BANKING IN IRAN: PREPARING FOR THE FUTURE

Mazars' presentation to the ICC Banking Commission

January 2014

MAZARS

Contents

01

About Mazars

Our firm

- An integrated and independent global firm specialising in audit, advisory, accounting and tax services
- Unique business model – the only international firm that is legally and operationally integrated worldwide
- Globally: over 850 partners and 13,500 professional staff in 71 countries
- Joint ventures and representative offices in a further 14 countries
- UK: 116 partners and 1,250 professional staff
- Clients include listed and large international corporations, government bodies, successful entrepreneurial businesses and individuals
- We cover a range of sectors – financial services, industry services and public sector
- Established as a credible alternative to the Big 4 with the ability to offer seamless and tailored solutions on a global basis

SERVING OUR CLIENTS
ON 5 CONTINENTS

Turnover as of
31st August 2012
€1,013m

Information including decisions taken by the Partners' General Assembly in December 2012

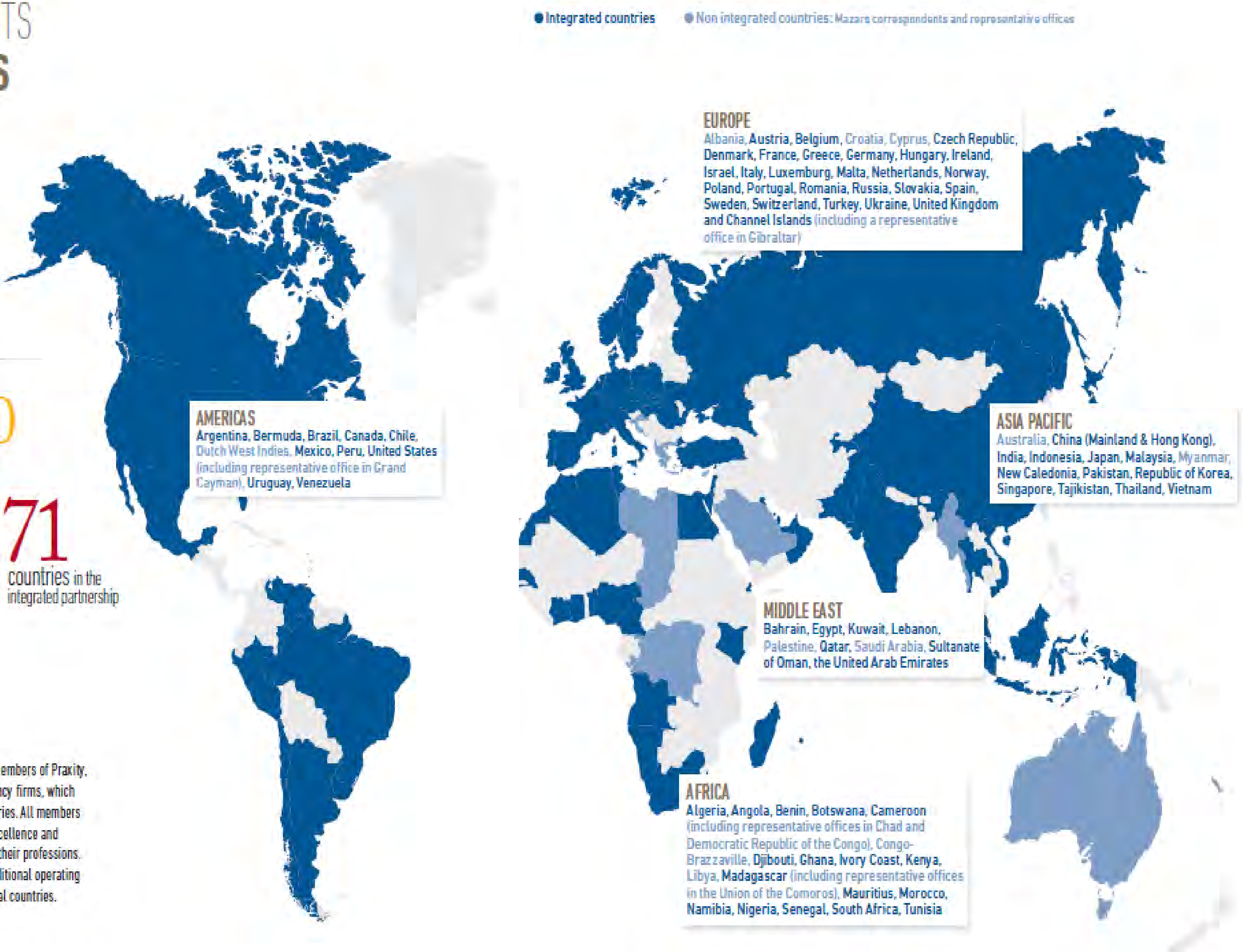
13,500 professionals

71 countries in the integrated partnership

14 additional countries where we serve our clients through our correspondents and our representative offices

PRAXITY ALLIANCE

In 2007, Mazars became one of the founding members of Praxity, an alliance of independent audit and consultancy firms, which now numbers 30,000 professionals in 92 countries. All members share the same high standards of technical excellence and uphold the same ethical values in conducting their professions. As such, the Praxity Alliance offers Mazars additional operating capacity via professional teams in 17 additional countries.



