

بانک خاورمیانه
Middle East Bank



NON-INTEREST INCOME IN THE IRANIAN BANKING SYSTEM

An Analytical Survey





NON-INTEREST INCOME IN THE IRANIAN BANKING SYSTEM

An Analytical Survey

June 2024

Disclaimer

The data, information, and analyses presented in this Report are for information purposes only. All the data and Information used have been taken from the referenced sources that were available at the time of publication (June 28, 2024). They are believed to be reliable but Middle East Bank does not warrant its completeness or accuracy. Your use of this Report does not entail any responsibility or obligation by Middle East Bank or any entity or person associated with it.

Economic Research Department, Middle East Bank

Contributors: Hossein Soltanabadi and Yaser Pakdaman

Translator: Arian Aghabeigi

Graphic Designer: Hannaneh Niazmand

Layout Designer: Zeynab Khosravi

NOTE:

- The analyses of the Iranian banking system in this Report are based on the year 1401 that follows the Persian Calendar, a solar calendar based on which years start on the first day of spring and end on the last day of winter. In terms of Gregorian Calendar, the year 1401 covers the period between March 21, 2022 and March 20, 2023. The following table provides an easy reference while reading this Report.

1400= 21/03/2021 to 20/03/2022

1401= 21/03/2022 to 20/03/2023

CONTENTS

Introduction.....	7
1. Non-interest Income in the Banking System.....	8
2. Pros and Cons of Non-interest Income.....	9
2-1 .Advantages of Non-interest Incomes.....	9
2-2 .Disadvantages of Non-interest Income.....	10
3. Non-interest Income Worldwide.....	11
3-1 .North America.....	12
3-2 .European Union.....	18
4. Non-interest Income in the Iranian Banking System.....	20
5. Conclusion.....	24
6. Policy Proposals.....	26
7. References.....	27
8. Appendix.....	28

INTRODUCTION

The Central Bank of Iran (CBI) has exercised a macroprudential policy since the year 1400 through controlling the Liquidity (M2) growth rate, aimed to rein in the CPI inflation rate. As policy requires the banks to put a cap on monthly growth rate of their assets¹, the profitability of the banks from interest-income would be challenged since their money creation which translates to loan making is limited. Precisely speaking, the more banks depend on interest income, the more vulnerable their profitability is to the CBI policy. This Report opens with definition of the non-interest income in the world banking system and compares that type of income in the Iranian banking system and the rest of the world based on the most recent financial statements of some selected banks. The Report concludes with the strengths and weaknesses of the Iranian banking system regarding non-interest income and provides policy proposals.

1. According to the circular of CBI, all banks and credit institutions are required to observe the capped growth rates. Cash balances, accounts with CBI and Islamic Treasury Bonds, as well as the below the line items are exempt from this circular.

1. NON-INTEREST INCOME IN THE BANKING SYSTEM

Generally speaking, non-interest income in the banking systems is referred to as any income that banks earn other than their core intermediation business (directly through making loans or indirectly through depositing with other

banks) including their investments. As the fees of banking services form much of the banks' non-interest income, it is also known as Fee Income. Non-interest income is classified into five groups based on some works, presented in Table 1.

Table 1. Various Types of Banks Non-interest Income

Source of Non-interest Income	Examples
Income from Fiduciary Activities	Income from trust department transactions and services
Trading Revenue	Income from exposure to financial instruments relating to commodities, foreign exchange, interest rates, and equity securities and indices
Service Charges on Deposit Accounts	Charges for account maintenance, failure to maintain minimum balances and processing of insufficient checks
Fee Income	Fees from credit cards, securitizing loans, mortgage financing and servicing, sales of mutual funds and annuities, and ATM surcharges
Other Nonfee Income	Income received from data processing services, sales of miscellaneous assets and other income not included above

Source: Feldman et al, 1999

In accordance with another classification, the non-interest income is classified into four distinct groups of Trust, Services

Fees, Transactions, and Other. Another classification of non-interest income is presented in Table 2.

Table 2. Various Types of Banks Non-interest Income

Source of Non-interest Income	Components
Service Charges	Service Charges, ATM fees, income from the sales of checks, safe deposit box fees, wire transfer fees, card charges
Trade	Trading revenues, net securitization income, net loans and leases sales, net real estate sales, net other sales
Investment Banking	Income from fiduciary activities, venture capital income, securitization fees, annuity fees, insurance
Other	Other (rent on property, foreign exchange profits)

Source: Haburich et al, 2019

2. PROS AND CONS OF NON-INTEREST INCOME

In the literature, some advocates of diversification of incomes believe that non-interest income enhances the profitability of commercial banks. For instance, Markowitz Theory suggests that the rise in non-interest income helps the banks minimize their risks or maximize their profit. Also, some believe² that diversified banking services would lead to sustainable income, efficient cost management, and higher profitability. Finally, some works regarding bank income indicate that non-interest trades in commercial banks would end up in less volatile profitability. On the other hand, some critics claim that even though non-interest income causes the effectiveness to escalate, it entails

some risks that might adversely affect a bank's operational efficiency. For instance, research³ on 734 European banks from 1996 to 2002 revealed that the banks that have moved towards modern services bear more risk than those providing traditional banking services. Similarly, some believe⁴ that non-traditional banking services might end up in considerable systemic risks. Regarding the Chinese Banking System, the non-interest income has caused the banks' income and risks to rise simultaneously from 1986 to 2008⁵ as the non-interest income is much more vulnerable than the interest income. The following parts shed light on the advantages and disadvantages of non-interest income.

2-1. Advantages of Non-interest Incomes

- **Income Diversity:** non-interest income is referred to as the major driver of the income diversity in the commercial banks. Non-interest income, as it is grasped from its name, mainly deals with scope of the banking services other than loans, hence it does not deal with interest rate risk even during business cycles. Precisely speaking, the more dependent a bank on interest-income, the more vulnerable its income to interest rate fluctuations.
- **Less Need to Capital:** contrary to the interest-income that is capital intensive, the non-interest income is free from that issue. In other words, for making more profit from loans by banks, more capital, deposit and also interest rate spread are required.
- **Less Vulnerability to Credit Risk:** any loan made is translated to taking a credit risk, i.e., in order to obtain interest-income,

one bank is required to bear credit risk. However, there is no room for credit risk in case of non-interest income.

- **Less Overhead Costs:** in order to obtain interest-income, banks are required to have a strong credit appraisal team that appraises the technical feasibility, economic viability, and bankability including creditworthiness of the prospective borrower. Once loans are made, another group of people is required to track the loan repayments and other activities regarding debt settlement of the borrowers. Accordingly, such processes are very costly, but with regard to the non-interest income the case is far different. In other words, non-interest income is mainly obtained via the services of the IT systems of the banks, hence for this sort of income less overhead cost is needed.

2. Klein and Saldenberg (1997)

3. Lepetit et al (2008)

4. Pozsar et al (2010)

5. Li and Zhang (2013)

2-2. Disadvantages of Non-interest Income

- **Massive Investment in Technology:** the IT infrastructure of a commercial bank plays a pivotal role in making non-interest income. The periodical fees paid to the banks are in a sense the fees of benefiting from the IT services of the banks. The important point in running IT services is the massive initial investment for running the business as well as high costs of maintenance staff. The nature of IT services itself, is a matter of concern as it is extremely revolving. Precisely speaking, remarkable costs for being up to date are vital if the IT services are to survive.
- **Competition with Fintech:** seeking for non-interest income might diverge the commercial banks from their main carrier. For decades, the commercial banks focused on expanding their relationships to gain interest- income. However, in case of non-interest income, commercial banks are left with

no choice but to expand IT services which force them to compete directly with Fintechs. As the Fintech companies are IT-based and provide customers with better services and products than those provided by banks, the commercial banks probably lose the competition with Fintechs.

