

بانك خاورميانه  
Middle East Bank



PILLAR 3 REGULATORY CAPITAL DISCLOSURE

Basel 3 Standardised and F-IRB Approaches  
20 March 2021

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## 1. SCOPE OF APPLICATION

### 1.1 Corporate Overview

Founded in 2012 and headquartered in Tehran, the Middle East Bank (“MEB” or the “Bank”) defines itself primarily as a corporate bank. The Bank’s business strategy focuses on providing financing and investment solutions to its corporate clients, high net-worth individuals and high-income earners. Rather than focusing on proliferation of branches, MEB seeks to leverage on its unparalleled domestic position in customer service and technology to deliver services to its client across the country, often through distance banking and using the internet. Thanks to a dedicated management team, combined with a highly skilled and motivated workforce, MEB has during a relatively short time-period since its inception managed to establish itself as one of Iran’s most profitable banks. Officially incorporated at the Companies Registrar Office of Tehran with registration number 430795, the Bank is listed on the Tehran Stock Exchange (TSE) under the ticker “vkhavar”.

### 1.2 Principles of Consolidation

The Consolidated Financial Statements include the accounts of MEB and its subsidiaries, including companies where the Bank owns a voting interest and for which it has the ability to exercise significant influence over operating and financing decisions. We have eliminated intercompany accounts and transactions. Results of operations of acquired companies are included from the dates that the Bank became the primary beneficiary. Assets held in a custodian capacity are not included in the Consolidated Financial Statements. The preparation of the Consolidated Financial Statements are in conformity with accounting principles generally accepted in Iranian GAAP, qualified by the report of the independent auditors and legal inspector, included in the Auditor’s Report and Audited Financial Statements section.

### 1.3 Basel 3 Regulatory Capital Standards and Disclosures

In addition to adhering to the regulatory capital requirements issued by the Central Bank of Iran (“CBI”), the Bank voluntarily discloses its capital adequacy and liquidity positions according to Basel 3 guidelines. Basel 3 is a regulatory framework composed of three pillars. The first pillar addresses capital adequacy and minimum capital requirements. The second pillar requires supervisory review of the capital adequacy assessment and strategies of banks and financial institutions. The third pillar promotes market discipline through transparency and public disclosures of the Bank’s capital adequacy and liquidity. Basel 3 provides two principal methods for calculating capital adequacy: the Standardised Approach and the Internal Ratings Based (IRB) approaches. Basel further divides the IRB approaches into the Foundation IRB approach (F-IRB) and the Advanced IRB approach (A-IRB). At present, MEB calculates its capital adequacy according to the Standardized Approach, and adopts the F-IRB approach on a partial basis for a subset of asset classes including corporate loans, specialized lending exposures and off-balance sheet items.

## 2. CAPITAL STRUCTURE

Basel 3 defines capital within two tiers, Tier 1 capital and Tier 2 capital. Tier 1 is further composed of Common Equity Tier 1 Capital (CET1) and Additional Tier 1 Capital (AT1). At MEB, we do not presently utilize capital instruments qualifying as AT1 Capital. Hence, our Tier 1 Capital is comprised entirely of CET1 capital. MEB's total capital as per Basel 3 is the sum of the Bank's Tier 1 and Tier 2 capital.

The following table presents the capital composition of the Bank as measured under the Basel 3 Standardised approach as of 20 March 2021. Investment in financial institutions were below the 10% Tier 1 capital threshold, hence no capital deduction was necessary in respect of such investments.

*Table 1 - MEB Capital Composition as of 20 March 2021 (m IRR)*

Share Capital	15,000,000
Retained earnings	17,115,498
Statutory Reserves	5,969,152
Other Disclosed Reserves	-
Goodwill & Intangible Assets	(304,420)
Investments in financial firms above 10% of Tier 1	-
Other Regulatory adjustments	(120,000)
<b>Tier 1 Capital</b>	<b>37,660,230</b>
Re-evaluation Reserves	-
General Loss Provisions up to 1.25% of RWA	3,651,178
Other Regulatory adjustments	(120,000)
<b>Tier 2 Capital</b>	<b>3,531,178</b>
<b>Total Capital under the Standardised Approach</b>	<b>41,191,408</b>

## 3. CAPITAL ADEQUACY

MEB manages its capital position according to its risk appetite, ensuring the Bank has sufficient capital at all times to support its business activities in line with its overall business strategy. The Bank's corporate governance processes incorporate capital management as an integral factor in the formulation of our business strategy, risk appetite and risk limits.

