



12. Private Financial and Banking Sector

Summary

This section essentially outlines reforming the financial and banking sector's legal and legislative frameworks (legislative authority), as well as the regulations and legal procedures (executive authority), so that this sector is able to conduct its activities in a manner that is open to the global banking system and regional and international capital markets, and so that it may deal with them competently to achieve stability and continuous growth.

The important role that financial and banking institutions play, and the need to provide the best banking services, requires adopting principles of transparency, disclosure, good governance, and flow of comprehensive socioeconomic and political information, in order for the financial and banking institutions to conduct real reform in the financial and banking sector in the region.

The financial and banking sector also suffers from low confidence in local banking services because of a few weaknesses. One is the weak banking performance and the absence of strategies in the management of different governmental banks. Others include the dearth of insurance services and lacking corporate governance in the banking sector. Furthermore, many overlapping laws obstruct the development of different aspects of banking and financial activity.

At another level, this section aims to pave the road to advancing the private banking sector, setting up a promising stock exchange in the region, and establishing insurance and re-insurance companies. This requires legislative and legal reform, and sizable governmental and institutional efforts.

Introduction

The goal behind [legislative and institutional reform](#) in today's world is to develop and restructure banking and financial institutions. This stems from the fact that these institutions constitute one of the most important pillars for sustainable and institutional development in several other economic sectors. They also constitute the engine for activating financial and monetary policies and investment laws on direct and indirect foreign investment. Defects and shortcomings in basic banking operations cause critical situations and problems that many banks in the world have faced, and which led to the establishment of international bank's rating institutions that operate in accordance with international agreements. Agreements were also signed on hedging standards, reflecting widespread international concern over the performance of banks because of the important role they play in international economic and financial relations, and which necessitates developing this performance measure in order to ensure that their services keep abreast with worldwide development.

It is not possible to radically restructure banks without the collaboration of the Ministry of Finance, the Central Bank, and other banks and financial and investment institutions, and without efficient governmental support. This enables banks to conduct business in an open manner before the global banking system and the regional and international capital markets, and it enables banks to deal with them competently to achieve stability and continuous growth.

[Legal reform](#) is the solid foundation of the economic activity of any society. Embarking on reform requires effective laws that are harmonious with the particular surroundings,

and that work harmoniously together to achieve their final goal—namely serving the society and regulating relations at the individual and institutional levels. These must also be compliant with international laws, since the world today is integrated and interconnected with foreign, regional, and international environments. Hence, it is necessary to emphasize the application of principles of transparency, disclosure, and the comprehensive flow of socioeconomic and political information in order to be capable of achieving real reform in any sector.

The overlapping of financial laws and the numerous authorities behind them are among the most significant factors that obstruct development at all levels. (There are several examples on overlapping laws issued in 2003 and 2004, despite their attempts to comply with international standards and laws and the consequent urgent need to restructure financial institutions that had been neglected for decades.)

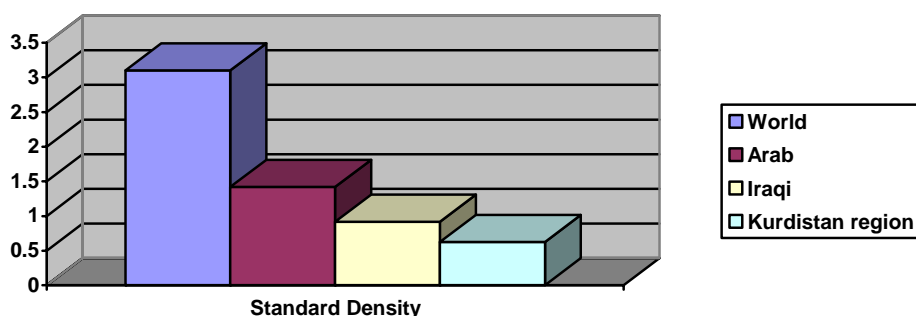
Characteristics of the Financial and Banking Sector in the Kurdistan Region

Lack of confidence in local banking services:

