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AN OVERVIEW OF THE IRAQI BANKING SYSTEM



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Introduction

This paper provides an overview of the banking system in the Republic of Iraq. It begins with a brief history of the modern banking industry. This is followed by a discussion of the current status of both the private banks and state-owned banks. The regulation and supervision of the industry are also discussed, including the role of the Central Bank of Iraq (CBI).

The banking industry is currently dominated by the seven state-owned banks in Iraq. They include the two largest commercial banks, Rafidain and Rasheed. In addition, there are five other state-owned banks: Real Estate Bank, Agricultural Bank, Industrial Bank, Iraq Bank, and the Trade Bank of Iraq. Collectively, the state owned banks control over 90% of the total banking assets in Iraq.

Unless otherwise cited, financial information in this report was obtained from CBI's Research and Statistics Department and from annual reports for individual banks for the year ending December 31, 2005.¹ Generally, the financial information evaluated in this report is limited to balance sheet entries. Due to uncertain income-recognition standards and a lack of sufficient disclosure regarding asset quality, it is difficult to assess with any degree of certainty income statement entries. Moreover, the integrity of financial information reported by the banking industry is affected by nearly all banks claiming to be profitable, the inadequacy of loan loss provisions, and insufficient reserves against volatile investment portfolios in a market that has been in steady decline.² Additional factors that affect the reliability of financial information reported by banks include decentralization of accounting functions within the banks, manual preparation of documents, lack of automation, and lack of management information systems.

¹ Annual reports for 2006 have not yet been released. We were able to obtain annual reports for most of the operating private banks. Of these, Ashour Bank, Kurdistan Bank, Dijlah wal Furat Bank (Tigris and Euphrates Bank) and Mansour Bank had not completed a year of operations at the time this paper was written, and Dar as-Salaam and Commercial Banks had yet to finalize annual reports for 2005.

² The Iraq Stock Exchange (ISX) reports a fall in index prices from nearly 20.0 in September 2003, to around 5.0 in October 2006. Average volume traded has fallen from around 5.5 billion shares to 1 billion in the same period. (As many shares are priced at ID 1, equivalent to \$.000685, the actual amounts being traded are relatively small.) Source: ISX website, <http://www.isx-iq.net/>

History and Current Status of the Banking Industry

Rafidain Bank was founded in 1941 as a private bank established by a member of the prominent Chalabi family. By the early 1960s, the following banks with foreign ties were represented in Baghdad: Ottoman Bank, Eastern Bank (British-owned), the British Bank of the Middle East; Federal Bank of Lebanon, National Bank of Pakistan, Arab Bank, Ltd., and Intra Bank (Lebanon). Iraqi banks operating then were Rafidain, Commercial Bank, Credit Bank and Bank of Baghdad.

In 1964, during a wave of nationalizations under the first Ba'ath regime, banks were seized and merged into four groups operated by Rafidain, Commercial, Bank of Baghdad, and Credit Bank. In 1970, a further consolidation took place, with banks merged into either Rafidain or Commercial. In 1974, the Commercial group was placed under the Rafidain banner, leaving the country with one state-owned bank. On January 1, 1989, Rashid Bank was spun off from Rafidain (and encumbered with most of the latter's non-performing assets).

Following the first Gulf War, the government once again sanctioned the establishment of private banks. Prominent industrialists and trading families took advantage of this relative liberalization of the financial sector, and established banks whose *raison d'être* was financing endeavors associated with the founders' core lines of business. While direct lending to Board of Directors members is controlled by the CBI (prior approval must be granted), associated companies and firms may be assumed to account for a substantial proportion of the private banks' portfolios.

Nevertheless, there are banks that are actively engaged in supporting small enterprises – primarily traders. Examples are the Economy Bank, which has its head office in a market or *suq* just north of the Bab al-Sharjah Square, and the Basrah Private Bank, with its head office in Karrada but with a branch office abutting Sadr City (formerly Saddam City) and another branch in the Sheikh Omar area of the city, a district dotted with small workshops that make up this branch's customer base. Even the relatively large Bank of Baghdad claims to extend many small credits in the several hundred dollars range, and to have a very diversified portfolio.

Indeed, the impetus for establishment of these banks – aside from serving as funding arms for family enterprises of prominent shareholders – was an attempt to reach some of the vast majority of small businesses in Iraq not associated with the prior regime. The state-owned banks alone were allowed to lend to state-owned enterprises, and such lending explains the preponderance of government risk on their books. The private banks were in general well capitalized at the time: the prevailing exchange rate pre-war (officially imposed) was \$3.20 to the Iraqi dinar. For example, with the exchange rate in 2004 at about ID2,000 = 1US\$, a bank with capital of ID 500,000,000 – once worth \$1,600,000,000 – would find itself with a net worth of only \$250,000.³ Accordingly, the Coalition Provisional Authority (CPA) Ministry of Economic Development charged the private banks with raising their capital to the equivalent of \$5,000,000 within 18 months – ID 10,000,000,000 at the prevailing exchange

³ This is based on the exchange rate prevailing in 2004. The current rate is 1 USD = ID 1,277.

rate. By financial statement date 2005, almost all of the private banks had met the new capital requirement.

The effects of the second Gulf War on the banks were devastating for state-owned and private banks alike. State-owned banks suffered most: Rafidain lost an estimated \$300,000,000 to looters and its head office and many branches were completely looted and burned. Currency losses at Rashid totaled ID 138 billion, equivalent to \$69,000,000. A large number of the private banks transferred their banknotes to the Central Bank's vaults before the war, thus avoiding the heavy losses that characterized the two large state-owned commercial banks.

In addition to stolen banknotes and looted premises, of course, was the damage sustained by banking industry customers, and by extension to the banks' loan portfolios. It may be safely assumed that a large proportion of loans on the books of the entire system after the war were non-performing. Banks made efforts to help customers recover by restructuring and rescheduling amounts past due. As there was not a classification and reserve policy in effect in Iraq (a Basel-compliant policy was promulgated by the CBI in July 2006), it was difficult to quantify the amount of arrears or accurately assess the degree of lending portfolio weakness in post-war Iraq. (For more on this topic, see "Regulatory Environment," below.)

Fortunately for the private banks, they were prohibited from lending to public sector companies. Such lending was the exclusive domain of the state-owned banks, and the damage sustained by state-owned enterprises (SOEs) due to post-war looting, coupled with the questionable economic viability of many of them, meant that public sector debt on the books of Rafidain and Rashid was virtually all non-performing. Indeed, the CPA stripped from the books of these two banks' all assets and liabilities associated with SOEs.

Paradoxically, while the banking system as a whole was essentially insolvent (non-performing assets meant that the banks probably could not meet normal depositor withdrawal demands in the immediate post-war period), system liquidity was high. Insecurity associated with the war and its aftermath occasioned a tremendous growth in bank deposits. The system remains awash in liquidity from new deposit accounts, a substantial amount of which is left on deposit with the CBI.

Communications within the country devastated by the war are slowly being restored. Communication between branches is now possible using mobile phone technology. A nationwide payment system at the CBI went on-line in late 2006, but due to communication and other difficulties, has processed only 1,000 transactions since its implementation (versus a volume of 6,000 transactions per banking day). Modernization of IT systems has been initiated in a number of the banks but a great deal still needs to be done.

Services offered by Iraqi commercial banks include current accounts, savings accounts and time deposits, short-term overdraft and bills discounted facilities, as well as short-term loans and advances. Banks also offer bid, advance payment, and performance bonds (but the maximum tenor is 12 months). A few banks offer loans over one year in tenor.

However, even banks engaged in medium-term financing do so on a "roll-over" basis. There is no medium-term funding available in the market; thus, rates must be reset on an annual basis.