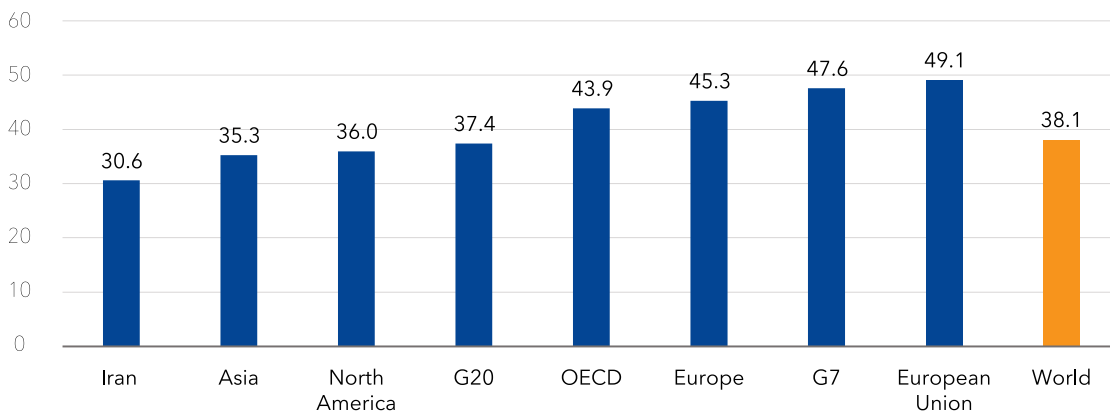
- **High Operating Leverage:** as previously mentioned, massive investment in infrastructure as well as maintenance are indispensable to obtaining non-interest income. Such expenditures are independent of operations, i.e., they are fixed costs and lead the banks to bear high operating leverage with translates to higher risk of bankruptcy for them. The bankruptcy of a bank can end up in systemic risk in the banking system, hence the risks of high concentration on non-interest income should be well taken into account in banking management.

3. NON-INTEREST INCOME WORLDWIDE

On the basis of the statistics issued in 2021, the share of non-interest income in total income of the world banking system was estimated 38.1 percent on average, with highest share of 91.1 percent in Syria and the lowest share of 10.7 percent in Cambodia. Note that for the case of Syria, as the banking system is in the hands of government, the banks are highly limited in making loans, i.e., during the decade ended 2011 the M2 money multiplier⁶ has averaged 2.2. Accordingly, the remarkable 91.1 percent share of non-interest income in total income of the Syrian banks does not translate to diversified non-interest banking services. Note that the numerical value of the M2 money multiplier per se could not represent the composition of a sample bank income. For instance, the M2 money multiplier in Cambodia has registered 2.8 on average -close to that of Syria - during the decade ended 2022, while non-interest income constituted only 10.7 percent of the total banking system income in that country. As for the USA, the M2 multiplier averaged 4.7 in the decade ended 2022, mainly a result of the Quantitative Easing⁷ shortly after the 2008 Financial Crisis, but in the years prior to 2008 registered higher values of 12.9 and 14.3 in 2006 and 2007, respectively.

The share of non-interest income in the total income of the banking system of the European countries is calculated 45.3 percent, above the 36.0 percent in the North American countries. Regarding the Asian countries, the corresponding figure in 2021 is estimated the low of 35.3 percent. As for the Iranian banking system⁸, the available financial statements of 18 banks that are used in this Report indicate that in 1401, about 30.6 percent of the banks' income has been obtained from the non-interest related activities. In examination of the non-interest income in the Iranian banking system, returns on the investments in non-bank activities, and returns from foreign assets - either operating or non-operating - are included in non-interest income and in that regard, the consolidated financial statements of the banks have been used. Should the subsidiaries be excluded, the share of non-interest income in total income of Iranian banks falls below that of the Asian countries to about 26.7 percent. The M2 money multiplier in Iran in the year 1401 has registered 7.4. In Graph 1, the share of non-interest income in total income of the banking system in Iran, selected countries, as well as the world average are illustrated.

Graph 1. Average Share of Non-interest Income in the Total Income of the World Banking System (percent)



Source: <https://www.theglobaleconomy.com>

6. M2 money multiplier is the ratio of broad money to the monetary base.

7. Quantitative Easing (QE) is a monetary policy strategy through which central bank purchases securities or other assets in an attempt to increase the supply of money and drive more lending to consumers and businesses.

8. According to the Central Bank of Iran, till the issuance of this Report 31 banks and non-bank credit instituting were active in the Iranian banking system.

The World Bank defines non-interest income as: "Bank's income that has been generated by non-interest related activities as a percentage of total income (net interest income plus non-interest income). Non-interest related income includes net gains on trading and derivatives, net gains on other securities, net fees and commissions and other operating income". However, this Report proceeds

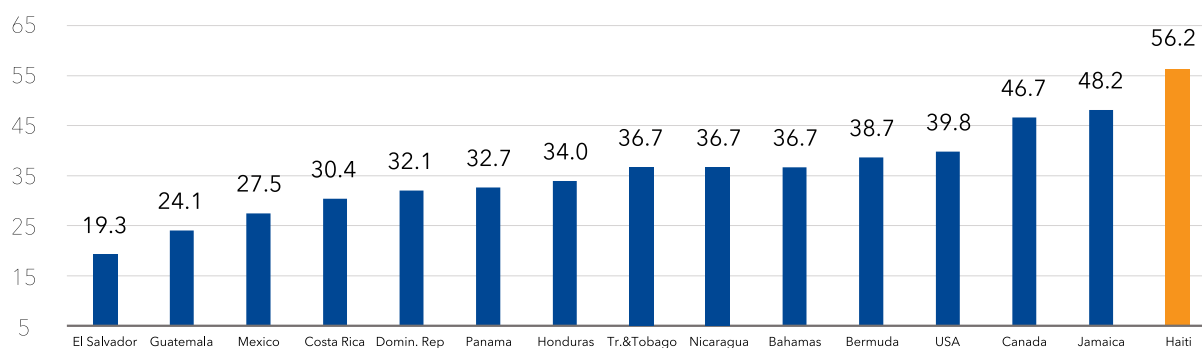
with examination of the share of non-interest income in total income of the banks by geographical areas which is different from the World Bank classification. Various shares of non-interest income in total income in different countries are mainly rooted in differences in monetary policy, supervision, scope and variety of banking services, real interest rates, interest rate spread, and services fees.

3-1. North America

On the basis of the most recent data, in 2021, among the North American countries the highest share of 56.2 percent of non-interest income in total income belonged to Haiti,

while the lowest belonged to El Salvador at 19.3 percent. Graph 2 presents share of non-interest income in total income of the banking system in North American Countries.

Graph 2. Share of Non-interest Income in Total Income of the Banking System in North American Countries in 2021 (percent)

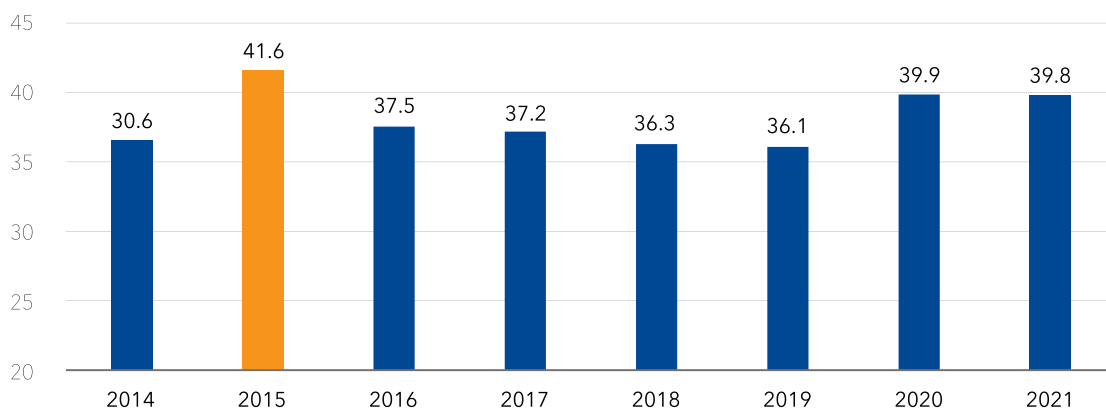


Source: <https://www.theglobaleconomy.com>

As for the United States, the share of non-interest income in total income of the banking system registered 39.8 percent in 2021 to put that country in the 4th place among the North American Countries in that regard. Non-interest income that formed 41.6 percent of the total income of the USA banking

system in 2015 started to fall and reached 36.0 percent in 2019, but reversed course in 2021 and registered 39.8 percent. The developments of share of non-interest income in total income of the USA banking system from 2014 to 2021 is depicted in Graph 3.