We periodically conduct an Internal Capital Adequacy Assessment Process (ICAAP) to capital adequacy based on our current risk exposures. ICAAP is a prospective estimation of the Bank's resources and capital needs under standard and stressed economic/market scenarios.

The Board oversees implementation of the ICAAP. The Risk Management Department regularly updates the Board concerning economic capital, liquidity adequacy and capital adequacy, as well as assisting the Board so to enhance the ICAAP supervisory process.

## 3.1 Regulatory Capital Ratios

MEB was well capitalized as of March 20 2021, exceeding all regulatory capital requirements. MEB measures and reports its capital adequacy ratio (“CAR”) in accordance with three separate models: CBI’s capital adequacy regulations, the Basel 3 Standardised approach, and the Basel 3 Foundation-IRB approach.

Please refer to note 48-7-3 of the Financial Statements for details of the Bank’s CAR calculation in accordance with CBI’s capital adequacy regulations. The table below illustrates the MEB capital ratios under the Basel 3 Standardised and Foundation-IRB approaches.

*Table 2 – Summary of Basel 3 Regulatory Capital Ratios*

<i>(Rials in millions)</i>	<b>Basel 3</b>	
	<b>Standardised</b>	<b>Foundation IRB</b>
<b>Regulatory Capital</b>		
Tier 1 capital	39,533,664	39,533,664
Total capital	43,184,842	42,039,988
<b>Assets</b>		
Total Risk Weighted Assets	416,658,995	417,720,738
<b>Capital Ratios</b>		
Tier 1 CAR	9.5%	9.5%
Total Capital CAR	10.4%	10.1%
Basel III Leverage Ratio <sup>1</sup>	8.9%	8.9%

<sup>1</sup>Tier 1 capital / (balance sheet exposures + converted off-balance sheet exposures).

## 3.2 Risk Weighted Assets

The Basel 3 Standardized and F-IRB approaches comprise estimates of credit risk, market risk and operational risk.

### 3.2.1 Standardised Approach

Under the Standardised approach, we estimate credit risk by classify all credit exposures and risk positions into pre-defined Basel 3 categories and sub-categories, with stated risk weights for each.

Market risk applies to covered positions that include securities trading, foreign exchange (FX) and commodity exposures. We calculate the market risk capital according to CBI rules as outlined in note 48-7-2-2 of the Financial Statements. The calculation of risk-weighted assets for market risk adhere relatively closely to the guidelines set forth by the Basel 3 Simplified Standardised Approach (published January 2019), albeit adjusted with regards to the Iranian economy.

March 20, 2021

We measure operational risk using the new standardised approach for calculating operational risk capital charge, published by the Basel Committee in December 2017.

The following tables represents RWA by risk and exposure type under the Basel 3 Standardised approach as of 20 March 2021.

*Table 3 - Risk Weighted Assets under Basel 3 Standardised Approaches as of 20 March 2021*

<b>Risk and Exposure Type</b>	<b>Exposure Pre-CRM &amp; Pre-CCF (m IRR)</b>	<b>Exposure Post-CRM &amp; Post-CCF (m IRR)</b>	<b>RWA (m IRR)</b>
Sovereigns	46,289,365	46,289,365	-
Multilateral Development Banks			
Banks			
Corporates & SMEs			
Specialized Lending	90,367,351	86,463,115	112,402,050
Exposures Covered by Real Estate			
Retail	3,093,564	3,093,564	1,538,588
Subordinated Debt and Equity	503,137	503,137	1,257,843
Other Assets	11,831,038	11,829,145	7,676,411
Defaulted Exposures	2,424,649	2,424,649	3,614,784
<b>TOTAL ON BALANCE SHEET EXPOSURES</b>			
Bank Guarantees	68,765,792	17,987,206	16,937,189
Letters of Credit (Sight)	50,665	4,176	4,176
Letters of Credit (Usance)	978,389	-	0
Other Commitments	11,831,832	11,831,832	1,590,278
<b>TOTAL OFF BALANCE SHEET EXPOSURES</b>			<b>18,531,644</b>
Market Risk	9,973,958		124,674,475
Operational Risk	1,768,435		22,105,442
<b>TOTAL RISK WEIGHTED ASSETS (RWA)</b>			<b>415,687,103</b>

### 3.2.2 Foundation IRB Approach

In addition to the Basel 3 Standardised approach, MEB voluntarily reports its capital position according to the Basel F-IRB approach using our own empirical models to estimate PD.