- The progress in banking awareness is directly related to the citizens' need for fast and competent banking services. If the business practices of banks are encouraging, then such awareness will gradually increase. The extremely slow progress in this process indicates the need for further efforts to achieve this goal. Many citizens recall previous problems they had faced with local banks that make them prefer (whether intentionally or out of ignorance of the current quality improvement in the local banking sector) to deal with other banks outside of Iraq.
- All banking services provided to citizens of Kurdistan became paralyzed in 1992, and for a long period after, during which an awkward situation prevailed where the Iraqi currency used for transactions in the region was of a print called the "Swiss dinar," while all other Iraqi provinces used the Iraqi-minted dinar in their transactions. This situation had a negative impact on the life of citizens in the region, before all Iraqi currencies were cancelled and withdrawn during the rule of the U.S. Governor Paul Bremer. All banking services ceased during that period, which lasted for almost fifteen years, and citizens were dependent on private sector money exchangers (particularly for transfers between the region and abroad, changing local currency with other currencies, especially the U.S. dollar). Citizens in the region experienced loss from expired currency because the Central Bank stopped exchanging expired currencies. Moreover, citizens suffered losses resulting from the decision to cancel the 25-dinar "Swiss" banknote.

Weak Banking Performance

The banking performance is weak and well below international standards, as revealed by indicators of banking density, such as the rate of banks to population. This requires accelerating the process of horizontal expansion of banking services to include all strata of society (see the chart below) and moving away from the search for large operations that bring easy profits. Providing services to public employees, mall customers, and retail traders constitutes an important stage in the development of banking, as it helps gain the trust of citizens from all social groups. This also serves as the introduction that opens the door for making profits in the near future.



The banking density indicator shows that the Kurdistan region's rate of deviation from the international level is almost 1/5.

Absence of Governmental Strategies to Deal with the Underdeveloped Governmental Banks

These banks continue to provide a poor level of general banking services, and they are not keen on detailed plans that can improve their performance, such as restructuring or the privatization of public sector banks.

Weak Insurance Services in the Region

There is an absence of the legal framework and practical incentives for establishing insurance companies for deposits and loans in order to protect depositors, banks, and investors. There has been no tangible progress in this direction since 1992.

Absence of a Clear Plan to Set up a Stock Exchange in the Region

Although the stock exchange constitutes a fundamental pillar to develop the investment environment and implement the new Investment Law in Kurdistan, and despite its crucial role in complementing financial institutions through transforming shares and bonds into cash in a fast and low-cost manner, this vital market is still absent from the region. This constitutes one reason for the slow money cycle and is an obstruction to investment opportunities.

Weak Advanced Financial Services in the Region

Banks have not embarked on the establishment of investment funds, insurance companies, performance rating companies, capital management companies, or other financial institutions that contribute to enriching the financial environment and provide a complementary package of interconnected financial services that push the economy toward continuous growth.

Poor Performance of the Sectors that Support the Financial Sector

The small and medium enterprise (SMEs) sector plays an essential role in modernizing and developing the financial sector, and it is a basic developmental tool that adds to the GNP in countries worldwide. Hence, various governments are concerned with business sectors such as tourism, agriculture, industry, mining, and other sectors since these constitute strategic options for diversifying sources of income and creating local job opportunities. In turn, these efforts

minimize a bank's risks in financing such projects. Hence, banks may take the lead in developing investment all over the region.

