

Establishment and Operations of Private Banks & Credit Institutions in Iran

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Abstract

After the revolution of 1979, all of the private banks existing in Iran were nationalized and the economic system was based on public, cooperative and private sectors and banking operations were categorized in public sector. Consequently, private sector and foreign banks were bared from doing banking operations in Iran. According to the recent laws and regulations passed in Iran, the Iranian private sector have been permitted to do banking operations in Iranian mainland and foreigners have been allowed to do so in Iranian free zones.

With regard to the importance of the subject, the regulations prevailing in Iranian mainland and free zones shall be examined.

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Introduction

After the revolution of 1979 and ratification of the Law on Nationalization of Banks in June 1979, all of the private banks existing in Iran were nationalized and the then Government appointed Directors for each. Following the approval of the Iranian Constitution¹ in January 1980 (the Constitution), the economic system of Iran was based on three sectors: Public (under the control of the Government), Cooperative and Private, and banking operations were categorized in public sector; consequently, private sector was barred from doing banking operations in Iran. As a result of nationalization of banks, as well as broad interpretation of Article 81² of the Constitution, Foreign banks were and still are forbidden to establish a branch bank in Iranian mainland³. Currently, they are only authorized to establish representative offices⁴, which are basically liaison offices and barred from doing any banking transactions.

¹Article 44.

² "Granting concessions to foreigners for the establishment of companies and institutions in the commercial, agricultural, industrial, mining and services fields is absolutely forbidden", (emphasis added). The historical root of this Article goes back to the period of granting concessions to foreign states and corporations in the past two centuries to have a monopoly in doing business in Iran; but, in practice, the Article 81 was broadly interpreted, so that the foreign companies were forbidden to do business in Iran, unless they have a contractual relationship with Iranian Government. It is noteworthy that the recently passed Law on the Promotion and Protection of Foreign Investment (March 10, 2002) in its Article 2, para. C, defined the word "Concession" as a special right that makes an investor to have a monopoly position in business.

³ Some lawyers believe that upon ratification of "Permission of Registration of Foreign Companies' Branches or Agencies Act"(1997) and specially Article 1 paragraph 7 of the implementing regulation thereof (1999), foreign banks can apply for the registration of a branch in Iran; nevertheless, it seems that paragraph 7 of Article 1 of the implementing regulation is against the broad interpretation of Article 81 of the Constitution. However, no foreign bank has applied for the registration of a bank branch in Iranian mainland yet. It is noteworthy that banks and credit institutions are subject to particular and special laws and regulations, such as Monetary and Banking Act.

⁴ To-date (April 2008), thirty-six foreign banks have established their representative offices in Tehran.

According to the recent laws and regulations passed in Iran, the Iranian private sector have been permitted to get authorization from the Central Bank of Iran (CBI) in order to establish credit institution and/or private bank in Iranian mainland, and also foreigners have been allowed to establish and/or participate in banks and credit institutions in Iranian free zones.

With regard to the importance of the subject, the regulations prevailing in Iranian mainland and then the regulations governing in Iranian free trade zones (as to both private banks and credit institutions) shall be examined in two separate parts, respectively as follow:

Part A. Regulations prevailing in Iranian Mainland

Section 1. Private Banks¹

Nationalization of Iranian banks in 1979 lead Iranian legal scholars and bankers to search for ways to motivate the banks to compete and to encourage investment in banks, of course with due respect for Article 44 of the Constitution.

As a result of endeavors of this group of financial experts, the single Article on Authorization of Establishing Non-Governmental Banks (single Article), as well as Article 98 of Third Five-Year Development Plan were passed by the Iranian Parliament in April 2000. The Money and Credit Council² (MCC) passed the implementing regulation of the

¹ In this article, the words “non-governmental bank” and “private bank” have been used interchangeably.

²-According to Articles 16 and 18 of the Monetary and Banking Act (1972), MCC is an organ of CBI and is the highest ranking legislative body for banking system in Iran. As per Note of paragraph 6, Article 10 of the Fourth Five-Year Development Plan (2004), it is presided by the Governor of CBI.

aforementioned single Article in December 2000¹ (hereinafter, in this section, shall be referred to as “the Implementing Regulation”).

With regard to Article 44 of the Constitution, Iranian lawyers have interpreted the single Article to be- banking is, and will remain under the category of public sector controlled by the Government. According to paragraph A of the said single Article, “monetary and forex policy making, issuance of bank notes and coins, portfolios management, supervision of banks and issuing license for doing banking operations are among the duties of Government and will remain the responsibility thereof for the purpose of exercising sovereignty”.