Our application of the F-IRB approach applies to the corporate exposure class and specialized lending exposures for all on -and off balance sheet exposures. The table below illustrates the historical default probabilities per risk rating category, and the total exposure to each category as a percentage of the Bank's total corporate loan portfolio.

<sup>1</sup> Includes all non-credit related assets, including receivables, fixed assets and intangible assets,

*Table 4 – Historical Default Probabilities and Exposure Percentages per Risk Category*

<b>Rating</b>	<b>Historical Default Probability</b>	<b>% of Total Corporate Exposures</b>
AAA	0.0%	0.0%
AA	0.0%	0.0%
A	0.0%	0.7%
BBB	0.9%	14.8%
BB	0.5%	20.1%
B	4.8%	27.3%
CCC	16.3%	22.9%
C/CC	45.0%	5.1%
Unrated	0.9%	9.1%
<b>TOTAL</b>		<b>100%</b>

As of the 20 March 2021, the weighted average rating for the Bank’s corporate portfolio was “B”. The Bank’s F-IRB Capital Adequacy Ratio was 10.4%, as illustrated in table 2.

## 4. RISK MANAGEMENT STRUCTURE AND RESPONSIBILITIES

MEB takes a systematic approach to risk management, defined within our risk strategy framework. The Risk Committee (RC) meets on a weekly basis to review the Bank’s risk strategy and report any breaches in risk limits or material risk related issues. The risk strategy outlines clear roles and responsibilities for the management of risk and provides the basis for delegation of authority to various committees and executive officers, as well as establishing specific risk limits in respect of the Bank’s activities.

The Basel document titled “Guidelines - Corporate governance principles for banks”, issued October 2014, forms the basis for the RC’s duties and responsibilities. The RC consists of three Board members, four Executive Committee members and the Senior Risk Manager (SRM). The SRM is responsible for reporting material risk-related issues to other members of the RC, as well as executing various resolutions issued by the RC.

The Risk Management Department operates under the guidance of RC and carries out the policies set forth by the committee. Headed by the SRM and managed by the Designated Risk Manager, the department comprises six additional risk officers. The team shares responsibilities for managing all material risks types (credit risk, market risk, operational risk, and liquidity risk), automation, modelling and reporting, amongst other duties.

The internal/external corporate audit functions report directly to the Board and/or the CEO. Internal corporate audit provide independent assessment and validation of key processes and controls across the Bank, including periodic testing and examination of credit portfolios and processes.

## 5. CREDIT RISK

Credit risk is the risk of economic loss emanating from the failure of the Bank's credit customers to meet their payment obligations in a timely manner. Several products expose us to significant credit risk, including loans, bank guarantees, letters of credit, debt securities and assets within the trading book. Recent adverse macroeconomic events in Iran may affect our credit portfolio, including a declining GDP and consumer spending, coupled with high inflation a volatile FX market, as well as uncertainty concerning interest rates. Increases in default rates among our credit customers would result in increased charge-offs and provisions for credit losses.

At MEB, credit risk management for each customer begins with a preliminary assessment of the customer's financial profile, credit history, business outlook, management and ownership structure. Using our industry-specific empirical rating models, and based on available data, we assign each customer a risk rating ranging from AAA to C/CC. The rating reflects the expected probability of default (PD) for the customer during the coming financial year. We monitor and review individual credit ratings on an ongoing basis to reflect changes in general risk profiles of our clients.

In making credit risk recommendations, we consider the customer's risk rating in addition to collateral, industry concentrations, aggregate amount of credit lines extended to affiliated/group companies, as well as the customer's long-term relationship with the bank.

### 5.1 Credit Risk Policy

MEB's credit policy follows CBI regulations as well as guidelines from the Basel Committee on Banking Supervision (BCBS). The Bank's overall credit risk bearing capacity is contingent on the credit-to-deposits ratio, capital adequacy measures, liquidity measures and CBI regulations.

Corporate clients constitute the core of MEB's credit customers. The Bank also welcomes individual business owners (sole traders) registered with the Chamber of Commerce and in possession of tax codes. MEB develops and maintains strong long-term banking relationships with all its credit customers.

The purpose of the majority of MEB's credit facilities is to assist its clients with their short-term working capital financing requirements. Our international activities are mainly limited to the importation of raw materials and spare parts for companies operating within the food and pharmaceutical sectors. Occasionally, MEB also engages in syndicated funding activities where funding is sourced through the capital market or state-financed National Development Fund (NDF).