The CBI does not encourage consumer finance (some bankers have indicated that it is prohibited). Traditional real estate lending is confined to the Real Estate Bank, although most banks seek to collateralize loans with real estate worth several times the loan amount.

Legal and Regulatory Environment

A modern legislative framework for banking is provided by the three main laws affecting banking:

1. The Central Bank of Iraq Law No. 56 of 2004
2. The Banking Law No. 94 of 2004
3. The Anti-Money Laundering Law No. 93 of 2004

In addition to these three laws, a number of banking regulations, instructions, letters, and guidelines have been issued by the CBI.

The CBI Law

The *Central Bank of Iraq Law* was promulgated on March 6, 2004.⁴ Principal 1 of the *Core Principals for Effective Banking Supervision*, developed by the Basel Committee on Banking Supervision⁵, provides that an effective banking authority shall be autonomous, possess operational independence, transparent processes, sound governance and adequate resources, and be accountable for the discharge of its duties. The CBI Law fully complies with this principal, providing that the CBI is autonomous and shall not take instructions from any other person or entity, including government entities. "The autonomy of the CBI shall be respected and no person or entity shall seek improperly to influence any member of a decision-making body of the CBI in the discharge of his duties towards the CBI or to interfere in the activities of the CBI."⁶

Objectives of the CBI

"The primary objectives of the CBI shall be to achieve and maintain domestic price stability and to foster and maintain a stable and competitive market-based financial system. Subject to these objectives, the CBI shall also promote sustainable growth, employment, and prosperity in Iraq."⁷

Monetary Functions

The CBI may perform open market operations with commercial banks, make loans secured by collateral, accept interest-bearing deposits from banks, impose reserve requirements at a rate established by the CBI, and act as lender of last resort.⁸

Managing Foreign Reserves

The CBI may conduct transactions in foreign assets and manage all official foreign reserves. Its Board may invest these reserves in monetary gold, banknotes and coins in foreign currencies, credit balances in foreign currencies, special drawing rights and the reserve

⁴ The CBI was originally established under the *Central Bank of Iraq Law*, Law No. 64 of 1976.

⁵ Basel Committee on Banking Supervision, *Core Principals for Effective Banking Supervision*, October 2006.

⁶ *CBI Law*, Article 2.

⁷ *Id.*, Article 3.

⁸ *Id.*, Articles 28 to 30.

position of Iraq in the IMF, and readily marketable debt securities issued by foreign governments.⁹

Relations with the Government

The CBI may act as the banker and fiscal agent for the Government of Iraq (GOI), and is to be remunerated for these services on a cost recovery basis. The CBI may not lend, directly or indirectly, to the GOI, but may lend to state-owned commercial banks on the same terms as it would extend to private commercial banks.¹⁰

Currency

The CBI has the exclusive right to issue Iraqi dinars and monetary coins in Iraq. The CBI arranges for the printing of banknotes and minting of coins and the removal of unfit notes and coins from circulation.¹¹

Payment Systems

The CBI may establish and maintain systems for clearing and settlement of payment transactions and may regulate and supervise payment systems operated by others. It may also facilitate new methods for payments¹² and design a plan for the evolution of the national payment systems in Iraq.

Bank Supervision

The CBI has exclusive authority to license, regulate, and supervise banks and their subsidiaries, to examine banks and their subsidiaries, to require banks and their subsidiaries to submit information as the CBI directs, and to enforce CBI guidelines and directives. The CBI may also adopt regulations after notice and an opportunity to comment.¹³

MFIs and NBFIs

Article 4(2) of the CBI Law provides that the CBI may take “whatever action it deems necessary to . . . regulate and supervise lending companies, microfinance companies, and any other non-bank financial institutions not otherwise regulated under Iraqi law”.

Governance

The CBI is governed by a Board comprised of the Governor, two Deputy Governors, three Senior Managers, and three individuals with suitable expertise not employed by the CBI in any capacity.¹⁴

Criminal Offenses

The CBI Law contains a number of criminal provisions related to counterfeiting, possessing, and uttering counterfeit currency and coins. Penalties include monetary fines and

⁹ *Id.*, Article 27.

¹⁰ *Id.*, Articles 25 and 26.

¹¹ *Id.*, Articles 31 to 38.

¹² *Id.*, Article 39.

¹³ *Id.*, Article 40.

¹⁴ *Id.*, Articles 10 to 20.

imprisonment. In addition, the CBI is authorized to enforce compliance with the CBI law, the Banking Law, and its own regulations and orders through administrative penalties.¹⁵

Financial Services Tribunal

The CBI Law establishes a Financial Services Tribunal empowered to review decisions and orders of the CBI, including actions taken by a bank conservator or receiver under the Banking Law. The Tribunal is not authorized to review CBI decisions or actions concerning monetary policy and exchange rate policy. The Tribunal is comprised of one or more panels of judges appointed by the Minister of Justice.¹⁶

¹⁵ *Id.*, Articles 49 to 62.

¹⁶ *Id.*, Articles 63 to 70.

State-Owned Banks

Six state-owned banks operated prior to the second Gulf War: Rafidain Bank, Rashid Bank, Agricultural Bank, Industrial Bank, Real Estate Bank, and Iraq Bank (formerly Socialist Bank). All are functioning once again to a greater or lesser extent. The seventh state-owned bank, the Trade Bank of Iraq, was organized in 2004 with a purpose of issuing international letters of credit and commitment, which the other banks could not issue because of the risk imposed by international sanctions and defaulted state obligations.

Rafidain Bank and Rashid Banks dominate the Iraqi banking sector, accounting for over 80% of the banking system's assets. When the other four specialized banks are added, the figure rises to more than 90%. Rafidain's total assets as of late 2003 were estimated to be \$1.03 billion, while Rashid's assets totaled \$750 million.¹⁷

The four specialized banks were heavily involved in state-owned enterprises and in regime-related lending activities, although they were authorized in 1997 to engage in general commercial banking activities. Only Rafidain and Rashid made commercial loans to a wide range of enterprises.

Rafidain and Rashid possess large, nation-wide branch systems (153 and 170 branches respectively) and are in many locations the only banks available to Iraqis. By comparison, the private banks total 175 branches among them. Indeed, the state-owned banks provide vital banking services in many areas where the private banks do not operate: the private banks tend to be concentrated in Baghdad and the larger cities.

Agricultural Bank was founded in 1936 and traditionally has lent to private sector agriculturalists. The bank has 40 branches. Total assets in 2003 amounted to \$52.8 million.

Industrial Bank was split off from the Agricultural Bank in 1940. Clients are both SOEs and private-sector companies. The bank has nine branches. Assets as of late 2003 totaled \$34.7 million.

Real Estate Bank was established in 1949 to provide housing construction finance and finance for the tourist industry. The bank has 25 branches, and total assets of \$10 million.

Iraq Bank (formerly Socialist Bank) was founded in 1991, and is the smallest of the state-owned banks. It has four branches and total assets of \$8.4 million as of 2003.

¹⁷ Total asset figures as quoted in "Working Paper, Iraq – United Nations/World Bank Joint Needs Assessment," October 2003.

PRIVATE BANKS

As of October 2006, there were approximately twenty-five private banks licensed by the Central Bank in the Republic of Iraq, with twenty-three in operation. This compares to late 2003, when there were eighteen private banks licensed and operating, most of them having opened their doors in the early 1990s.

After the second Gulf War, the expectation was that, as the situation in Iraq stabilized, and as foreign investment in the banking sector took place, there would be a winnowing out of weaker banks and a series of mergers to create larger, more competitive private banks. In fact, despite a certain degree of post-conflict euphoria, foreign investment in the banking sector has been limited to seven banks, and no new investments have been made since 2005.