Our global reach

- We are committed to providing our clients with tailored services and solutions based on our global experience
- Our unique business model enables us to provide high quality services wherever our clients are located
- We can deliver a seamless services to clients worldwide – working together as one team, across borders.
- Our global reach and integrated teams offer strength of experience and understanding of cross-cultural issues and requirements
- We audit more than 400 listed companies on 50 stock exchanges throughout around the world

02

Our experience

Mazars’ banking practice

- Recognised player as auditor of major international banks such as BNP Paribas, Caisses d’Epargne-Natixis, Crédit Agricole, Dexia and ICBC (London)
- Strong position as consultant to banks such as Société Générale, GE, GMAC and HSBC
- UK Banking and Financial Services: 15 partners and 150 professional staff
- Developing activities on securitisation throughout Europe
- Monitoring Trustee on behalf of the European Union for UK and European banks
- Enviable strength of relationships with UK Ministries and European Institutions
- Financial Services activities represent 29% of Mazars’ large accounts turnover

Mazars' banking practice

Service offering	A selection of our international clients
Financial report auditing	BNP PARIBAS, Persia International Bank PLC, AXA, BPCE, NATIXIS, ICBC 中国工商银行
Financial advisory services	CREDIT SUISSE, RBS The Royal Bank of Scotland, HSBC, SOCIETE GENERALE, citi, JPMorgan
Consulting	ABN·AMRO, Standard Chartered, AIG, AIB, AVIVA
Bank restructuring	LLOYDS BANKING GROUP, BLACKROCK, ALPHA BANK, BARCLAYS, BBVA, WestLB, LBB, IBRC, ZTBL
Tax services	AXA, SCOR, ICBC, BNP PARIBAS, TYSERS, THB
Accounting advisory and assistance	FORTIS, HSBC, SOCIETE GENERALE, CREDIT SUISSE

Case studies: bank audit

Persia International Bank UK: Statutory Audit	BNP Paribas: Group Audit
Mazars performs the statutory audit of Persia International Bank PLC, a UK regulated bank owned by two Iranian banks, Bank Mellat and Bank Tejarat. The bank provides a variety of services to its corporate and personal clients including trade finance, commercial finance, commercial loans, money transfer services and deposit and savings accounts. Mazars audits the bank in line with International Standards of Auditing, and has performed this role since 2008. The audit involves: • Reviewing the work performed by compliance and risk management; • ensuring adherence to capital adequacy requirements; • testing internal controls and IT systems; and • ensuring the financial statements are presented in line with appropriate financial reporting standards.	Since 1997, Mazars has performed the role of joint-auditor of BNP Paribas in 29 countries. Mazars is in charge of several areas of BNP Paribas' business worldwide: consumer finance, leasing activities, insurance, real estate, equity derivatives, and retail. We have provided services in respect of restructurings, mergers and demergers, changes in the legal form, divestments and acquisitions. This demonstrates: • We have the professional skills and appropriately qualified staff to work with one of the largest European banks. • We have the ability to act on complex and international banking projects.

Case studies: anti-money laundering

Review of anti-money laundering arrangements	Review of anti-money laundering & anti-bribery and corruptions systems and controls
For the UK subsidiary of a Nigerian bank, Mazars reviewed the bank's new anti-money laundering (AML) policies, procedures, systems and controls, following a fine from the regulator for significant AML deficiencies. This involved a review of 140 customer files, a gap analysis of existing AML documentation against UK AML requirements as well as a review and testing of the bank's transaction monitoring systems and controls. We identified specific gaps that were relevant to the bank's AML policy such as: • trade finance procedures, controls and training; • correspondent banking procedures and controls; and • gaps in the implementation of the policies and procedures, principally concerning evidencing source of wealth and funds of clients.	For a large UK bank, Mazars provided assurance that changes required following a financial crime assessment by the UK's Financial Services Authority (FSA) had been appropriately embedded within the bank's framework. We completed testing of a selected sample that we agreed with the FSA, and reported on whether the amended systems and controls are in compliance with all relevant anti-money laundering (AML) and anti-bribery and corruption (ABC) legislation. We provided: • an opinion to the FSA on the bank's compliance with the AML and ABC requirements; • A recommendation on enhancements of the bank's AML and ABC framework and supporting arrangements; and • A report to the bank's board and the FSA outlining our findings and recommendations for enhancements.

