

Central Bank of Iraq

Statistics & Research Dept.

Financial Market Research Division

Summery: Annual Report on Financial Stability in Iraq for 2014

The Central bank of Iraq performs its regulatory, supervisory and control role on banks and intermediary financial institutions to maintain a financial system based on market competition, achieving domestic prices stability, avail job opportunities, maintain low inflation rates, and ensure a smooth and active payment system, in addition to compile and classify statistics in order to follow up developments in the banking system and Iraqi economy for analytical and prudential purposes, the Central Bank also acts as the financial advisor to the government, apart from supporting and coordinating efforts for , anti-money laundry and combating terrorism financing, those activities aim at enhancing sustainable development and realizing prosperity in Iraq.

Accordingly, this report reviewed the most important developments occurring in the financial sector and its stability in Iraq during 2014 through two main objectives:

First: continue the supervisory control on banks and non banking financial institutions aiming at early diagnose of weaknesses in performance, risks and treat problems and violations faced

Second: provide a remedial system that strive to contain different types of crisis and accelerate procedures to prevent spreading over the financial and banking fields

The Central bank operates according to the legislative environment represented in the following laws and regulations as one of stability requirements:

- 1- Central Bank of Iraq Law No. 56 of 2004
- 2- Banking Law No. 94 of 2004
- 3- Investment Law No. 13 of 2006
- 4- Anti- Money Laundry Law No. 93 of 2004
- 5- Iraq Securities Market Law No. 74 of 2004
- 6- Companies Law No. 21 of 1997 amended
- 7- Public Companies Law No. 22 of 1997
- 8- Trade Law No. 30 of 1984
- 9- Instructions and regulations issued under the above mentioned Laws

We indicate below the most important indicators for financial stability for banks and the supportive institutions of the banking system operating in Iraq and the related departments in the Central Bank of Iraq:

- Banks Assets balance recorded 226.6 trillion IQD for 2014 rising at an amount of 8.5% compared with 2013 ,asset stock for state

owned banks maintained its lead at a rate of 90.3% of total assets for all banks, for relative importance for private banks amount to 9.7% in 2014, also government assets stock rose to 204.6 trillion IQD in an increase of 16.9 trillion IQD at a rate of increase 9.0% compared with 2013, in addition to the rise in assets stock for private banks to 22.0 trillion IQD at a rate of increase 4.3% compared with 2013.

- The total stock of deposits in the Iraqi banking system amounted to 74.1 trillion IQD accounting for 32.7% of total liabilities, this was due to the CBI efforts in realizing financial and monetary stability and create public confidence in operating banks apart from the rise in interest rates spread on deposits with the continued and notable increase in the number of bank branches to 1024 bank branch, so the bank density¹ for each bank is 29 thousand person, but it is still low compared with other countries, where it amounted to 6 branches for 10 thousand person in developed countries and it may be one bank branch for each ten thousand persons in some countries such as Lebanon

Growth affects banks capital positively in enhancing banking stability, for it increases financial leverage and enhances its ability to face risks, so banks' capital grew in Iraq from 7.7 trillion IQD in 2013 to 9.1 trillion IQD in 2014 but this increase is considered slight against big development projects, Raffidain bank capital did not reach 400 billion IQD, Rashid Bank to 300 billion IQD and specialized banks to 200 billion IQD implementing

¹ -population in Iraq 35.10million / source: Ministry of Planning /COSIT

the economic committee resolution in its letter No.341 dated 31/3/2008, where Raffidain bank capital is still 126billion IQD , Rashid Bank 50 billion IQD, and specialized banks 325billion IQD, whereas 24 private banks started raising their capital to reach the minimum requirement amounting to 250 billion IQD due to the inability of some banks to implement CBI circulation concerning the increase in their capital within three years as of 30/6/2010.