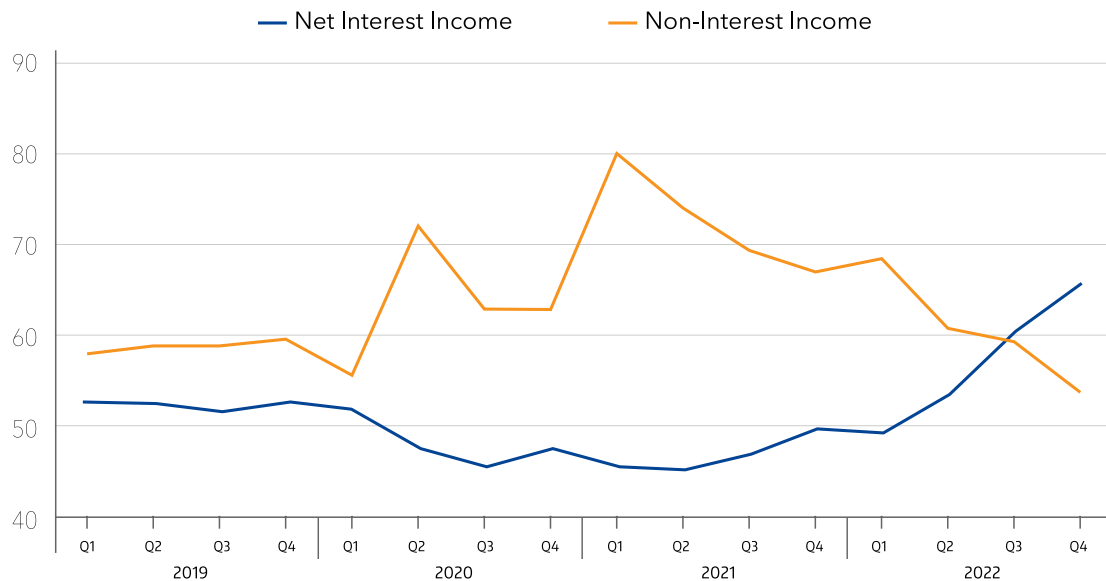
Graph 3. Share of Non-interest Income in Total Income of the USA Banking System (percent)



Source: <https://www.theglobaleconomy.com>

The developments of the aggregate income of the top six largest US banks⁹ (in terms of assets) by net interest and non-interest income are depicted in Graph 4 from 2019 to 2022 on a quarterly basis.

Graph 4. The Sum of Net Interest Income and Non-interest Income of Top Six Largest US Banks (USD billion)

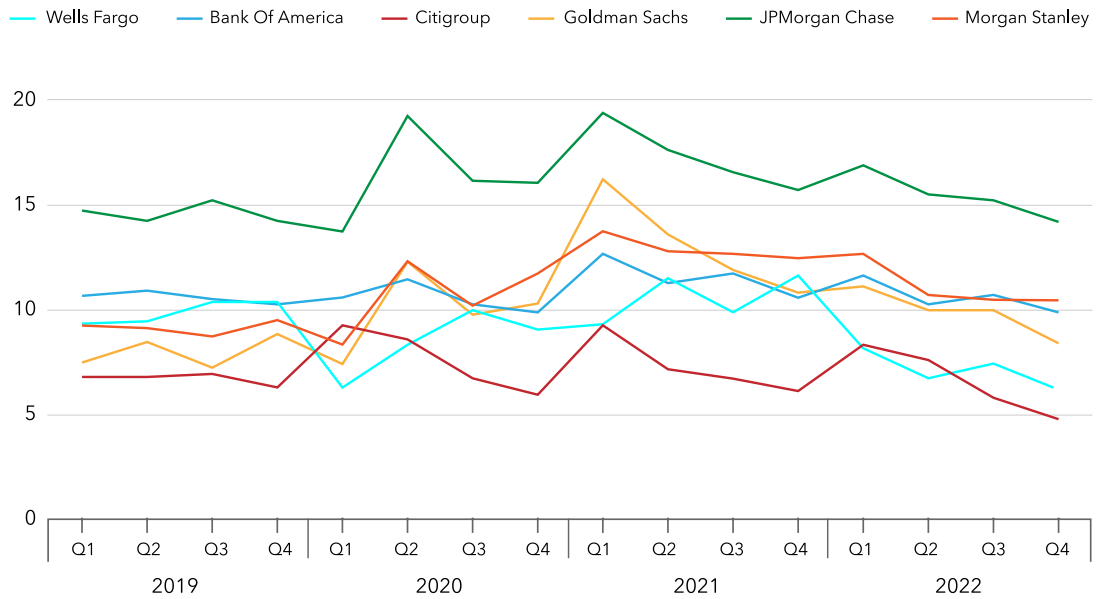


Source: <https://www.calcbench.com>

In addition, Graph 5 depicts the developments of the non-interest income of the six aforementioned banks in the same period, separately.

9. Bank of America, Citigroup, Goldman Sachs, J.P. Morgan, Morgan Stanley and Wells Fargo

Graph 5. Top Six Largest US Banks Non-interest Income (USD billion)



Source: <https://www.calcbench.com>

In the following sections some of the aforementioned USA banks have been investigated through the lens of non-interest income.

• **J.P. Morgan:** in the first half of 2023, non-interest income formed 29.8 percent of the bank total income, 15.8 percentage points below its share in the same period of 2022. Principal Transactions constituted much of the non-interest income of this bank with 41.4 percent share in the first half 2023, indicating 35.6 percent expansion from the same period of 2022. Commissions and Other

Fees as well as Lending and Deposit related fees constituted 20.3 percent and 11.7 percent of the non-interest income during the same period, respectively. All in all, the three aforementioned items formed 73.4 percent of the J.P. Morgan non-interest income in the period under discussion. J.P. Morgan non-interest income in the first halves of 2022 and 2023 is presented in Table 3 in detail.

Table 3. Non-interest Income with its Share in Total Income of J.P. Morgan

	First Six Months of (USD million)		Percentage Change	Share in Non-interest Income in the First Half of 2023 (percent)	Share in Total Income in the First Half of 2023 (percent)
	2022	2023			
Investment Banking	1,602.0	1,283.0	-19.9	4.3	1.3
Equity	115.0	116.0	0.9	0.4	0.1
Debt	1,021.0	778.0	-23.8	2.6	0.8
Advisory	466.0	389.0	-16.5	1.3	0.4
Principal Transactions	8,465.0	10,456.0	23.5	35.4	10.6
Interest Rate	1,345.0	2,696.0	100.4	9.1	2.7
Credit	535.0	650.0	21.5	2.2	0.7
Foreign Exchange	2,648.0	2,893.0	9.3	9.8	2.9
Equity	3,434.0	4,803.0	39.9	16.3	4.8
Commodity	1,050.0	1,182.0	12.6	4.0	1.2
Private Equity Losses	-547.0	-1,768.0	223.2	-6.0	-1.8
Service Fees	13,697.0	13,607.0	-0.7	46.1	13.7
Lending and Deposit Related Fees	3,710.0	3,447.0	-7.1	11.7	3.5
Asset Management Fees	1,268.0	1,350.0	6.5	4.6	1.4
Commissions and Other Fees	5,773.0	5,983.0	3.6	20.3	6.0
Mortgage Fees and Related Income	838.0	499.0	-40.5	1.7	0.5
Card Income	2,108.0	2,328.0	10.4	7.9	2.3
Other	2,538.0	4,168.0	64.2	14.1	4.2
Non-interest Income	26,302.0	29,514.0	12.2	100.0	29.8
Interest Income	31,372.0	69,558.0	121.7	-	70.2
Interest and Non-interest Income	57,674.0	99,072.0	71.8	-	100.00

Source: J.P. Morgan Consolidated Financial Statements for the First Half of 2023.

According to its consolidated financial statements, 70 percent of the total income of J.P. Morgan was obtained through interest income at USD69 billion in the first six

months of 2023 that stood 121.7 percent above that of the first six months of 2022.

• **Wells Fargo:** the non-interest income formed 26.9 percent of the total income of the bank in the first half of 2023, down 14.5 percentage points from the same period of 2022. Notwithstanding its 12.5 percent fall in Service Fees, this item had the highest share of 49.5 percent in total non-interest income of Wells Fargo in the first half of 2023, followed by

Investment Banking Fees with 33.7 percent and Trading Activities Fees with 13.7 percent. These three items formed 93.3 percent of the total non-interest income of the bank in the period under review. The non-interest income of Wells Fargo is presented in Table 4 in detail in the first halves of 2022 and 2023.