The Credit Department performs its own evaluation on its customers before submitting their information for assessment by the Risk Management Department. Part of MEB's credit risk policy is to maintain an average Moody's-equivalent credit risk rating above "B2" (similar to S&P/Fitch rating of "B") in respect of its overall credit portfolio. Customers with lower credit ratings are required to post sufficient collateral to cover their higher-than-expected probability of default. We manage concentrations of large loans on an ongoing basis to ensure they adhere with CBI limitations for "significant loans".

## 5.2 Credit Approval Process

Depending their nature and scope, credit approvals at MEB may take place at either branch level, or at the Banks's headquarters within the Central Credit Committee, Supreme Credit Committee or Board Committee. Note 48-3-4 of the Financial Statements details the organizational hierarchy at MEB for credit approvals.

For information about the various stages involved in the Bank's credit approval process, see note 48-3-2 of the Financial Statements.

## 5.3 Credit Risk Exposures

### 5.3.1 Total Asset Balances

As of 20 March 2021, the Bank's total consolidated assets were approximately 419 trillion IRR, up 201 trillion IRR from 20 March 2020. The primary drivers behind the increase in total assets balances was:

- Increase in loans driven by strong demand for corporate credit lines.
- Increase in the size of the bond portfolio, in line with the Bank's strategy to diversify asset classes on the balance sheet.
- Higher cash and cash equivalents resulting from strong deposit inflows and a prudent liquidity management strategy during the COVID19 economic crisis.

### 5.3.2 Cash and Cash Equivalents

Cash and cash equivalents increased 23 trillion IRR, primarily due to strong deposit inflows driven by growth in customer and client activity, combined with a risk-averse liquidity management strategy during COVID19 economic crisis. For more information regarding cash and cash-equivalent assets of Bank, see note 9 of the Financial Statements.

### 5.3.3 Loans and Leases

Commercial loans and leases increased approximately by 122 trillion IRR, driven by strong demand for corporate loans. Table 5 illustrates borrowers' repayment behavior in respect performing loans denominated in local currency. Table 6 illustrates a breakdown of the Bank's total performing and non-performing loan exposures as of 20 March 2021.

*Table 5 – Borrowers’ repayment behavior in respect of performing local-currency loans*

<b>Late Payment Status for Current Customers</b>	<b>Description</b>	<b>% of Total Exposure Amount</b>
Excellent	No late payments	7%
Good	1 to 7 days late payment	43%
Average	7 to 25 days late payment	16%
Below average	25 to 60 days late payment	15%
Others	No payments due to date	18%
<b>TOTAL</b>		<b>100%</b>

*Table 6 – Breakdown of performing and non-performing loan exposures*

<b>Loan Status</b>	<b>Description</b>	<b>% of Total Exposure Amount</b>
Current	< 2 months late payment	98.8%
Overdue	2 to 6 months late payment	0.1%
Suspended	6 to 18 months late payment	0.3%
Doubtful	> 18 months late payment	0.8%
<b>TOTAL</b>		<b>100%</b>

For more information regarding quality, concentration, collateral, industry distributions and management of loans and leases, see note 48.3 (“Credit Risk”) of the Financial Statements.

### 5.3.4 Debt Securities

Debt securities, including investments in Islamic treasury bills, governmental bonds and corporate bonds, totaled approximately 49 trillion IRR as of 20 March 2021. We use the debt securities portfolio primarily to manage interest rate and liquidity risk and to take advantage of market conditions that create economically attractive returns on these investments. For more information on debt securities, see note 12.2 of the Financial Statements.

### 5.3.5 Equity and Subordinated Debt

The Bank made a strategic decision to exit its equity-trading portfolio in 2019 primarily due to regulatory and capital adequacy treatments of such assets. Total equity holdings on the banking book stood at around 746,110 million IRR as of 20 March 2021, up from approximately 302,388 million IRR the previous year. For more information on the bank’s equity investments, see note 12.1 of the Financial Statements.

### 5.3.6 Off-Balance Sheet Exposures

The Bank’s total off-balance sheet exposures increased to 97 trillion IRR as of 20 March 2021, from around 63 trillion IRR the previous year. For more information regarding the Bank’s off-balance sheet exposures, see note 44 of the Financial Statements.

