

# Operational Ethical Banking in Rastin Banking

## (Professional Ethics, Auditing, Inspection, Control, Monitoring and Preservation)

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### Abstract

**Purpose:** This paper aims to discuss some of the operational Islamic banking features considered in ethical banking as the aspects of Rastin Banking. Ethical banking is a branch of “ethic economics” and a narrow expression of a number of Islamic banking aspects.

**Design:** These features are often involved in the discussions under the topic of internal control and describe the operational characteristics of ethical banking within the framework of Rastin Banking.

**Findings:** This study refers to the principles of Rastin Banking including: operational, financial, economic, ethical, social, legal, international and organizational principles. Additionally, it takes into account some of internal control systems.

**Research implications:** Converting ethical codes into executable laws and regulations needs sophistication and the art of codification in this subject can be observed in the present paper.

**Practical implications:** As far as the ethical behaviour of assessor and trustee is concerned, the necessities of honesty, belief, virtuosity, rectitude and compliance with moral values, as well as reward and punishment mechanisms are operationally examined. Transparency, governance and disclosure of information are the other components. The methods of auditing, accounting, inspection and preservation of Rastin Banking achievements are amongst the other matters of concern.

**Social implications:** An assiduous attention to the operational details of each of the above-said discussions revealed that the Islamic banking components are capable of covering the topics and discussions beyond ethical banking.

**Value:** This paper fulfils an identified need to solve the practical ethical problem in operational banking.

**Keywords:** Ethical Banking, Rastin Banking, Islamic Banking, Monitoring, Audit, Inspection, Internal Control, Ethics, Preservation.

**Article Type:** Technical paper.

### Introduction

Although the current studies have not provided a clear and all-acceptable definition of ethical banking, this subject can be argued under the category of “ethic economics”. In “ethic economics”, resources are mobilized to be placed in the correct position for humans’ achievement of perfection while the behaviour is economically optimized. This mobilization is perceived as justice and optimal use of resources in the religious and mathematical philosophies, respectively. The discoursed perfection is defined as the access to innate extremity. In other words, resources should be used in a way that humans can acquire their intellectual and spiritual transcendence while satisfying their material needs.<sup>3</sup>

In the contemporary literature, ethical banking involves environmental improvement, promotion of welfare, creation of opportunities, establishment of equality for public services and utilities, and

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<sup>3</sup> Bijan Bidabad, Equilibrium in ethic economics and neoclassical economics, <http://www.bidabad.ir/doc/taadol-akhlaq-neoclassic.pdf>

etc. To put it differently, humanitarian deeds come up with banking activities. Due to the broad scope of the ethical and moral considerations in all religions, especially in Islam, the true Islamic banking has been an indication of ethical banking. The issues such as support of needy people, the performance required for sustainable development, internalization of trust, transparency, respect to moral and ethical principles beyond legal duties, etc., which have been explored by different theorists of ethical banking, are among the indicators of Islamic attitudes and teachings.

Different dimensions of ethics and morality in ethical banking, as opposed to conventional banking that is merely based on profit, are present in Islamic banking. Like ethical banking, Islamic banking has no definite definition. In order to properly realize the operational description of Islamic banking, Rastin Banking<sup>4</sup> came into existence as a modern and operational real/true Islamic banking, which not only overcomes the theoretical and operational problems of Iran's banking system, but also suggests the ethical, legal and procedural strategies on the basis of the most recent scientific and technical achievements. All systems, sub-systems<sup>5</sup>, instrument, innovations and operational procedures in Rastin Banking have been designed for alleviation of problems.<sup>6</sup> This study highlights the ethics-dominant dimensions. As Rastin Banking is a comprehensive system and has a specialized terminology, the respective concepts and terms have been employed for the specific purpose of the present paper. In addition, it is worth mentioning that the legal details of this method are stipulated in the drafts of the Bill and the Executive Bylaw of Rastin Banking.<sup>7</sup>

### **Principles of Rastin Banking**

The system of internal control is a process, which takes place for the purpose of creating reasonable confidence toward the enhancement of the operational effectiveness and efficiency, financial reporting, observance of the related rules and regulations, and protection of resources and assets by the board of directors, managers and employees. It involves policies, practices, duties, activities, etc., which create confidence toward the protection of resources and assets from misuse, wasting and fraud, and also toward effectiveness of operations, improvement of the quality of financial reporting and information, and observance of regulations. Accordingly, Rastin Banking was established based on the specific principles that determine the operational procedures.<sup>8</sup> These principles are as follows:

#### **1- Operational Principles:**

In Rastin Banking, through omitting usury in the banking operations, avoiding formality, and real use of contracts, bank becomes an intermediary between depositors<sup>9</sup> and recipients of financial

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<sup>4</sup> Rastin Banking is a true operational Islamic banking.

Rastin Profit and Loss Sharing (PLS) is an activity in Rastin Banking, which is based on the participation of depositors in the investment and economic activities of the entrepreneur based on the real yield of projects in order to land the interest-free banking according to the Islamic commandments and ethics.

In Rastin PLS banking, bank is a unit, which allocates the resources of depositors to those who look for financing (i.e., entrepreneurs) and according to specific contracts; the obtained profit or loss will be divided between depositor and entrepreneur. By receiving commission (*Jol*), bank provides capital management services for depositors, and invests their resources according to their choices and in return, provides them by Rastin PLS Banking Certificate. Bank has to use all its specialized potentialities to protect depositors' rights.

<sup>5</sup> The financial sub-systems of Rastin PLS banking system refer to different defined financing methods and services. These sub-systems are governed according to the regulations of Rastin PLS Base System.

<sup>6</sup> See related documents for further technical details at <http://www.bidabad.ir>

<sup>7</sup> Bijan Bidabad, Azarang Amirostovar, Saeed Abdollahi, Mahmoud Allahyarifard, Eskandar Pordel, Maryam Heidari, Alireza Shafiei, Mohammad Ali Pourbehrouz, Draft of Rastin Banking Bill, Bank Melli Iran, 2012. <http://www.bidabad.ir/doc/rastin-banking-bill.pdf>

Bijan Bidabad, Azarang Amirostovar, Saeed Abdollahi, Mahmoud Allahyarifard, Eskandar Pordel, Maryam Heidari, Alireza Shafiei, Mohammad Ali Pourbehrouz, Draft of Rastin Banking Executive Regulation, Bank Melli Iran, 2012. <http://www.bidabad.ir/doc/rastin-banking-regulation.pdf>

<sup>8</sup> Instructions for internal controls for the accepted stock issuers in Tehran Stock Exchange: A Report from the Organization of Stock Exchange and Securities. Approved in spring of 2012.

<sup>9</sup> Depositor is a real person or a legal entity with a certain amount of fund (cash), who asks the PLS bank to participate in Rastin PLS banking products through a direct contact with the PLS bank, or via internet, and buys the Rastin Certificate of one of the PLS banking products.

resources (i.e., entrepreneurs<sup>10</sup>) and earns income by providing the capital management services rather than interest rate premium. The gain or loss is transferred to the exact owner of the related assets. The whole operation is carried out on the basis of the established rules and regulations and via internet networks. Along with the protection of depositors' interests, bank will be a trustee for all parties. Consequently, they gain confidence of the fact that they do not become bankrupt in case of loss and that insurer hedges the depositors' assets in case of loss. The assessment, supervision and implementation of projects<sup>11</sup> are based on the assessor and trustee profession, liability, and freedom of expression. The capacity of the project entrepreneur should be authenticated and the financial credit should be assessed by the previous tax payments. The entrepreneur is accountable for the information presented in his/her project proposal.

## 2- Financial Principles:

Toxic assets, such as outstanding claims, are not created in the bank, and the bank does not become bankrupt due to a financial crisis. Through lowering the banking risks, the capital adequacy ratio is reduced and the free resources are raised. With regard to the trusteeship of funds, legal and precautionary reserves are decreased. The depositor, entrepreneur, and bank receive their shares of participation justly. A wide range of instruments and banking processes are used to fulfil different public demands and through making correspondence between the price of Rastin Certificates<sup>12</sup> and the real sector return, the prices can be stabilized. Therefore, no bubble will be formed and rather, the persons with different risk tastes are attracted and this could make a positive interaction between returns and risks. Individuals can conduct any transaction in Rastin Certificate Market<sup>13</sup> without any agent. Information transparency improves the transparency of the respective systems including the tax and social security systems, which are related to entrepreneurs. In this regard, the reliable assessment and supervision mechanisms have been defined and considered. Entrepreneur is obliged to disclose the information concerning the implementation of the project. Moreover, supervision over the entrepreneur's operations is established, and a system of corporate governance over the entrepreneur's company results in the transparency of information and the project-related operations and this prevents asymmetric information. In addition, monitoring and application of insurance by the bank will minimize different types of risks. Furthermore, the operational facilitation prevents money laundering and improves the auditing system and internal controls. Moreover, by monitoring the bank's employees, their breach of obligations is checked and controlled through online inspection. Additionally, the accounts of depositors and projects are separately booked and recorded and the credibility of the bank and banking operations are increased.