Case studies: prudential regulation

Review of key regulatory documents	Workshop on UK Financial Services Authority's new liquidity regime
A Turkish bank had prepared their Internal Capital Adequacy Assessment Process (ICAAP), Internal Liquidity Adequacy Assessment Process (ILAA) and five-year strategic plan and was looking for an independent review of the documents. Mazars performed a detailed desktop assessment of the documents, focusing on: • compliance with corresponding regulatory requirements; • the bank's current policies, procedures, liquidity and capital requirements and risk management framework; and • consistency between the different documents (e.g. assumptions, key risks, risk appetite etc). Our final report included tailored recommendations on associated business policies and procedures including the risk management framework, corporate governance, stress testing methodology, business model and business strategy.	The UK subsidiary of Gulf International Bank was required to comply with the new liquidity regime in the UK. Mazars delivered a detailed workshop with the CFO, senior managers, and heads of business in the UK. This served to: • set out the requirements of the new liquidity regime; and • facilitate discussion of the Bank's liquidity risk appetite, liquidity risk management framework, key risk drivers, stress testing methodology and ILAA preparation process. The result was a clear understanding of the new liquidity regime and implications for the bank. Our final report identified relevant risk drivers, beginning the process for formulating a structured stress testing methodology and liquidity risk management framework.

Case studies: governance and risk management

Review of governance and risk management arrangements	LIBOR Case Team: Serious Fraud Office secondments
For a large Irish bank, Mazars conducted a review of the governance and risk management arrangements. Mazars interviewed each member of the banks board and senior management team, and review all processes and procedures as they related to governance and risk management. Issues of culture and risk appetite were also addressed. The review also included a comprehensive benchmarking exercise to compare the bank's governance and risk management arrangements to those of national and international peers. The output of the review was a report that identified strengths and weaknesses in the bank and documented detailed implementation plans to assist the bank in remediating identified weaknesses.	Mazars seconded two individuals to the UK Serious Fraud Office (SFO) to assist the SFO's LIBOR Case Team with the criminal investigation into the manipulation of the London Interbank Offered Rate (LIBOR). The work required knowledge of the mechanics of LIBOR; knowledge and understanding of complex derivative banking products; knowledge and understanding of market disclosure rules and the banking sector in general; and evidence review. Mazars worked closely with members of the SFO's LIBOR Case Team to analyse a vast and varied quantity of data and information to identify instances of fraudulent manipulation of LIBOR and to build a criminal case against the protagonists. Mazars' banking expertise was used as a reference point for the Case Team in respect of investment banking products and the banking sector in general.

Case studies: bank restructuring

Lloyds Banking Group: monitoring trustee to the European Commission	Alpha Bank: monitoring trustee to the European Commission
As a result of state aid received by Lloyds Banking Group, the UK's largest bank, in 2008 and 2009, the bank was required to submit a restructuring plan to the European Commission that included a commitment to dispose of a UK retail banking business. The bank was required to appoint a Monitoring Trustee to monitor the disposal of this business and the bank's other commitments in the restructuring plan. Mazars was appointed as the Monitoring Trustee, and our work involves monitoring a £181 billion reduction in a pool of assets following a data validation exercise for these assets. This includes asset classes such as residential property mortgages, commercial real estate loans, corporate loans, consumer finance and loans, loans to SMEs, and structured credit instruments. We provide regular reports with our findings to all stakeholders.	Mazars is currently performing the role of Monitoring Trustee to the European Commission with respect to Alpha Bank, Greece's third largest bank. Mazars' review involves monitoring the bank's compliance with its commitments under the restructuring plan agreed with the European Commission. This includes: • the efficiency and adequacy of the bank's internal organisation; • the commercial practices of the bank and risk monitoring; and • numerous behavioural commitments.

Case studies: technical assistance

Da Afghanistan Bank (the Central Bank of Afghanistan): Financial Sector Strengthening	Central Bank of Uzbekistan
Mazars audited five commercial banks in Afghanistan as part of Da Afghanistan Bank's Financial Sector Strengthening Project. This involved the completion of a quality assessment of the Central Bank's portfolio. We then undertook a detailed examination of the five commercial banks' accounts with a view to expressing an opinion on the accuracy and reliability of the accounting system and the banks' reported financial performance in the period under review. We completed an examination of the capital adequacy, asset, earnings, liquidity, and sensitivity to risk, and compliance with existing regulatory directives of DAB. In addition, the work involved a detailed institutional diagnostic to examine the management and organisation of the five commercial banks; their operating procedures, policies and systems; and internal controls, with a view to determining their effectiveness in ensuring that these banks' assets are safeguarded.	For this World Bank-funded project, Mazars provided the Central Bank of Uzbekistan with legal advice, bank supervision assistance, accounting, and bank/credit restructuring services. The legal work we undertook focused on: • a review of key areas of banking legislation; and • a review of relevant aspects of commercial law. The final report provided a series of recommendations for how the Central Bank of Uzbekistan can strengthen the legal foundation underlying commercial banking activities in the country.