### 5.3.7 Geographic and Industry Distribution of Credit Exposures

For additional information on the geographic and industry distribution of MEB's credit exposures, please refer to notes 48-3-8-1 ("Distribution of credit facilities and investments by economic sector") and 49.2 ("Geographical concentration of major items of assets, liabilities and income") of the Financial Statements.

## 5.4 Credit Risk Rating System

The Bank's primary risk rating system consists of a range of internally, empirically developed rating models based on various industries. Such models are generally based on a combination of data available from financial statements combined with customer-specific information, and calibrated based on the bank's historical default experience. The credit risk team calibrates the models periodically based on the bank's historical default experience with existing customers, resulting in generally consistent default probabilities across risk ratings between different industry categories.

## 5.5 Determining Credit Risk Parameters

MEB's capital risk parameters are regularly back-tested and benchmarked to evaluate their ongoing performance and suitability. Through back testing, we validate the appropriateness of each parameter by comparing its predicted values to the realized results. We then benchmark each parameter against external standards or through alternative measurement methodologies to determine its validity.

### 5.5.1 Probability of Default (PD)

Probability of default or "PD" is an empirical estimate of the average one-year default rate of a customer over a mix of economic conditions including upturns and downturns. Our method of estimating PDs aligns our risk ratings with the definition of default according to Basel 3. We define "default" either as write-offs, or on arrears on payment obligations of more than consecutive 90 days.

### 5.5.2 Exposure-at-default (EAD)

The exposure-at-default or "EAD" is an empirical estimate of the amount of exposure that is outstanding to an obligor, when that obligor defaults, based on statistical analyses of historical data.

### 5.5.3 Loss-Given-Default (LGD)

We define loss-given-default or "LGD" as the estimated economic loss (in percentage terms of the EAD) that the Bank would expect to incur if the customer (or any obligor within the customer's rating category) were to default within a one-year horizon. For the F-IRB approach, we assume a 45% LGD in line with Basel guidelines, although the Bank's empirical LGD estimates fall well below this threshold.

## 5.6 Credit Risk Mitigation

The Bank manages the size and risk profile of its credit portfolio through diversification of assets classes, industry and obligor concentrations. We proactively maintain our credit management practices and standards to meet the constantly changing economic environments in Iran and abroad.

The Bank bases its credit granting decisions primarily on the credit standing of the borrowers and their debt servicing ability, rather than collateral postings and/or guarantees. Nevertheless, we use collateral and third party guarantees whenever possible to mitigate the credit risk assumed and monitor the value of the collateral on a regular basis.

The main types of collateral taken by the Bank include cash, marketable securities, real estate, equipment and trade receivable cheques. The practice of using trade receivable cheques as collateral allows the Bank to monitor the ongoing cash flow and business performance of its loan customers on an ongoing basis. The Bank also regularly takes personal guarantees and collateral (e.g. principal residences) from key shareholders and directors, as a form of moral support to ensure ethical fulfillment of the borrower’s credit obligations vis-a-vis the Bank.

The Bank recognizes the credit risk mitigation (CRM) effect of qualifying collateral, described in Basel 3 with eligible haircuts in its regulatory capital calculations. These include primarily cash deposits and marketable securities posted by the borrowers. As illustrated in table 3 (“Risk Weighted Assets under Basel 3 Standardised Approach as of 20 March 2021”), the main reduction in exposure post implementation of the CRM technique appears within the corporate, retail and defaulted exposure types.

## 5.7 Stress Testing

The table below illustrates the impact on the Bank’s capital adequacy ratio (CAR) under various credit stress testing scenarios. Credit exposures included in our stress tests include corporates, SMEs, specialized lending and all rated off-balance sheet exposures. Together, these account for almost 80% of the Bank’s total credit risk-weighted assets. Bank exposures and Retail exposures account for around 10% and 2% of total credit risk weighted assets respectively, with the remainder primarily consisting of subordinated debt and equity, defaulted exposures and non-credit related assets. We detail all assumptions used for each stress-test scenario below.

*Table 7 – Credit Stress Testing*

Stress Scenarios	Corporate Portfolio						Corporate Portfolio Risk Weight	F-IRB CAR
	% rated A- and above	% rated +BBB to BBB-	% rated BB+ to BB-	% rated B+ to B-	% rated CCC+ to CCC-	% rated C/CC		
Base Case <sup>1</sup>	0.7%	14.8%	20.1%	27.3%	32.0%	5.1%	120.0%	10.1%
Scenario 1 (mild stress) <sup>2</sup>	0.0%	0.7%	14.8%	20.1%	27.3%	37.1%	159.0%	8.7%
Scenario 2 (moderate stress) <sup>3</sup>	0.0%	0.0%	0.7%	14.8%	20.1%	64.4%	187.0%	7.9%
Scenario 3 (severe stress) <sup>4</sup>	0.0%	0.0%	0.0%	0.7%	14.8%	84.5%	194.0%	7.7%

1- Base Case Scenario:

a. Assuming asset composition and risk weights are equivalent to that of March 20, 2021.