Since Monetary and Banking Act (1972) as amended, vested the above-mentioned authority and duties with CBI as the regulator of monetary and credit system of the country and also as the banker of the Government, therefore, CBI should be the competent authority for granting authorization to, as well as supervising private banks in Iran. Accordingly, in practice, CBI-on behalf of the Government- grants authorization to the Iranian private sector to pursue banking operations so as to supplement the economic activities of the public sector and to cause economic growth and development of the country².

The following laws and regulations govern private banks:

¹-According to Monetary and Banking Act (1972), MCC is the sole competent authority to approve the articles of association of private banks and credit institutions in Iran. In order to make the procedures and practices transparent, MCC approved the said Implementing Regulation but the Administrative Court of Justice annulled it in 2002; but MCC approved another Approval on: "the Necessary Points in the Articles of Association of Non-Governmental Banks" on May 20, 2001, which contained the summary of the Implementing Regulation and it is still in force. However, it seems that MCC unofficially has a look at the Implementing Regulation when it is going to examine the applications and to approve the articles of association of a bank or a credit institution.

²- "Regulating the Informal Money Market Act" (2005) reaffirms the authority of CBI in this regard.

- The single Article on Authorization of Establishing Non-Governmental Banks (April 10, 2000) and Article 98 of Third Five-Year Development Plan (April 6, 2000). The text of these two provisions are identical. They authorize the Iranian non-governmental sector to establish bank in Iranian mainland. The qualifications of the non-governmental bank promoters have been enumerated in these laws;
- The Implementing Regulation of the above-mentioned laws, passed by MCC on December 11, 2000. This Implementing Regulation is about the process of establishing a bank, the minimum capital required and also the qualifications of the bank's board members and managing director;
- The Monetary and Banking Act (1972) as amended, on the mode of operations and cases of liquidation of the bank;
- Usury-Free Banking Operations Act (August 30, 1983) and its implementing regulations and directives issued in compliance with it on the objectives and functions of the banking system, granting facilities in the framework of usury-free Islamic contracts and regulating the terms and conditions which must be included in those contracts;
- The other laws and regulations, such as Commercial Code of Iran and the directives of CBI.

1.1. Establishment

The private banks shall be established and registered in the Companies Registration Department of Iran only in the legal form of public joint stock company with registered shares¹, when the promoters have obtained

¹The Implementing Regulation, Articles 1 & 2; Monetary and Banking Act, Article 31 para. A.

the necessary authorization¹ from CBI. According to Commercial Code of Iran², the minimum shareholders of a public joint stock company are five persons.

As per the single Article and the Implementing Regulation, only Iranian real persons and non-governmental legal entities may apply to establish a private bank; and, hence, public sector³ and also foreigners may not apply to establish a private bank in Iran. However this does not mean that foreigners may not have any share capital in private banks established in Iran.

According to Monetary and Banking Act⁴, each bank 60% or more of whose share capital belongs to Iranians (either real persons or legal entities) is regarded as an Iranian bank; all the legal entities 75% or more of whose capitals belong to Iranians are regarded as Iranian. The Iranian banks are not authorized to transfer 40% or more of whose share capital to foreign persons⁵.

By virtue of the single Article⁶, the following qualifications have been enumerated for promoters of a private bank:

1. To have nationality of Iran;

¹According to Article 1 of the Implementing Regulation, in order to establish and operate a non-governmental bank, three authorizations should be obtained: a) Preliminary Authorization: CBI's first agreement with the establishment of a bank. It is necessary for filing an application in the Companies Registration Department and for subscription of the bank's shares; b) Authorization for Registration: CBI's final agreement with the registration of the bank in the Companies Registration Dept.; c) Authorization for Operation: CBI's permission to start banking operation.

²-Article 107.

³-The Implementing Regulation, Article 5.

⁴-Article 31, para. C.

⁵-The Implementing Regulation, Article 1 para. 3; Monetary and Banking Act, Article 31, para. C & D.

⁶-Para. C.

2. To have the required experience and knowledge in the banking field;
3. To have adequate capital for funding and financing; and,
4. Not to have any criminal convictions.

However, Monetary and Banking Act has anticipated that foreign banks may be established in Iran upon the Parliament's approval¹.

The promoters of a private bank are jointly and severally liable for all acts and functions that they perform in connection with the formation of that bank².

1.2. Capital

The Board of Ministers, in its session dated September 10, 2008, determined the minimum capital of the private banks as Iranian Rial "two thousand billion"³, of course 50% of which shall be deposited to CBI prior to applying for establishment⁴. The share capital of a private bank is only payable in Iranian currency. The share capital of a private bank shall not be funded through financing by another bank or credit institution⁵.

Throughout the operation, the bank should maintain the minimum capital required. In the likelihood of losses, its promoters and/or shareholders shall fund the registered bank, so that its share capital, under no circumstances, shall fall below the referred minimum.