Case studies: asset quality review

Central Bank of Ireland/BlackRock: Asset Quality Review	Central Bank of the Netherlands/BlackRock: Asset Quality Review
Mazars was engaged by BlackRock to support the Central Bank of Ireland's Prudential Capital Assessment Review of five distressed Irish banks. We performed a Distressed Credit Operations Review and Asset Quality Review of portfolios of SME loans held by the banks: • Based upon indicative benchmarks, Mazars performed a qualitative analytical review of the loan resolution operations for SME product lines with the banks' ROI divisions; and • We performed an asset quality review to assess the quality of aggregate and individual assets held by the banks and of the processes employed by the banks for establishing and monitoring asset quality. The assessment was derived from both qualitative and quantitative processes, including loan file review, statistical analysis and risk-based sampling.	Mazars was engaged by BlackRock to support the Central Bank of the Netherlands (DNB) to accompany a distressed credit review on Dutch banks. Mazars conducted the audit work related to the review of financing portfolios of commercial real estate loans on three major Dutch banks. This included conducting an assessment of the integrity and reliability of data used, and availability and quality of data on the performance of credit and estimation of collateral received. It also included an asset quality review of a portfolio of commercial real estate loans, focused on: • individually and collectively assessing the quality of lending and collateral received; and • evaluating control processes used to assess and monitor assets.

03

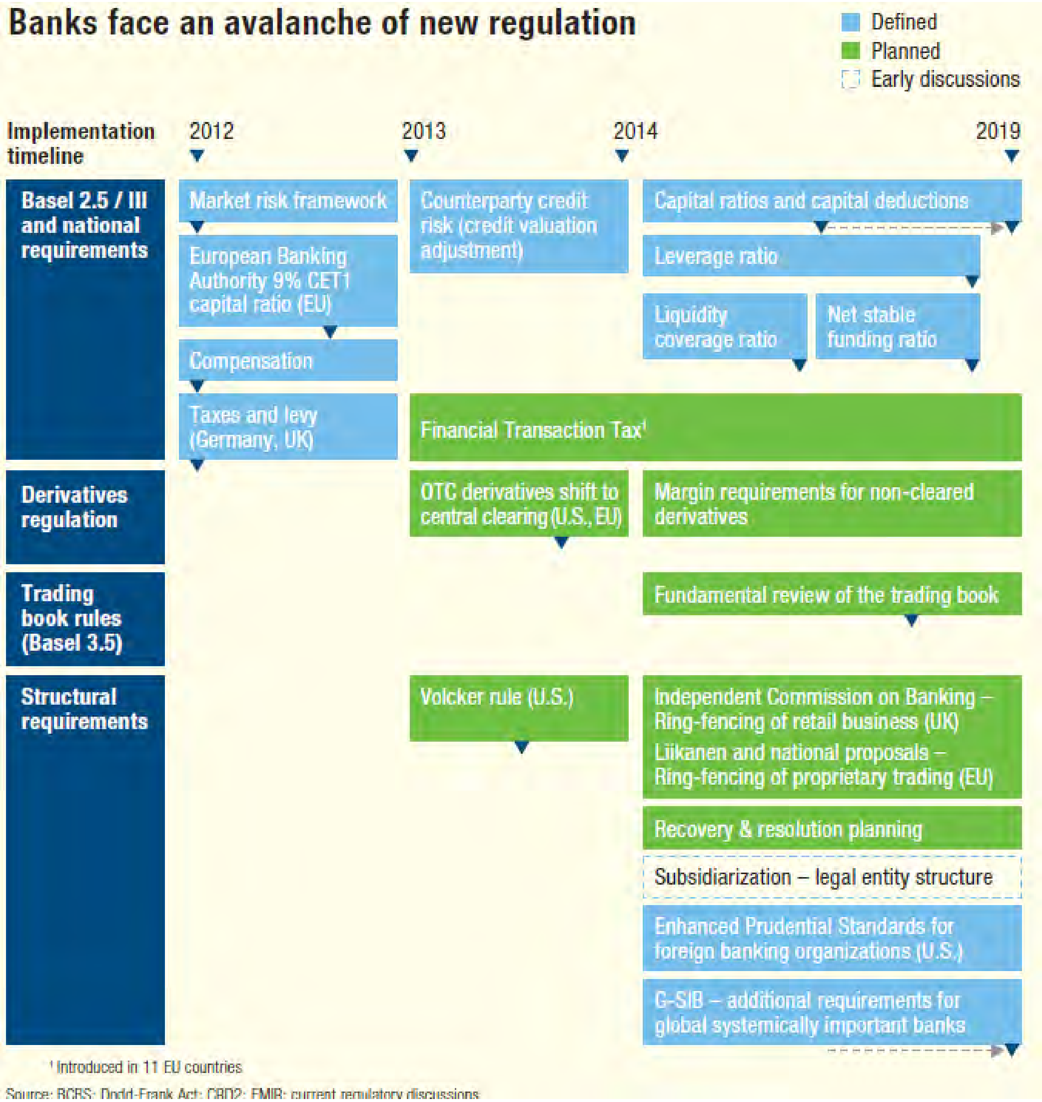
The key challenge for Western banks post-financial crisis: regulatory compliance