- 2- *Stress Scenario 1 (mild stress):*
  - a. *Downgrading all rated corporate loans with by three notches.*
  - b. *Assuming all loans rated CCC+ and below become C/CC.*
- 3- *Stress Scenario 2 (moderate stress):*
  - a. *Downgrading all corporate loans with by six notches.*
  - b. *Assuming all loans rated B+ and below become C/CC.*
  - c. *Assuming the all specialized lending exposures deteriorate by one cardinal (in accordance with Basel's supervisory slotting criteria for specialized lending <sup>1</sup>)*
- 4- *Stress Scenario 3 (severe stress):*
  - a. *Downgrading all performing corporate by nine notches.*
  - b. *Assuming all loans rated BB+ and below become C/CC.*
  - c. *Assuming the all specialized lending exposures deteriorate by two cardinals (in accordance with Basel's supervisory slotting criteria for specialized lending <sup>1</sup>)*

## 6. MARKET RISK

In this section, we discuss the risk that the Bank may sustain negative effects on the value of its assets, liabilities or earnings due to changes in market conditions. Market risk is especially relevant to the Bank's trading book, including bonds and equities, as well as its foreign exchange (FX) exposures.

The Bank's ALCO committee governs market risk. The committee members meet on a weekly basis to update senior management and provide recommendations on market risk related matters. The Bank's market risk framework comprises policies and practices, validation and valuation procedures and valuation models. The Risk Management Department employs a range of Value at risk (VaR) models to monitor the Bank's market risk on an ongoing basis, in line with sound market practices.

The Bank employs a comprehensive approach to monitoring and stress testing market risk to ensure it remains well capitalized, even under adverse market conditions.

### 6.1 Reporting of Market Risk

The Bank currently adopts an approach similar to the Basel 3 Simplified Standardised Approach (published January 2019) for the calculation of regulatory market risk, albeit adjusted with regards to the Iranian economy. We outline the calculations in note 48-7-2-2 of the Financial Statements.

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<sup>1</sup> According to Basel's slotting criteria for Project Finance, cardinals range from 1 (strong) to 5 (default). Risk weights are 70%, 90%, 115% and 250% for cardinals 1 to 4 respectively. If a project is deemed to be in default and assigned a cardinal of 5, the full amount of the exposure should be provisioned for and hence deducted from the Bank's capital.

## 6.2 Measuring Market Risk

Separate from regulatory reporting, the Bank adopts several internal models to measure and control market risk, primarily based on the VaR approach. Financial exposures measured and controlled by our internal market risk models include interest rates, foreign exchange, and equity risk.

The VaR method assumes that observed historical changes could predict future movements in market rates. Complementing the VaR risk estimates, the Bank performs stress testing under various macro-economic scenarios to identify the Bank’s vulnerability to event risk. The purpose of these tests are to provide the Bank an early-warning mechanism of in the case of systemic shocks. We base our VaR calculation on a one-percent probability (one tail) using daily standard deviations over a 10-day horizon.

## 6.3 Interest Rate Risk

Partially owing to recent debt market developments in Iran, the Bank faces an increased level of interest rate risk. MEB may face the prospect of losing funds by abiding by regulatory limits on interest rates while other banks deviate significantly from such regulations.

### 6.3.1 Interest Rate Risk on Trading Book (IRRTB)

The only assets on the Bank’s trading book as of 20 March 2021

consisted of corporate and government bonds. Despite the still relatively small size of the secondary bond market in Iran, we have witnessed a notable increase in volume expect IRRTB to constitute a larger part of our overall market risk going forward. Due to the nature of these assets, their values may change due to a range of factors including yields, market liquidity, inter-market correlations and market volatility. The following table illustrates the effect of parallel shift in interest rates on the trading book.