No bank, whether public (controlled by the Government) or private and also credit institutions shall not have more than one percent of a private bank's share capitals, unless otherwise authorized by CBI⁶.

¹Article 31, para. E. In this respect, it seems necessary that the competent authority (Guardian Council) should interpret Article 81 of the Constitution and to repudiate the broad interpretation prevailing in Iran (see footnotes nos. 1 & 2).

² The Implementing Regulation, Article 19.

³ The Board of Ministers' Decree no. H40881T/117772 dated October 5, 2008.

⁴ The Implementing Regulation, Article 12.

⁵ Ibid, Article 14.

⁶ Ibid, Article 15.

Other conditions and regulations pertaining to the establishment of a private bank have been prescribed in the Commercial Code of Iran, under the title of “Public Joint Stock Companies”.

1.3. Board of Directors and Managing Director

The single Article lists the qualifications and requirements of the promoters of a bank, instead of being about the board members and the managing director thereof. However, the Implementing Regulation governs the qualifications of the members of the board of directors.

According to the Implementing Regulation¹, the members of the board of directors and the managing director of an Iranian bank should possess the following qualifications:

- 1- Lack of any criminal conviction;
- 2- To hold a degree in banking field (minimum, the bachelor degree);
- 3- To have minimum, five years, of experience in bank management position or in capital market;
- 4- To hold no position or ownership (share capital) in any other bank, without prior permission of CBI;
- 5- To have the legal capacity.

The other conditions have been enumerated in Article 111 of the Commercial Code.

Monetary and Banking Act² requires that managing director, chairman and majority of the boards (executive board and board of directors) members of Iranian banks to be Iranian.

Legal entities may be elected as director of a bank. In this case, the legal entity concerned shall hold the same civil responsibilities as a real

¹ Articles 8 and 9.

² Article 31, para. B.

person acting as a board member and shall introduce an individual as its permanent representative to exercise the functions of the directors¹.

Managing director, chairman and the board members of Iranian banks shall have the responsibility against the shareholders and/or the customers for the infringement of the provisions of Monetary and Banking Act or the Implementing Regulations relating thereto and the articles of association of the bank².

1.4. Mode of Operations

A private bank, after having obtained the necessary authorization from CBI, may proceed with the banking operations in Iranian Rial, with due respect for the relevant laws and regulations and CBI's directives. Of course, doing forex operations and transactions require a separate and particular authorization from CBI³.

Paragraph B of the single Article reads: "The mode of banking operations, e.g. observance of the determined financial proportions, contracts and banking operations shall be governed by and be subject to Monetary and Banking Act (1972) and the Usury-Free Banking Operations Law (1983)".

The banks are prohibited to do the following operations:

- 1- Sale of goods for business purposes;
- 2- Sale of real estates (immovable properties) except for the banks established for this purpose;
- 3- Buying stocks and share capitals of companies and/or other securities in excess of the amount prescribed by CBI;

¹ Commercial Code of Iran, Article 110.

² Monetary and Banking Act, Article 35, para. C; Commercial Code of Iran, Article 142.

³ The Implementing Regulation, Article 26 and Note 1.

- 4- Granting facility(ies) to their own members and/or to the members of the organs, heads of departments or inspectors of CBI, unless respectively CBI or MCC authorizes otherwise;
- 5- Issuance of sight bills to the order of the bearer¹;
- 6- Usury operations.

According to the Usury-Free Banking Operations Law, banking operations in Iran shall be done through Islamic and usury-free contracts, regardless of the fact that, pursuant to Article 595 of the Penal Code recently enacted in Iran, paying/receiving usury (Reba) is regarded as a crime.

1.5. Liquidation

In the following cases, on the recommendation of the Governor of CBI, the confirmation of MCC, and approval of a board composed of the President, the Minister of Economic Affairs and Finance, and the Head of Judiciary, CBI may undertake the management of a bank, or another arrangement may be made for the management thereof, or the granted authorization may be annulled:

- 1- "Upon the request of the competent authorities of the bank;
- 2- Failure of the bank to commence its operations within one year after issuance of the authorization by CBI;
- 3- Unjustifiable stoppage of operations, for a period exceeding five working days;
- 4- Violation of Monetary and Banking Act and the implementing regulations relating thereto, as well as the directions of CBI, issued on the basis of Monetary and Banking Act and the implementing regulations pertaining thereto, or its own articles of association;
- 5- Failure to meet its financial obligation (insolvency).
- 6- As soon as the authorization of a bank is annulled, it shall be

¹ Monetary and Banking Act, Article 34.

managed as per instructions issued by CBI"¹.

In cases of insolvency or bankruptcy of a bank, the court, prior to passing a judgment, shall seek the opinion of CBI. CBI shall submit its written opinion to the court, within one month from the date it receives the court's inquiry. The court, with due attention to CBI's opinion and existing evidence in the file, shall make the appropriate decision².