Regulatory compliance

- There are multiple new regulations for banks to contend with, in various stages of development and implementation.
- At a time when revenues are under severe pressure, bank costs are rising as a result of regulatory initiatives.

Regulatory compliance

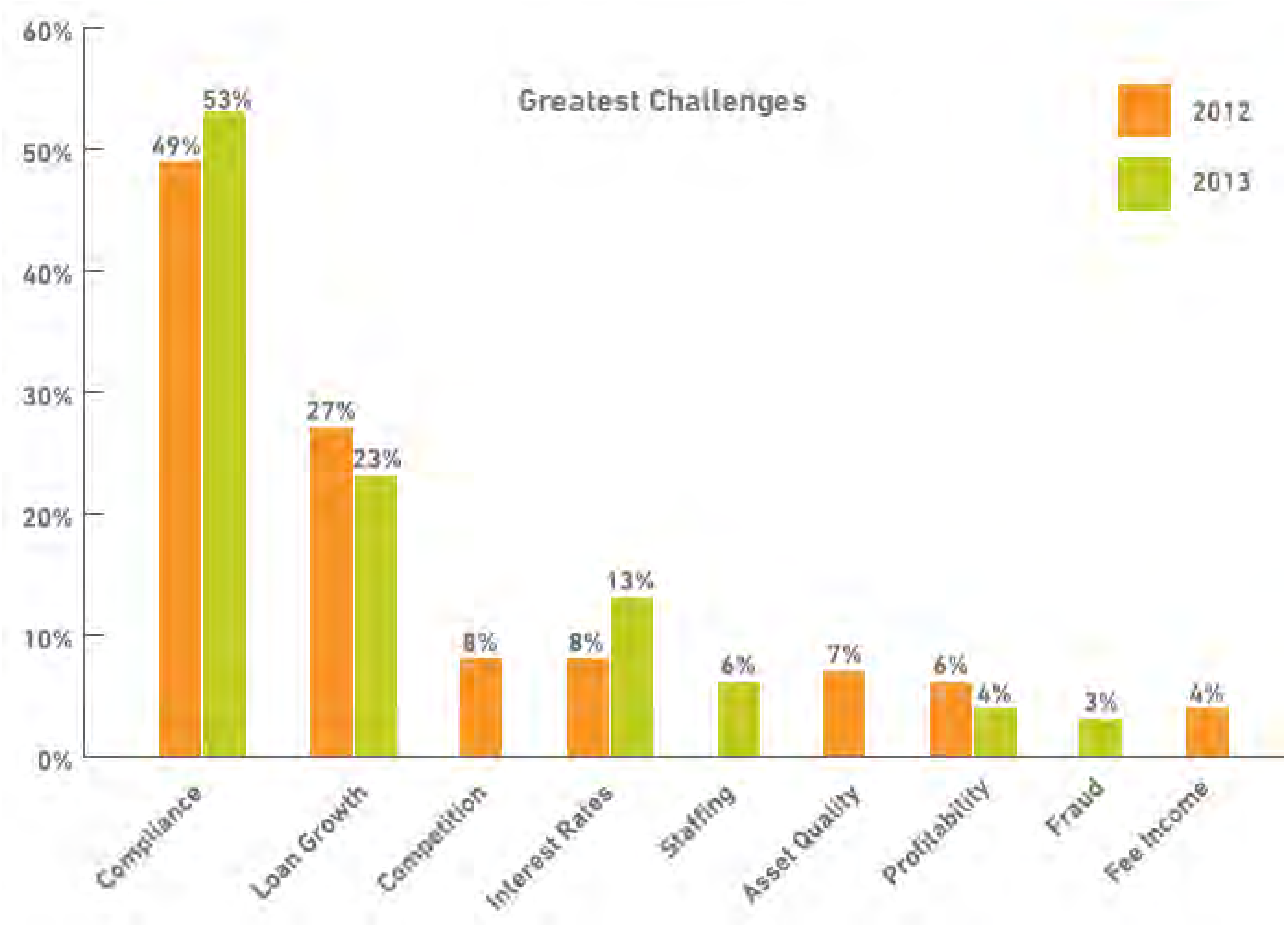
New regulatory frameworks are a key driver of uncertainty. Much regulation is still to be finalised.