*Table 8 – IRRTB Stress Testing: Sensitivity of Market Values due to Parallel Shifts in the Yield Curve*

MEB Consolidated				
Category	400 bp increase	200 bp increase	200 bp decrease	400 bp decrease
<b>20 March 2021</b>				
Fixed Income Securities (m IR)	(1,516,865)	(773,773)	797,277	1,628,480
<b>20 March 2020</b>				
Fixed Income Securities (m IR)	(1,743,107)	(950,540)	774,662	1,714,740

### 6.3.2 Interest Rate Risk on Banking Book (IRRBB)

MEB does not use floating rates, or significant optionality (e.g. early repayment) within its loan portfolio. Consequently, Bank's profitability may suffer in the short term due to increases in regulatory interest rates. The following table illustrates the effect of parallel shift in interest rates on the banking book.

*Table 9 – IRRBB Stress Testing: Sensitivity of Income due to Parallel Shifts in the Interest Rates*

MEB Consolidated				
Category	400 bp Increase	200 bp Increase	200 bp decrease	400 bp decrease
<b>20 March 2021</b>				
Loans (m IRR)	3,940,591	1,970,296	(1,970,296)	(3,940,591)
Fixed Income Securities (m IR)	(1,600)	(800)	800	1,600
Deposits (m IRR)	(8,330,898)	(4,165,449)	2,664,623	5,329,246
Total (m IRR)	(4,391,907)	(2,195,953)	695,127	1,390,255
<b>20 March 2020</b>				
Loans (m IRR)	2,127,418	1,063,709	(1,063,709)	(2,127,418)
Fixed Income Securities (m IR)	(1,600)	(800)	800	1,600
Deposits (m IRR)	(2,245,109)	(1,122,555)	1,122,555	2,245,109
Total (m IRR)	(119,291)	(59,646)	59,646	119,291

## 6.4 Foreign Exchange Risk

MEB's foreign exchange risk is primarily due to off-balance sheet commitments related to imports of goods. MEB does not engage in speculative foreign exchange activities. The Bank does occasionally however end up with open long or short positions, mainly because of FX denominated credit products extended through the NDF or to customers engaging in import/export activities.

- Notes 48-5-5-2 and 48-5-6 of the Financial Statements illustrate the possible effects on the Bank's income due to FX risk and the amount of capital required to covers such risks under both single-asset and variance-covariance VaR models.

## 6.5 Equity Risk on the Banking Book

The Bank's total equity exposure as of 20 March 2021 totaled 500 billion IRR and was predominately restricted to a strategic investment in the ME Life Insurance Company as illustrated in note 12-1 of the Financial Statements.

# 7. OPERATIONAL RISK

The seven operational risk event types according to Basel committee are:

- 1- Internal Fraud
- 2- External Fraud
- 3- Employment Practices and Workplace Safety
- 4- Clients, Products, and Business Practice
- 5- Damage to Physical Assets
- 6- Business Disruption and Systems Failures
- 7- Execution, Delivery, and Process Management

Risk Management Department uses these categories to identify and assess operational risks as part of its Risk and Control Self-Assessment framework, explained below.

## 7.1 Risk and Control Self-Assessment framework

The operational risk assessment process follows the Risks and Controls Self-Assessment (RCSA) methodology, according to which:

- Each of the Bank's branches and risk taking units has a designated RCSA representative, responsible to conduct the process within their unit in close co-ordination with a risk officer.
- The designated RCSA representatives determine the frequency and severity of identified operational risks and divide them into two categories: "material risks" and "non-material risks".
- The heads of all risk-taking units (in co-ordination with the relevant risk officers) are required to verify all identified "material risks" within their unit and propose mitigation procedures to control such risks.

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- The Risk Management Department classifies all residual risks that remains unhedged following the application of the Bank’s mitigation procedures as a “material risks” and include them within its Risk Inventory.

By applying the RCSA, we have identified numerous material operational risks within the various sections of the Bank and its branches to date.

## 7.2 Operational Risk Portal

The Bank's Operational Risk Portal allows for timely identification and mitigation of operational risks (e.g. internal and external fraud) through an online reporting system used by bank employees and managers. To date, our Operational Risk Portal has enabled us to identify hundreds material operational risks in various business units of the Bank, as well as within our branches.

## 7.3 New Product and Services Process

The Bank’s New Product and Services Process (NPSP) ensures that operational risk emanating from new products and services within the Bank and its branches can be properly identified and mitigated through a multi-disciplinary, multi-departmental framework.