Moreover, when CBI finds that the promoters have not performed and/or are not able to perform their obligations and duties, or they are not able to establish the bank, or they have provided false, misleading or incomplete information, or CBI considers that it is convenient for the banking system of the country, may annul the granted authorization³.

Section 2. Credit Institutions

As per Monetary and Banking Act⁴, non-banking credit institutions are credit institutions, which do not use the title of "bank", but are considered by CBI as intermediary among the suppliers and demanders of funds and credits.

The Regulation on the Establishment, and Operations of Non-Banking Credit Institutions were set forth in MCC's July 1992 approval (MCC's 1992 Approval); but according to Article 92 of Third Five-Year Development Plan⁵, the manner of establishment, mode of operation as

¹ Ibid, Article 39 and Note; the Implementing Regulation on the Mode of Management and the Manner of Annuling the Establishment Authorization of a Bank in Cases Mentioned in Article 39 of the Monetary and Banking Act, (1973).

² Ibid, Article 41.

³ The Implementing Regulation, Article 25.

⁴ Article 31, para. E.

⁵ Third Five-Year Development Plan Act, Article 92: "In order to further promote competition among various banks, to develop financial markets and to encourage domestic savings by the public, CBI shall pave the way for authorized activities and operations by various non-bank (non-governmental) institutions, organizations and credit institutions and shall exert control and supervision over the activities and

well as dissolution and bankruptcy of non-bank credit institutions (non-governmental) shall be subject to Monetary and Banking Act (1972); consequently, MCC's July 1992 Approval shall not govern on those three subject-matters and they are subject to Monetary and Banking Act¹, but other provisions of the said approval are still valid and effective.

Therefore, the laws and regulations governing credit institutions are:

- Monetary and Banking Act (1972) as amended, on the establishment, mode of operation, dissolution and bankruptcy of credit institutions;
- MCC's 1992 Approval, on the required capital and also qualifications of the board members and managing directors of credit institutions;
- Usury-Free Banking Operations Act (August 30, 1983) and its implementing regulations and the directives approved in compliance with it;
- Other laws and regulations such as commercial code of Iran.

operations of such entities and establishments and shall prevent similar operations by unauthorized institutions.

The requirements and conditions governing the **manner of establishment** and **mode of operation**, as well as **dissolution and bankruptcy** of non-bank (non-governmental) institutions, organizations and credit institutions shall be subject to the rules and regulations, which are applicable to the banks, as mentioned in Monetary and Banking Act approved in 1972; such establishments shall be authorized to engage in the activities which, at the discretion of MCC, shall exclusively be carried out by banks.

CBI shall supervise good performance of the activities and operations to be carried out by non-bank (non-governmental) institutions, organizations and credit institutions, in compliance with approved rules and regulations”(*emphases added*).

¹- Interpretative Act on Article 92 of the Third Five-Year Development Plan Act (May 24, 2000) reads: “Single Article- According to Article 92 of the Third Five-Year Development Plan Act, Monetary and Banking Act governs on the establishment, mode of operation as well as dissolution and bankruptcy of non-bank credit institutions”.

2.1. Establishment

For establishing a credit institution, articles of association of which should be approved by MCC and then an authorization should be obtained from CBI. Any changes in the articles of association should also be approved by MCC¹.

The credit institutions may be established in Iran only in the legal form of public joint stock company, with registered share².

Foreign credit institutions shall be established in Iran, only after the Parliament approves thereof³. According to some lawyers, the branches of foreign credit institutions may be established in Iran by virtue of the Law on Permission of Registration of Foreign Companies' Branches or Agencies (1997)⁴.

As per Monetary and Banking Act⁵, each credit institution 60% or more of whose share capital belongs to Iranians (whether real persons or legal entities), is regarded as an Iranian credit institution; for the purposes of Monetary and Banking Act, all the legal entities 75% or more of whose share capitals belong to Iranians, are regarded as Iranian.

The Iranian credit institutions are not authorized to transfer more than 40% of whose share capitals to foreign nationals or to foreign legal entities, unless otherwise authorized by the law⁶.

¹ Monetary and Banking Act, Article 30, paras. C, D and E.

² Ibid, Article 31, para. A.

³ Ibid, Article 31, para. E.

⁴ Regarding the registration of foreign credit institutions and their branches in Iran, it seems necessary that Guardian Council should interpret Article 81 of the Constitution and to abolish the broad interpretation currently prevailing in Iran (see footnotes nos. 2, 3 & 15); moreover, by virtue of "Regulating the Informal Money Market Act" (2005) the CBI's permission should be taken as well.

⁵ Ibid, Article 31, para. C.

⁶ Ibid, Article 31, para. D.