Source: McKinsey, *Return of Strategy*, 2013

Regulatory compliance

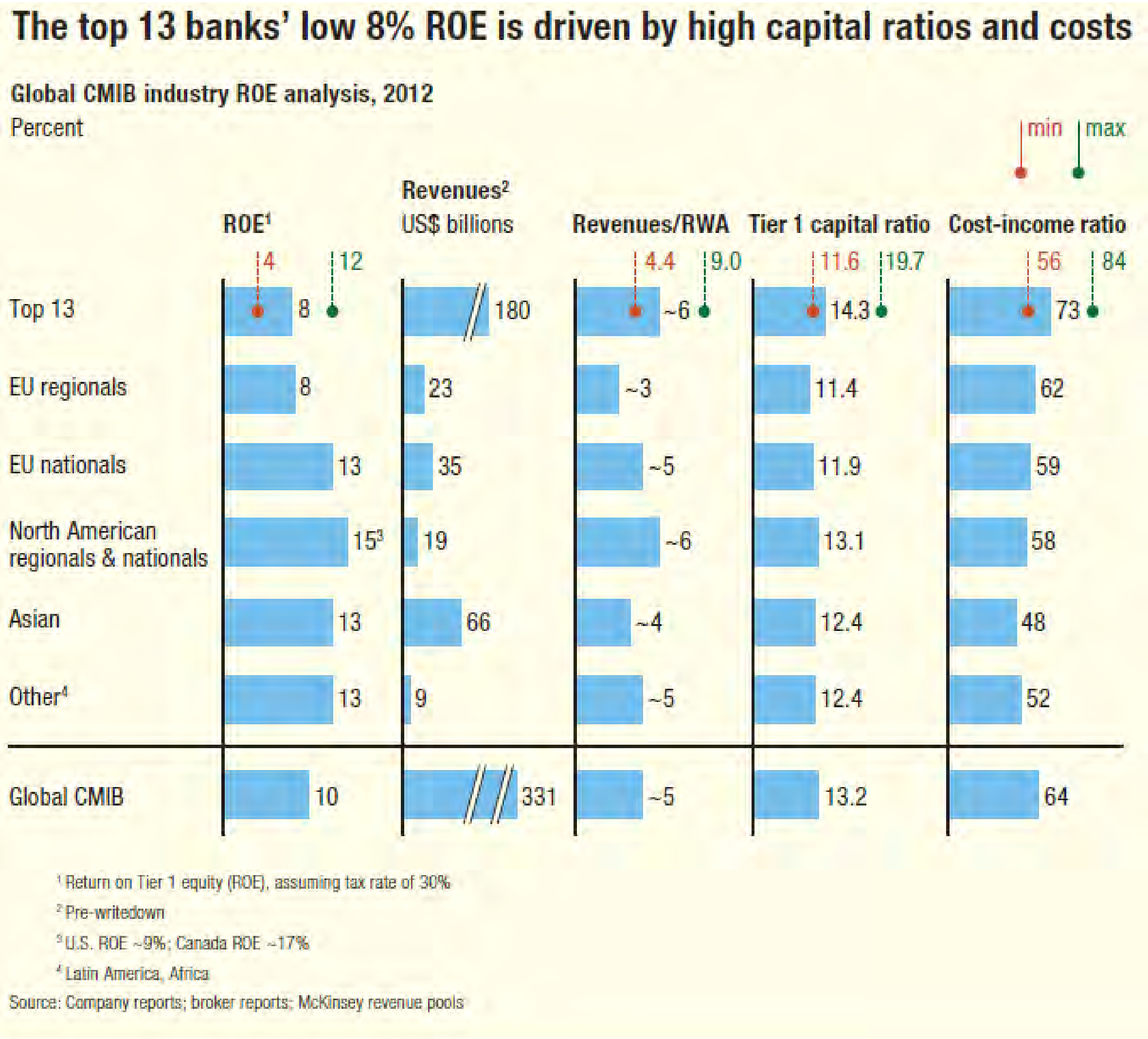
Banking survey results indicate that compliance is viewed as the greatest challenge facing Western financial institutions – and increasingly so.