- Banking Companies (private banks) capital ratio and market value of their traded stocks in Iraq securities market to GDP, amounted to (1.9% , 1.8%)* which is a slight and low ratio and did not reach the maximum investment ratio amounted to 20% of Banks capital and their sound reserves determined by the CBI according to the provisions of article 33 of the banking Law, those indicators shows the deep financial weakness of the banking system
- The reserve requirement stock for banks operating in Iraq amounted to 10.5 trillion IQD at the end of 2014 compared to 2013 whose stock amounted to 9.6 trillion IQD, that is; an increase of 0.9 trillion IQD.
- Monetary credit extended by banks achieved an increase of 14% in 2014 to reach 34.1 trillion IQD.in 2013 distributed at a rate of 35.8% for services sector ,26% for building and construction sector, 14.3% for retail and wholesale sector, 6.3% for transportation, storage and communications,

- Iraqi Securities Market Annual report 2014 (p.70, p.71) issued by Iraq Stock Exchange

5.8% for manufacturing industries sector, 5.7% agriculture and fishing sector , 3.1% for insurance and finance sector,2.8% for water ,gas and electricity, 0.2% for external sector and mining sector, however those ratios are of slight influence over the required economic growth against large development projects that Iraq needs presently and in the near future

- Monetary credit ratio granted by private banks still does not exceed 21.1% of total monetary credit granted by all banks although their capital accounts compose 83.5% of total capital of all banks , on the contrary monetary credit granted by state-owned banks accounts for 78.9% of total monetary credit granted by all banks, although the capital of those banks accounts for 16.5% of total of all banks capital , this means that governmental banks still practices a risky policy in extending credit compared with their moderate capital and reserves .
- The hesitation of private banks in extending credit to meet economic sector needs is mostly due to the following :
 - 1- Weak credit rating of the borrowers' category characterized with moral hazard.
 - 2- Weak collaterals submitted against extended credit is a matter resulted from the effect of inflationary expectations or what is called market risk.
 - 3- Most banks , especially the private ones lack solvency that enable them to expand their credit activity in the light of deposit composition which are mostly short term for, total capital for all banks amount to 9.1 trillion IQD while Raffidain

bank attracts the largest stock of deposits , however capital adequacy for this bank is less than 12% where the stock deposit for state –owned banks amounts to 64.4 trillion IQD, 33.1 trillion of which is for Raffidain bank,17.3 trillion IQD for Rashid bank and the rest 14 trillion IQD for (Agricultural, Industrial, Real estate and Trade Bank of Iraq)while private banks got 9.7 trillion IQD of total deposit stock, their capital adequacy ratio is larger than twice the standard ratio of 12%.

4– Private banks as a whole are still hesitant in expanding their credit activity and prefer to proceed towards extending pledged credit larger than monetary credit which amounted to 12.8% of total pledged and monetary credit for all banks ,whereas monetary credit extended by those banks amounted to 8.5%,while monetary credit extended by state –owned banks amounted to 31.6% of total pledged and monetary credit for all banks , whereas pledged credit for state–owned banks amounted to 47.1%

5– Nonperforming debt stock amounted to (2,361.1) billion Iraqi dinar, 77.3% of which is for state owned banks amounting to (1,825.3) billion Iraqi Dinar, 22.7% for private banks at an amount of 535.8 billion Dinar.

6– Regarding capital adequacy ratio, we note that capital adequacy with State owned Banks, especially Raffidan Bank is lower than the ratio legal ratio amounting to at (12%), whereas it amounted to more than 60% in most of private banks because the latter reserves from extending credit that resulted

in high liquidity exceeding the standard ratio (30%) which indicate the existence of idle financial resources with no secure and sound credit and investment opportunities. Accordingly, state owned banks in granting credit according to high ratios referred to above, are considered risky banking institutions and exposed to moral hazard.

7- Total investments balance of banks in domestic investment tools amounted of 2014 (5.5) trillion dinar at (70.9%) for state banks and at (29.1%) for private banks which are moderate amounts compared to what those banks own of idle large resources.

Total foreign investments of all banks for the same year amounted to (1.6) trillion dinar (75%) of which is for state owned banks and (25%) for private banks.

Thus, the total of both (Iraq investments + foreign investments) recorded (7.1) trillion dinar, representing 2.7% of GDP (260.6) trillion dinar which is a small ratio when compared with the country's economic development requirements.

8- The Central Bank hoped through foreign partnerships, that banks that made partnerships would use technical and modern banking systems such as issue credit cards , use automated cash Machines , points of sale and develop other payment means, but partnership banks activities are still limited in this field and does not meet the level of ambition, also their

partnership with Iraqi banks capitals is still simple & does not correspond to the efforts and expectations of the CBI desired from this partnerships to develop the Iraqi Banking Sector.