2.2. Capital

The share capital of a credit institution is only payable in Iranian currency. The minimum share capital of a credit institution is Iranian Rial five billion, at least 35% of which shall be deposited to CBI at the time of applying for establishment¹.

The banks may not fund the share capital of a credit institution². Throughout the operation, the credit institution should maintain the minimum capital required. In the likelihood of losses, the credit institution shall be funded so that its share capital, under no circumstances, shall fall below the above-mentioned minimum³.

2.3. Board of Directors and managing Director

The specialization and qualifications of the managing director, the deputy- managing director and the board members of a credit institution shall be verified and approved by CBI, and they may be re-appointed only upon the approval of CBI⁴.

The managing Director, chairman and the majority of the board members of Iranian credit institutions should be Iranian⁵.

In practice, when the said people possess the following qualifications, CBI shall approve the appointment of them:

- 1- Lack of any criminal conviction;
- 2- To hold a degree (minimum the bachelor degree in one of the banking, economics, or commercial management courses);

¹ MCC's July 1992 approval, Article 12.

² Ibid, Article 12 and Note.

³ Ibid, Article 13.

⁴ Ibid, Article 14 and Note.

⁵ Monetary and Banking Act, Article 31, para. B.

- 3- To have minimum five years of experience or more in bank management position (i.e. management of a first class bank branch or directorship of a specialized department in a bank);
- 4- Lack of any position or responsibility in any other credit institutions or banks¹.

The highest-ranking executive authority, chairman and the members of the board of directors and the executive board of the credit institutions, jointly and severally, have the responsibility against the shareholders and/or the customers for the infringement of the provisions of Monetary and Banking Act or the articles of association of the relevant credit institution².

2.4. Mode of Operations

Credit institutions are prohibited from doing the following operations:

- 1- Sale of goods for business purposes;
- 2- Sale of real estates (immovable properties) except for credit institutions established for this purpose;
- 3- Buying stocks and share capitals of companies and/or other securities in excess of the amount prescribed by CBI;
- 4- Granting facility(ies) to their own members and/or to the members of the organs, heads of departments or inspectors of CBI, unless respectively CBI or MCC authorizes otherwise;
- 5- Issuance of sight bills to the order of the bearer³;
- 6- Usury operations.

In practice, the credit institutions give prize to the holders of the usury-free (non-interest) deposits, by lottery.

The present credit institutions are not allowed to open current account or other similar accounts, the sum of which is transferable through drawing checks or other similar negotiable instruments, according to their

¹ MCC's July 1992 Approval, Article 36.

² Ibid, Article 15 ;Monetary and Banking Act, Article 35, para. C.

³ Monetary and Banking Act, Article 34.

articles of association which was drafted and approved at the time of the validity of MCC's 1992 Approval (which in part has repealed and replaced by Monetary and Banking Act). In fact, the said prohibition was prescribed in MCC's 1992 Approval¹, but since it has been incorporated in the articles of association of the credit institutions, therefore they are not authorized to open current account, as per their articles of association, but not under the replaced MCC's 1992 Approval. Furthermore, according to MCC's 1992 Approval², banking operations on foreign currencies required a special license from MCC.

The said approval was partly repealed but MCC has still the authority to approve or disapprove the articles of association of the credit institutions, which are to be established; considering this authority, in practice, MCC does not approve credit institutions to open current account and to do foreign exchange operations.

However, considering Monetary and Banking Act, it seems that the credit institutions may change their articles of association and request MCC to approve them, in order that they get authorization to open current account and to do foreign exchange operations.

2.5. Liquidation

By virtue of Article 92 of the Third Five-Year Development Plan, dissolution and bankruptcy of credit institutions is subject to and governed by Monetary and Banking Act.

As per Monetary and Banking Act³, in the following cases, on the recommendation of the Governor of CBI, the confirmation of MCC, and approval of a board composed of the President, the Minister of Economic Affairs and Finance, and the Head of Judiciary, CBI may undertake the

¹ Ibid, Article 18.

² Ibid, Article 22.

³ Article 39 and Note; the Implementing Regulation on the Mode of Management and the Manner of Annuling the Establishment Authorization of a Bank in Cases Mentioned in Article 39 of the Monetary and Banking Act, (1973).

management of a credit institution, or another arrangement may be made for the management thereof, or the granted authorization may be annulled:

- 1- Upon the request of the competent authorities of the credit institution;
- 2- Failure of the credit institution to commence the operations within one year after issuance of the authorization by CBI;
- 3- Unjustifiable stoppage operations, for a period exceeding five working days;
- 4- Violation of Monetary and Banking Act and the implementing regulations relating thereto, as well as the directions of CBI, issued on the basis of Monetary and Banking Act and the implementing regulations pertaining thereto, or its own articles of association;
- 5- Failure to meet the financial obligations (insolvency).