The seven banks with foreign shareholding are:

1. Commercial Bank, 49% owned by al-Ahli United Bank of Bahrain (through an Iraqi holding company)
2. Bank of Baghdad, 49% owned by the United Gulf Bank of Bahrain
3. National Bank of Iraq, 49% owned by the Export and Finance Bank of Jordan (renamed as Capital Bank)
4. Credit Bank of Iraq, 75% owned by the National Bank of Kuwait and 10% by the International Finance Corporation (IFC)
5. Dar as-Salaam Bank, 70% owned by Hong Kong and Shanghai Banking Corporation (HSBC)
6. Economy Bank, 49% held by the A'ayan Company of Kuwait
7. Mansour Bank, 60% owned by the National Bank of Qatar

No bank mergers have taken place. Although the lower tier private banks remain small, they have managed to increase capital to the ID 10 billion (\$5 million) requirement mandated by the Banking Law (with this capital requirement effective the end of March 2005).

In addition to the operating private banks, three banks are setting up operations:

1. Tigris and Euphrates Bank
2. National Islamic Bank
3. Bank Audi (Lebanon)

In addition, there are approximately seventeen applications pending at the Central Bank for new banking licenses.

Two foreign banks have been licensed by the CBI – T.C. Ziraat Bankasi of Turkey (the state agricultural bank) and the Arab Banking Corporation, the latter of which maintains an office in Baghdad but is not engaged in retail banking operations.

Preliminary approval has been granted by the Central Bank for the following banks to be issued licenses: Bank Melli Iran (the national bank of Iran), Al-Ahli United Bank (Bahrain), the Commercial Bank of Kuwait, the Housing Bank for Trade and Finance (Jordan), and Arab Bank Ltd. (Jordan). Given the present security situation in Iraq, however, it is unlikely that these banks will pursue opening branches at this time.

In Kurdistan, the Emerald Bank and Kurdistan Investment Bank are operational and Bank Audi and Byblos Bank (of Lebanon) are slated to open soon, in addition to Intercontinental Bank. Standard Chartered Bank also has a representative office in Erbil.

Relative Size of the Banks

Al-Warka' Bank is the largest private bank in Iraq (ranked by total assets), with over \$230,000,000 in assets as of December 31, 2005. Middle East Bank is second, with assets of \$219,000,000, followed by Bank of Baghdad with assets of \$218,000,000. Credit Bank and Dar as-Salaam follow, and then there is a rather sharp drop-off in asset size, with banks ranging from \$18 million on the low end to \$107 million on the high end.

Considerable growth has occurred in the total assets of the private banking system, particularly over the year 2004 -2005, which saw an average increase of 254% and a system-wide jump of 146%. As will be seen below, however, increases in "real" lending (after inflation) were not so pronounced.

Earning Assets

As was the case in 2003, earning assets (loans and advances plus investments) do not comprise even 50% of most of the banks' assets. For the fifteen reporting banks, the ratio of earning assets to total assets averaged only 36.2%. A comparable ratio for banks in developed economies is 70% or higher.

In addition, loans comprise just over 70% of earning assets, with the remainder in short-term investments (excluding bank deposits).

Four of the reporting banks display earning assets/total asset ratios of 3% to 13%: an extremely meager showing. At the other extreme, two banks exhibit ratios of 61% and 63%; in addition, the composition of their earning assets is heavily weighted towards loans and advances rather than investments.

Some of the banks with healthier ratios are actually engaged in very little lending when compared with other deployments of assets (such as short-term investments). One leading bank exhibits a loans/earning assets ratio of 14.3%, with an overall earning assets/total assets ratio of 58.3%.

Although lending as a percentage of earning assets (and total assets) varies greatly among the banks, virtually all private banks exhibit considerable balance sheet growth over the past three years. The average growth in loans and advances for the fifteen reporting banks in 2004-2005 was 111.9%. For the period of 2003-2004, it was 283.5% (based on eleven reporting banks).

Nevertheless, correcting for inflation of 46.9% in 2003-2004 and 31.7% in 2004-2005 reduces growth in 2004 and 2005, and eliminates it altogether for three of the banks. Two banks show before-inflation decreases in loans outstanding.

While figures for 2006 are not available, it appears that outstanding credit decreased over end-of-year 2005 levels. A major constraint mentioned by private sector businesses is the lack of access to bank credit. Accordingly, one of the policy recommendations made by IZDIHAR is that the CBI encourage private banks to raise their earning assets/total assets ratios to 50%, and that this increase be made in the loans and advances component of the ratio. Were banks to increase lending efforts accordingly, an additional \$294 million could be intermediated to borrowers (using year-end 2005 figures as a base). The results of expanded bank capitalization and continuing high liquidity manifest themselves most noticeably in the increase in deposits at the CBI and other banks, rather than an increase in lending. Incentives and moral suasion regarding private sector lending, and an altered interest rate policy by the CBI, could help redress this situation.

Another important factor, of course, is the local real estate market, which experienced a post-war boom that saw prices increase more than 1,000%. As Iraqi bank lending historically has been largely secured by real estate, the borrowing capacity of local businesses that owned their own premises suddenly grew exponentially. However, the market contracted in 2004, as investors shied away from the increasingly insecure Iraqi business environment. During 2005 and 2006, the exodus of Iraqis and contraction of the real estate market, plus the increasing difficulty in perfecting liens against real property (given the deteriorated security situation) had a chilling effect on traditional bank lending.

Table 1: Loan Breakdown 2005

Bank	Overdrafts Businesses	Overdrafts Persons	S/T Loans Businesses	S/T Loans Persons	Total S/T Loans	Other
Investment	2.0%	19.9%	0.0%	72.8%	72.8%	5.3%
Commercial	23.1%	18.2%	N/A	N/A	55.4%	3.3%
United	0.7%	43.7%	14.0%	34.1%	48.1%	7.5%
Al-Warka'	56.4%	20.3%	4.6%	16.4%	21.0%	2.3%
National	6.9%	35.1%	0.0%	54.5%	54.5%	3.5%
Babel	0.4%	4.5%	12.1%	58.7%	84.3%	10.8%
Middle East	7.2%	31.5%	10.3%	42.6%	52.9%	8.4%
Mosul	0.0%	43.5%	1.5%	39.7%	41.2%	15.3%
North	3.6%	38.0%	3.4%	14.5%	46.2%	12.2%
Sumer	0.9%	6.9%	0.0%	4.3%	4.3%	87.9%*
Baghdad	0.4%	11.7%	1.0%	77.6%	78.6%	9.3%
Basrah	-8.4%	11.7%	0.0%	61.0%	61.0%	35.7%**
Credit	23.8%	18.9%	N/A	N/A	57.2%	0.1%

*Sumer Bank's loan portfolio is comprised almost entirely of bills discounted.

**Basrah Bank shows a negative overdraft balance for businesses.

A number of reporting banks provide in their annual reports a loan breakdown as cited above: overdrafts and short-term loans to individuals and to businesses. This distinction is largely meaningless, however, as virtually no bank makes consumer loans, all loans are for "business purposes". Banks find it easier to process loans to individuals, particularly if the collateral is in the individuals' names.

The former distinction, however, is of interest as we wish to broker an SME lending industry in Iraq. Traditionally, all lending (other than discounted bills and letters of guarantee – and these latter are contingent liabilities) was essentially to traders or merchants on a secured overdraft basis. SME loans, of course, are in specific amounts for specific tenors, and feature monthly repayments. Thus, the use of “short-term loans” rather than overdrafts is preferable, even if current practice among Iraqi banks calls for “bullet” repayments (one repayment), rather than monthly installments.