Poor Banking Corporate Governance

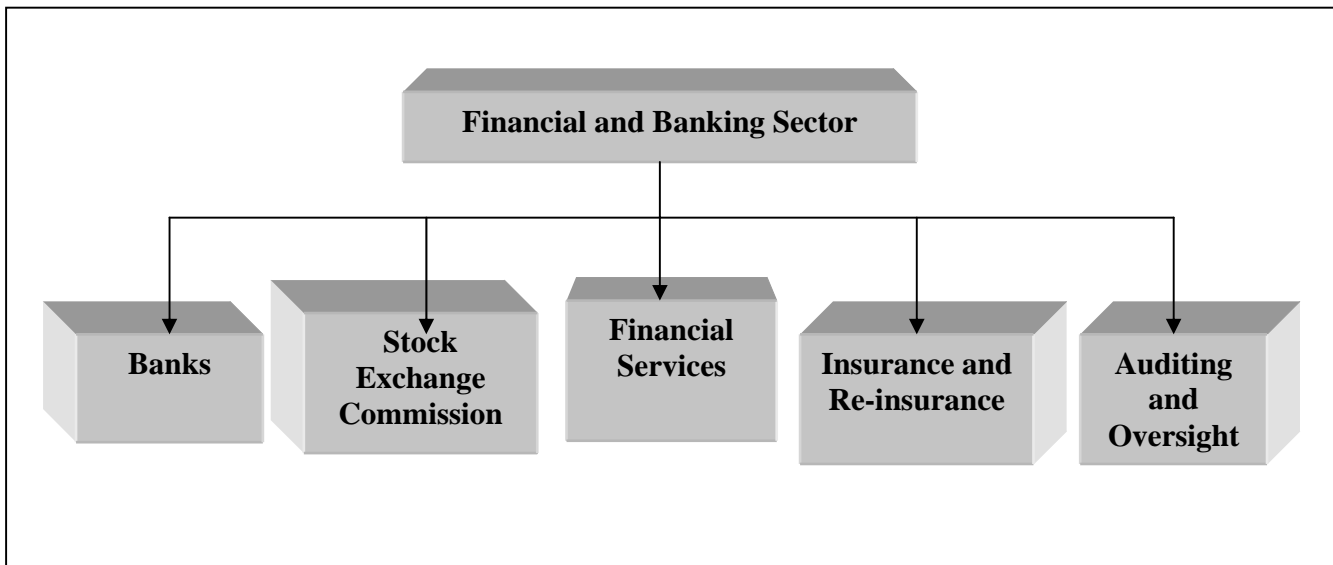
There is an absence of any effective oversight related to the principles of corporate governance in publicly traded banks such as the separation of management from ownership and the restricting of the aim to fulfill narrow (or family) interests. This leads to poor performance and a lack of transparency in banking.

Methodology

Major Partners

1. Private banks operating in the region
2. Chambers of Commerce (Erbil, Suleimaniya, Dohouk)
3. Businessmen's associations and unions in Kurdistan
4. Kurdistan Economists Union
5. Several prominent businessmen
6. Experts for the banking and financial sector

Classification of the Financial and Banking Sector



Problems and Proposed Solutions

Banks and Insurance Companies/The Role of the Central Bank

Problems	Proposed Solutions
1. Overlapping banking and financial legislation (Capital Markets Law, Companies Law, and Banks Law)	1. The need for financial legislative reform to identify the jurisdictions and define the mandates and applications on private sector institutions.

	<p><u>Stakeholders:</u> Council of Ministers Ministry of Finance</p>
2. Private financial institutions are not obliged to comply with the legally binding principles of transparency and disclosure, which weakens investors' confidence in their institutions.	<p>2. Obligate private sector institutions to apply the legally binding principles of transparency and disclosure.</p> <p><u>Stakeholders:</u> Central Bank, Hareem Branch</p>
3. Lack of interest of the Central Bank in issuing digital analysis indicators for evaluations of banks.	<p>3. The Central Bank must embark on issuing digital analysis indicators for bank evaluation ratings.</p> <p><u>Stakeholders:</u> Central Bank, Hareem Branch</p>
4. Poor general performance of the banking sector because of weak adoption of modern technology-based operations systems.	<p>4. Obliging banks to adopt modern technology systems within a specific period in order to face future competition challenges, as Iraq is on its way to signing free trade agreements.</p> <p><u>Stakeholders:</u> Central Bank, Hareem Branch</p>
5. The Central Bank, Hareem Branch, has no role or clear plan to participate in the Payment System Project, which is one of the most important systems to improve bank operations and reduce the movement of currency and accompanying risks.	<p>5. The Central Bank, Hareem Branch, must adopt a plan for participating in the Payment System Project.</p> <p><u>Stakeholders:</u> Central Bank, Hareem Branch</p>
6. The Central Bank, Hareem Branch, has no role or clear plan to implement the Central Clearinghouse Project for banks of the region, nor for the long-awaited e-Clearinghouse Project.	<p>6. Start setting up a location for a central clearinghouse for all banks in the region as soon as possible</p> <p><u>Stakeholders:</u> Central Bank, Hareem Branch</p>
<p>7. Depriving staff at private banking and financial institutions of available training opportunities at local, regional, and international training institutions.</p> <ul style="list-style-type: none"> • Few international development projects implemented in Iraq or in the region have invested in developing the banking sector, such as the National 	<p>7. Proposed solutions:</p> <ul style="list-style-type: none"> • Include private financial and banking institutions in opportunities that international and regional institutions provide for the Iraqi government and the region's government in order to partake in courses inside and outside the region and Iraq. • Benefit from international training projects by listing banking training