As soon as the authorization of a credit institution is annulled, it shall be managed as per instructions issued by CBI¹.

In cases of insolvency or bankruptcy of a credit institution, the court, prior to passing a judgment, shall seek the opinion of CBI. CBI shall submit its written opinion to the court, within one month from the date it receives the court's inquiry. The court, with due attention to CBI's opinion and existing evidence in the file, shall make the appropriate decision².

Part B. Regulations Governing in Iranian Free Zones

By virtue of Note 19 of the First Five-Year Development Plan (1989), the Government was authorized to establish, at the maximum, three Free Trade-Industrial Zones (free zones) in the country's borderlands. Subsequently, in 1993, the parliament, by virtue of the Law of Administration of Free Zones, determined the following three borderlands as free zones: Kish and Qeshm islands and Chabahar port, and authorized

¹- Ibid.

²- Ibid, Article 41.

the Government to administer them. Furthermore, according to "Law on Establishment of Trade-Industrial Free Zones in Abadan, Khorramshahr, Jolfa and Bandar Anzali" ratified on Aug. 24, 2004, some part of those areas were determined as free zones.

In July 1999, the Expediency Council amended the Law of Administration of Iranian Free Trade-Industrial Zones (1993). According to the amendment, the legal rights of foreign investors have been guaranteed and in case of nationalization for a public purpose or expropriation, the Government shall be obliged to pay a fair compensation¹. Moreover, foreign investment in Iranian banks incorporated in Iranian free zones allows up to 100% of the share capital of the relevant bank².

Following the amendment to the Law of Administration of Free Zones in July 1999, the Board of Ministers approved an implementing regulation on the "Monetary and Banking Operations in Iranian Free Trade-Industrial Zones" (hereinafter, in this part, shall be referred to as "the Implementing Regulation") on November 30, 1999. The Implementing Regulation governs on the establishment, the minimum capital, qualifications and liabilities of the directors and mode of operations of private banks and credit institutions, as well as foreign exchange system prevailing in Iranian free zones.

However, the following laws and regulations govern private banks and credit institutions in Iranian free zones:

- The Law of Administration of Free Zones of Iran (1993) as amended in 1999;
- Implementing Regulation of the Monetary and Banking Operations in Free Zones of Iran (1999);

¹ The Amendment to the Law of Administration of Free Zones of Iran (July 1999), Article 21.

² Ibid, Article 18 and Note 1; see also footnote no. 64.

- The Money and Credit Council (MCC)'s Directive (herein after shall be referred to as MCC's Directive) on Monetary and Banking Operations in Iranian Free Zones (Sept. 2000);
- Usury-Free Banking Operations Law (1983) and the Implementing Regulations and Directives issued in compliance with it, on the objectives and functions of the banking system, granting facilities in the framework of Islamic contracts and regulating the terms and conditions which much must be included in those contracts;
- Other laws and regulations, such as Directives of CBI, Commercial Code and Criminal Code of Iran.

It is noteworthy that Standard Chartered, Europäisch-Iranische Handelsbank and also Future Bank got the necessary authorization from CBI and registered their branches in Kish Island.

1. Establishment

Establishment of a bank/credit institution and also registration of a bank/credit institution branch, whether Iranian or foreign, shall be determined upon the relevant Free Zone Organization's proposal and obtaining CBI's authorization¹. The articles of association of banks/credit institutions and the future amendments thereto should be approved by MCC, after the proposal of the relevant Free Zone Organization².

The banks/credit institutions established and registered in each of the free zones, while their head offices are located therein, are considered Iranian, whether Iranians or foreigners incorporate them³.

Iranian or foreign bank/credit institution's representative office shall be established in the free zones upon the approval of the relevant Free

¹The Implementing Regulation, Article 4; MCC's Directive, Article 4.

²The Amendment to the Law of Administration of Free Zones of Iran (1999), para. 2, amending Article 18, Note 1; the Implementing Regulation, Article 4 and Note 1.

³MCC's Directive, Articles 2 and 3.

Zone Organization and registration therein. Representative offices are not authorized to do banking operations¹.

The establishment of offshore banking units in Iran (either in the form of an off-shore bank or an offshore credit institution), for the first time was anticipated in the Implementing Regulation of November 1999. According to the said Implementing Regulation, offshore banking units are only authorized to do banking operations with foreign currencies, but not with Iranian currency. They are required to use the word of “Offshore”, after their names².

The banks/credit institutions shall be established in the free zones in the legal form of private or public joint stock companies, with registered shares³. According to Iranian Commercial Code, there should exist at least three shareholders in a private joint stock company, and the minimum shareholders in a public joint stock company are five shareholders⁴.