## 3- Economic Principles:

Rastin Banking bridges the gaps in the market, removes the reciprocity of capital and money markets, and increases the scope of the insurance operations in the economy. The confidence created by the bank's supervision and internet access to Rastin Certificate Market (RCM) provide opportunities for attraction of capitals and create a pleasant competitive environment for entrepreneurs, depositors, traders, banks and other stakeholders. The new financial instruments add a variety to financial assets. By issuing certificates for specific projects, goods, and assets, the market will be

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<sup>10</sup> Entrepreneur is a real person or a legal entity, who proposes a project to the PLS bank for financing through the PLS banking system and executes the project up to the end. In addition to encompassing the required legal, financial, technical and performance capabilities, the entrepreneur should have the other capabilities and facilities/possibility to carry out the job.

<sup>11</sup> Project is a collection of economic activities with a specified and concrete plan, and also with pre-defined costs and terms, to make profit through Rastin PLS banking offered to the PLS bank.

<sup>12</sup> Rastin Certificates are a collection of certificates, designed and issued in the base system and financial sub-systems of Rastin PLS banking. The supervisory feature of the trustee unit of the PLS bank on these certificates, distinguishes them from the other financial papers and they have the prefix of "certificate". Being nameless, negotiable in secondary virtual Rastin Certificates Market, having market price based on the supply and demand of certificates, settlement by the last certificate holder are some of the characteristics of Rastin Certificates. Settlement of these certificates are carried out under the supervision of the trustee unit of the PLS bank.

<sup>13</sup> Rastin Certificate Market is a web-based settlement system for the transaction and transfer of Rastin Certificates and other valuable papers of Rastin banking.

immune from paper market instabilities. Involvement of capitals in projects prevents the rapid movement of resources and the financial crisis arising from fluidity of capital and debt leverage. Any person with economic ability can receive financial resources or grasp employment opportunities offered by entrepreneurs. Practice of various financial professions increases the scope of the related financial employments, improves investment, employment, production, and welfare, and dampens the financial and economic fluctuations.

#### 4- Ethical Principles:

The obligation for supplying correct information as well as accurate and real documents facilitates the contribution to honesty and individual calmness, the accordance of word and action, and the correct supervision, and decreases distrust, and the individual and social mental and emotional stresses and tensions. Prevention of deceit and elimination of financial corruption, as a consequence of the designed inspection, monitoring, and assessment systems, alongside the moral hazard prevention facilitates placing everything in its appropriate position and precludes injustice. Damages to others, treachery, lottery, gamble, fraud, usurpation, prodigality, wastefulness and misuse of assets are forbidden in Rastin Banking. Furthermore, misappropriation, conspiracy and bribery ways will be closed as many as possible. Respect for people's rights especially the weak sides and the financial justice causes parties to obtain mutual consent and show beneficence. On the other hand, the unlawful gains from usury and squandering are avoided.

#### 5- Social Components:

Carrying out the operations in compliance with the established rules fosters the financially healthy relationships in the society and reflects personal discipline. No discrimination and priority is accepted in cases of identical terms and conditions. Persons are encouraged to project their own financial activities, and predict and formulate them accordingly.

#### 6- Legal Principles:

Respecting all the rights of the other parties as well as their ownership is a crucial component in Rastin Banking. By determination of duties, parties hardly file lawsuits against each other and their disputes are settled by arbitration. On the other hand, by using databases' inquiries, misuses are almost prevented. By applying the new method of enforcement of the binding documents, debts are collected more rapidly.

#### 7- International Principles:

During all the day and night in the week (7×24×365), people in all regions of the globe have access to online bank services and therefore, the international interests are shared and political stability shall be achieved by attracting international capitals. The beneficial advantages of this system make it an internationally operational model. By development of Rastin Certificate Market (RCM), reasonable price anchors are created for financial assets.

#### 8- Organizational Principles:

Organizational fitness is defined according to the organizational requirements, together with the proper positioning and promotion, meritocracy, embracing assignment of qualified persons, admiring the organizational communications, duties, and responsibilities of personnel, and setting up an effective reward and punishment system. The organizational development, change and stability come up with standardization and documentation. Accountability of organizational members for their performances makes barriers against the damaging impact of unofficial organizations and political pressures.

### **Professional behaviours of assessor and trustee**

In compliance with the Stock Exchange Organization's instructions, honesty and ethical values of the company should comply with the established code of ethics. Along with compliance, honesty, belief, and also commitment on the basis of the code of ethics, the senior management is required to take the necessary measures for the observance of employees. Additionally, the senior management should improve the organizational environment by taking actions, such as circulation of the information concerned with the corporate ethical values, operation of the reward and punishment

mechanism, avoidance of overemphasis upon the short-term outcomes, and suitable treatment with employees.<sup>14</sup> The operational mechanism of the assessor and trustee fundamental duties in Rastin Banking has been stipulated in the Draft of Rastin Banking's Executive Bylaw. The mentioned chapter includes the general terms and conditions and the basic principles of ethics, which should be taken into consideration by the professionals of assessment<sup>15</sup> and supervision<sup>16</sup> in Rastin Banking<sup>17</sup>.

Assessor<sup>18</sup> and trustee<sup>19</sup> are the bank employees<sup>20</sup> or real persons or institutes, who provide the bank with the professional services under supervision of the bank's assessment<sup>21</sup> and trustee units<sup>22</sup> administered by the PLS department<sup>23</sup>. The assessment and supervision services are, in fact, any economic, engineering, technical, and financial services supplied by assessor and trustee that involve and demand the related knowledge and skills. Assessor and trustee should offer their services at their best and in compliance with the respective rules and regulations.

Whereas assessment and supervision are significant to the protection of stakeholders' interests in Rastin Banking, for any breach of the committed responsibilities the assessor and trustee are accountable to stakeholders. For establishment of professional credibility and creation of confidence among the users of their services, they should consider the following principles:

- 1- Righteousness and Trusteeship: They should be honest and trusted in performing their duties and submitting their carrier documents.
- 2- Impartiality: They should not allow any prejudice, bias, conflict of interests, and other people's pressures to create barriers against the provision of their professional services. Regardless of the type and scope of the service, assessor and trustee are required to provide an honest and fair treatment to other people without affecting their conflict of interests.
- 3- Professional Accuracy and Carefulness: They should provide their professional services accurately, carefully and competently.
- 4- Knowledge and Skill: They should possess the necessary skills and knowledge in a way that the others become confident of the performance and the reliability of their services on the basis of the most recent professional and legal developments in the related profession.
- 5- Secrecy: They should keep the collected information about the project that are accrued during

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<sup>14</sup> The first paragraph of the instructions for internal controls for accepted stock issuers in Tehran Stock Exchange: A Report from the Organization of Stock Exchange and Securities. Approved in spring of 2012.

<sup>15</sup> Assessments are the actions, performed by the bank for the protection of depositors' interests, identification of the entrepreneur's skills, and economic, financial, executive, and technical justifiability of the concerned project in Rastin Banking.

<sup>16</sup> Monitoring is an action, carried out by bank for the protection of depositors' interests and the good performance of the executive operation in Rastin Banking. Bank is obliged to take measures for good operational performance. The standards for monitoring are based on the articles of the executive bylaw of Rastin Banking.

<sup>17</sup> Participation in Rastin Banking: It is the depositors' participation in gain and loss of investment projects and economic activities in compliance with the real rate of returns. This category of activities is done in line with the establishment of the Islamic-ethics-based banking.

<sup>18</sup> Assessor: S/he is an experienced and competent professional of the assessment unit of the PLS department, or a natural and legal entity outside the bank, who is sufficiently experienced with the key personnel and adequate resources and fulfills the duties of assessment on the project and its justifiability.

<sup>19</sup> Trustee: S/he is an experienced and competent professional of the trustee unit of the PLS department, or a natural and legal entity outside the bank, who is sufficiently experienced with the key personnel and adequate resources and fulfills the duties of supervision on the projects in Rastin Banking.

<sup>20</sup> Rastin Bank: It is a department, which allocates the financial resources of depositors to entrepreneurs on behalf of depositors. In compliance with the drawn-up contracts, the profit or loss is distributed among depositors, bank, and entrepreneur. Bank provides depositors with the capital management services by remuneration for rendering a service and invests the resources of depositors in one of the participation forms of Rastin PLS banking according to their own request. In return, bank issues a Rastin Certificate to the depositor for allocation of her/his financial resources. Bank as the attorney of depositors is obliged to safeguard their rights, for which it should exploit all its professional resources.