9- The entry of Foreign Banks with the operating Iraqi banks now to meet the country's needs of Banking Institutions to cover all parts of Iraq after a study prepared in this Department indicated that banking intensity in 2007 amounted to one bank for each (75,000) person and improved in 2013 to be one bank for each (32000) person at a rate of improvement of (50%) due to the increasing number of branches opened by all banks, including foreign bank partnership, noting that the standard intensity is (one bank branch) for (10000) person.

10- In a step to catch up with the global technology developments, the private banks after 2003 including participating banks introduced professional banking system in their work such as (BANKS) system, (ORIENT) system as well as (SWIFT) system, (Western Union) system to ensure the confidentiality of the transfer and to avoid global hacking. In addition Banks participated in the unified system which is Automated Clearing House (ACH) for checks settlement in order to serve business sector as well as Automated Teller Machine (ATM) & Points-of -Sale (POS).

It's worth mentioning that the payment & settlement systems are closely linked with two main functions of the Monetary Authorities represented by:

- The achievement of Financial Stability (Banking Supervision)
- The achievement of Monetary Stability (Monetary Policy)

So, Monetary Policy is concerned with efficiency & safety of those systems in addition to their role as a user of payment system to settle open market operations or buying & selling operations of government bonds & treasury bills or any other payment operations.

Iraq owns one of the most advanced electronic payment systems in the world and is responsible for exchange of payment orders among banks electronically via an efficient and secure network. The Central Bank of Iraq (CBI) is the dominating party & operational manager to the system, as the owner of the system, CBI manages settlement accounts of the participants to ensure the safety and efficiency of payment systems and clearing operations. The CBI aims to reduce the use of cash in the country, IPS consists of the following:

- **Real Time Gross Settlement System (RTGS):** is the system which exchange payment orders among banks automatically via an efficient and secure network it ensures final and real settlement to payment orders exchanged by participants & on an ongoing basis during working day. The system activities provide replacing manual implementation of processes, so it ends risks arising from manual settlement among banks, since the CBI is the owner of the system, so it should take the responsibility of programs installation for participants onsite, also this system enables the CBI to monitor banks' accounts.
- **Automated Clearing House (ACH):** The system enables the participating banks and their branches to exchange payment orders automatically. The final settlement is processed and sent to

the Real Time Gross Settlement System (RTGS). Within this system the encoded checks are exchanged and the original copies of the checks are kept at the deposited branch electronically, then the copy of the check's data is sent to the withdrawn branch.

To study the reality of the banking system used in the state and private Iraqi banks and foreign banks branches operating in Iraq, financial market research division in the Statistics and Research Department conducted a questionnaire in 2004 which showed the following results:

- Most of Iraq private and foreign banks have comprehensive banking system except (Iraq Union Bank & Barcian Bank) that is; at ratio of (96.2%) of total states owned, private and foreign banks.
- As for State –owned banks ,Raffidain bank lacks (ATMs, credit cards and prepaid cards),however the bank contracted with B-Plan company to provide them with a comprehensive banking system since 2007 then discontinued in 2010 due to the insurgent incident that inflicted the bank in addition to technical difficulties that emerged during implementation, the company offered alternative solutions that are yet to be implemented ; the Ministry of Finance was addressed many times concerning the issue, except Trade bank of Iraq whose ATMs number increased to 72 machine at a rate of 10.77 % for 2004 compared with 65 machine for 2013. Raffidain bank used smart card to cash pension and social security net payrolls and some Ministries

through the points of sale in bank branches in the provinces amounting to 495 P.O.S also the number of Q card issued to customers amounted to 2,228,184 card, as for the rest of specialized governmental banks , they did not use the universal banking system ,for cooperative Agriculture bank did not initiate the implementation in the universal system consequently, it did not issue credit cards nor has an ATM because it is a specialized bank practicing its business in the area of Agricultural lending , as for real estate bank, it does not adopt any banking system nor have ATM machines or credit cards in its business given its activity of real estate lending area only .

We conclude that state-owned banks although taking the lead in the Iraqi banking sector in terms of assets and deposits, they do not use modern technology effectively compared with Trade bank of Iraq where it uses a universal banking system deploying 30 ATMs in Baghdad and 42 Machines in other provinces, apart from issuing 33,275 debit cards and 427 credit cards.