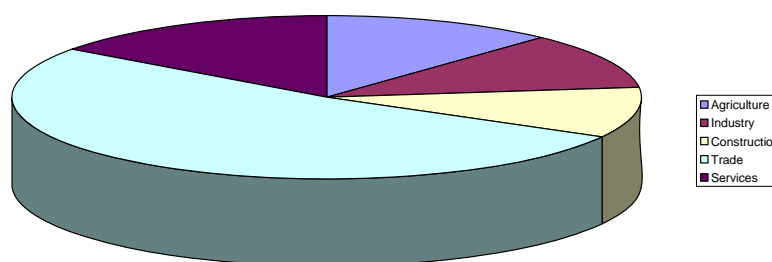
One thrust of IZDIHAR bank training efforts over the past two years has been to stress the advisability of using loans for specific purposes and tenors with monthly repayments as the preferred lending structure. Indeed, the Iraq Company for Bank Guarantees (ICBG) program, as currently configured, requires that eligible loans be of this type. Advantages to the bank include matching of repayments to cash flow from operations, and relative ease in monitoring borrower performance: Monthly repayments give the bank an early warning (in the form of a missed or delayed installment) should the borrower experience difficulties.

Investment, Commercial, National, Babel, Baghdad, Basrah and Credit banks use the short-term loan structure for over 50% of their credits. One of the largest banks relies heavily on overdraft financing (76%). Overdrafts, or their more structured cousin, revolving lines of credit, are of greater convenience to traders than straight loans. However, they are much more difficult to police and monitor, and can easily lapse into “evergreens” – facilities that are never paid off in full and that come to resemble permanent working capital injections rather than loans.

Sectoral Loan Breakdown

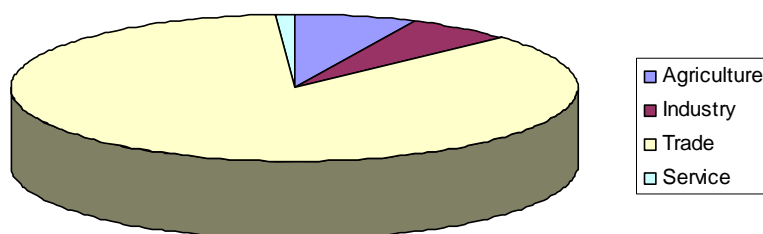
Only two of the banks surveyed provided an industry breakdown of their loan portfolios, Gulf and National. Gulf’s breakdown (for 2004) shows sectoral distribution as follows:

Chart 1: Gulf Bank Sectoral Loan Distribution 2004



Agriculture 12%, Industry 11%, Construction 10%, Trade 52%, Services 15%

The majority of credits are to the trade sector, probably in the form of overdraft facilities (although we do not have a breakdown by loan structure for Gulf Bank).

Chart 2: National Bank's Sectoral Loan Distribution 2005

Agriculture 7%, Industry 6%, Trade 86%, Service 1%

In the case of National Bank, 86% of credits are in the trade sector, with a high percentage of loans represented by overdrafts.

These breakdowns are indicative of the banking industry as a whole. Primary lending activities involve traders and merchants. Overdraft financing plays a prominent role. In this regard, one constant theme of the IZDIHAR training courses has been the advisability of diversifying lending portfolios by sector and subsector. Concentrations in the trade sector (or any sector), accordingly, are to be avoided.

Past Dues and Reserves

Past due accounts are reported by the banks among the entries in the Other Debtors account. It is necessary to consult the notes to the financial statements to locate the components of Other Debtors. However, the amounts reported were calculated before the new CBI regulations on classification of loans and provision of reserves. Accordingly, and unless there is specific mention of a reserve against overdrafts, no provision is made for doubtful debts. Furthermore, only past due installments are included in "Past Dues;" in other words, no provision is made against the outstanding amount of principal not currently due.

Of the nineteen private banks for which we have data, nine show provisions in excess of past dues. The remaining ten banks have provisioned amounts smaller than identified past dues. Eight banks show past dues in excess of 10% of portfolio; of these, only one has provisions in excess of past dues.

Related Party Lending

New CBI regulations limit insider lending as shown in Table 2. All insider lending is to be reported to the CBI.

Table 2: Insider Lending Limits

Group	Percent of Capital
Members of the Board of Directors, staff, and large shareholders	5%
Companies or groups of family members of Board members, staff or large shareholders	25%
Individual businesses or family members of Board members, staff or large shareholders	10%
In aggregate, lending to individuals or groups of insiders as defined above	50%

Like elsewhere in the developing world, the private banks in Iraq started as family banks. Most have as shareholders members of more than one family, but since inception these banks were meant to be the financing arms for the family businesses of prominent traders. The extent to which insider lending takes place is unknown, but must be assumed to be material.

One means of attempting to ascertain (if not limit) the scope of insider lending would be to require banks to report not simply maximum lending to borrowers, but maximum exposure as well. This latter figure would include amounts guaranteed to third parties, as well as other forms of indirect exposure and/or lending (letters of guarantee outstanding, for example). In addition, it should be required that maximum exposure to groups of borrowers (related parties) be shown.

CBI Reporting and Regulation

CBI regulations require that banks submit trial balances on the 15th of each month, and every six months. The former are to include balances in current accounts and balances in overdraft accounts. The latter report is to include names of account-holders. In addition, credit facilities made to insiders must be reported on a monthly basis.

CBI regulations covering various aspects of account and loan management include:

- Protection of confidentiality of account holders
- Bank officers signing corrections made to reports
- Safeguarding of bank official stamps
- Powers of Attorney
- The death of account holders
- Approval for payment of checks that overdraw accounts
- Procedures for pledging deposits
- The design of checks

There is a need for establishing a structure and methodical procedure for the development of banking regulations. Many aspects of bank operations would benefit from clear policy guidelines. For example, the regulation concerning bank confidentiality specifies that account holders and their account balances may not be disclosed only: no mention is made of borrowers.

In summary, there is a need for a considerably expanded prudential regulation regime. In addition, prudential regulation should be effectively implemented by the CBI using a progressive means of enforcement.

Rates of Interest on Loans

Since 2004, Iraqi banks have been free to set their own interest rates on loans (previously rates had been set by the CBI). A survey conducted by IZDIHAR in September 2006, with nine banks responding, yielded the following results shown in Table 3.

Table 3: Interest Rates on Loans

Bank	Rate on One-Year ID Loan
Gulf	16%
Ashour	14%
Mosul	14%
Middle East	14%
North	12%
Investment	15%
Baghdad	12%
Dar as-Salaam	15%
Commercial	17%

For the same month, the CBI reported that the average rate charged on one-year ID loans was 14.6%.¹⁸ As banks do not discriminate among borrowers on the basis of perceived risk, these rates are applied across the board to all loans. The results show a considerable range, although five of the nine charge 14-15%.

At the same time, deposit rates paid by banks averaged 7.3% for September. When you add to this the fact that a considerable amount of the funds on deposit with the private banks are in non-interest-bearing accounts, it is evident that the banks enjoy a healthy spread over cost of funds.

From the standpoint of developing an SME lending industry in Iraq, the rates CBI pays on deposit placements are not helpful: The CBI currently pays 19% on 14-day deposits and 20% for 30-day deposits. Faced with a market which pays on average 14.6% on short-term

¹⁸ CBI Web site, <http://www.cbiraq.org/>

loans before reserves (and virtually all lending is for one-year tenors or less), it is no wonder that banks prefer to place their funds on deposit with the Central Bank, and pocket the spread of 6-9% without incurring any risk whatsoever.