<sup>21</sup> Assessment unit: It is a unit in the PLS department that considers the possibility of project execution by assessing the project proposal and examining the capacity of the entrepreneur.

<sup>22</sup> Trustee unit: It is a unit that exercises supervision over the processes of participation in Rastin Banking on behalf of the bank by using fundamental indicators and examining financial statements. It exercises supervision for the followings: good implementation of project, control of executive operations as expressed by planned projects, methods for allocation of resources, optimization of resources, etc.

<sup>23</sup> PLS department: It is a bank department that along with subordinate units manages the participation processes in Rastin Banking.

their professional service cooperation at their best. They should not exploit the information in favour of their own or a third party's interests, or disclose without an explicit written permission of the assessment or trustee units in the PLS department, or beyond the legal considerations.

- 6- Professional Behaviour: They should use their performance in compliance with their professional goodwill and refrain those actions, contradictory to the professional credibility.
- 7- Professional Discipline and Principles: They should respond to the requests of the assessment and trustee units according to the professional discipline and principles by considering accuracy and skilfulness in such a way that fulfilling duties would be in compliance with the obligations of honesty, impartiality, and independent opinion.

Assessor and trustee, in selecting the conditions and also doing the actions essentially connected to their impartiality, should appropriately refrain from relations which might be affected by others' lobbying and their own prejudice and biased tendency. They should become confident of the impartiality and devotion of their employees and also the consultants who receive advice or service from them. They should not receive any money or property (whether with or without recompense), any deal lower than the market quote, any grant or payment receipt, and any asset given directly or indirectly, which does not comply with the rules and regulations of the Rastin Banking framework. Assessor and trustee are not permitted to receive or pay any amount of money as a commission to grant a deal or to refer it to someone else.

The duties of assessor and trustee are sometimes in conflict with the internal and external organizational expectations. In such cases, attending and avoiding threats, such as pressures from managers, senior colleagues, etc., due to family and personal relationships is critical. Moreover, they are also required to have fidelity to their superiors in accordance with their professional principles and standards. Presentation or disclosure of misleading information by assessor and trustee against the benefits of the bank are considered the examples of the conflict of interests, for which assessor and trustee are taken accountable. In cases of contrary to the professional ethics, they should do the following:

- 1- They shall follow the internal policies and instructions of the bank and observe the rules of the bylaw.
- 2- They shall notify the immediate superior about the issue.
- 3- If the problem was not solved and the decisions were required to be made by a higher level of management, the superior person shall be informed. If the above-said superior person seems to be stakeholder in the concerned case, the report should be delivered to a higher level manager and, if necessary, to the inspection department of the bank.
- 4- If necessary, the case should be confidentially notified to an independent consultant and his/her opinion should be submitted in writing to the immediate superior person and also, to a higher level manager for alleviation of the problem.
- 5- When the rules, regulations, and professional principles have already considered sending reports to the authorities outside the bank in case of necessity, assessor and trustee shall perform their responsibilities in this regard.
- 6- Where despite the above-said actions, no effective solution is obtained, in important cases (such as commitment of some offences), they shall submit their resignation to the managing director of the bank in writing by mentioning the related concrete reasons.
- 7- They can pursue the case through the competent authorities outside the bank.

Assessor and trustee should gain confidence about the adequacy of formulated policies and instructions for alleviation of the problems arising from the conflicts of interests, and if necessary, they should inform the senior manager about the shortcomings and present the probable solutions.

Professional competence encompasses two major aspects: (1) acquisition of professional competence through higher education, specialized training, apprenticeship, passing exams, and obtaining professional experiences; and (2) maintenance of professional competence through regular awareness about the professional developments and alterations including the new theories of the principles and instructions of assessment and supervision, as well as the laws and regulations that should be possessed by assessor and trustee. They should not pretend to possess experiences and skills that they lack.

Assessor and trustee are obliged to pursue the aims and objectives of the bank and observe its regulations, bylaws and instructions. However, they should not breach professional principles, rules and laws for the reason to pursue their own organization's objectives. Or, they are not permitted to mislead the auditor or inspector of the bank by false statements, or to cover the truth or verify the documents and evidences containing incorrect information. Assessor and trustee should treat their gathered information regarding entrepreneur(s) as confidential according to the contents of the respective bylaw. This confidentiality continues even after the termination of the relationship between assessor, trustee, and entrepreneur(s). Assessor and trustee are required to gain confidence about their employees' and consultants' secrecy, who receive service or consultation from them. Moreover, they cannot approve project proposals<sup>24</sup> and issue supervisory reports in the case of incomplete, incorrect, counterfeit, or misleading information, or when the data have not been provided accurately, or in the case of absence of the authenticated documents and evidences, or when the omission, distortion, classification, and collection of information can mislead the PLS department of the bank.

If assessor and trustee become aware of any mistake in the information, or any exclusion or distortion of some information by the entrepreneur, they should immediately notify the assessment and trustee units in writing. In this case, assessor and trustee are not liable for any failure. Having any working or financial relationship with entrepreneur can influence on the independence of assessor and trustee. Accordingly, assessor and trustee should notify the assessment and trustee units about their professional or financial relationship with the entrepreneur (if any) and shall not accept any duty in relation with the respective entrepreneur. Exclusion from this principle is only subject to the commands of the PLS department of the bank. Assessor, trustee, and their affiliates may have financial relationships with the entrepreneur in one of the following methods:

- 1- Having direct and indirect financial interests shared with the entrepreneur;
- 2- Receiving financial facilities from the entrepreneur or from any of his/her board of directors' members, senior managers, or main shareholders, except for conventional financial services, which are supplied by credit institutions and banks;
- 3- Cooperation with the entrepreneur, or any of his/her board of directors' members, senior managers, or main shareholders;
- 4- Having financial interests in the economic unit which has significant impact on the entrepreneur's firm (company)<sup>25</sup> or is under its influence.

If assessor and trustee, in the period of fulfilling their duties in assessing the project proposal and clarifying about the entrepreneur's ability and operation, would be the members of the entrepreneur's board of directors, executive directors, or senior employees, or involved in the employment of these individuals, they must notify the assessment and trustee units about this cooperation and shall not accept any duty in this regard. Acceptance or rejection of the assessor's and trustee's request is subject to the viewpoint of the PLS department of the bank. Personal and family relationships can influence the independence of assessor and trustee. Therefore, as far as confidence about the assessor's and trustee's independence is concerned, they are personally obliged to notify the respective assessment and trustee units about such a relationship with the entrepreneur, the members or chairman of his/her board of directors, the CEO, and the senior executive and financial employees, and refrain from commencement or continuation of any cooperation. Acceptance or rejection of the assessor's and trustee's request is subject to the viewpoint of the PLS department of the bank.

Assessor and trustee should not receive and provide any service, for which the payment is subject to satisfaction of any particular outcome, like a percentage of a specific price or such other things, unless the payment is made in compliance with the typical rules and regulations. Buying and selling goods, or receiving services with special conditions, accepting unreasonable invitations and unconventionally large rewards, are all the threats against the independence of the assessor's and

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<sup>24</sup> Project proposal: It is a text that includes the fundamental information regarding the specifics of the proposed project, analysis of the project justifiability in economic, financial, and technical terms, documentation, and the legal permits for decision making. After examination and final approval by the assessment unit of the PLS department, it is a claimable document against the entrepreneur.

<sup>25</sup> Firm is a technical or business unit, where the goods are manufactured or services are provided. Having a legal personality is not necessary for a firm. Consequently, a natural person, as the head of the firm can act as a party to contract.

trustee's opinion. Assessor, trustee, and their affiliates should refrain from such relationships.

If one or more of the partners of the assessment or trustee companies have common interests with the entrepreneur to the extent that their independence may be lost, assessor and trustee should avoid any responsibility on assessment and supervision in relation to that entrepreneur. In order to preserve the assessor's and trustee's independence and their impartiality, if they are involved in the same legal or criminal lawsuit with the entrepreneur, considering the nature of legal and criminal lawsuits and the probable influence, they shall notify the assessment and trustee units about the case, and avoid accepting responsibilities on the assessment and supervision of that entrepreneur. Exclusion from this principle is subject to the command of the PLS department of the bank. A long relationship between the employees of the assessment and trustee companies with the entrepreneur during several years can impact on the assessor's and trustee's independence. In such situations, the assessment and trustee companies should take the necessary measures in order to gain full confidence about the independence and impartiality of their employees. Assessor and trustee are independent and separated from each other. In the process of a project, the same legal or natural person (or the same personnel of a legal person) cannot act simultaneously as both assessor and trustee. Also, neither assessor nor trustee is permitted to formulate or participate in the formulation of a project proposal for the entrepreneur.