Source: CSI Banking Priorities Survey

Regulatory compliance

Increasing compliance demands mean rising costs – and subsequent lower returns on equity.



Source: McKinsey, *Return of Strategy*, 2013

04

Preparing for the future

Banking sector priorities

International banks considering engaging with Iran would expect to see best practice in the following priority areas:

1. Financial soundness
2. Anti-money laundering and countering the financing of terrorism
3. IT systems
4. Corporate governance
5. Trade finance

Reform priorities: financial soundness

The safety and soundness of banks has become a key priority in the post-financial crisis regulatory landscape.

- **Capital**: Increasing both the quantity and quality of capital buffers in order to reduce the possibility of bank failures.
- Key policies: Basel III (Global); CRD IV (Europe); Dodd-Frank (US); Capital Surcharges (FSB).
- Some of the key Basel III capital requirements include:
  - Greater focus on common equity. Minimum Common Equity Tier 1 ratio at 4.5% of RWA, more than double the previous 2% level.
  - Capital conservation buffer comprising common equity of 2.5% of RWA, bringing the total Common Equity standard 7%.

Reform priorities: financial soundness

- Countercyclical buffer within a range of 0-2.5%, applicable when supervisors judge that credit growth is resulting in an unacceptable build up of systematic risk.

- A tighter definition of capital with:
  - The phasing out of non-standard Tier 1 over 10 years beginning 2013;
  - A tighter treatment of deductions including minority interests, investments in other financial institutions, and deferred tax assets; and
  - Tier 3 abolished.

- Better risk coverage especially related to capital markets activities, with trading book exposures subject to a stressed value at risk requirement, and higher risk weights for securitisations and re-securitisations in both the banking and the trading books.

Reform priorities: financial soundness

- Minimum Tier 1 Leverage ratio at 3% of Tier 1 capital to total on- and off-balance sheet exposures. A simple and non-risk based "backstop" measure that will restrict the build-up of excessive leverage in the banking sector to avoid destabilising deleveraging that can damage the financial system and the broader economy.

- Focus on Trade Finance
  - For the purpose of the leverage ratio, off-balance sheet items will be converted into credit exposure equivalents through the use of credit conversion factors (CCFs). The CCF expresses the likelihood of an off-balance sheet item to become on-balance sheet.
  - Initial proposal in Basel III rules was for contingent liabilities, including those associated with trade finance, to have a CCF of 100%. This would have greatly increased the total exposure and thus the minimum capital required.
  - The Basel Committee amended the rules on 12 January 2014. Instead of using a uniform 100% CCF, the leverage ratio will use the same CCFs that are used in the Basel framework's Standardised Approach for credit risk under the risk-based requirements, subject to a floor of 10%.

- Banks will need to raise new capital, and close some business lines selling assets and slowing the growth of new lending.

Reform priorities: financial soundness

- **Liquidity**: Ensuring that banks have enough liquid assets to meet a potential run on funds.
- Key policies: Basel III (Global); CRD IV(Europe)
- Some of the key Basel III liquidity requirements include:
  - The Liquidity Coverage Ratio (LCR) requiring banks to have sufficient high-quality liquid assets to withstand a 30-day stressed funding scenario.
  - The Net Stable Funding Ratio (NSFR). A longer-term structural ratio designed to address liquidity mismatches.
- Meeting Basel III liquidity requirements will involve banks needing to make expensive changes to their balance sheets, by holding larger amounts of low-yielding assets that are counted as high quality liquid assets.

Reform priorities: financial soundness

The safety and soundness of banks has become a key priority in the post-financial crisis regulatory landscape.

- **Supervision**: Ensuring that banks are properly supervised, proportionately to the nature, size and complexity of their business.

- Key policies: New supervisory structures, eg. in the US, UK, and Europe

- Closer cooperation with the Basel Committee on Banking Supervision to adopt best practices.

Reform priorities: anti-money laundering

Large, global banks are facing increasing pressure from their regulators to comply with anti-money laundering (AML) and counter financing of terrorism (CFT) legislation

- Iran faces – and is likely to continue to face – international scrutiny with regards to AML and CFT risks.

- In order for international banks to consider transacting with Iranian banks, reforms would need to be implemented in the following areas:

  1. Identification and assessment of money laundering and terrorist financing risks both at country and firm levels. This would inform a risk-based approach at both levels.

  2. National cooperation and coordination through national AML/CFT policies and mechanisms of collaboration between policy-makers, the financial intelligence unit, law enforcement authorities, supervisors and other relevant competent authorities.