Table 4. Non-interest Income with its Share in Total Income of Wells Fargo

	First Six Months of (USD million)		Percentage Change	Share in Non-interest Income in the First Half of 2023 (percent)	Share in Total Income in the First Half of 2023 (percent)
	2022	2023			
Investment Banking	5,577.0	4,979.0	-10.7	33.7	9.1
Advisory	4,844.0	4,277.0	-11.7	29.0	7.8
Other	733.0	702.0	-4.2	4.8	1.3
Trading Activities	770.0	2,017.0	161.9	13.7	3.7
Net Gains (losses) From Equity Securities	106.0	-447.0	-521.7	-3.0	-0.8
Other	664.0	2,464.0	271.1	16.7	4.5
Service Fees	7,744.0	6,775.0	-12.5	45.9	12.3
Lending and Deposit Related Fees	3,544.0	3,021.0	-14.8	20.5	5.5
Commissions and Brokerage Services Fees	1,079.0	1,189.0	10.2	8.1	2.2
Mortgage Banking	980.0	434.0	-55.7	2.9	0.8
Card Fees	2,141.0	2,131.0	-0.5	14.4	3.9
Other	1,258.0	992.0	-21.1	6.7	1.8
Non-interest Income	15,349.0	14,763.0	-3.8	100.0	26.9
Interest Income	21,737.0	40,186.0	84.9	-	73.1
Interest and Non-interest Income	37,086.0	54,949.0	48.2	-	100.0

Source: Wells Fargo Consolidated Financial Statements for the First Half of 2023

During the first half of 2023, the interest income of Wells Fargo expanded by 84.9 percent compared to the same

period of 2022 to reach USD40 billion, forming 73 percent of the total income of the bank.

• **Morgan Stanley:** during the first six months of 2023, non-interest income of this bank formed 50.8 percent of its total income, 22.8 percentage points below that of the same period of 2022. Despite its 6.3 percent fall from the first six months of 2022, the Service Fees had the highest share of 50.3 percent in the non-interest income of Morgan Stanley. Besides, income from Investment Banking and Trading

Activities, respectively, accounted for 10.5 percent and 36.1 percent of the non-interest income of Morgan Stanley in the period under review. The three aforementioned items accounted for 96.9 percent of the non-interest income of the bank in the first half of 2023. The details of non-interest income of Morgan Stanley in the first halves of 2022 and 2023 are presented in Table 5.

Table 5. Non-interest Income with its Share in Total Income of Morgan Stanley

	First Six Months of (USD million)		Percentage Change	Share in Non-interest Income in the First Half of 2023 (percent)	Share in Total Income in the First Half of 2023 (percent)
	2022	2023			
Investment Banking	2,908.0	2,485.0	-14.5	10.5	5.3
Trading Activities	7,678.0	8,519.0	11.0	36.1	18.3
Service Fees	12,667.0	11,874.0	-6.3	50.3	25.5
Mortgage Banking Fees	10,031.0	9,545.0	-4.8	40.4	20.5
Commissions and Other Fees	2,636.0	2,329.0	-11.6	9.9	5.0
Other	182.0	740.0	306.6	3.1	1.6
Non-interest Income	23,435.0	23,618.0	0.8	100.0	50.8
Interest Income	6,262.0	22,918.0	266.0	-	49.2
Interest and Non-interest Income	29,697.0	46,536.0	56.7	-	100.0

Source: Morgan Stanley Consolidated Financial Statements for the First Half of 2023

The interest income of Morgan Stanley in the first half of 2023 reached USD23 billion, accounting for 49.2 percent of

the total income of the bank and also up 266.0 percent from the corresponding figure in the first half of 2022.

• **Bank of America:** non-interest income accounted for 27.2 percent of the total income of Bank of America in the first half of 2023, albeit 16.8 percentage points below that of the first half of 2022. The Service Fees income grew by 5.0 percent in the first half of 2023 compared to its preceding year to form 95.8 percent of the non-interest income of

Bank of America in that period. In addition, the Investment Banking Fees contributed to the bank non-interest income by 10.4 percent, while Other Fees by negative 6.2 percent share was a factor of decrease in the non-interest income. The details of non-interest income of Bank of America in the first halves of 2022 and 2023 are presented in Table 6.

Table 6. Non-interest Income with its Share in Total Income of Bank of America

	First Six Months of (USD million)		Percentage Change	Share in Non-interest Income in the First Half of 2023 (percent)	Share in Total Income in the First Half of 2023 (percent)
	2022	2023			
Investment Banking	2,585.0	2,375.0	-8.1	10.4	2.8
Underwriting	1,107.0	1,226.0	10.7	5.4	1.5
Advisory	865.0	738.0	-14.7	3.2	0.9
Other	613.0	411.0	-33.0	1.8	0.5
Service Fees	20,846.0	21,889.0	5.0	95.8	26.1
Lending and Deposit Related Fees	3,550.0	2,774.0	-21.9	12.1	3.3
Asset Management Fees	6,388.0	5,887.0	-7.8	25.8	7.0
Brokerage Services Fees	7,950.0	10,213.0	28.5	44.7	12.2
Card Fees	2,958.0	3,015.0	1.9	13.2	3.6
Other	-1,531.0	-1,415.0	-7.6	-6.2	-1.7
Non-interest Income	21,900.0	22,849.0	4.3	100.0	27.2
Interest Income	27,869.0	61,009.0	118.9	-	72.8
Interest and Non-interest Income	49,769.0	83,858.0	68.5	-	100.0

Source: Bank of America Consolidated Financial Statements for the First Half of 2023

In the first half of 2023, the interest income of Bank of America rose by 118.9 percent compared to the same

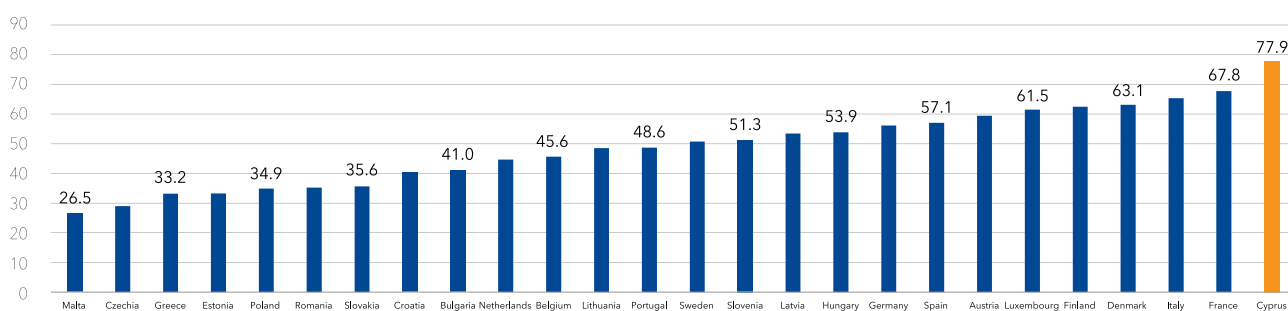
period of 2022 to USD61 billion, constituting 72.8 percent of the total income of that bank.

3-2. European Union

In 2021, the highest share of non-interest income in total income of the banking system in the European Union (EU)¹⁰ was attributed to Cyprus with 77.9 percent and the lowest to

Malta with 26.5 percent. The share of non-interest income in total income of the banking system in the European Union is depicted in Graph 6 by country.