Assessor and trustee shall not accept professional services, in which they are incompetent. In case assessor and trustee need to receive expert services, they can use such services. The assessment and trustee units cannot change or substitute assessor and trustee during the assessment or supervisory operation of a project without a concrete and reasonable reason. For such a substitution, these units should receive a certification from the PLS department of the bank along with the presentation of the acceptable reasons. In the case of substitution of assessor or trustee, the previous assessor or trustee is obliged to give all the collected information and documents to the new assessor or trustee in charge.

Where an assistant is required to be employed due to the extension of the scope of the assessment and supervision operation, assessor and trustee can have assistantship services upon their request and by certification of the assessment and trustee units of the PLS department. In all cases, the main assessor and trustee of the project are accountable for the related assessment or supervisory responsibilities. The assessor's and trustee's assistants should have all the professional characteristics stipulated for the main assessor and trustee in the Executive Bylaw of Rastin Banking and they should observe the same rules and regulations. The main assessor or trustee is accountable for non-observance of these matters. The main assessor and trustee can pass all the related information of the project to their assistants by the permission of the assessment and trustee units.

These units should act in a way that each of the assessors and trustees could make decisions about their own professional assessment and trusteeship issues and the units could not force them to change their decisions unwillingly. But by presenting justifiable documents to the PLS department of the bank and drawing the attention of the related department, they can refer the project to other assessors and trustees for reconsideration and making a new decision. If assessor and trustee do not have the required knowledge and experience, they should notify the assessment and trustee units about the necessity and also the extent of using assistance and advice of other assessors and trustees, machines, laboratory and measurement equipment, and other software or hardware facilities.

Assessor and trustee are required to submit their complete, honest and professional reports in a way that they would be clear, certain, transparent and understandable within the framework of the principles. Assessor and trustee should store the information, documents, and evidences of the project so that they could clearly indicate all the facts about the executive and financial events of the project. All the information and events should be classified and stored accurately and timely.

Correct implementation of these points is generally supervised by the PLS department of the bank. The disciplinary regulations on the assessor's and trustee's performance are enforced by the mentioned department, which include the following items:

- 1- Oral and written notice, with or without insertion in the employee's personnel file;
- 2- Oral or written reprimand, with or without insertion in the employee's personnel file;
- 3- Enforcing for further necessary trainings;
- 4- Enforcing for payment of fines and compensations, reimbursing the received fees or completing the job by the other members, at the expense of the faulty member based on the received assurances;



- 5- Referring the case to the board of the administrative misconducts of the bank employees;
- 6- Referring the case to the competent disciplinary authority.

Disciplinary measures might be undertaken by the PLS department of the bank, the board of administrative misconducts, legal entities, or jointly. Such disciplinary inspections are triggered when resolving the issue through making notices is impossible.

### **Financial transparency**

In order to gain confidence about the observance of regulations and bank approvals and avoid different forms of corruption in financial reporting, bank is obliged to ensure the transparency of financial information in accordance with the following points. The chairman and members of the board of directors, and the director of the bank are accountable in this regard.

In Rastin Banking, fraud is defined as an action by which the subject attempts to infringe others' rights or interests, or breach the bank's rules and approved decisions, and incorporates the following cases:

- 1- Preparation, presentation, or disclosure of incorrect financial information;
- 2- Withholding the information, which should be essentially presented or disclosed;
- 3- Preparation, presentation, or disclosure of unreal, insincere, or superficial balance sheets, asset statements, income statements, cash flow statements;
- 4- Forgery, falsification, or change of the real documents and evidences;
- 5- Incorrect presentation, disclosure, or omission of the financial details of transactions and their effects;
- 6- Making superficial transactions and registering them without the supporting documentation;
- 7- Non-registration of transactions or their documents;
- 8- Deliberate and incorrect application of accounting procedures.

The bank is obliged to prepare, present, and disclose its financial information in compliance with the accounting standards of the State Audit Organization in a way that their contents are observable. The financial reports and statements should be accountable and transparent according to a number of items:

- 1- Categorized list of the performed transactions, based on macro-transactions;
- 2- Accounting operations, including chapters, with a clear classification of accounts;
- 3- Providing a clear and orderly relationship between financial events, the documents and evidences related to the books of primary registration, and the financial reports and statements;
- 4- Transparency of accounting procedures;
- 5- Organization of managers and employees, and their payments;
- 6- Report of the prime cost;
- 7- Integration of information.

In preparing financial reports and statements, some points, such as disclosure of information, the ways and means of presenting information, the applied terminology, responsibilities of the providers of financial statements, and application of financial statements are required to be carefully considered in a way that all important, significant, and related financial information are presented and disclosed. In addition, the correct classification and categorization of items in financial statements and accuracy in their placement, the method of presentation, separation of assets, liabilities, and shareholders' equity rights into current and non-current classes, underline commitments, division of incomes and costs into operational and non-operational groups, presentation of assets in the balance sheet on the basis of the degree of liquidity, and division of the cash flow according to the operational activities, taxation, fixed investment activities, buying and selling of assets, return on investments, transactions, finance activities, comparative statements of assets at the book and daily prices, and other necessary points.

The applied terminology should be comprehensible for all public users. Financial reports and statements prepared for specific purposes, such as the reports of the board of directors' activities to

the council, the feasibility report for capital increase, tax declaration, etc. should follow the contents of this section if they are written and prepared to be presented and disclosed. Financial reports and statements should fulfil the information requirements of users, on which they rely their economic decisions. The main users are shareholders, investors (including actual and potential), depositors<sup>26</sup>, owners and purchasers of shares, securities, and Rastin Certificates<sup>27</sup>, providers of financial loans, suppliers and demanders of financial products, services and resources, customers, recipients of facilities, bank employees, government and the affiliate organizations, including Tax Department and Social Security Organization, and financial agents and analysts. Additional information should be added as the explanatory notes for better comprehension of financial statements.

The information of financial statements and reports should be “relevant”, “reliable”, “comparable” and “comprehensible”. As far as relevance is concerned, only the information, documents, evidences, and supplementary reports in relation to the financial statement or report should be inserted.

As far as reliability is concerned, the following points should be observed in the preparation of financial reports and statements:

- 1- Honest expression: The honest expression of information means to precisely indicate the claiming subject.
- 2- Priority of content over form: Financial events are written according to the economic contents and facts, and not merely on the basis of the legal form.
- 3- Impartiality: Financial reports and statements should be submitted with full impartiality and should not be designed, prepared, and set to create any specific impact on users.
- 4- Caution: It is required to use accuracy in the estimation of the items that need estimation, scheduled delivery, assessment, and storage, and also the items with suspicious delivery, and so forth.
- 5- Completeness: It means to properly reflect the information according to their importance and without omission of some parts of information that may mislead or obscure financial reports and statements.

In order to have comparable information, the consistency of the accounting procedure and the financial reporting system should be ensured in the preparation and provision of information during the banking operation. In case of any alteration in the accounting procedure, supplementary reports should be submitted to ensure the comparability of financial reports and statements, and also, the accounting standards set by the State Audit Organization should be observed. As far as comprehensibility of financial reports and statements is concerned, the presentation and classification method for the information and explanatory notes is essential.

## **Bank governance**

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<sup>26</sup> Depositor: It is a legal entity or a natural person with cash money, who seeks and attempts to participate in Rastin Banking products and purchase Rastin Certificate by attending the bank (in person or via internet). Depositor can make investment and enhance participation in the following products:

- First-type Product: It is participation in profit and loss of a particular project. Depositor can choose one of the projects proposed by the bank, make investment in the chosen project by purchasing its Rastin Certificate, and enhance his/her participation on the basis of the duration stipulated in the certificate and the nominal value of the purchased certificate.

- Second-type Product: It is participation in a basket of projects. In fact, rather than investing in a single project, depositor can make investment in several projects proposed altogether by the bank due to the features of the projects. S/he enhances his/her participation in the selected basket of projects on the basis of the duration stipulated in Rastin Certificate and the nominal values of the purchased certificates.

- Third-type product: It is participation in profit and loss of the bank. Depositor can make a deposit in the bank in order to enhance his/her participation in profit and loss derived from the bank investment activities in Rastin Banking projects.

<sup>27</sup> Rastin Certificate: It is defined as the certificate designed for Rastin Banking. It is awarded due to the supervision of the trustee unit over the operational performance of the project and is different from the securities in this subject. Transferability, possibility of selling and buying in the secondary virtual market (Rastin Certificate Market), profitability of transactions for bank, valuation on the basis of the supply and demand mechanism in Rastin Certificate Market, periodic liquidation of the latest owner of the certificate, possibility of privatization and governmental manner, and being legal or natural entity of customers are amongst the features of these certificates. They can be liquidated or converted under the supervision of the trustee unit.

