025 which will simplify switching to dollar-free trading. Late last year, the Russian State Duma proposed the creation of a single area for payment in national currencies. Such measures are expected to minimize Western influence on the economy of the EEU.
- Last July, the group of emerging economies signed the long-anticipated document to create the US\$100 billion BRICS Development Bank, and a reserve currency pool worth over another \$100 billion. Both will counter the influence of Western-based lending institutions and the US dollar.

This comprehensive economic plan, therefore, shall be composed of:

- a) An agreement with Russia to reduce tariff on Iranian exports to that country;
- b) An approval to export dairy and meat products within the next two months;
- c) Creation of a visa-free regime for Iranian (and Russian) merchants;
- d) Creation of a single market for financial services by the EEU countries; and
- e) Using the US\$200 billion of the BRICS Development Bank for rendering banking and financial services by and to the BRICS members.

In the context of these five important developments, Iran will benefit from its economic relationship with Russia and other members of the BRICS to create and establish a maneuvering space for its economic endeavours.

A more detailed analysis of this paradigm shift is indispensable.

Creation of BRICS Development Bank – How would Iran be able to benefit from the services of the Development Bank (DB)? The following elements extracted from a report of *rt.com* on July 15, 2014 may help us to get closer to understanding the functioning of the DB and the modalities of rendering banking and financial services by the DB to Iran:

- Membership in the DB may not be limited to just BRICS nations. Future members could include countries in other emerging markets blocs, such as Mexico, Indonesia, or Argentina, once the DB sorts out its debt burden. Membership of Iran in this bank would be beneficial for both sides. Iran would have access to a huge source of financial support while the DB could also benefit from the foreign exchange reserve of Iran that amounts to \$150 billion, according to the governor of Iran's Central Bank, as reported by Reuters on January 17, 2014. Further, Iran has about \$100 billion in foreign exchange assets around the world that are subject to the international sanctions imposed on Iran. Easing or ideally removing these sanctions would enable Iran to transfer this amount, or at least part of it, to its DB account.
- The \$100 billion crisis lending fund, called the Contingent Reserve Arrangement (CRA), has also been established by the BRICS members. China will contribute the lion's share, about \$41 billion, Russia, Brazil and India will chip in \$18 billion, and South Africa, the newest member of the economic bloc, will contribute \$5 billion. It would be possible for Iran to chip in a higher amount of money to show its serious intention to join the club.
- The group has already created the BRICS Stock Alliance an initiative to cross list derivatives to smooth the path for international investors interested in emerging markets. Iran has recently opened its stock market to foreign investors. Foreign investment may help the stock market of Iran to get out of its current crisis to start functioning according to international standards.
- Bringing emerging economies closer has become vital at a time when the world is guttered by the financial crisis and BRICS countries can't remain above international problems. A main potential ally to BRICS countries in the region is Iran. Neighbouring countries of Iran, whether situated in east, west or south of Iran, would have no interest to join BRICS.

Financial agreement between Russia and China – As reported by *rt.com* on December 29, 2014, China and Russia have effectively switched to domestic currencies in trading with each other, using financial tools as swaps and forwards, as they seek to reduce the influence of the US dollar and foreign exchange risks. The agreement signed in the end of October came into force Monday, December 29 to provide a currency swap of CNY150 billion (up to US\$25 billion). The financial policy of Iran is completely in line with the above development. It could be expected that after establishing a joint Iran-Russia bank, the next step for Iran would be to establish a joint Iran-China bank. Establishing a banking and financial network composed of these two international joint banks and the DB could reasonably be the third step in this direction.

Monetary agreement between Brazil and Uruguay – Another major development reported by *rt.com* on December 3, 2014 was that Brazil and Uruguay switched to settling bilateral trade with local currency to stimulate turnover and to bypass the US dollar. Payments in the Brazilian Real and Uruguayan Peso are based on the agreement that was signed on November 2, 2014 by the head of Brazilian Central Bank Alexandro Tombini and his Uruguayan counterpart Alberto Grana. Both countries believe such a move would strengthen trade across Latin America. In this way, a BRICS member started to expand the BRICS financial policy in Latin America. Signing a similar agreement with Iran would enable BRICS to expand the same policy in the region through Iran whose long financial arms can influence the financial markets in Iraq, Afghanistan, UAE and Turkey.

Ditching currency peg to USD – Reuters also reported on January 27, 2015 that:

The six nations in the Gulf Cooperation Council (GCC) have pegged their currencies to the U.S. dollar - or in the case of Kuwait, a peg to a basket of currencies that is believed to be dominated by the dollar - to stabilize them.

But in recent years the GCC economies have moved more out of sync with the United States, as the pegs press GCC policymakers to mirror the U.S. central bank's decisions even if trends at home call for the contrary....