Profitability Consciousness

Infrequency of financial statement preparation underscores a lack of awareness and of concern about levels of bank profitability. The current large spread between cost of funds and interest earnings means that no efforts to calibrate competing rates of return for varying deployments of funds need to be undertaken. Iraqi banks need to be able to provide a blended, or average, cost of funds. Undoubtedly, the information is available, as it is a simple matter (and standard feature of banking software) to obtain cost of funds calculations.

As the economy grows in a deregulated environment, and outside banking institutions become active in Iraq, it may be assumed that competitive pressures will shrink the spreads commercial banks currently enjoy.

Generally, such standard profitability measurements as Return on Assets and Return on Equity are not widely known. On a positive note, there is considerable interest among both senior and middle managers in training courses focused on analytical skills, such as managerial accounting, credit analysis, bank analysis, profitability measurement, and the like.

The Credit Culture

Iraqi banks historically have lent on the basis of collateral. The only analytical effort expended in the process involved appraising the collateral on offer and registering it in the name of the bank. To describe it as "asset-based lending," misses the point: Banks in Iraq did not customarily finance the acquisition of equipment and machinery. All lending, until very recently, was secured by pledged commercial or residential real estate, sometimes for as much as 300% of the value of the loan received. Recent initiatives (such as training programs and the advent of the ICBG) have started a shift in the lending culture.

Only since 2005, with real estate values plunging and banks facing a security situation that made perfecting liens on real property difficult and even dangerous, have banks turned to other forms of security. Among them are pledged shares (in face amounts well over the value of funds received), gold, and personal guarantees.

Banks in the survey reported anywhere between 25% and 300% collateral coverage (half of the respondents require collateral ranging between 100% and 300% of the amount lent). As banks question the efficacy of securing credits with pledged real estate, there appears to be some growth in loans collateralized less than 100%. While Middle East Bank reported that 95% and Mosul Bank 96% of their collateral coverage was in the form of pledged real estate, Ashour and Investment rely more on gold and pledged securities (which can be held in their vaults).

Loans to Deposits

A standard measure of bank efficiency is the usage of deposit funds to generate profits by deployment as earning assets. To promote economic development, of primary interest is the percentage of deposits deployed as loans. This ratio also gives an idea of a bank's liquidity, although there are better methods of measuring liquidity that will be discussed below. The

higher the ratio, the more efficient a bank is deemed to be; yet, the higher the ratio, the less liquid is the bank.

Given the high level of liquidity throughout the system, the ratio is primarily of interest as a measure of efficiency. Banks in developed economies generally show quite high loan to deposit ratios: 65% - 70% is normal. In these economies, central banks are ready to inject liquidity into the banking system whenever required. In the United States, for example, the Federal Reserve Bank and commercial banks in the interbank market are available to provide overnight funds to banks facing unforeseen liquidity squeezes (as long as there is no underlying major cause for concern).

The Iraqi market is highly liquid, and the CBI responsive to banks' needs. However, Iraqi banks exhibit very low loan/deposit ratios. The overall average for the twenty-one banks is 56%; however, after removing the four banks with ratios in excess of 100%, the average drops to 28.52%. As a major goal of IZDIHAR has been to help broker an SME lending industry, we believe it advisable for CBI to promote a policy of encouraging banks to raise their loan/deposits ratios.

In a similar situation in Palestine in the late 1990s, for example, local banks placed most of their funds on deposit abroad in Amman or Jerusalem. The Palestinian Monetary Authority established and vigorously enforced a regulation calling for the achievement within a specified time-frame of a 50% loan to deposits ratio. Similar regulatory efforts are used by US banking authorities to penalize banks for "redlining" certain districts or neighborhoods.

Capital Adequacy

All banks in the survey have substantially increased their capital over the past three years. Only Economy and Baraka have failed to raise their capital to the ID 10 billion (\$5 million) level mandated by the CBI.

With the exception of the above-mentioned banks, leverage and capital adequacy ratios for the private banks appear acceptable, based on the financial information reported by the banks. This information, of course, should be verified by the CBI through period on-site and off-site examinations.

The Basel convention requires that Tier 1 capital represent 8% of risk-adjusted assets, and CBI has established a 12% ratio as the Iraqi guideline. Given the high liquidity of all Iraqi private banks, and the relatively low level of earning assets as a percentage of total assets, risk-weighting of assets (cash and its equivalents is 0 and most of what is shown on the balance sheet in capital and reserves is Tier 1 capital) will produce a margin comfortably in excess of the 8% Basel standard. The exceptions, if there were any, would only be in cases of high contingent liabilities (letters of guarantee, for the most part).

Banks that are unable to forge strategic alliances with global banking institutions may continue to lag behind their brethren with foreign shareholders in capital, growth potential and international reach. Their capacity to conduct international trade may remain compromised by an inability to attract lines of credit for the confirmation of letters of credit from international banks, while their counterparts will be able to rely upon their foreign partners to either guarantee their L/Cs or issue them on their behalves. Given the precarious state of the Iraqi economy as well as political uncertainty, local banks without foreign partners, in all likelihood, will remain unable to open correspondent banking accounts in such financial centers as London and New York.

Liquidity

Bank liquidity can be measured by the ratios of liquid assets/total assets and liquid assets/deposits. The first ratio provides an absolute measurement of liquidity: cash and bank deposits as a percentage of total assets. Under ideal circumstances, it is inadvisable for banks to maintain a high liquidity ratio. Generally, amounts left on deposit earn much less than earning assets like loans and investments. Thus, for efficiency and profitability reasons, banks in many economies closely monitor their cash positions, keeping them as low as possible. Careful asset-liability management allows them to keep liquidity low, and borrow overnight or for short periods on the interbank market or from the central banking authority to cover unanticipated cash demands.

The second ratio shows coverage of the deposit base by cash and near-cash assets. As such, the numerator includes short-term investments as well as cash and bank accounts. Generally speaking, there is no need to have a one-to-one relation between liquid assets and deposits. Extremely low ratios are commonplace in many countries. Barring a run on the bank, depositors do not appear *en masse* demanding to withdraw their funds, and banks learn to adjust their liquidity position to fit the normal requirements of day-to-day business.

Extremely high liquidity has characterized the Iraqi banking system from late 2003 until the present. Banks were, and remain, beneficiaries of the public's concern about leaving money "under the mattress" during times of civil insurrection and general lawlessness. For the sake of comparison, the 2005 liquidity ratios of twenty-one private Iraqi banks were compared to two international banks.

Table 4: Liquidity Ratios

	Liquid Assets/Deposits	Liquid Assets/Total Assets
21 Iraqi banks	367.71%	57.53%
HSBC	1.27%	3.54%
JPMorganChase	4.86%	38.41% ¹⁹

On average over half of Iraqi private bank assets were in cash or bank deposits, while coverage of deposit liabilities is by an average factor of 367.71%, or nearly four times. There are several explanations for this anomaly:

- A high degree of risk aversion on the part of the banks surveyed
- The difficult political and economic environment in which the banks operate
- An alternative deployment of funds that is much less risky than lending and that offers a good return

Of the three, the deciding factor is probably the last. The CBI pays banks 12% on 30-day deposits²⁰, just two or at maximum four percentage points below rates charged on loans,

¹⁹ The difference between the two with respect to the Liquid Assets/Deposits ratio is probably explainable in JPMorganChase's extensive security trading operations, and the need to maintain a large portfolio.

and before reserves (of at least two percent). Regardless of the fact that most banks debit interest from the net proceeds of the loan (raising the yield to above the nominal rate), the offer of 12% risk-free is probably the critical factor (and the factor that more than one Managing Director has mentioned as the primary disincentive to lending).