For the purpose of monitoring and effecting on the bank management, to regulate and observe the rules and regulations, accountability, transparency, justice and honesty, and protect the rights of stakeholders and contract parties, bank is obliged to pursue governance principles, regulations and procedures. Bank governance is a collection of rules, regulations, structures, processes, cultures, and systems, which through monitoring and influencing on the bank management, contributes to the formulation and observance of regulations, accountability, transparency, justice and honesty, and protection of the rights of stakeholders and contract parties.

The bank's managing director and chairman of the board of directors should not be a single person (even the representative of legal entities, who are members of the board of directors, should follow the same rule). The duties, authorities and responsibilities of the board of directors' chairman and the bank director should have been specified explicitly, obviously and definitely without any interference with each other. The vast majority of members of the board of directors should be outside directors<sup>28</sup>. Their internal directorship shall be approved by the board of directors and the interested director has no right to vote in this regard. In the board of directors, one outside financial member should be the member with, at least, a bachelor degree in accounting, management, or finance. The said member will be responsible for the audit committee. In order to apply the correct and sound management and make better decisions about the bank affairs, the number of the members of the board of directors shall not be less than 7 persons and, at least, two out of the members shall be from the independent directors<sup>29</sup>. The members of the inside board of directors cannot act as the inside managing director or member of the board of directors in other banks.

The board of directors of the bank should have a secretariat, as described in the following paragraphs and with an executive responsibility for information collection and specialist investigation of the request of the members of the board of directors, to ensure the execution of the enactments of the board of directors:

- 1- The secretary of the board of directors shall preside over the secretariat, is appointed with the suggestion of the chairman of the board of directors and enactment of the board, and performs his/her duties under supervision of the chairman of the board of directors.
- 2- The secretary of the board of directors is responsible for compiling the negotiations and following the enactments of the board of directors.
- 3- The managing director shall prepare the required information of the secretary, which are requested personally or through the board of directors, and deliver them to him/her.
- 4- The members of the board of directors shall not exploit confidential information<sup>30</sup> in their own or others' favour (including dependent persons<sup>31</sup> and single stakeholders<sup>32</sup>). The board of directors

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<sup>28</sup> Outside director is a part-time member of the board of directors without any executive liability.

<sup>29</sup> Independent director is a director who is not appointed by the major shareholder in the assembly or his/her representative, or by a group of shareholders, who form a unity of more than 50% of the attendants, or is not their representative. S/he shall have no direct or indirect financial relationship with the bank or the main company, and the bank or the subsidiary company, or the subsidiary of the subsidiary. S/he shall not be a member of the board of directors for more than three periods. S/he shall have no executive liability in the bank.

<sup>30</sup> Confidential information includes the information about the present or future status of the bank, and the holder of these information can affect the financial flow of the bank, or his/her or others' personal benefits with the aid of the said information.

<sup>31</sup> Dependent persons include the persons under Article 129 of the Commercial Act, also all the first class relatives by marriage or blood according to Article 862 of the Civil Act, members of the board of directors and the managing director, members of the board of director and substitute or deputy of each, and the senior managers of the bank.

<sup>32</sup> - Single stakeholder includes natural persons or legal entities that are exposed to common benefits due to proprietary, managerial, or financial relationships.

- Proprietary relationships: two or more natural persons or legal entities with each of the following conditions are meant to have proprietary relationships with each other: the members of a bank group, a natural person or a bank in which the said person holds more than 50% of the shares, and the persons who are stakeholders in common asset(s).

- Managerial relationships: two or more natural persons or legal entities or the members of a bank group, with each of the following cases are meant to have managerial relationships: control, considerable influence, commonality of at least two third of the members of the board of directors, commonality of the chairman of the board of directors.

- Financial relationships: two or more natural persons or legal entities with each of the following cases are meant to have managerial relationships: dependent persons, natural persons or legal entities with mutual relationships with each other, persons as members of the unit consortium among whom more than 50% of their annual gross income are financed from their activity in the consortium, the persons that more than 50% of their annual gross incomes are financed by another

shall make the necessary arrangements in order to ensure non-disclosure of the bank's confidential information by the personnel so that the holders of the bank's confidential information<sup>33</sup> cannot transact the shares or securities of the bank by using these information. In this regard, the board of directors must employ an effective mechanism of internal control for the supervision and prevention of such transactions, and whenever some cases of transactions by use of and on the basis of the confidential information are detected, the Central Bank shall be informed. With regard to this case, the Central Bank will make decision about the disclosure or non-disclosure of the related information.

In order to supervise the correct performance of the commercial operation between the bank and the other natural persons or legal entities, the members of the board of directors or the bank's managing director shall announce their own full specifications as well as the specifications of their dependent persons and banks, main companies<sup>34</sup>, subsidiaries<sup>35</sup>, subsidiaries of subsidiaries, single stakeholders, and persons with considerable influence<sup>36</sup> to the Central Bank. Making decisions about the following cases shall be presented to the Central Bank: selection of the managing director and the directors of the bank or the main company, the members of the board of directors of banks and subsidiaries, and subsidiaries of subsidiaries, enactment of policies, bylaws and internal regulations of the bank, enactment of major transactions between the bank and dependent persons, single stakeholders, banks and main companies, subsidiaries, subsidiaries of subsidiaries, and persons with considerable influence, and also selling, purchasing, pricing, and the sale and purchase terms of the bank's properties and assets. In addition, deciding on selling, purchasing, pricing, and the sale and purchase terms of the properties and assets related to the project, determination or change of the salary benefits, rewards, and authorities of the members of the board of directors and the other directors of the bank, unconventional gifts, borrowing from banks or other non-bank sources, and the actions, which in some way affect the benefits of the depositor, shall be confirmed by the Central Bank.

Discrimination in the distribution of profit or benefits between shareholder and depositor, in cases where the depositor has taken part in the financial performance of the bank, is not permitted, and the bank, for performing transactions, shall use the bylaw of transactions enacted by the board of directors. The board of directors shall establish an appropriate internal control system for protection of assets, suitable reporting, and observance of laws and regulations. The board of directors and the independent auditor shall investigate the internal control system separately, at least yearly, and present the report to the Central Bank. The board of directors shall establish an audit committee comprising of the majority of outside members of the board of directors so that, at least, one member of this committee shall have financial knowledge and experience. The audit unit acts under the supervision of the audit committee.

The board of directors shall specify the duty of the audit committee in writing in such a way that includes the following items:

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person, the commercial agency of the real entity, whose 50% of annual gross income is financed by the bank or the main company. In case two or more persons including the bank, or the bank or non-bank credit institution, or natural person receive loans and one or some of them guarantee another one. In case the bank or non-bank credit institution or natural person creates undertaking in favor of two or more persons.

<sup>33</sup> Holders of confidential information: the persons cited under Note 1 of Article 46 of the Securities Market Act are the holders of confidential information: the bank's director and managers are the bank's members of the board of directors, the managing board and director, and their deputies, inspectors, consultants, accountants, auditors, and attorneys, the shareholders that solely or accompanying with their own family dependents have more than 10% of the bank's shares, the director and member of the board of directors and the related managers or the other banks' representatives and holding corporations that holds at least 10% of the shares of the bank or their representatives, or has at least a member in the invested bank. Other persons with respect to their duties and positions have access to confidential information.

<sup>34</sup> Main bank (company) is the bank (company), which has one or more subsidiary bank(s).

<sup>35</sup> Subsidiary bank (company) is a bank (company) that majority of its attending shares in the assembly directly or indirectly belongs to the bank, or in any way, the majority of the members of the board of directors are assigned by the main bank (company).

<sup>36</sup> Considerable influence: the real person (or his/her dependents) or legal entity who owns more than 20% of the shares or capital of the bank directly or indirectly; or based on an agreement with the other shareholders or partners has more than 50% of the voting right of the other bank, or possesses the right of dismissal and assignment of the majority of the members of the board of directors personally and by procuration, or can control the bank directly or indirectly by any means.