## 7.4 Risk Inventory

The Bank’s Risk Inventory process is a multi-disciplinary process according to which various types of risks are collected, identified and assessed at all levels of the Bank. MEB’s Risk Inventory process comprises credit risk, market risk, operational risk, liquidity risk, concentration risk, legal and compliance risk and reputational risk. The Risk Inventory provides a detailed catalogue of all identified risks – categorized according to risk type – within the Bank, along with relevant mitigation procedures.

## 7.5 Updated Standardized Measurement Approach

We apply the Updated Standardized Measurement Approach as per Basel 3 (“USMA”) to calculate operational risk capital charge. According to this approach, we first calculate a value for the Bank’s business indicator (BI) based on the its interest income and interest expenses, interest earning assets, services incomes, and net profit/loss on the trading book and banking books. We then convert the calculated BI amount into the business indicator component (BIC) and map it to the required operational risk capital charge in accordance with Basel 3 guidelines. However, as the Bank’s BIC is less than 1 billion Euros, adjustments of the Bank’s operational risk capital using the Internal Loss Multiplier (ILM) component do not apply. The USMA model uses three-year averages of each of the above components.

- Interest income includes income from loans and advances, securities held to maturity as well as the trading portfolio, in addition to other income emanating from interest on the Bank’s statutory deposits.
- Interest expenses relate mainly to deposits.

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- Interest earning assets consist of total gross outstanding balances of loans and other assets such as fixed income securities.
- Services income includes various fees and commissions charged by the Bank in respect of its products and services.
- Financial income relates to realized and unrealized gains and losses on assets measured at either fair value or through amortized costs.

The table below illustrates the Operational Risk capital charge calculation using the USMA method.

Table 10 – Operational Risk Capital Charge Calculation using the USMA Method

Factor	Sub-Factor	2019	2020	2021	Average
<b>Interest income, except for financial and operating lease</b>	Interest income form loans and advances	11,208,402	12,427,834	24,692,756	
	Interest income form assets held to maturity	1,063,237	2,484,191	2,922,206	
	Interest income form trading assets	-	2,441,385	8,060,444	
	Other interest income	68,269	86,677	184,894	
	<b>TOTAL</b>	<b>12,339,908</b>	<b>17,440,087</b>	<b>35,860,300</b>	<b>21,880,098</b>
<b>Interest expenses, except for financial and operating lease</b>	Interest expenses from deposits	8,644,721	10,005,694	22,382,890	13,677,768
<b>Interest earning assets (balance sheet item, not P&amp;L)</b>	Total gross outstanding loans, advances, and interest bearing securities (including government bonds) measured at the end of each financial year	111,940,379	157,141,292	304,177,065	191,086,245
<b>Dividend income</b>	Dividend income from investments in stocks and funds not consolidated in the bank's financial statements, including dividend income from non-consolidated subsidiaries, associates and joint ventures.	348,413	369,448	69,709	262,523
<b>Fee and commission income</b>	Income received from providing advice and services. Includes income received by the bank as an outsourcer of financial services.	2,466,552	4,419,139	9,843,556	5,576,416
<b>Fee and commission expenses</b>	Expenses paid for receiving advice and services. Includes outsourcing fees paid by the bank for the supply of financial services, but not outsourcing fees paid for the supply of non -financial services ( eg logistical, IT, human resources)	141,275	132,013	275,281	182,856
<b>Other operating income</b>	Income from ordinary banking operations not included in other BI items but of similar nature (income from operating lease s should be excluded )	-	-	-	-
<b>Other operating expenses</b>	Expenses and losses from ordinary banking operations not included in other BI items but of similar nature and from operational loss events (expenses from operating lease s should be excluded)	-	-	-	-
<b>Net profit (loss) on the trading and banking book</b>	Realized net profit/loss on trading assets and trading liabilities (derivatives, debt securitie, equity securities, loans and advances, short positions, other assets and liabilities)	86,189	121,863	866,091	
	Unrealized net profit/(loss) on trading assets and trading liabilities (derivatives, debt securities, equity securities, loans and advances, short positions, other assets and liabilities) measured at fair value or amortized cost through profit and loss	-	-	-	
	Net profit/loss from exchange differences	2,779,871	3,029,334	6,912,396	
	<b>TOTAL</b>	<b>2,866,060</b>	<b>3,151,197</b>	<b>7,778,487</b>	<b>4,598,581</b>
<b>Business Indicator (BI)</b>		<b>7,963,676</b>			
<b>Business Indicator Component (BIC)</b>		<b>955,641</b>			
<b>Operational Risk Capital Charge (m IRR)</b>		<b>955,641</b>			