- Private Iraqi banks have 27 universal banking systems, the number of operative systems are 15 effective system, as for the rest 13 banks they have taken a number of steps to implement universal banking system, as for the others they have the systems but they are inoperative; noting that the number of banking services offered by all Iraqi banks is about 6-35 service, their revenues amounted to 642,856,955 thousand IQD as at

31/12/2014 excluding (Raffidain, Rashid banks and Trade Bank of Iraq)

- Iraqi banks have 485 ATM distributed to; 330 machine in Baghdad ,155 machine in the other provinces, for Al Warkaa Bank has 186 Machine followed by Trade Bank of Iraq 72 Machine ,Baghdad bank 43, then Middle East Bank 42, Gulf Commercial Bank 28, Al Bilad Islamic Bank 20 , as for the remaining Banks, 5–15ATM.

- With respect to foreign bank branches operating in Iraq which are 16 branch they have a comprehensive banking system, (except Parisian bank), they issue debit and credit cards about 5268–3549 card respectively, also the number of domestic private banks, state–owned and foreign bank branches operating in Iraq that are using automated banking system is 43 bank out of 53 bank for 2014.

- Those systems helped in developing banking business in many aspects including the speed in delivering services, accuracy in preparing financial data ,facilitate internal control and comprehensive oversight performed by the Central Bank of Iraq including monitoring suspicious funds and combat terrorism financing .

- In the area of providing the required financing for economic sectors, Iraqi economy depended on oil revenues. As a result to the continued fluctuations in those revenues and the deterioration in tourism revenues due to the events Iraq witnessed after 2003 , Iraq started to adopt monetary and financial policies aiming at not only accommodation with lower levels of revenues but strive to rationalize consumer spending ,the optimal use of resources ,encourage the private sector by giving it a greater role in economic activity ,establish plans and programs to increase the number of financial institutions ,develop their business through working on, developing rules , basis and financial market laws, such as Iraqi Securities Market ,by developing a law for capital market due to its role in creating job opportunities and deliver different financial services through the Iraqi financial market which is considered newly established compared with International financial markets .

- In recent years ,Iraq has given an increasing importance to the development and improvement of financial market by preparing and reforming legal environment ,Capital movement liberation , the implementation of disclosure and transparency principal , and according to the role played by this market in mobilizing savings and channeling it to available investment areas , provide financing and different services that help in developing financial market in particular and national economy in general . The financial market include the following institutions :

- 1– Banks and their branches
- 2– Iraqi Insurance companies both governmental and private
- 3– Postal saving Fund
- 4– Securities Commission
- 5– Iraq Stock Exchange
- 6– Exchange Companies
- 7– Financial transfer Companies
- 8– Financial Investment Companies
- 9– Pension Funds
- 10– Companies for Small & Medium Loans
 - Iraqi Company for Bank Guarantees
 - Iraqi Company for Financing SMEs
- 11– Iraq Depository Center
- 12– Global Smart Card Company
- 13– Electronic Banking Funds Services Company
- 14– There are smaller institutions that include Zakat Funds , Funds for care of Minors, and Iraqi Company for currency Transport
- 15– There are other Banking System Supportive institutions which include :
 - Association of Iraqi private Banks
 - Banking Training Center in Commercial Gulf Bank
 - In the area of implementing Anti Money Laundry Law No.93 of 2004 The Central Bank of Iraq through the Anti– Money Laundry Reporting Office, addressed letters and circulations to Banks and financial Companies urging them to comply with all instructions issued from this Bank according to its Law No.56 of 2004 and

submit analytical statements twice a month concerning transfers operations.

The Central bank of Iraq is significantly interested in Anti-money laundry and terrorist financing issue consistent with what international central banks and supervisory authorities including the United Nations UN, International Monetary Fund IMF, World Bank WB and Interpol supported by International Financial Task Force group FATF in addition to the efforts of biggest industrial countries in the world to implement international resolutions, standards and procedures to face Anti-money Laundry phenomenon to ensure the combat effectiveness, eliminate the risk of those funds off domestic banks, avoid international sanctions taken against countries that are in cooperative with the international community in combating this dangerous phenomenon through the compliance of their banks and supervisory authorities, with all international resolutions and standards, adopt banking policies that serve in realizing this objective by finding effective internal control systems, choosing sound customers and exchange information and reports in addition to developing joint efforts with the related parties.