- 1- Supervision of the correctness of annual and mid-term reports, and the other official statements related to the financial performance of the bank.
- 2- Supervision of the selection and change of the accounting procedures and financial software by the management, in the framework of the national accounting standards of the State Audit Organization.
- 3- Investigating the transactions between bank and dependent persons, single stakeholders, banks and main companies, subsidiaries, subsidiaries of subsidiaries, and persons with considerable influence.
- 4- Investigating the major estimations performed by the management for preparation of the annual and mid-term reports, suggesting to the assembly for selection, retention or change of the independent auditor, and also the terms of the independent auditing contract.
- 5- Supervision of the auditor's independence and the effectiveness of the independent auditing process in the framework of the independent auditors' professional behaviour bylaw and according to the auditing standards of the State Audit Organization.
- 6- Ensuring the establishment of suitable internal control system.
- 7- Supervision of the performance and ensuring the effectiveness of the internal auditing.
- 8- Appointment and dismissal of the internal audit manager.
- 9- Ensuring the presence of the written bylaw considering the ethical values (the code of ethics of the bank) and adherence of the executive manager to it.
- 10- Investigating the risk management policies and the method of identification and confrontation with the potential risks.
- 11- Ensuring the full access of the independent and internal auditors to the required information, evidences and documents.
- 12- Establishing the communication between the board of directors and the independent and internal auditors.

In election of the board of the chairmen of the assemblies, the following limitations are applied:

- 1- The major shareholder elects maximum one of the members of the board of chairmen.
- 2- One of the members of the board of chairmen is elected from the sub-shareholders<sup>37</sup> and with the majority of their votes.
- 3- One person is elected under the supervision of the board of chairmen and from the present sub-shareholders in the assembly and with majority of their votes.
- 4- Reward of each one of the members of the board of directors shall be approved by the assembly.

The board of chairmen shall investigate and confirm the ownership or attorneyship of the attendants in the assembly before holding the assembly. Representativeness of the legal entities in the assembly will be valid according to the official correspondence of the bank. The reports of the board of directors to the assembly and the reports of the legal inspector and the independent auditor are permanently provided to the public through the bank's website before holding the assembly. The main financial statements shall be notified on the bank website, at most, 10 days after holding the assembly. The majority of the members of the board of directors shall be present in the session on the day the assembly is held; otherwise, the reasons for their non-attendance shall be announced in writing to the assembly, and to the shareholders and holders of the securities of the bank through the bank's website. Shareholders, whether present or absent (only through the official attorneyship or delegation to the custodian<sup>38</sup> of shares), shall apply their votes. There should be sufficient and reasonable opportunity for the shareholders to ask the board of directors before the start of the approval process. The

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<sup>37</sup> Sub-shareholder: S/he is a person who is not in conjunction with the major shareholder and possesses less than 0.1% of the bank's shares.

<sup>38</sup> Custodians of shares: It is an institute, which is permitted by the Stock Exchange Organization to offer securities services. These services include holding securities, cash and participation papers, receiving profit, awarding the shares and the right of priority and the other benefits of the bank's shareholders, subscription, participating in assemblies, selling and buying shares, managing share baskets, and so on.

attendance right of the outside members of the board is determined in the general assembly.

The board of directors is obliged to provide clear and valid information in the periodical, annual, and mid-term reports of the bank through the bank's website and according to the rules specified by the bylaw. In order to provide clear and complete information to the Central Bank, the managing director and the members of the board of directors have a common liability. The information, presented to the Central Bank or to be published on the bank website, as well as their method of preparation, shall be enacted by the board of directors. The annual report, which states the past and present status and the future vision of the bank, shall be disclosed on the website of the bank. This report shall include the minimum cases, which have been specifically detailed in the Executive Bylaw of Rastin Banking.

In one hand, the name and full specifications of the members of the board and the managing director, including the inside and outside, and the dependent and independent directors, and their ownership percentage of the shares of the bank, membership in the board of directors of other banks, and their full receivables, including salary and benefits, overtime working, missions (local and foreign), loan and reward, shall be disclosed in a separate paragraph in the annual report. Moreover, the details of major transactions with third parties, and also considerable purchases or sales of all types of materials, goods, properties, services, technology, technical knowledge, and services with the dependent persons, single stakeholders, banks and main companies, subsidiaries, subsidiaries of subsidiaries, and the persons with considerable influence, shall be disclosed in the annual report.

### **Disclosure of bank information**

On the other hand, in order to clarify the bank operation, the bank is obliged to disclose its financial information<sup>39</sup> and other important information<sup>40</sup>, and provide them to the public through the website of the bank and the other mass media. The information, disclosed by the bank, shall be real, explicit, reliable, timely, and impartial. The information with negative effect shall be disclosed and published with the same speed and accuracy as the information with positive effect. The bank shall prepare and disclose its financial reports and statements according to the national standards and the other information under the Executive Bylaw within the due time. The details of disclosure of bank information are stipulated in the Executive Bylaw of Rastin Banking.

Periodical reports shall include the necessary financial information, the auditing method, and the type of accounting standards. In case the annual and mid-term financial statements and reports have been prepared before the deadline, they shall be immediately disclosed by the bank. The trusted auditor shall provide his/her comment and issue the auditing report after presenting the financial reports and statements by the bank, at most within the deadlines stated in the bylaw.

Immediate disclosure of important information, including conclusion of important commercial contracts, merger or purchase of shares, capitals, or securities of the other banks or companies, major transactions, change in the stock exchange market, events and changes in the market conditions that have considerable effect on the shares or securities of the bank, explanation or confirmation of the rumours and reports, unconventional transactions, shall be directly disclosed by the bank.

For the issue of unreal information, the bank shall avoid disclosing public notices, which have not explained the real changes in the activity of the bank, and avoid revealing the exaggerated reports and predictions in information disclosure, which are for the purpose of advertisement and more than what is necessary for making decision about investment. In the case of publishing a rumour<sup>41</sup> or a report, containing unreal and misleading information or forged documents, the bank is obliged to immediately disclose enough information and remark about the said rumour or report to the public.

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<sup>39</sup> Information disclosure: It is on-time public publication of information through the bank's website according to the instructions of the Executive Bylaw of Rastin Banking.

<sup>40</sup> Important information: It is the information related to the bank's decisions and events, and also the decisions related to banks, which importantly influence the way of activity and the price of the shares or the valuable papers of the bank.

<sup>41</sup> Rumor: They are the news that regardless of their correctness or incorrectness, present important information that have been published unofficially and importantly affect the price of the shares or the valuable papers of the bank.

When an unconventional activity<sup>42</sup> of the market shows that the transaction of shares or securities have been affected by the rumours without a justifiable reason, the Central Bank will ask the bank to publish a suitable notice in this field.

In case the bank is informed about a rumour or a report, which irrespective of the correctness or incorrectness, will affect the price and volume of the transaction of shares or securities of the bank in future, the bank shall investigate the case immediately and take the necessary measures about that rumour or report (for instance, shall publish a notice or disclose the necessary information).

It is necessary to immediately disclose the information related to the events such as major changes in the structure and ownership of the bank, borrowing or receiving considerable bank loans, changes in the goals of the bank, and important claims presented in legal authorities for or against the bank.

The bank shall announce the time, date, place of holding, and agenda of the general assemblies in widely circulated newspapers and on the bank's website, and announce the details, at least, 10 days before holding the assembly. The agenda of the general assemblies shall be explicit and clear. The important subjects, including the election of the members of the board of directors, election of the auditor and the legal inspector, distribution of dividends and reserves, and change in the subject of activity, shall be mentioned specifically in the agenda and cannot be presented under the section of "other cases". The bank is obliged to disclose the decisions of the general assemblies, at most, a week after holding the meeting on the bank website, and the date of an extraordinary session of the general assembly for increasing the capital, at least, 10 days before holding the meeting, and also the adjusted minutes, at most, 3 working days after holding the assembly on the bank website.

The bank shall disclose the payment schedule of cash profit and reward of the board of directors and the other personnel based on the name of people, by inserting the amount and cash profit and reward, prior to holding the ordinary general assembly on the website of the bank. The approvals of the assembly shall be disclosed by observing the provisions of the Executive Bylaw of Rastin Banking maximum within 30 days of holding the assembly on the website of the bank.

The bank shall disclose the important information of its activity once received, or in some cases, later, when the important information has been formerly obtained. In cases that publication of important information may be done late due to their confidentiality, the reasons for suspension shall be announced to the Central Bank beforehand. The instances of important information, related to the influential events on the activity, financial condition, and results of the bank performance, are as follows:

- 1- Suspension or stoppage of all or part of the bank's activity.
- 2- Change in the type of the main activity of the bank.
- 3- Acquiring the shares or securities of other banks directly or indirectly which would have an important effect on the current or future performance of the bank.
- 4- Holding or participation in the important bids and auctions and their results.
- 5- Change in the accounting method or procedure and the causes and financial effects resulting from it.
- 6- Change of the managing director of the bank or the composition of the members of the board of directors.
- 7- Concluding, dissolving, or making any major change in important contracts.
- 8- With regard to the important claims presented for and against the bank, intervening in important claims or attracting them, referring important disputes to arbitration, or disclosing the result of the final verdicts of courts and the other legal authorities, and the important legal acts and events, which are effective on the price of the shares or securities of the bank.
- 9- Specifications of the investment projects of the bank and any important change in them.
- 10- Stoppage of the activity of the major customers of the bank.
- 11- Inability to execute the bank obligations and contracts, announcing the bankruptcy of the bank or the main companies.
- 12- Announcing any returned funds to the registration fund or to the Justice Administration, under

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<sup>42</sup> Market unconventional activity: It is the unusual fluctuation in the price or volume of transactions of shares or valuable papers of the bank.

any subject.