After depositing 100% of the required capital with CBI, the necessary authorization for registration of the banking units (including private banks, credit institutions and their branches and/or representative offices, whether Iranian or foreign) in the relevant free zone, shall be issued by CBI⁵. This authorization is not transferable⁶, and the validity period of which is six months from the date of issuance⁷; hence, it should be registered in the same free zone prior to the end of the said period.

2. Capital

¹MCC's Directive, Articles 5 and 71; the Implementing Regulation, Note of Article 5.

²MCC's Directive, Article 8 and Note; the Implementing Regulation, Article 2 and Note.

³MCC's Directive, Article 9; the Amendment to the Law of Administration of Free Zones of Iran (1999) para. 2; the Implementing Regulation, Article 4, Note 2.

⁴ Articles 3 and 107.

⁵MCC's Directive, Article 18.

⁶Ibid, Article 19.

⁷Ibid, Article 20.

Up to 100% of capital of the banks/credit institutions in the free zones may belong to Iranians and/or foreigners (subjects of the governments recognized by the Iranian Government). Foreign legal entities, including banks and companies which shall fund the capital of banks/credit institutions, should have been registered in the country the government of which is recognized by the Iranian Government and it should have at least three years record of operations.¹

The minimum capitals for the establishment of a bank and a credit institution are respectively: Iranian Rial 1000 billion², 15 billion and for the registration of a foreign bank/credit institution's branch is as follows: Iranian Rial 10 billion, 100% of them shall be deposited with CBI, in cash³.

The foreign nationals or foreign legal entities, who wish to establish or fund a bank/credit institution or to register or fund a bank/credit institution branch, should change their currencies into Rial through one of the banks/credit institutions established in the relevant free zone.

¹Ibid, Article 7. According to Article 18, Note 1 of the Amendment to the Law of Administration of Free Zones of Iran (July 1999), the banks and credit institutions shall be established in the zones with Iranian **and** foreign capital. But as per Article 3 of the Implementing Regulation of it (Nov. 1999), the banks and credit institutions may be funded by Iranian **or** foreign capital or the combination of Iranian and foreign capital. Finally, Articles 2 and 7 of MCC's Directive, respectively provided that: "Banks and credit institutions with Iranian **or** foreign capital and or with the combination of Iranian and foreign capital may be established in the zones."; "The capital of banks and credit institutions may, up to 100 per cent, belong to Iranian **or** foreign nationals." (emphases added). Therefore, it seems that in this respect, the scope of the Implementing Regulation as well as MCC's Directive are broader than the scope of Note 1, Article 18 of the Amendment to the Law of Administration of Free Zones of Iran (July 1999).

² The Board of Ministers' Decree no. H40881T/117772 dated October 5, 2008.

³ MCC's Directive, Article 10, Section 1; the Implementing Regulation, Article 7, paras. A, B and C.

Otherwise, CBI shall not issue the necessary authorization for the establishment or registration of the banking unit¹.

The minimum capitals for the establishment of an offshore bank and offshore credit institution are respectively USD 10 and 5 million and also for the registration of an offshore foreign bank/credit institution branch is USD 3 million, 100% of them shall be deposited with CBI, in cash².

CBI is authorized to increase the minimum capitals mentioned above³.

Throughout the operation, the bank/credit institution should maintain the minimum capital required. In the likelihood of losses, the bank/credit institution in the free zone(s), shall be funded, within six months, so that its capital shall not fall below the minimum mentioned above⁴.

Transferring of more than 10% of the share capital of a bank/credit institution to other persons requires prior approval of CBI⁵.

The legal rights of a foreign investor, whose capital has been imported with the permission of the Board of Ministers, shall be protected. In case of nationalization and/or expropriation, the Government shall compensate the said foreign investor⁶. In this respect, reference should be made to the Law of Promotion and Protection of Foreign Investment (2002) and its implementing regulation (2002).

3. Board of Directors and Managing Director

CBI should approve the professional qualification of the members of the Board of Directors, the Managing Director and the members of the

¹ MCC's Directive, Article 10, Note 2; the Implementing Regulation, Article 7, Note 1

² MCC's Directive, Article 10, Section 2; the Implementing Regulation, Article 7, para. D.

³ MCC's Directive, Article 10, Note 4; the Implementing Regulation, Article 7, Note 3

⁴ MCC's Directive, Article 70; the Implementing Regulation, Article 28.

⁵ MCC's Directive, Article 21.

⁶ The Amendment to the Law of Administration of Free Zones of Iran (1999), para. 3 amending Article 21.

Executive Board as well as the managers of branches of Iranian and foreign banks/credit institutions established and registered in the free zones¹. CBI should also approve any changes in the members of Board of Directors, Executive Board, the Managing Director and Vice-Managing Director of the banks/credit institutions².