There is considerable uncertainty here with the oil price and the Fed," Khalid Alkhater, the Qatar Central Bank's Director of Research and Monetary Policy, said in a research paper seen by Reuters. "If the low oil price persists in the medium term and the Fed starts to raise interest rates, that might contribute to economic slowdown in the GCC. But it depends on the pace of the tightening process, how fast and how persistent they will be."

The new de-Dollarization policy of the Iranian government, therefore, is in line with the policies of Russia, China, India and perhaps will even heavily influence the financial policy of the Persian Gulf Arab states in the near future.

Bilateral monetary treaties of Iran

Iran and Russia have not signed a monetary treaty to establish a joint bank yet. In the absence of any detailed information on their objectives and plans, two ways are available to approach this issue: a) To look at the joint banks already established by Iran; and b) to study similar treaties signed by other countries.

International joint banks established by Iran

a) *Iranian Venezuelan Bi-National Bank (IVBB)* - According to *laht.com*:

- IVBB was engaged in financial transactions on behalf of the previously sanctioned Export Development Bank of Iran (EDBI). EDBI was designated under Executive Order 13382 on October 22, 2008, for providing financial services to Iran's Ministry of Defense and Armed Forces Logistics (MODAFL).

- IVBB has been processing funds transfers on behalf of EDBI since at least January 2012. EDBI has used IVBB to act as a proxy to fund export activities and to transfer millions of dollars worth of funds from China's Bank of Kunlun to EDBI. Additionally, senior EDBI staff is entitled to authorize transaction instructions to Bank of Kunlun on behalf of IVBB.

b) *Iran-Uganda Joint Bank*: The *freelibrary.com* reported on July 28, 2008 that:

- In a meeting between managing director of EDBI and Uganda's foreign minister the two sides agreed on establishment of a joint bank in Kampala.

- The bank is to be established with the aim of facilitating Iranian exporters' activity as well as providing the required finance by the two sides' trade activists.

- Uganda's Foreign Minister, for his part, said supplying a \$10 million dollar credit line for Ugandan buyers of Iranian goods and services by EDBI is among the most important steps put forward to expand bilateral ties between the two countries.

- After establishing the bank, it was planned to open a new credit line for Iranian exporters.

- According to Seyed Mohammad Ali Mousavi, chairman of the Iran Uganda Establishments Company Ltd., his efforts to bring Iran Export Development Bank to Uganda failed because Bank of Uganda said that it had no banking laws to make this happen, as reported on April 13, 2013 at *theeastafrican.co.ke*.

International monetary treaties

a) *Bilateral currency swap agreements* (BSAs) – The main features of BSAs are explained by Steven Liao in his paper titled "Redback Rising: China's Bilateral Swap Agreements and RMB Internationalization" as follows:

- They are signed between the People's Bank of China (PBC) and a growing number of partner central banks designed to promote the currency's use in cross-border trade and direct investment settlement. This means that the international monetary treaty with Russia will be signed, most probably, by the central banks of Iran and Russia.

- The objective of BSAs is to replace USD with another international currency to serve three purposes: a medium of exchange, a unit of account, and a store of value.

- Internationalization of a currency depends on economic power of the country that uses and promotes that currency. For example, China has promoted internationalization of its currency, RMB, since 2010. As a result, according to Liao, for the entire year of 2009, the volume of RMB-based trade totaled a meager \$570 million whilst in the fourth

quarter of 2012, roughly \$135 billion—or about 13 percent—of Chinese trade was settled in RMB.

- If Iran signs a BSA with China, the foreign exchange side of export transaction will go through the following process as explained in pages 8-9 of the above paper: A Chinese manufacturer that buys, let's say, petrochemical primary products from an Iranian firm can now use RMB to pay for its purchases. The Iranian producer, then, can take these RMB to a local bank and exchange them for Rials, the local currency of Iran. The bank, then, can exchange these RMB for Rials with the Central Bank of Iran which can easily recycle the RMB for Rials when it reverses the swap with the People's Bank of China (PBC).

b) *Reciprocal Currency Deal (RCDs)* – According to *cbc.ca* on November 8, 2014:

Canada and China have signed a reciprocal currency deal that's expected to dramatically boost exports...Authorized by China's central bank, the deal will allow direct business between the Canadian dollar and the Chinese yuan, cutting out the middle man — in most cases, the U.S. dollar. Canadian exporters forced to use the American currency to do business in China are faced with higher currency exchange costs and longer waits to close deals.

"It's a great boon for the Canadian business community, both importers and exporters, because they can now do business in China with the currency and not have to go through multiple financial exchange transactions," Stewart Beck, president and CEO of the Asia Pacific Foundation of Canada, told CBC News.