Graph 6. Share of Non-interest Income in Total Income of the European Union Banking System in 2021 (percent)*



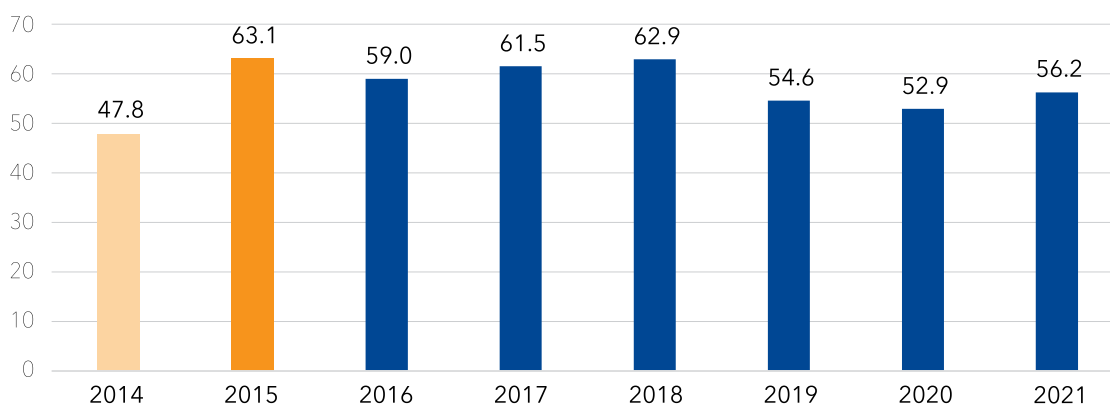
Source: <https://www.theglobaleconomy.com>

*The data for the Republic of Ireland was not available while preparing this Report

The share of non-interest income in the total income of the banking system of Germany as a leading EU member was following an upward path between 2014 and 2018 and from 47.8 percent rose to 62.9 percent in that time span. However, it reversed course and registered 56.2 percent in

2021 and Germany ranked 9th among the EU members in that regard. The developments of the share of non-interest income in total income of the German banking system from 2014 to 2021 is shown in Graph 7.

Graph 7. Share of Non-interest Income in Total Income of the German Banking System (percent)



Source: <https://www.theglobaleconomy.com>

The following section goes over non-interest income in | selected German banks.

10. European Union is a supernational political and economic union of 27 countries.

• **Hamburg Commercial Bank:** in the first half of 2023, non-interest income constituted 24.3 percent of the total income of this bank with 8.4 percentage points rise compared to the same period of its preceding year. Among the components of non-interest income, Trading Activities surged by 188.0 percent in the period under review to have

the highest share of 79.1 percent in non-interest income of the bank in the first half of 2023, followed by Service Fees and Investment Banking with 18.7 percent and 1.1 percent shares, respectively. Details of Hamburg Commercial Bank non-interest income are presented in Table 7.

Table 7. Non-interest Income with its Share in Total Income of Hamburg Commercial Bank

	First Six Months of (EUR million)		Percentage Change	Share in Non-interest Income in the First Half of 2023 (percent)	Share in Total Income in the First Half of 2023 (percent)
	2022	2023			
Investment Banking	1.0	1.0	0.0	1.1	0.3
Trading Activities	25.0	72.0	188.0	79.1	19.2
Service Fees	21.0	17.0	-19.0	18.7	4.5
Lending-related Fees	10.0	6.0	-40.0	6.6	1.6
Guarantees	2.0	2.0	0.0	2.2	0.5
Account Transactions	9.0	9.0	0.0	9.9	2.4
Other	1.0	1.0	0.0	1.1	0.3
Non-interest Income	48.0	91.0	89.6	100.0	24.3
Interest Income	255.0	284.0	11.4	-	75.7
Interest and Non-interest Income	303.0	375.0	23.8	-	100.0

Source: Interim management report of Hamburg Commercial Bank for the first half of 2023

In the first half of 2023, interest income of Hamburg Commercial Bank rose by 11.4 percent to EUR284 million

compared to the first half of 2022, constituting 75.7 percent of its total income.

• **Deutsche Bank:** the share of net non-interest income in net total income¹¹ of this bank in the first six month of 2023 fell by 10.5 percentage points to 61.9 percent from the first half of 2022. Notwithstanding its 15.4 percent fall in the first half of 2023, the net income from Investment Banking still had the highest share of 54.4 percent in the net non-interest income

of the bank in that period, followed by net Service Fees with 41.5 percent share. Accordingly, the two aforementioned items with aggregated share of 95.5 percent were the main contributors to the net non-interest income of Deutsche Bank in the first half of 2023. The details of net non-interest income of Deutsche Bank are presented in Table 8.

Table 8. Net Non-interest Income with its Share in Net Total Income of Deutsche Bank

	First Six Months of (EUR million)		Percentage Change	Share in Net Non-interest Income in the First Half of 2023 (percent)	Share in Net Total Income in the First Half of 2023 (percent)
	2022	2023			
Investment Banking (net)	5,969.0	5,052.0	-15.4	54.4	33.6
Advisory	707.0	618.0	-12.6	6.6	4.1
Other	5,262.0	4,434.0	-15.7	47.7	29.5
Service Fees (net)	4,270.0	3,859.0	-9.6	41.5	25.7
Commissions and Other Fees	2,932.0	2,650.0	-9.6	28.5	17.6
Asset Management	1,338.0	1,209.0	-9.6	13.0	8.1
Other (net)	399.0	384.0	-3.8	4.1	2.6
Net Non-interest Income	10,638.0	9,295.0	-12.6	100.0	61.9
Net Interest Income	4,061.0	5,720.0	40.9	-	38.1
Net Interest and Net Non-interest Income	14,699.0	15,015.0	2.1	-	100.0

Source: Consolidated financial statements of Deutsche Bank for the first half of 2023

The net interest income of Deutsche Bank reached EUR5.7 billion in the first half of 2023, constituting 38.1

percent of its net total income and indicating 40.9 percent rise compared to the same period of 2022.

11. In the financial statement of Deutsche Bank net values of interest and non-interest incomes are available only.

4. NON-INTEREST INCOME IN THE IRANIAN BANKING SYSTEM

To have a robust insight of the Iranian banking system, being familiar with the framework within which the Iranian banks operate is of high importance. Precisely speaking, in the Iranian banking system the banks are required to observe the Central Bank regulations and all of their fields of activity ought to be confirmed by that monetary authority. The Money and Credit Council as the highest monetary policy making body was formerly in charge of determination of banking activities and all the Iranian banks were required to adjust their operations in line with the decisions made by that policy making authority. The banks were also required to specify their activities in their articles of association which also needs to be confirmed by the same Council in advance. However, according to the new Central Bank of Iran Act¹², the Money and Credit Council is replaced by the Supreme Council from mid-1402. Moreover, the Central Bank has the right to prohibit banks from doing some specific activities. In addition, this Monetary Authority is in charge of setting fees for the various banking services and is also entitled to unilaterally set price floor and ceiling in that regard. This

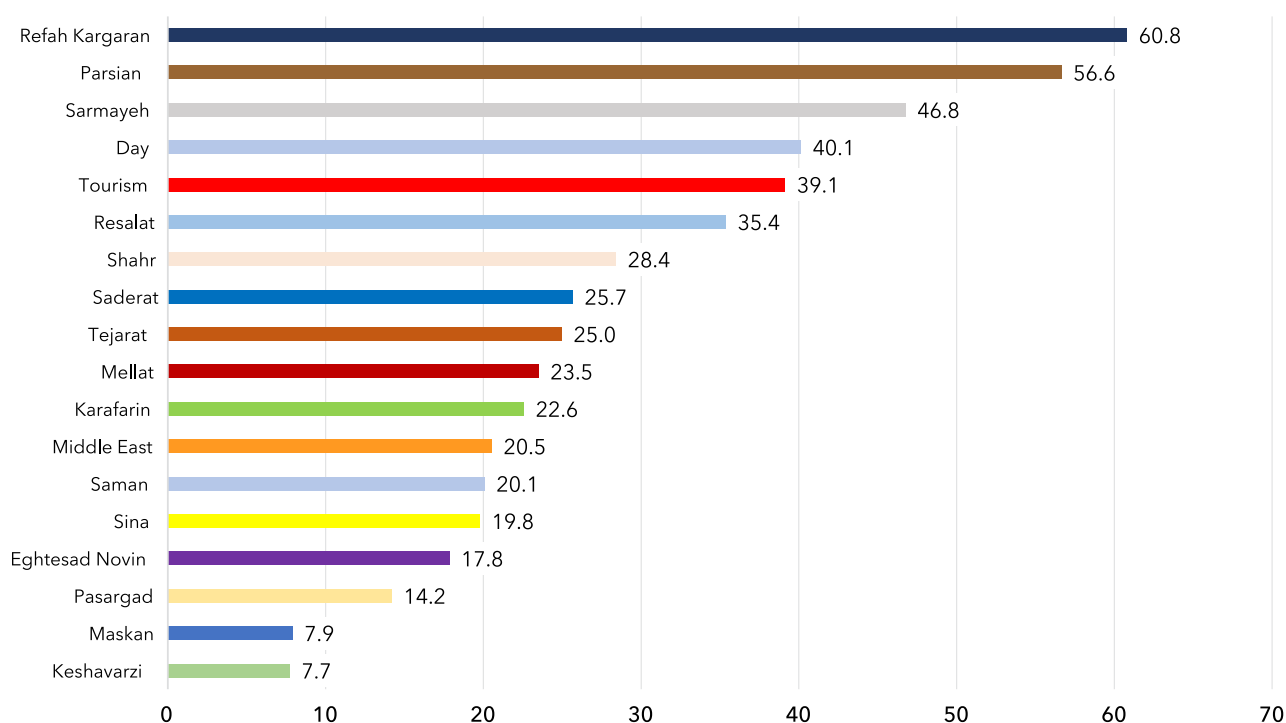
procedure has even exacerbated recently and the banks have even become more limited in enforcing discount on their fees, i.e., maximum 30 percent discount is allowed only. From the above explanations, it is crystal clear that the Iranian banking system considerably lacks competition, not only in services but also in loan making that was briefly discussed in the opening of this Report¹³.