The Implementing Regulation does not define the professional qualification necessary for assuming the responsibility of a bank/credit institution in the free zones. However, MCC's Directive provides that: "Those convicted, whether as principal offender or as abettor of theft, corruption, embezzlement, breach of trust, fraud, forgery, drawing of check without honoring it, culpable or fraudulent bankruptcy, whether in Iran or abroad, shall not be permitted to have any position in the banks/credit institutions in the free zones"³.

4. Mode of Operations

Except representative offices which are not authorized to proceed with banking operations⁴, since the functions and mode of operation of the banks/credit institutions and the offshore banks/credit institutions are different, they will be discussed separately:

- Banks/credit institutions: All of the banking operations and transactions in Iranian currency shall be subject to Islamic banking laws, including Usury-Free Banking Operations Law. However, if they would have obtained the necessary authorization from CBI to engage in foreign exchange operations, their operations on foreign currencies shall be governed by international banking rules and they will be authorized to receive/pay fixed rate profits from/to their customers. The open market shall determine the rates of the profits

¹MCC's Directive, Article 94; the Implementing Regulation, Article 31.

²MCC's Directive, Article 21.

³ Article 95.

⁴ MCC's Directive, Article 71.

and fees¹. Any way, the credit institutions shall not be authorized to open current account for their customers, whether in Iranian currency or in foreign currency².

- Offshore banks/credit institutions shall only be authorized to do banking operations on foreign currencies, but not on Iranian currency³. They are authorized to follow the rules and regulations prevailing in international banking⁴; hence, they may receive/pay fixed rate profits from/to their customers.

Nevertheless, the banks/credit institutions established and registered in the free zones, are prohibited to do the following operations:

1. Sale of goods for business purposes;
2. Sale of real estates (immovable properties), except for the banks/credit institutions established for this purpose, in excess of the limits prescribed by CBI;
3. Buying stocks and share capital of companies and/or other securities in excess of the amount prescribed by CBI;
4. Granting facility(ies) to their managing director and members of the board of directors and the companies that they have any share(s) therein, in excess of the amounts prescribed by CBI;
5. Granting facility(ies) to the members of the board of directors and the directors of the Organization of the relevant free zone and the directors and inspectors of CBI, in excess of the amounts determined by CBI⁵.

¹ The Implementing Regulation, Article 13, para. B and Articles 15, 16, 18 to 20; MCC's Directive, Articles 46 and 47.

² Ibid, Article 39; the Implementing Regulation, Note of Article 17.

³ MCC's Directive, Article 8, 40 and 41.

⁴ The Implementing Regulation, Article 13, para. B and Articles 18 to 20; MCC's Directive, Articles 38 and 46.

⁵ The Implementing Regulation, Article 27.

All of the banks/credit institutions in the free zones shall be under supervision of CBI and shall be required to provide to CBI, any document or information that CBI deems necessary¹.

Buying and selling foreign currencies and transferring them from free zones to abroad and vice versa is authorized. The open market shall determine the exchange rate therein².

5. Termination of Operations

In the following cases, on the recommendation of the Governor of CBI, the confirmation of MCC, and approval of a board composed of the President, the Minister of Economic Affairs and Finance, and the Head of Judiciary, CBI may undertake the management of a bank/credit institution, or another arrangement may be made for the management of it, or the granted authorization may be annulled:

- 1- When the competent authorities of a bank/credit institution request so;
- 2- When a bank/credit institution unjustifiably stops its operations, for a period exceeding five working days;
- 3- When a bank/credit institution violates and contravenes Monetary and Banking Act and the implementing regulations relating thereto, as well as the directions of CBI, issued on the basis of Monetary and Banking Act and the implementing regulations pertaining thereto, or its own articles of association;
- 4- When a bank/credit institution fails to meet its financial obligations (insolvency).

As soon as the authorization of a bank is annulled, it shall be managed as per instructions issued by CBI³.

¹ Ibid, Article 29.

² MCC's Directive, Articles 33 to 35.

³ Implementing Regulation, Article 34; Monetary and Banking Act, Article 39 and Note; MCC's Directive, Articles 103 and 105.

Conclusion

For making competition among the banks and attracting private sector's investment, some of the Iranian legal scholars proposed a new interpretation from Article 44 of the Constitution; so that banking operation is and will remain under supervision of the Government, but it may be delegated to private persons to engage in banking operations. Of course, private banking is an aspect of the general policy of privatization pursued by Iranian Parliament in the Third and Fourth Five-Year Development Plans (2001 and 2006), just the same as private insurance in Iran. However, considering the whole circumstances of the country, it seems that the Iranian free zones are a suitable channel for foreigners to get familiarity with the laws and regulations applicable in Iran and to enter into private banking in Iranian mainland.

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