IZDIHAR has called for a reconsideration of the rates paid on deposits (far higher than rates obtainable abroad, for example). It is difficult to see banks opt for the less predictable returns from SME lending, whether guaranteed or not – despite the fact that both rates on loans (something in the neighborhood of 25% currently, and deposit returns of 20%) are below the inflation rate.

Branch Systems

By 2006, the banks' branch networks have been restored to their pre-war status, and some banks have added branches (particularly in the North, where the security situation is better and economic investment is taking place).

Telephone communications are being put in place in the branches, thereby facilitating inter-branch payments. The charge for payments is .00125 of the amount transferred plus a \$4.00 fee.

With the exception of branches of the state-owned banks, Rafidain and Rashid, (as well as the Agriculture, Social, Real Estate and Industrial Banks) much of Iraq is not served by commercial banks. There are no private commercial bank branches in many large towns (the equivalent of county seats) throughout the country.²¹

Table 5: Private Bank Branches 2006

Name of Bank	Baghdad	West	East	North	Central	South
Warka'	15	Al-Qaim		Mosul (4) Kirkuk Sulaimaniah	Najaf	Nasiriah Basrah
Investment	14 Mahmudiah				Hillah, Kut Najaf, Kerbala	
Basrah	2				Najaf	Basrah (4)
Sumer	6					
Middle East	7	Samara		Mosul (2) Kirkuk		Basrah
Islamic	4	Ramadi Falujah		Mosul	Najaf	Basrah
Commercial	10				Hillah	Basrah
Emerald				Arbil, Dahuk		

²⁰ Raised to 18% in late November, and currently 20%.

²¹ County seats (*marakiz al-aqadhiah*) with no private bank presence include Hamdaniyah, al-Rutbah, al-Majr al-Kabir, Shahr bazar, Binjoun, Khaneqin, Hawijah, Shaqlawah, Jouman, 'Ali al-Gharbi, ar-Rafaie, 'Emadiyah, Sarsank, Shatrah, Zirkawah, Badra, Medaiin, Kasaibah, Jubaish, and al-Hayi'.

Name of Bank	Baghdad	West	East	North	Central	South
National	3			Mosul		
Baghdad	10 Mahmudiah	Falujah	Baquba	Mosul- Ninevah Kirkuk Sulaimaniah	Hillah Karbala Najaf	Basrah
Credit	10				Hillah	Basrah
Commercial	9					Basrah
Gulf	4				Hillah Najaf (2) Karbala	Basrah
Mosul	3			Mosul (2) Tikrit Sulaimaniah		
United	4					
North	2			Sulaimaniah		
Ashour	1					
Dar as-Salaam	8 Amiriyah			Mosul	Karbala Diwanayah	

The Appendices provide a more detailed break-up of branch systems by state-banks, private banks and those that are participating in the recently established loan guarantee program (discussed elsewhere in this paper). It should be noted that the data is not accurate due to closure and opening of locations brought about by factors such as new expansion as well as the security threat environment.

Management

Most of the members of senior management of the private banks are 'graduates' of the Rafidain Bank, and have limited experience working for foreign banking institutions. Antiquated Rafidain systems and isolation from the rest of the banking world, account in large part for the banking sector's relative backwardness.

While Rafidain was once in line with banks in Europe and the US, over the past three decades (prior to the 2003 war) it devolved into a sort of state funding apparatus, reminiscent of the banks operating in the former Soviet Union. Its *raison d'etre* migrated from finance to funding: It became a conduit for government monies for state enterprises, issued letters of credit on behalf of the state and the public sector, and performed certain statistical and administrative functions for the government and the Ministry of Finance and Central Bank.

The credit function as performed by Rafidain involved at most an appraisal of the collateral on offer and its registration in the name of the bank. Thus, while most of the private bank managing directors have had long, distinguished careers at Rafidain, Rashid and the CBI, they were subject to thirty years of isolation from the international banking community by the prior regime and not able to access contemporary banking practices. Likewise, bank staff have had limited formal banking training confined to operational courses in such areas as data entry. There is therefore a massive need for banking training of all kinds, and an associated need for Iraqi bankers to travel abroad and see how the rest of the world - both the Arab world and Europe and the US - are operating in the 21st century.

Bankers Association and Training

The Iraqi Private Banks League (IPBL) was set up as the association to represent the banking community. It has undertaken limited advocacy work and done some basic training for the banks. However, the institution is yet to gain the level of acceptance and credibility within the banking community.

A very limited number of banks have in-house training programs, but the scope of these efforts has also been limited.

Considerable emphasis on training has been placed by the USAID/Izdihar project working closely with the Iraq Company of Bank Guarantees (ICBG). Over the life of the IZDIHAR project, several bankers have been trained in 30 plus banking courses developed especially for Iraqi private banks. A core curriculum including the Managerial Accounting and Credit Analysis course, Loan Administration, Security and Collateral, and Loan Classification and Reserves has been offered to credit officers from over twenty private banks.

Related to this the project can take credit for promoting the Credit Officer concept – the creation of loan officers responsible for developing and servicing their own loan portfolios - to replace the existing division of responsibilities among multiple bank departments. Centralizing responsibility for marketing, loan structure, credit recommendation, and repayment in the hands of individual Credit Officers, helps build *esprit de corps* while at the same time fostering a healthy level of competition. It also highlights the importance of the loan portfolio's profitability.

Courses in Goal Setting and Marketing, Performance Planning, and Setting up a Model SME Lending Unit round out the offerings for Credit Officers and Credit Department Managers. In addition, the SME Development/Bank Lending component has offered general courses in Basle Requirements, Money and Banking, Anti-Money Laundering, and Corporate Governance. Specifically targeted courses such as Internal Audit and Control have fleshed out the curriculum.

Recognizing the importance of earning the support of senior bank managers in the bank capacity-building effort, the component has offered courses specially tailored for senior management covering credit appraisal, cash flow lending, bank profitability, and the role of boards of directors.

Finally, under the auspices of the Iraq Company for Bank Guarantees (ICBG) training efforts have centered on the program's Participating Bank Agreement, Loan Agreement, and using the forms and following the procedures required for participating banks to qualify for ICBG guarantees.

New Developments in the Private Banking Sector: The Iraqi Company for Bank Guarantees

The Iraqi Company for Bank Guarantees Ltd. (“ICBG”) was established in November 2006 in order to assist small and medium size enterprises in Iraq gain access to loan finance from participating Iraqi banks, as well as assist the banks that use the guarantee facility to develop credible loan administration and risk management systems.

The ICBG is privately-owned by 11 Iraqi private banks and is organized as a Non Banking Financial Institution (NBFI), structured as a Limited Liability Company (LLC) to eventually fall under the oversight of the Central Bank of Iraq (CBI) and other applicable laws and regulations. The initial equity of the 11 shareholder banks is USD 3.633 million and its guarantee fund has been further supplemented by a USAID grant in the amount of USD 5 million. The investment portfolio also acts as a guarantee fund to support the company in the event of losses in the guaranteed loan portfolio.

The company provides partial guarantees of both principal and interest for loans made to small and medium sized businesses (including start-ups) by privately owned banks established in Iraq operating in the following sectors: Manufacturing, services, tourism, construction, trade and agriculture. The loan guarantee program supports cash flow based lending, however the participating banks are authorized to require personal guarantees and suitable collateral.

ICBG relies on the revenue stream from the fees generated from loan guarantees as well as interest income from an investment portfolio to support operations. A 2% loan guarantee fee is charged per annum on the guaranteed portion of the loan and the accrued interest. The fee is calculated and payable on a reducing balance basis.