While preparing this Report, among the 31 banks and non-bank credit institutions, the financial statements of 18 commercial banks were available. Besides, the most recent data in this section covers the year 1401. Accordingly, non-interest income formed 26.7 percent of total income of the 18 banks under review in 1401 which stands 11.4 percentage points below the 38.1 percent world average. By excluding sources of non-bank activities, share of non-interest income in total income in those banks even falls to 22.9 percent on average. The share of non-interest income in total income of the 18 Iranian banks under discussion in 1401 is shown in Graph 8.

12. The Central Bank of Iran Act is the amended version for the Monetary and Banking Act.

13. The interest rates on loans and deposits are also decreed by the Central Bank.

Graph 8. Share of Non-interest Income in Total Income of Selected Iranian Banks in 1401 (percent)



Source: Financial Statements of Selected Iranian Banks in 1401

Among the 18 banks under review, the highest share of non-interest income in total income in 1401 belonged to REFAH KARGARAN BANK (for short Refah Bank), while the lowest to BANK KESHAVARZI IRAN (for short Keshavarzi Bank) at 7.7 percent. Note that 93.4 percent of the non-interest income of Refah Bank in 1401 was emanated from Trading Activities. Out of the income from Trading Activities, 60.8 percent was obtained from returns of investment in non-bank activities. In 1401 the Service Fees constituted 2.9 percent and the income from conversion of foreign assets and liabilities by new exchange rates formed 1.7 percent of non-interest income of Refah Bank. In the absence of income from investment in non-bank activities and conversion of foreign assets and liabilities by new exchange rates, the share of non-interest income in total income of Refah Bank shrinks to 39.2 percent. The net income from Service Fees in the same period formed 27.8 percent of the non-interest income of Keshavarzi Bank. The income from conversion of foreign assets and liabilities by new exchange rates accounted for 36.7 percent of the non-interest income of the same bank in 1401. Excluding

the income from investment in non-bank activities and conversion of foreign assets and liabilities by new exchange rates, the share of non-interest income in total income of Keshavarzi Bank falls to 5.0 percent.

All in all, of total non-interest income obtained by the 18 Iranian banks under review, 16.0 percent has been from net Service Fees income - the differential of the Service Fees Income and Expense.

Among the components of Service Fees income, the Guarantee Issuance Fees had the highest share of 27.4 percent, followed by Foreign Currency Operations Fees with 14.4 percent, Other Services Fees with 11.7 percent, Shetab¹⁴ Fees with 10.7 percent, and Letters of Credit Fees with 7.9 percent, that altogether constitute 72.0 percent of Service Fees income of the 18 banks under review in 1401. Moreover, the Fees of Exploration of Customer Credit File accounted for 5.3 of the Service Fees income in the same period.

14. Interbank Information Transfer Network, known as Shetab, is an electronic banking clearance and automated payments system used in the Iranian banking system.

A comparison between the USA and the Iranian banking system reveals a remarkable difference in the share of Service Fees income in non-interest income in the banking systems of the two countries - 63.9 percent share in the former and 16.0 percent in the latter. In addition, share of Service Fees income in total income of the US banks is estimated 20.5 percent while in Iranian banks surveyed, this share was 4.3 percent only in the year 1401.

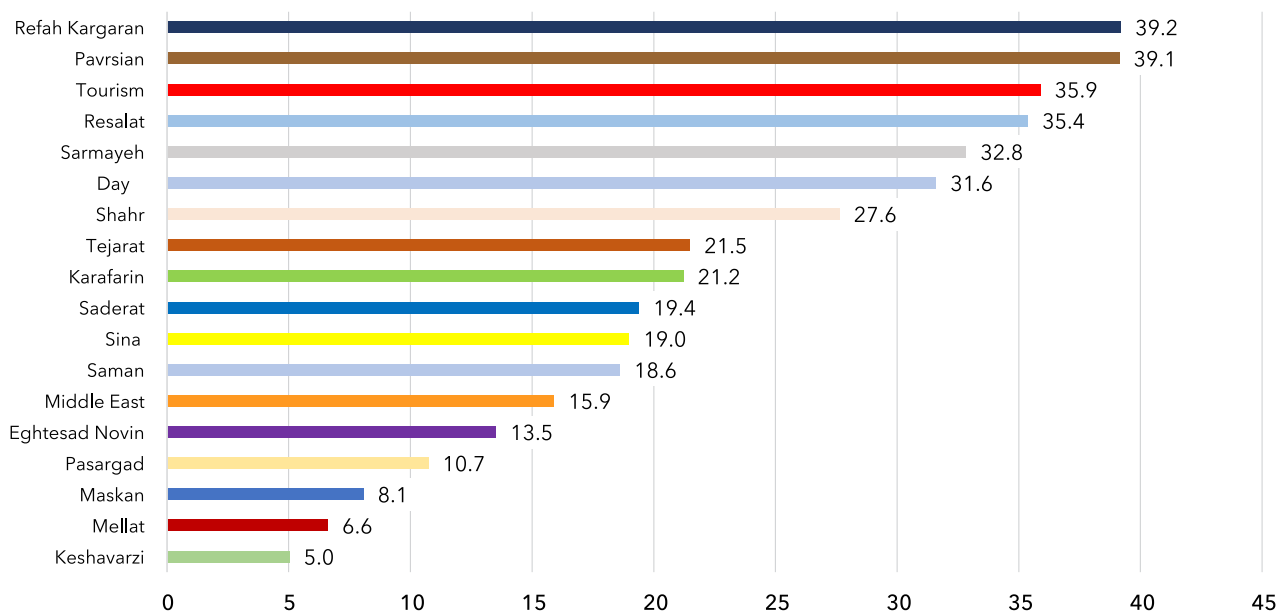
In addition to Service Fees income, income from Trading Activities including investment in securities and net profit (loss) from foreign transactions accounted for 40.4 percent of the non-interest income of the Iranian banks under discussion in 1401. Out of the Trading Activities, 71.3 percent belonged to investment in stocks and other securities, 22.3 percent to investment in debt securities, and 6.4 percent to net profit (loss) from foreign transactions. All in all, the three aforementioned items form the income from Trading Activities of banks as a whole. Note that in the consolidated financial statements, income from sales of properties as well as net profit (loss) from sales of goods are also included in income from Trading Activities. The income from investment in stocks and other securities itself encompasses return (dividend) on stock and investment funds, profit (loss) from investment in non-bank activities, and profit (loss) from sales of stocks and investment funds units. Non-bank activities form 49 percent of the profit from investment in stocks and other securities.

Other sources of non-interest income of the 18 Iranian banks under review accounted for 43.6 percent of the non-interest income of those banks in 1401. Profit (loss) from conversion of operating foreign assets and liabilities by new exchange

rates, profit (loss) from sales of acquired collaterals, doubtful debt reverses return, net other non-operating income and expenses, and net profit (loss) from overseas branches are the major components of other sources of non-interest income that accounted for 38.9 percent of the non-interest income of the 18 Iranian banks in 1401. Note that the Rial depreciation against foreign currencies as a result of chronic inflation in the Iranian economy has contributed to the income from profit (loss) of conversion of operating and non-operating foreign assets and liabilities by new exchange rates to account for 26.5 percent of the total non-interest income of the Iranian banks under examination.