Capacity Development (NCD) program.	courses in their training agenda. <u>Stakeholders:</u> Ministry of Planning Central Bank, Hareem Branch
8. Neither the Central Bank of Iraq nor the Central Bank, Hareem Branch, play any role in applying international accounting standards at banks or in preparing the compliance officers in accordance with the Central Bank Law and Basel decisions on minimizing risk.	8. Start formulating a plan, in cooperation with the Central Bank of Iraq, to train a workforce capable of advancing bank operations towards legally binding standard accounting systems. The same should apply to the post of compliance officer, an extremely important task that minimizes risk in banking operations. <u>Stakeholders:</u> The Central Bank of Iraq Central Bank, Hareem Branch
9. Poor corporate governance at banks in the region.	9. Governmental supervision institutions, in cooperation with the Organization for Economic Cooperation and Development (OECD), which is taking the lead in this international effort, must strike a balance between the recent decisions and principles of the Basel Committee and the international principles of corporate governance in order to improve corporate governance at banks in the region. <u>Stakeholders:</u> Central Bank, Hareem Branch
10. Weak confidence in local banking services and a growing culture among the public to refrain from dealing with banks.	10. The state must seriously contribute to initiatives that aim to restore trust in the banking system and its services, and it must exert effort to inform citizens of the progress of banking services, stressing the level of competence and security it has acquired. <u>Stakeholders:</u> Council of Ministers Central Bank of Iraq
11. The Central Bank of Iraq and the Central Bank, Hareem Branch, have not played any role in supporting private Iraqi banks compared to the support that the Iraqi Commercial Bank receives. This bank	11. Support and strengthen banks of the Region to acquire the right to issue letters of credit and governmental letters of guarantee, most of which are undertaken by the Iraqi Commercial Bank, although local

<p>was established in order to develop banking in Iraq, but has taken all governmental allocations without playing an actual role in supporting and developing local banks.</p>	<p>banks have the capabilities to provide such services.</p> <p><u>Stakeholders:</u> Council of Ministers The Central Bank of Iraq Central Bank, Hareem Branch</p>
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Stock Commission and Stock Exchange

<p>1. Principal parties have not formed a founding committee to establish a stock exchange. (The public sector institutions mentioned to the right, in addition to banks and private sector companies.)</p>	<p>1. Form a founding committee for a stock exchange in Kurdistan.</p> <p><u>Stakeholders:</u> Council of Ministers Ministry of Finance Ministry of Planning Ministry of Trade Central Bank, Hareem Branch</p>
<p>2. The absence of a committee that examines the relation with the Iraqi Deposit Center, which is in charge of finances and letters of credit settlements with any stock exchange in the region.</p>	<p>2. Form a commission that is in charge of defining procedures for any form of financial settlements in terms of stock, currency, or mineral trading in order to guarantee the rights of all parties conducting transaction in the region, Iraq, and abroad.</p> <p><u>Stakeholders:</u> Council of Ministers Federal Stock Exchange Commission Central Bank of Iraq Central Bank, Hareem Branch</p>
<p>3. The absence of a committee to promote the formation of shareholding companies, which would play a role in attracting foreign and local capital in preparation for globalization challenges and free trade agreements.</p>	<p>3. Form a committee to encourage the private sector to establish shareholding companies, or to convert private companies into shareholding companies, in order to prepare the business environment for an economy of large companies.</p> <p><u>Stakeholders:</u> Council of Ministers Ministry of Finance Ministry of Planning Ministry of Trade</p>
<p>4. The urgent need for moving toward institutional frameworks in order to</p>	<p>4. Build clear institutional frameworks, adopting the principle of a “one-stop</p>