It must be noted that reciprocal currency arrangements have been around since 2007 as a response to the financial crisis that started in August 2007. As reported by *newyorkfed.org* in April 2010:

Accordingly, the Fed simultaneously announced the establishment of reciprocal currency arrangements, or "swap lines," with the European Central Bank and the Swiss National Bank. The swap lines increased the capacity of these central banks to deliver dollar funding directly to financial institutions in their jurisdictions, reducing funding pressures on those institutions and potentially improving conditions in the global funding and credit markets more generally.

The purpose of these arrangements was to strengthen and promote using USD by the European Central Bank (and other European banks) as well as by the Swiss National Bank. The objective of RCDs, on the other hand, was to encourage and promote substituting other currencies, especially RMB of China, for USD.

The objectives of the RCD signed between Canada and China, according to *globalnews.ca* are:

- 1) Canada becomes the first country in the Americas to have a deal to trade in the RMB.
- 2) It will allow direct business between the Canadian dollar and the Chinese yuan, cutting out the middle man – in most cases, the U.S. dollar.
- 3) Higher currency exchange costs and longer waits to close deals will be removed.

4) An RMB trading hub will be established in Canada.

Establishing an RMB trading hub and using RMB in transactions with Chinese businesses will have significant advantages according to *canadianbusiness.com*:

1) An HSBC study earlier this year also found that more than half of Chinese businesses would be willing to give their trade partners up to a 5% discount if they denominated deals in yuan.

2) In Canada, Vancouver is the logical place to host a renminbi hub. The city has a large Chinese-speaking population and has long been regarded as a gateway to the Pacific. With no offshore hubs yet established in North America, a Vancouver centre could attract a sizeable chunk of the international yuan market, which currently mostly runs through Hong Kong.

If we look at the above issue from the perspective of the Iranian government and Iranian business persons, it can be argued that dealing with Chinese businesses in RMB will have benefits similar to those explained above for both public and private sectors of Iran. However, two requirements must be met before taking the above initiative:

a) Iran and China need to establish a joint bank to be used by both sides for their mutual transactions; and

b) An RMB hub needs to be established in Iran, preferably either in Tehran or in Mashad, i.e. the closest major city of Iran to China that attracts attention of merchants travelling to Iran from CIS countries such as Turkmenistan and Kazakhstan. Businesses of these two countries have close contacts with Chinese firms and companies.

c) *Currency agreement* - According to *ibtimes.com* on November 24, 2010:

China and Russia have agreed to allow their currencies to trade against each other in spot inter-bank markets.

The motive is to promote the bilateral trade between China and Russia, facilitate the cross-border trade settlement of [the yuan], and meet the needs of economic entities to reduce the conversion cost, according to Chinese officials.

Meanwhile, China and Russia are gradually revolting against the U.S. dollar. This latest move to shift bilateral trade away from it is significant in itself because China-Russian trade -- previously denominated in dollars -- is currently around \$40 billion per year. For Russia, trade with China is larger than trade with the U.S.

Moreover, as this policy extends to Russian exports of oil and natural gas to China, it threatens the global petro-currency status of the U.S. dollar.

For China, it is promoting the use of yuan as a trade settlement currency in Asia. Recently, it allowed its currency to trade against the Malaysian ringgit. Just like the deal with Russia, the

purpose of that agreement was to promote bilateral trade between China and Malaysia and facilitate using the yuan to settle cross-border trade.

What is the meaning of “trade in spot inter-bank markets”? To understand the technical meaning of this term, it is necessary to look at the following definitions:

- **Interbank market:** The interbank market is “between banks,” with each trade representing an agreement between the banks to exchange the agreed amounts of currency at the specified rate on a fixed date. The interbank market is alternately referred to as the cash market or the spot market to differentiate it from the currency futures market, which is the only other organized market for currency trading (*Dummies.com*).

- **Spot transaction:** A spot transaction requires almost immediate delivery of foreign exchange. In the interbank market, a spot transaction involves the purchase of foreign exchange with delivery and payment between banks to take place, normally, on the second following business day. The date of settlement is referred to as the "value date" (*colorado.edu*).

- **Swap transaction:** A swap transaction involves the simultaneous purchase and sale of a given amount of foreign exchange for two different value dates. The most common type of swap is a spot against forward, where the dealer buys a currency in the spot market and simultaneously sells the same amount back to the same bank in the forward market. Since this agreement is executed as a single transaction, the dealer incurs no unexpected foreign exchange risk (*colorado.edu*).

After familiarizing ourselves with the basic concepts of currency agreements, it is now time to put these agreements into the perspective of Iran, taking into consideration two set of facts:

1) Interbank transactions with the Iranian banks are subject to international sanctions; and

2) It is announced by SWIFT on its website on March 15, 2012 that:

Following an EU Council decision, SWIFT is today announcing it has been instructed to discontinue its communications services to Iranian financial institutions that are subject to European sanctions.