- 13- Decisions of the general assemblies of the bank, main companies, and corporate or bank groups.
- 14- Decisions and major transactions of the bank, main companies, and corporate or bank groups.

The instances of important information related to the decisions and conditions, effective on the capital and financing structure of the bank are as follows: change in the capital of the bank(s) and the companies controlled by the bank, change in the bank's profit distribution procedure, factors effective on the other components of the capital structure, such as guaranteeing or presenting important bank guarantees, financing out of the balance sheet, and borrowing or repayment of considerable amounts compared to the financial turnover of the bank. The instances of important information about the changes in the ownership structure include: major changes that alter the control of the bank, and changes that lead to merge, acquisition of capital, or composition of shareholders. The instances of other important information affecting the price of the shares or securities of the bank are as follows:

- 1- Performing any important transaction on the assets of the bank.
- 2- Authentication or redemption of mortgage for the important properties of the bank.
- 3- Creating or settling the important debts.
- 4- Important change in the prediction of the performance or the future plans of the bank management, by indicating the reasons.
- 5- Predicting the increase or decrease in the incomes and costs of the bank in future, by indicating the reasons.
- 6- Any important damage, resulting from natural events (such as fire, flood, earthquake, etc.) or from the operative and non-operative activities of the bank.
- 7- Important annual adjustments.
- 8- Requesting the inclusion in or exclusion from the list of the banks accepted in the stock exchange and OTC, by indicating the reasons.
- 9- Any event or change in the banks and companies under control, which would have a significant effect on the activity, financial status, and results of the performance of the bank or the main company.

The bank shall immediately disclose its prediction of the performance or its future management programs. However, due to some limitations such as the need for immediate disclosure, the bank might cause loss or no important profit for itself; in fact sometimes, it is making negotiations and no agreement has been made yet or maybe, the disclosed subject is continuously changing; therefore in such cases, having received a letter of confirmation from the Central Bank, it can disclose the important information with a delay after removing the limitation. In the case that a delay in disclosure of information leads to rumours or transactions based on the confidential information or any unconventional activity of the market in connection to the shares or securities of the bank, the bank will take further necessary measures, such as immediate disclosure of information, under the supervision of the Central Bank.

In order to prevent the disclosure of unrevealed information, the bank shall limit the access to the mentioned information only to the competent managers and personnel of the bank, and the access to these information should be permitted only by considering the duties and responsibilities of competent persons, including personnel, attorneys, accountants, auditors, financial advisors of the bank, and the other competent persons. In addition, confidentiality of such information and prohibition of their personal use in transactions (i.e., based on the confidential information) shall be emphasized. Additionally, the bank shall disclose any other requested information of the Central Bank, as the case may be. The supervision department of banks continuously supervises the flow of the events effective on the financial flow of the bank and the shares or securities market of the bank. In case necessary, it will ask the bank to disclose the required information or issue a notice. The bank can disclose the correspondences between itself and the Central Bank, for the information of the public, as the case may be.

In case the bank violates the stated regulations and that is confirmed by the Central Bank, the following actions shall be performed by the Central Bank:

- 1- The bank will be immediately notified in writing.



- 2- The credit degree of the bank will be reduced.
- 3- It will be stated on the website of the Central Bank.
- 4- The bank will be completely or partly prohibited from using banking services.

### **Auditing**

Auditing is basically performed for special purposes, such as court auditing for discovery of fraud, valuing shares, taxing, observing laws and the Commercial Act in particular, internal auditing, etc. In Rastin Banking, the predicted regulations, in addition to observing the special cases of the operation of the profit and loss sharing in Rastin Banking, are based on the national accounting standards and regulations as well as the internal control instructions of the issuers, who have been accepted in the Tehran Stock Exchange and OTC of Iran, and also based on the other monetary and banking regulative requirements of the country. The details of these cases have been inserted in the Bill and the Executive Bylaw of Rastin Banking.

In this regard, for the purpose of auditing the entrepreneur company, the auditor shall be selected from the auditing institutes, which have been verified by the Iranian Association of Certified Public Accountants (IACPA), with the agreement of the bank, and this shall be mentioned in the contract. The entrepreneur shall provide the requirements for performing different stages of auditing (particularly implicit auditing) for the auditing institute. In the mutual auditing contract between the entrepreneur company and the auditing institute, the necessity of provision of the required information of the bank by the auditing company and particularly provision of the information related to the details of prime cost shall be explicitly stipulated. In addition, the auditing institute shall send a copy of all correspondences with the executive company, called management letters, to the PLS department of the bank. The necessity of provision of the audited financial statements, attached with the report of the auditing institute, by mentioning the final vote of “acceptable”, is among the obligations of the entrepreneur company.

In case, the viewpoint of the auditing institute in the auditing report is “conditional”, the entrepreneur shall adjust the specified terms at the discretion of the PLS department of the bank (as the case may be) or accept the violation of contract terms and compensate for the related damage. Comment of the auditing institute in the auditing report as “rejected” or “no comment” would reflect the violation of contract terms by the entrepreneur, and the entrepreneur shall compensate for the damage at the discretion of the PLS department of the bank and according to the contract terms. It should be stipulated in the contract that the entrepreneur is obliged to present the annual financial statements in addition to the mid-term financial statements based on the accounting standards and present them to the bank, attached with the full prime cost details. Failure to provide the said information, or presentation of imperfect, unreal and unclear information, is considered as the violation of contract terms.

The authority, to make comments on the observance of the cases, will be the specified the auditing institute and this point shall be inserted in the auditing contract between the auditing institute and the entrepreneur and also, in the mutual contract between the bank and the entrepreneur. The entrepreneur shall deliver the above-mentioned information, along with the financial and operational information related to the prime cost details, and also the related documents such as statements, contracts, etc. to the bank. The right of vouching is always preserved for the PLS department of the bank during the performance of the contract until the final settlement, and this matter should be explicitly expressed in the contract. Failure of the entrepreneur to adhere to the obligations of this article means the failure to perform obligations and s/he shall tolerate the incurred damages.

### **Operation Control and Monitoring (OCM)**

General controls include the policies, procedures, and actions that are typically applied in most information systems, and with their help, the true and continual application of these systems will be assured and this supports the effective function of the applied controls. These controls usually include the controls over the data centre operations, acquisition, change and maintenance of software, access, security and protective controls, and creation and maintenance of applied systems. The applied controls are the manual or automatic methods, designed to control the processing of the executive

software and with their help, the completeness and correctness of the processing, and the approval and validity of the transactions, can be assured.<sup>43</sup>

The factors effective on increasing fraud in organizations are originated from the increasing complexity in their structure, which eventually leads to provision of different opportunities for abusing. Along with the technological developments, fraudulent methods have also been grown, and organizations must always search for the holes in their financial and executive operations in order to prevent people from profiteering.

In the banking operation, considering the application of information and communication technology and the public access to internet networks, and also according to the high number of people and transacting parties, as well as the number and volumes of transactions, there exists a potential opportunity for violation. Accordingly, banks try in different ways to identify and obstruct the holes of illegal entrance into the banking operation. In this regard, different methods are expressed for identification of frauds. Considering the volume of operations in banks, the traditional methods are not responsive, and while making use of them, the smart inspection and control<sup>44</sup> systems, should always investigate the activity of the bank's personnel and customers and detect the suspicious behaviours.

Some types of banking frauds are frauds in payment cards (e.g., pickling and decoding of electronic parts and magnetic tapes), detection of impersonation and fake signature (including paper and electronic types) by different means, phishing, forged loans, transfer of accounts by the bank personnel, manipulation of documents, deception in issuance of documents, deception in banking calculations and account statements, false banking inspectors, and other different cases, where each may be accompanied with deceptive manoeuvres that might be innovative and new other than the existing records of legal cases.