minimize personal influence on investment opportunities in financial and other sectors.	investment shop” for projects in order to inform investors of their rights in a clear and specific manner and grant them legal protection. <u>Stakeholders:</u> Council of Ministers Investment Commission Ministry of Finance Ministry of Planning
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Audit Bureau

Problems	Proposed Solutions
1. The Audit Bureau does not play a clear role in developing standard accounting systems and international audit principles.	1. The Audit Bureau must play a clear role in developing standard accounting systems and international audit principles and in training accountants in the region. <u>Stakeholders:</u> Board of Financial Audit
2. The lack of desire to develop principles of accounting for insurance companies, Islamic banking systems, and other modern financial systems.	2. Develop accounting systems for insurance companies, Islamic banking, and other financial services that are spreading all over the world and making large profits for their proprietors. <u>Stakeholders:</u> Board of Financial Audit Central Bank, Hareem Branch

Challenges and Aspirations

Challenges

1. Absence of clear future governmental strategies regarding governmental banks.
2. The tremendous technological progress and the increasing competitiveness of financial and banking institutions in the world juxtaposed with the deterioration of financial services and technical capacity in the region, thus reducing the competitiveness of local institutions during times of rapid change. This may strongly reverse the competitive edge in favor of foreign enterprises.

Aspirations

1. Formulate a clear strategy to rescue and restructure governmental banks and make courageous privatization decisions, enabling them to present the best possible services based on competition, which these banks have not had to operate within for some time.
2. Encourage banks and investment companies to offer innovative and advanced investment tools in the capital markets, such as options, fixed terms, and futures in order to bolster investment portfolio management companies. This can be achieved through an integrated strategic vision that adopts the development of competitiveness of different sectors in the region—first and foremost the financial and banking sector.

Principal Parties:

- Council of Ministers
- Central Bank, Hareem Branch
- Ministry of Finance

Challenges–Stock Exchange

The challenge lies in the slow pace of establishing a modern stock exchange in the region, which would present financing opportunities and attract global investment. This delay will have a grave negative impact on the future of economic activity in the region.

Aspirations–Stock Exchange

Set up an effective, modern stock exchange to serve private sector development and competition in the region and contribute to building a close-knit system of businesses and investments in the region, and one that is linked to global capital markets. Founders must, however, avoid the mistakes of others, such as the legislative and technical problems suffered by the Iraqi Stock Exchange.

Principal Parties:

- Regional government

Challenges–Audit Bureau

There is an absence of a constructive vision for evaluating the performance of institutions. Traditional evaluation methods are adopted instead, thus restricting the positive

impact on desired progress. This is in addition to the deteriorating quality of the Bureau's output and a scarcity of training on modern evaluation and auditing techniques.

Aspirations–Audit Bureau

Following are a number of aspirations:

- Conduct a comprehensive and radical review of evaluation and audit controls.
- Encourage private sector companies to participate in establishing auditing and evaluation companies, provided they are committed to accelerate, modernize, and automate operations.
- Focus on the importance of acquiring relevant ISO certifications.
- Provide training and educational opportunities to specialists in order for them to acquire advanced knowledge that contributes to upgrading the levels of auditing and performance evaluation.

Principal Parties:

- Investment Commission
- Audit Bureau