Reform priorities: anti-money laundering

3. Customer due diligence and record keeping requirements for financial institutions. Some measures to be undertaken by financial institutions include:
   - Verifying customers' identity;
   - Identifying beneficial owner;
   - Understanding the purpose of the business relationship;
   - Conducting ongoing due diligence and monitoring transactions; and
   - Keeping all records obtained through CDD and in relation to transactions for a minimum period of time.

4. Enhanced due diligence measures e.g. establishing source of wealth and source of funds or determining the reputation of an institution for high-risk relationships such as:
   - Politically Exposed Persons (PEPs), their family members and close associates; and
   - Correspondent banking institutions.

Reform priorities: anti-money laundering

5. Obligation to report suspicious transactions and prohibition from “tipping-off”.

6. Implementation of effective IT tools to support CDD, sanctions screening and transaction monitoring.

- Foreign banks entering western markets and targeting foreign nationals struggle to comply with breath of rules for on-boarding, monitoring and reporting

Reform priorities: IT systems

As the cost of compliance increases for Western banks, so too does the amount of investment in the IT systems required to enable banks to monitor themselves and report to the authorities.

- The existing IT platform structure within Iranian banks likely reflects what is required to support domestic regulatory reporting structures.

- Banks will have to invest heavily in technology if they need extensive changes to their operating models as a result of regulatory requirements from international engagement.

- Bank will need to develop a specific additional IT solutions comprising data collection, data storage and reporting, in order to meet new regulatory reporting requirements.

Reform priorities: corporate governance

Poor standards of corporate governance were one cause of the financial crisis, so standard-setters and supervisors have been active in setting and monitoring banks' performance against a higher and more challenging set of standards.

Key priorities include:

- The active involvement of the Board in establishing the bank's strategy, risk appetite, capital adequacy assessment and culture and values;
- The appointment of non-executive directors with experience and expertise in banking, with the willingness and ability to challenge the senior executive team, and with the time available to perform their roles effectively;
- The effective working of the key Board committees – audit, risk, remuneration and nominations;
- The effectiveness of risk governance, including the role of the Chief Risk Officer (CRO) in providing the Board of a bank with an enterprise-wide view of risk and an evaluation of the risks inherent in significant changes to the bank's strategy, business model and operations

Reform priorities: trade finance

- New rules under **Basel III**:
  - **Cost of trade finance:** Banks must set aside more capital against trade finance deals (documentary trade instruments such as Letters of Credit — which are contingent in nature and rarely require monetisation — will move onto balance sheets, significantly raising the product’s capital costs).
  - **Lending between financial institutions:** Asset Value Correlation (which places an additional 1.25% capital surcharge on interbank credit exposure), could restrain lending between financial institutions.
- Anti-money laundering rules and requirements in trade finance has become a key focus

Rudi Lang

- German - English – French
- Training with a Big 4 firm, joined Mazars in 1997.
- Head of the UK Banking practice covering audit, advisory, tax and consulting.
- Member of Mazars Group Financial Steering Committee, responsible for the strategic development of financial services across the Mazars Group.

Education

- Master Degree University of Dusseldorf;
- Member of the Institute of Chartered Accountant in England and Wales; and
- German certified Chartered Accountant.

Specialisation

- Bank restructuring;
- Monitoring trustee mandates;
- Banking audit; and
- Assessment of lending portfolio.

Credentials

- **Senior statutory auditor of Persia International Bank**
- **Monitoring Trustee** to monitor the restructuring process of Lloyd's Banking Group.
- **Monitoring Trustee** to the Commission, the ECB and the IMF for Alpha Bank.
- **Monitoring Trustee** of WestLB and WestLB's compliance with its state aid commitments.
- **Responsible** for the preparation of an expert **study for the European Commission** with regards to the state aid commitments of "Bankgesellschaft Berlin".
- **Client Engagement Partner** of several entities of BNP Paribas, e.g. BNP Paribas London Branch, BNP Paribas Lease Group, BNP Paribas Securities Services, BNP Paribas Private Bank, Arval PHH UK Ltd.
- **Client Engagement Partner** on a number of special assignments in relation to Société Générale in the UK; primarily in corporate and investment banking.
- **Client Engagement Partner** and **Special Adviser** in Irish covered bond programs of the Bank of Ireland and the Allied Irish Bank.
- **Client Engagement Partner** Morgan Stanley, Unicredito, Natixis, Société Générale.
- **Engagement Partner** of an agreed-upon-procedures review for UBS with regards to the acquisition of a real estate portfolio.

Should you require any further information,
please do not hesitate to contact:

Rudi Lang
UK Head of Banking

T: +44 (0) 20 7063 4440
E: Rudi.lang@mazars.co.uk

Tower Bridge House
St Katharine's Way
London E1W !DD

MAZARS