The new European Council decision, as confirmed by the Belgian Treasury, prohibits companies such as SWIFT to continue to provide specialised financial messaging services to EU-sanctioned Iranian banks. SWIFT is incorporated under Belgian law and has to comply with this decision as confirmed by its home country government.

The interbank spot transactions are either of OTC type or mostly they are carried out by phone or through the Internet, i.e. by using the SWIFT system. The international

banking sanctions make all of the above means and ways prohibited. Therefore, currency agreements are of no use to the Iranian banking system. In practice, the other two types of agreements must be used to enter into monetary arrangement with Russia or China.

Legal basis of establishing international joint banks

Tehran Times reported on May 26, 2010 that:

The Majlis approved a bill on Tuesday according to which foreign entities will be allowed to hold over ten percent of the shares in joint banks with Iran but not more than 49 percent of the shares. An amendment to the Fourth Socio-Economic Development Plan (2005-2010) had stipulated that real or legal entities could not hold over five percent of shares in joint banks....

According to the new bill, joint banks established with legal foreign entities as partners in which over 51 percent of the shares are held by Iranian shareholders will be regarded as Iranian entities.

The legal basis of establishing international joint banks, therefore, is the Act Amending Articles of the Law on Fourth Plan for Economic, Social and Cultural Development of the Islamic Republic of Iran and Execution of the General Policies of Article 44 of the Constitution (2008). Article 5 of this Act provides that:

“Banks that are not chartered [i.e. less than 51% of their shares belong to the public sector], financial and credit institutions and other intermediary financial firms that are established before or will be established after passing of this Act as well as chartered banks whose shares are transferred are authorized to carry out their activities if their legal type is either public joint stock company or public cooperative joint stock company. The authorized cap for ownership of shares, either directly or indirectly, for each public joint stock company or public cooperative joint stock company or every public non-chartered firm or institute shall be ten percent (10%) and for individuals and other juridical persons is 5%. Transactions that go beyond the caps authorized in this article shall be null and void. Any increase in the authorized cap through inheritance shall be subject to the same rule, and heirs and their legal representatives shall be required to sell the amount above the cap during the period of two months after issuance of probate certificate. If increase of share of a person due to other reasons and without his intention or action results in surpassing the above cap, in maximum three months the amount of share must be reduced to the level of authorized cap provided by this Article.”

Note 5 of the Act on adding one Note to the Law on Execution of General Policy of Article 44 of the Constitution states that:

“In establishing a joint Iranian-foreign bank, share of the foreign party shall be exempted from the caps mentioned in the above Article 5.

1. Government of Islamic Republic of Iran is authorized to establish development banks only with the partnership of foreign partners.

Foreign juridical persons who own more than 51% of Iranian companies shall be considered Iranian.”

It is clear that above provisions apply to joint banks that are established or will be established in Iran. Even inside the country, especial rules apply to establishing joint banks in free zones of Iran. According to Articles 3, 4 and 5 of the Regulations on Monetary and Banking Operations in Free Trade-Industrial Zones:

Article 3 - Banks and institutes with either Iranian or foreign capital or with Iranian or foreign partnership being registered in a Zone and whose main office being located in the same Zone shall be regarded as the registered Iranian banks or institutes in the Zone.

Article 4 - Establishment of banks and institutes and setting up of branches of banks and institutes, either Iranian or foreign, in the Zones shall be subject to the recommendation of the Authority and issuance of the due license by the Central Bank.

Article 5 - Registration of banks or institutes or branches of foreign banks in a Zone shall be contingent upon issuance of the license subject of the Article 4 above. The registry authority in a Zone is obliged to demand the said license prior to registering the banks and institutes.

Note - Establishment of representation offices of the Iranian or foreign banks and institutes shall be subject to confirmation of the Authority as well as the registry authority in the Zone. Such offices are not authorized to perform any banking transactions and operations.

Conclusion

International banking and financial operations of Iranian public and private entities are in dire need of finding a way out of the restrictions imposed on them by the international sanctions. A rapid and comprehensive solution, perhaps, is to establish joint banks with foreign countries, especially with Russia and China.

There are few challenges to handle, before initiating the project of joint banks:

- a) The banking law system of Iran needs to open up to international banking law because its main function has been to regulate domestic banking operations.
- b) Banking contract and treaty law also needs to adapt itself to the latest developments in this field. Monetary and banking treaties to be concluded with Russia and China need to be planned in advance carefully be taking into consideration the provisions of similar treaties explained above.

c) Finally, banking and financial policy of Iran needs to be reviewed and restructured in order to get ready for the challenges of twenty first century.

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