Participating banks have entered into a “Participating Bank Agreement” with ICBG which defines the obligations of both the ICBG and the Bank. The Participating Bank is bound to comply with ICBG’s operating guidelines as well as performance benchmarks based on achieving and maintaining certain levels of loan administration, guaranteed loan production, and minimum loan loss experience. Appendix A lists participating banks as of March 2007.

The amount of the ICBG loan guarantee issued will vary with the risks that are ascertained, on a loan-by-loan basis. The guarantee will not exceed 75% of the loan amount and accrued interest is guaranteed for a period not exceeding 180 days. ICBG will guarantee loans with volumes ranging between the ID equivalent of USD 5,000 and USD 250,000.

ICBG may guarantee eligible for both working capital and fixed asset acquisition; working capital loans may not exceed 360 days in tenor; fixed asset loans may be from 1 year to 5 years in tenor; and all loans should have monthly repayments. Should the borrower satisfy the respective eligibility criteria set by the Board, the participating bank must complete and

present the guarantee application package to ICBG for review and certify that proper due diligence and normal underwriting has been completed.

Summary and Recommendations

Internal organization of the banks and the assignment of responsibilities do not correspond with international standards. There are few internal auditors and internal control departments (In most cases there is an “inspection” department that carries out branch audits). Few banks have a credit manual or an operating manual. CBI circulars are kept in a folder and not replaced when updates are issued. Auditing is limited to proving cash totals in the branches, and justifying various operating statements. Limited oversight is exercised with respect to the loan portfolio. There is limited risk management function in select banks, a scant portfolio review function, and, until the recent promulgation of credit standards by the CBI, no standards set or reviewed for the contents of a credit file (beyond the setting of basic documentation requirements – which did not include financial statements of borrowers).

While the banks have made strides over the past three years in the improvement of internal operating (and reporting) systems – computer hardware and software – there are still only few banks capable of publishing monthly balance sheets and income statements. No credit department head receives a daily credit outstanding and past dues report. It takes the banks between six and nine months to complete their annual reports (as of November 2006, two still had not completed them for 2005) and, with the exception of one bank, no interim figures are published. Few private banks surveyed were able to provide a deposit breakdown or cost of funds calculation.

The payment system operates via telephone and can handle payments within one bank’s branch system. The Baghdad check-clearing house is operating once again, but checks take six days to clear as opposed to three days before the war. There are clearing houses in the governorates as well. The CBI branches in Basrah and Ninevah handle check clearings for those governorates and those surrounding them that do not have clearing houses. Rashid Bank in Kirkuk and Rafidain Bank in Babylon perform the same function for banks in these areas, rather than the CBI. The CBI branch in Arbil has become more of a central bank for Kurdistan than a branch of the CBI. There is no inter-governorate clearing system, per se. For an additional fee, the clearinghouse banks themselves will contact the issuing bank and make payments to check-holders after having obtained appropriate authorization.

There is not a system in effect for assigning borrowing relationships to individual credit officers. Instead, responsibility for handling lending relationships is shared among several departments, which leads to a lack of continuity. However, Middle East Bank and Mosul Bank have followed on to Izdihar’s recommendations to adopt the Loan Officer concept, giving officers their own portfolios and making them responsible for everything from marketing and application preparation, to follow-up and final repayment.

All credit authority is centralized (at a head office credit committee) and an extremely large percentage of loans must be approved by the Board of Directors, none of whom has any banking and credit experience or background. Credit products are limited in scope – overdrafts and short-term loans. The banks’ preferred customers – traders and wholesalers – some of the most difficult credits to analyze (because the nature of their businesses keeps changing with the different mix of goods they import and sell) and the most difficult to monitor. The preference for overdrafts – while certainly convenient for the traders – leaves the banks in the position of not knowing whether their loans are performing or not. Debiting interest periodically to an already overdrawn account and treating it as income, falls short of prudent banking practices. Further, some banks offer short-term loans to persons who use

the proceeds to speculate on the local stock market – and without a margin requirement (but subject to varying collateral conditions).

The most critical shortcoming is the failure of the banks to perform their principal function as financial intermediaries - to attract deposits and lend funds to credit-worthy enterprises throughout the country. It is this vital role that needs to be addressed, and that can be addressed through extensive training efforts and by means of loan guarantees offered through ICBG.

While there has been development in the private banking sector over the past three years, the hope that change would be brokered by sectoral foreign investment and the associated enforced competition has largely gone unrealized. The reasons for this include:

- The poor security situation in Baghdad
- Severe dislocations in the non-state-sector national economy
- Limited post-war foreign investment in the industry

Potential foreign investors in the banking sector may be waiting to see what the future will bring. Of the seven banks and companies that have formed joint ventures with Iraqi banks, none has reoriented or redirected the bank acquired to a position of active lending. It seems that the foreign partners have made strategic investments (on relatively nominal terms given the potential of a renascent Iraqi economy operating under conditions of political instability) and are willing to sit on the sidelines until there is some sign of improvement by which they might justify becoming more involved. The exception to this picture is Kurdistan, where three Lebanese banks are in the process of opening branches or establishing affiliates.

Should initial encouraging results of the current troop buildup continue and overall security conditions improve, and should foreign investors take a more active role in the management of the institutions they have acquired, one might expect the effects on the banking sector to be considerable. No longer would the time-honored practices of the Rafidain Bank be acceptable. The inefficiencies and credit oversights, the lack of banking products, the lack of branch systems, the absence of a profitability-driven, yet consumer- and business-oriented banking culture, would no longer be tolerated. Competition would force the smaller banks to merge, and the larger ones to adapt – and quickly. Several banks are already demonstrating that – with the support of the ICBG – they can make good loans to deserving businesses on a cash-flow (rather than a collateral) basis. As guarantee company outstandings increase, and as the loans themselves repay, the momentum will grow for increased cash-flow-based lending.

Recommendations for the CBI

1. Lower deposit rates paid to more closely reflect comparable LIBOR and Fed Funds rates and encourage lending OR limit the amount of funds which individual banks may place at the Central Bank;
2. Further encourage banks to engage in lending activities by pressuring them to raise their Loans/Deposits ratio;
3. Require additional disclosure on the part of banks with regard to exposure to guarantors and groups;

4. Promulgate regulations governing overdraft lending, in particular clean-up periods, annual review, classification and reserves;
5. Change the format of bank balance sheets to clearly reflect Gross Loans and Advances, Loan Loss Provision, Net Loans and Advances;
6. Require that transfers to various reserves, including the Loan Loss Provision, be clearly indicated on Income Statements; and
7. Insist that all credit facilities be reviewed on an annual basis rather than the biennial basis required at present.

Finally, the CBI should use its considerable power and influence to support the development of an SME lending industry in conjunction with the ICBG by encouraging banks to lend, by insisting that they increase their Loans/Deposits ratios, and by limiting the amount of funds on which they will pay high deposit rates. Raising interest rates, of course, is one of the effective ways to curb inflation. Imposition of high interest rates, however, has the effect of protecting foreign investors and creditors at the expense of local businesses, in particular small businesses. The IMF itself admits that interest rate adjustments in Iraq have practically no economic effect as the banking system is by its own description “inert”. The benefits of encouraging banks to lend to SMEs therefore outweigh potential inflationary effects (which, in any event, are much more closely tied to the increase in oil prices and the effects of the ongoing insurgency than to any other factor).²²

Recommendations for the Banking Community

1. Move forward to quickly reach consensus on an effective Banker’s Association that represents the united voice of the community and advocates for modern and prudent banking practices;
2. Development of a modern financial services training center in collaboration with a prominent regional institution(s) that serves as a sustainable avenue for training and certification of competent bank professionals; and
3. Leverage the assistance and training programs developed for and by the ICBG aimed at building a modern banking culture in the country.
4. The Iraqi Banking and Finance Conference organized in April 2007 is a starting point for the industry to find the best way forward for its future development.