Given their non-bank nature, by excluding profit (loss) from investment in non-bank activities and profit (loss) from conversion of operating foreign assets and liabilities by new exchange rates, share of non-interest income in total income of the 18 Iranian banks under review plummets from 26.7 percent to 17.8 percent, 20.3 percentage points below the world average. For instance, in this case in Refah Bank the share of non-interest income in total income severely falls by 21.6 percentage points from 60.8 percent to 39.2 percent. As for Bank Mellat, this share falls by 16.9 percentage points from 23.5 percent to 6.6 percent, which is the second lowest share after Keshavarzi Bank in 1401 among the 18 banks under review. In addition, the share of net Service Fees income in total income of the banks rises by 0.5 percentage point to 4.8 percent. Graph 9 illustrates the share of non-interest income in total income of the Iranian banks under review less profit (loss) from investment in non-bank activities and profit (loss) from conversion of operating foreign assets and liabilities by new exchange rates.

Graph 9. Share of Non-interest Income in Total Income of the Iranian Banks in 1401 (percent) Less Non-bank Activities and Conversion of Operating Foreign Assets and liabilities by New Exchange Rates



Source: Financial Statements of Selected Iranian Banks in 1401

5. CONCLUSION

The share of non-interest income in total income of the Iranian banking system are far distinct from the rest of the world. Unlike the banking system abroad that investment banking serves as a source of sustainable income, no Iranian bank has gained any income through investment banking activities. The degree of investment banking activities in commercial banks in the world has been evolving over time. For instance, the Glass-Steagall¹⁵ Act of 1933 prohibited the banks in the United States from investment banking activities, aiming for protection of the depositors against the potential losses of stocks trade. In fact, the Act was passed in order to prevent the reoccurrence of bankruptcy of commercial banks due to the 1929 stock market crash. Prior to the Great Depression of 1929¹⁶, the US commercial banks used their funds in high-risk speculative activities in the stock market. Hence, a regulatory firewall was created between commercial and investment activities of the banks as follows:

- Banks were forced to choose between specializing in commercial or investment banking. 10 percent of a commercial bank's total income could stem from securities. however, an exception allowed commercial banks to underwrite government-issued bonds;
- An amendment to the Act created the Federal Deposit Insurance Corporation (FDIC);
- The law enabled the Federal Reserve to regulate retail banks;
- Federal Open Market Committee and ultimately decision-making body of monetary policy was formed;
- Banks were encouraged to use their funds for lending rather than investing those funds in equity markets.

After more than 2 decades, the Bank Holding Act was passed in 1956. Based on the Act, the Holdings that own one or more banks were eligible for participating directly and indirectly in banking-related activities including underwriting, however the banks affiliated to those holdings were not allowed to do so.

The consequences of enforcement of Glass-Steagall Act were in debate over time. Some critics of the Act believed that diversified banking activities lower the risks that banks

face and some other claimed that the Act hinders economic growth. The advocates, on the other hand, believed that the Act prevented market fluctuations and was a driver of post-World War II booms.

Eventually in 1999, the US Congress partially repealed the Glass-Steagall Act and by establishment of the Gramm-Leach-Bliley Act (also known as the Financial Services Modernization Act), eliminated the Glass-Steagall Act's restrictions against affiliations between commercial and investment banks. However, the FDIC was not disabled during the repeal of Glass-Steagall. Consequently, commercial banks, investment banks, brokerage firms, and insurance companies were given the right of mergers.

In the financial statements of the Iranian banks no income from the investment banking related activities could be found, although on the basis of approval of the Money and Credit Council, the banks are allowed to provide customers with advisory services regarding investment, financial services, asset management, underwriting, and capital raising. However, some commercial banks indirectly provide investment banking activities through the investment banks affiliated to them including portfolio management, evaluation, advisory, managing Investment Funds, underwriting, and market making.

Accordingly, in the Iranian banking system, the commercial and investment activities are not allowed to be provided simultaneously by the same bank. Unlike the US banking system that was freed from the restrictions of Glass-Steagall Act in the aftermath of the establishment of the Gramm-Leach-Bliley Act, it seems that the regulatory firewall between the commercial banking and investment banking in Iran still exists. On the basis of the Iranian Capital Market Act, Initial Public Offerings (IPO) ought to be registered in Securities and Exchange Organization of Iran in advance and get the approval of the same organization unless otherwise specified. Public offering of government bonds, Central Bank bonds, municipality bonds, bonds issued by banks and non-bank credit institutions, privately offered securities, and public offering for any company whose equity is below the minimum requirement of the

15. The phrase "Glass-Steagall" generally refers to the separation of commercial banking from investment banking.

16. The Great Depression was a severe global economic downturn from 1929 to 1939. The period was characterized by high rates of unemployment and poverty, drastic reductions in liquidity, industrial production, and trade, and finally widespread bank and business failures around the world.

Securities and Exchange Organization of Iran are exempt from the aforementioned Act. All in all, the Central Bank has required all the banks, either state-owned or private to carry out underwriting for applicants, conditional on the written consent of the Securities and Exchange Organization of Iran.

In addition, income from trading activities, which accounted for 40.4 percent of the non-interest income of the Iranian banks under review, is mainly emanated from investment in debts securities and stocks coupled with net profit (loss) from transactions in foreign currencies. Unlike the Iranian banking system, the foreign banks diversify their non-interest income not only through investment in debt securities and stocks but also via trading derivatives in various markets. The derivative agreements (including swaps, futures, and options) lack a sizeable market in Iran and also the banks have not much dealt with them. Besides, income from asset management fees is a major driver of Service Fees income in the banks worldwide which is almost absent in the Iranian banking system. In recent decade, the private banking has been launched in some Iranian banks, but such service calls for subsidiaries or sister companies via which, financial advisory services to customers, managing their financial affairs, and wealth management could be carried out.

As previously mentioned, the interest rate in the Iranian market is decreed by the CBI through interest rate ceiling, which results in excess demand for loans, setting the banks free from competition for loan making. Under such

conditions, in order to urge the depositors, by violating the Central Banks regulations, the banks compete with each other in absorbing more deposits by various tactics such as arbitrary waiver of service fees or giving fee discounts. Consequently, the structure of the Iranian banking system not only has tempted the banks into Ponzi Schemes and overdraft from the Central Bank, but also into discount or waiver of Service Fees which have served as a hinderance to obtaining non-interest income.

The Central Bank of Iran has implemented its macroprudential policy for reining in the inflation rate by putting a cap on the monthly growth rate of banks assets, which has limited their interest income and their profitability from this source. Note that the Central Bank's policy is maintained in a condition that some banks are suffering from accumulated loss. Under such conditions, increasing the interest rate spread is neither possible nor desirable for enhancing profitability of the banks. Precisely speaking, in the presence of negative real interest rates the banks are left with no choice but to offer the depositor with higher interest rates, translating to narrower interest rate spread. On the other hand, wider interest rate spread translates to more costly financial intermediation. Consequently, expanding the sources of non-interest income could be a contributor to the profitability of banks. In order to do so, regardless of the technical and legal restrictions, the system of decreed interest rates ought to be abandoned.

6. POLICY PROPOSALS

- An examination of the Iranian banking system coupled with the performance of the 18 Iranian banks under survey reveals the limitations on investment banking activities of the Iranian commercial banks. It seems that such limitations are adapted from the Glass-Steagall Act of the USA which have prohibited the banks from simultaneous commercial and investment banking activities, however the Act has been repealed more than 2 decades ago and the US commercial banks are markedly dealing with investment banking as well. Backed by the US banking system experience, in order to expand sources of non-interest income in the Iranian banking system, deregulation of investment banking activities by the Central Bank is highly recommended. Besides, the instructions regarding investment banking activities could help the banks form the Chinese Wall¹⁷ in order to prevent conflict of interest.
- The Money and Credit Council that has allowed the banks to participate in advisory services in investment, finance, as well as asset management, has left no room for banks to act beyond those services. On the basis of the Iranian banks' financial statements, establishment of the private banking service in some banks has not been reasonably successful. Accordingly, relaxing the limitations on asset management

activities of the banks is highly recommended.