Many studies have attempted to discover a variety of deceptive ways in the banking operations, and detected and recorded various types of them. Alongside the deceptive operations, their detection methods shall be also extended and developed. Therefore, some methods, such as data mining and invisible monitoring shall be updated concurrently with other organizational functions. In the data mining operation, different behaviours are classified and behavioural defect in them and their nonconformity with the organizational procedures and internal regulations are practically controlled and inspected. The high volume of accumulated data at any time requires suitable procedures to convert them into meaningful and useful information. These are the information, which can help the bank management make decisions for improving services and preventing the shortcomings in the banking operations. Data mining can be regarded as one of the ways of converting data into information. Data mining is also applied as a way of Knowledge Discovery from Database (KDD). By classifying the ordinary and suspicious transactions with different qualities of price, place, time, etc., and also by their statistical analysis, one can find the abnormal phenomena among the transactions. In this field, various algorithms have been innovated by different banks and companies, where each has a specific focus on definite subjects.<sup>45</sup>

In the process of completing the data mining operation, there exists an invisible suspicious monitoring operation, which makes management aware of the potential hazards. The data mining operation is performed on the customers and personnel of the bank, while the monitoring action mainly controls the bank personnel behaviour. Based on the above considerations, the operation control and monitoring (OCM) system has been predicted in Rastin Banking, which facilitates the

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<sup>43</sup> Instructions for internal controls for accepted stock issuers in Tehran Stock Exchange: A Report from the Organization of Stock Exchange and Securities. Approved in spring of 2012.

<sup>44</sup> Control is the authority for making policies and leading the financial and executive operations of an economic unit to gain the benefits of its activities.

<sup>45</sup> See:

- Ghazanfari, Mehdi., Alizadeh, Somayyeh., and Teymour-pour, Babak. (2012). Data mining and knowledge discovery, *Iran University of Science and Industry*.
- Shahrabi, Jamal., and Hadavandi, Esmacil. (2011). Data mining in the banking industry, *at Jahad Daneshgahi of AmirKabir University of Technology*.
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detection of violation and deception. According to the Bill and the Executive Bylaw of Rastin Banking, bank is obliged to create the Operation Control and Monitoring (OCM) system with the following specifications and capabilities:

- 1- Online inspection of all the operations based on the executive instructions, and in accordance with the related regulations.
- 2- Online monitoring of all the operations of different units of the PLS department and the PLS branches.
- 3- Establishing the internal control system.
- 4- Detection of unfamiliar operations.
- 5- Detection of mismatching of accounts.
- 6- Detection of mismatching of documents with accounts.
- 7- Detection of defalcation, collusion, and fraud.
- 8- Having various access levels.
- 9- Routines of reporting, data analysis, and data mining.
- 10- Security systems with impermeability.
- 11- Detection systems for tracing cyber-attacks to the system.

The bank is obliged to design and activate the instruments and filters of the Operation Control and Monitoring (OCM) system with the following specifications and capabilities for the assessment of transactions:

- 1- Daily Velocity Filter: This filter prevents high-volume deceptions by setting a threshold for transactions.
- 2- Amount Filter: This filter works by defining the low and high thresholds for limiting the risk of transactions, which mostly check the validity of the account holder, account number, or card number.
- 3- Hourly Velocity Filter: This filter prevents the common attacks as a result of the high-volume deceptions by setting a threshold for exchanges.
- 4- Shipping-Billing Mismatch Filter: In case there is a mismatch between the shipping and billing addresses, it stops the transaction. This filter detects the stolen payment cards.
- 5- Transaction IP Velocity Filter: It filters the suspicious activities from a source with different identities by identifying different transactions from a single IP (Internet Protocol).
- 6- Suspicious Transaction Filter: It is responsible for checking suspicious transactions by matching the entered information to the previous customer information in the databases of the bank.
- 7- Authorized AIM IP Addresses: It allows the customer to perform his/her transactions with the specified IPs through the Advanced Integration Method (AIM).
- 8- IP Address Blocking: It blocks specific IP addresses, which have been identified in performing deceptive activities.
- 9- Enhanced AVS Handling Filter: Address Verification Service (AVS) is one of the components of the electronic payment gateways, which compares the address of the transaction applicant with the customer addresses in the file. This system should be able to store the provided information of the transaction applicant for the purpose of next monitoring, and uses them in case of contradiction.
- 10- Card Code Verification (CCV) Filter: This system should be able to store the provided information of the transaction applicant for the purpose of next monitoring and will use them in case of contradiction.
- 11- Shipping Address Verification Filter: This filter controls the postal address authenticity.
- 12- IP Shipping Address Mismatch Filter: This filter controls the postal address with the IP address of the transaction country.
- 13- Regional IP Address Filter: This filter controls the operations of different regions or countries by studying the IP address of the transaction applicant.

## Preservation

In order to protect the good performance of the Rastin Banking Act, it is necessary to establish a committee comprising of the experienced specialists of this banking method, as the Rastin Banking Preservation Committee, under the supervision of the Central Bank. This committee observe the good performance, training, development, removal of potential defects, alleviating theoretical and legal problems, and completion or design of the mentioned or the new processes for a period of 10 years. The members of the Preservation Committee comprise of an independent advisor<sup>46</sup> and other economic, legal, technical, engineering, and financial experts, who have participated in formulation of the Rastin Banking system in the framework of the Committees of Rastin Profit and Loss Sharing Banking and the Committee of Formulating Rastin Banking Regulations. The Preservation Committee starts its operation after the issuance of the respective mandates by the Director General of the Central Bank for its members and according to the proposed act. The committee will have 11 members and the sessions will be held in presence of, at least, 5 members under presidency of the independent adviser. Dismissal of the members of the Preservation Committee will not be possible within the mentioned period and in case of death, resignation, retirement, incapacity, separation, or long absence, the founding members will elect and introduce a substitute member to the Central Bank.

The Preservation Committee can have secretariat and sub-committees, under different titles, such as consultation, education, performance assessment, development, and design. Members of the sub-committees are elected through the introduction of the Preservation Committee and by the order of the managing director of Bank Melli Iran. The scope of duties and authorities of the sub-committees is determined by the Preservation Committee. The Rastin Banking Preservation Committee and also the secretariat and its sub-committees are located in Bank Melli Iran. It should be stressed that this will be the viewpoint of the Preservation Committee, which ultimately resolves the disputes and removes the ambiguities deductions from the interpretation of the Act, the Executive Bylaw, and the other theoretical issues in Rastin Banking.

The Ministry of Science, Research and Technology can set up the majors of Rastin Banking, Rastin Profit and Loss Sharing Banking, and also other related financial services, such as insurance, marketing, assessment, supervision, brokerage, and financial consultation in universities and higher education institutes by preserving the concepts stipulated in the Law and the Executive Bylaw of Rastin Banking as well as in the reformative and complementary extensions of this banking method. The syllabus of the educational courses of Rastin Banking will be specified by the Education Committee of the Preservation Committee.

For good performance of Rastin Banking and also for preservation and protection of the rights of depositors, entrepreneurs, and people who have trusted the bank, all the personnel of governmental and private banks, as well as other individuals such as assessor, trustee, and auditor in all managerial and line levels, are obliged to carefully execute the Rastin Banking regulations and bylaws, and avoid committing the actions such as the following cases. It should be mentioned that if the committed crime does not have a pre-defined criminal title as listed below, the offender shall compensate the incurred damage according to the intensity and weakness of the committed act, the incurred damage, and the repetition of crime. In addition, in case of damage, s/he shall compensate the maximum amount of compensation, or otherwise, will be fined 10 million to 1 billion Rials:

- 1- Forcing a lower level employee by the manager to perform any affair against the rules and regulations, abusing his/her professional and administrative position.
- 2- Discriminating between depositors, executives, trustee, assessor, etc., while they are in equal conditions.
- 3- Abusing the professional position, facilities, and properties, in order to delay or not perform the

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<sup>46</sup> Independent advisor: A real person with master's degree or higher, in one of the fields of banking, economics, law, accounting, finance and engineering, which after passing Rastin Banking courses and receiving the related certificate, can be assigned in the position of the independent advisor (according to the case) in other banks or certified financial institutes by the Central Bank. The members of the Committees of Rastin Profit and Loss Sharing Banking and the Committee of Formulating Rastin Banking Regulations, whose names have been inserted in the scientific and executive documents of Rastin Banking in Bank Melli Iran can receive the independent advisor certificate without passing the cited course. Position of the independent advisor can be added along with governmental positions.

- proposal or to perform an unconfirmed proposal.
- 4- Disclosure or nondisclosure of information against the regulations.
  - 5- Presenting an unreal certificate, confirmation, or report.
  - 6- Appointing or employing persons, such as assessor, trustee, and auditor, who have no legal qualification.
  - 7- Suppression, concealment, inspection or opening of sealed envelopes and cargos, or destroying them without the essential legal formalities.

In this regard, it has been predicted that the court can also apply punishments such as rescission of the certificate, deprivation of activity in the field of Rastin Banking, and disclosure of the offender's specifications on the website of the Central Bank, as the complementary punishments for the offender.

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