- Derivatives have highly contributed to diversification of income from Trading Activities in the banking systems in various countries under survey in this Report. However, in the Iranian banking system, much of the income from Trading Activities is emanated from trading of stocks and debt securities. Hence, collaboration between the Central Bank and the Securities and Exchange Organization of Iran to expand modern financial instruments could be a factor of increase in income from Trading Activities of the Iranian banks.
- The low share of Service Fees income in non-interest income and total income of the Iranian banks is not only attributed to the system of decreed Services Fees, but also to the decreed interest rates that stand below the market rate. Under such circumstances, in order to maintain their market share and encourage potential depositors, the banks are left with no choice but to waiver the Service Fees or give fee discounts, resulting in less non-interest income of the banks. In order to cope with that problem, reforming the interest rate determination mechanism as well as eliminating system of decreed Service Fees are inevitable.

17. A Chinese Wall is an ethical concept of separation between groups, departments, or individuals within the same organization, a virtual barrier that prohibits communications or exchanges of information that could cause conflicts of interest.

7. REFERENCES

- 2Q23 Quarterly Supplement, Wells Fargo.
- Advantages of Non-Interest Income, Management Study Guide.
- Analysis of the Impact from Non-interest Income to The Operational Efficiency of Commercial Banks in Vietnam, Sang Nguyen Minha and Tam Tran Thi Thanhb, Management Science Letters, 2020.
- Are there diversification benefits of increasing noninterest income in the Chinese banking industry?, Li Li and Yu Zhang, Journal of Empirical Finance, 2013, vol. 24, issue C.
- Bank income structure and risk: An empirical analysis of European banks, Laetitia Lepetit, Emmanuelle Nys , Philippe Rous and Amine Tarazi, Journal of Banking & Finance, 2008, vol. 32, issue 8.
- Bank of America Reports Q2-23, United States Securities and Exchange Commission.
- Central Bank of Iran, Laws and Regulations.
- Consolidated Financial Statements for the Six Months Ended June 30, J.P. Morgan, 2023.
- Disadvantages of Non-Interest Income, Management Study Guide.
- Diversification, organization, and efficiency: Evidence from bank holding companies, Klein, P. G., & Saldenberg, M. R. (1997),Federal Reserve Bank of New York.
- Hamburg Commercial Bank well on track with EUR230 million pre-tax profit in the first half-year, Hamburg Commercial Bank, 2023.
- Minha and Tam Tran Thi Thanhb, Management Science Letters, 2020.
- Morgan Stanley Second Quarter 2023 Earnings Results, Morgan Stanley.
- Noninterest Income: A Potential for Profits, Risk Reduction and Some Exaggerated Claims, Ron J Feldman and Jason Schmidt, Federal Reserve Bank of Minneapolis 1999.
- Shadow Banking, Pozsar, Z., Adrian, T., Ashcraft, A., & Boesky, H. (2010), New York, 458, 3-9.
- Trends in the Noninterest Income of Banks, Joseph G Haubrich and Tristan Young, Federal Reserve Bank of Cleveland, 2019.
- <https://www.theglobaleconomy.com>
- <https://www.codal.ir/>

8. APPENDIX

Table 9. Aggregate Interest and Non-interest Income of the 18 Iranian Banks in 1401 (IRR million-percent)

	Total		Share in Total Non-interest Income of the Parent Company	Share in Total Income of the Parent Company
	Group	Parent Company		
Net Service Fees	389,723,624	284,351,115	16.0	4.3
Service Fees Income	494,123,594	388,809,064	21.9	5.8
Letters of Credit	30,635,845	30,635,846	1.7	0.5
Guarantee Issuance	106,552,785	106,594,173	6.0	1.6
Fees of Checking Account, Loan Extension and Roll Over, Stock-related Activities, Credit Card, SMS Banking, Interbank Transfers, Insurance Services, Government's Account Keeping, Negotiable Instrument, Plan Appraisal, Safe Boxes, etc.	40,322,500	38,009,389	2.1	0.6
Issuance of Interbank Cheques, Debit Card, and Bankbook	1,397,947	1,397,947	0.1	0.0
Guarantee and Sales of Participation Bonds	10,643,987	10,643,987	0.6	0.2
Shetab System and Holders of Debit Cards Linked to Shetab	42,990,194	42,990,194	2.4	0.6
Fees of Loans from National Development Fund Sources	3,496,000	3,496,000	0.2	0.1
Foreign Currency Operations	55,910,233	55,816,007	3.1	0.8
Data Processing, POS Terminals, Payment Gateways, Amendments to Contracts, Subscription, and Other Services	155,359,059	52,759,684	3.0	0.8
Bank Remittances	12,422,246	12,210,747	0.7	0.2
Evaluation and Insurance of Collaterals	6,470,865	6,470,865	0.4	0.1
Exploration of Customers Credit Files, Managed Funds,	27,921,933	27,784,225	1.6	0.4
Service Expenses	104,399,970	104,457,949	5.9	1.6
Shetab System	34,319,146	34,464,151	1.9	0.5
POS Terminals and Payment Gateways	42,018,276	41,829,861	2.4	0.6
Service Providers	11,933,947	13,032,626	0.7	0.2
Other	16,128,601	15,131,311	0.9	0.2
Trading Activities	1,032,619,043	716,512,304	40.4	10.8
Investment in Debt Securities	170,199,044	159,774,828	9.0	2.4
Investment in Stocks and Other Securities	496,965,175	510,817,316	28.8	7.7
Profit (Loss) of Investment in Non-bank Activities	359,913,449	250,256,006	14.1	3.8
Net Profit (Loss) of Foreign Currencies and Goods Trade	251,446,290	45,920,160	2.6	0.7
Sales of Properties	8,968,935	-	-	-
Other	105,039,599	-	-	-
Other	788,810,745	773,796,217	43.6	11.6
Profit (Loss) of Conversion of Operating and Non-operating Foreign Assets and Liabilities by New Exchange Rates	480,329,256	470,518,014	26.5	7.1
Net Profit (Loss) of Abroad Branches	24,606,564	24,606,564	1.4	0.4
Profit (Loss) of Sales of Fixed Assets	13,551,966	17,987,907	1.0	0.3
Profit (Loss) of Sales of Acquired Collaterals	101,485,147	108,781,424	6.1	1.6
Legal Reserve Exemption	31,051,919	31,008,588	1.7	0.5
Other	137,785,893	120,893,720	6.8	1.8
Investment Banking	-	-	-	-
Total Non-interest Income	2,211,153,412	1,774,659,636	100.0	26.7
Total Non-interest Income Less Profit (Loss) of Non-bank Activities and Conversion of Foreign Assets and Liabilities by New Exchange Rates	1,370,910,707	1,053,885,616	-	-
Total Interest Income	4,778,640,804	4,873,581,938	-	73.3
Income from Extended Facilities	4,486,406,980	4,588,946,902	-	69.0
Net Fees of Interest-free Loans	87,427,857	85,180,950	-	1.3
Deposits in Banks and Non-bank Credit Institutions	204,805,967	199,454,086	-	3.0
Total Income	6,989,794,216	6,648,241,574	-	100.0
Non-interest Income to Total Income Ratio (percent)	31.6	26.7		
Total Non-interest Income Less Profit (Loss) of Non-bank Activities and Conversion of Foreign Assets and Liabilities by New Exchange Rates to Total Income (percent)	22.3	17.8		
Net Service Fees Income to Total Income Including Profit (Loss) of Non-bank Activities and Conversion of Foreign Assets and Liabilities by New Exchange Rates	5.6	4.3		
Net Service Fees Income to Total Income Excluding Profit (Loss) of Non-bank Activities and Conversion of Foreign Assets and Liabilities by New Exchange Rates	6.3	4.8		

Source: Financial Statements of Selected Iranian Banks in 1401

MIDDLE EAST BANK HEADQUARTERS

No. 2, 5th St., Ahmad Qasir (Bucharest) Ave., Tehran, Iran

Tel: (+9821) 4217 8000 Fax: (+9821) 9121 2383

www.middleeastbank.ir

info@middleeastbank.ir