²² See IMF Country Report 06/301, August 2006.

APPENDICES

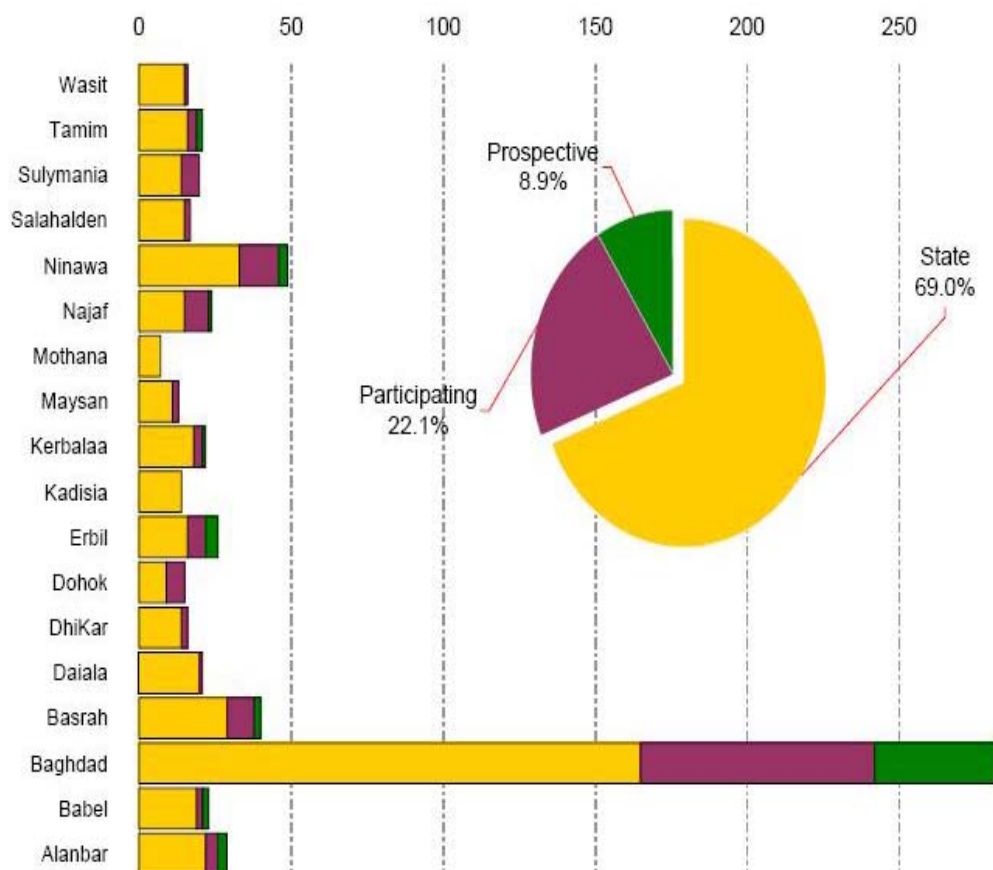
Consolidated Overview of Public and Private Banks in Iraq
The State-owned Banks in Iraq by Location
Iraq Company of Bank Guarantees – Member Banks by Location
Iraqi Private Banks – Prospective Member Banks of the ICBG

(Please note that the information herein may not be accurate due to closure and opening of locations brought about by factors such as new expansion as well as the security threat environment).

Consolidated Overview of Public and Private Banks in Iraq As of March 2007

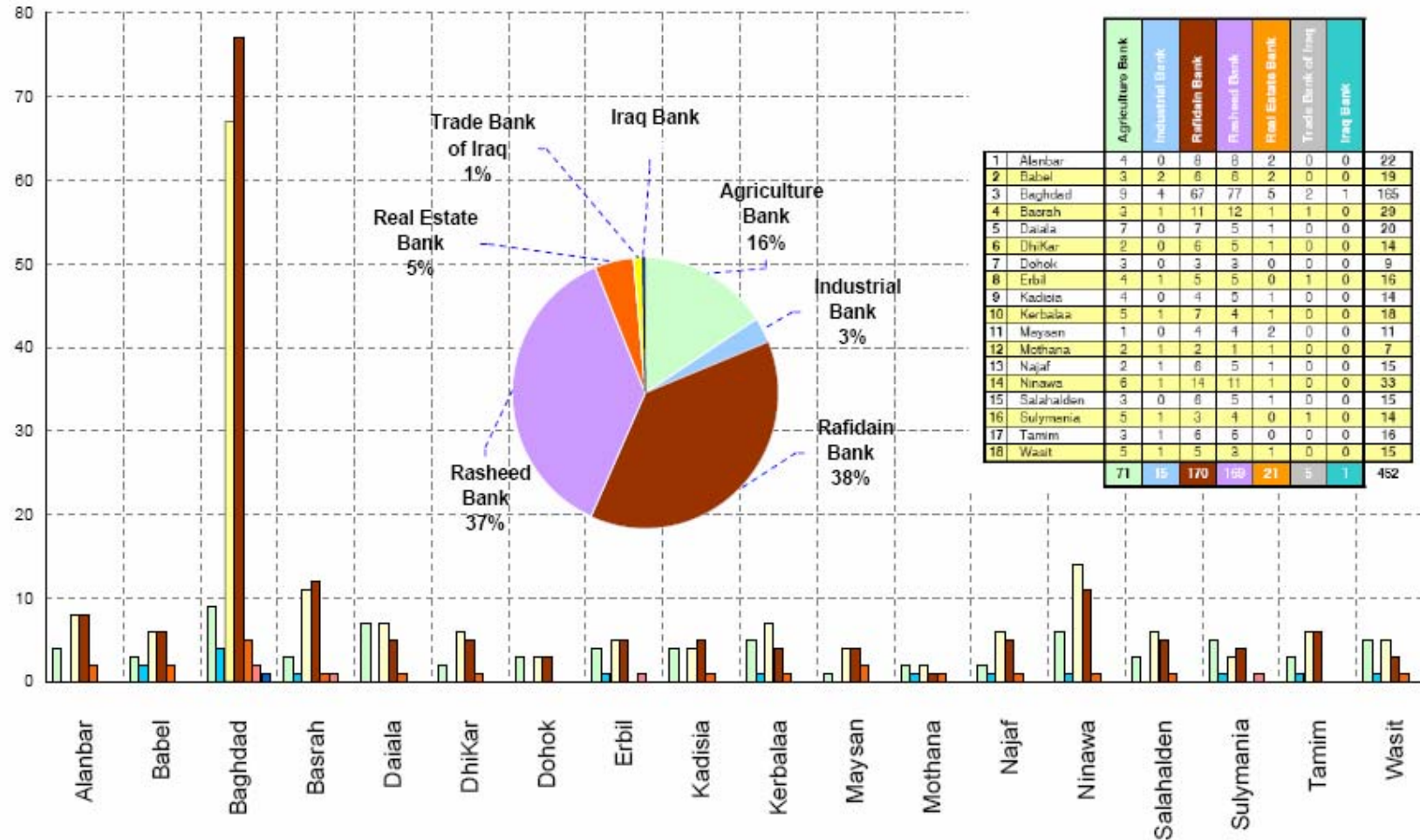
Number of Branches Per Governate				Percentage Representation per Governate					
State	Participating	Prospective	Total	By Governate			Within Governate		
				State	Participating	Prospective	State	Participating	Prospective

1	Alanbar	22	4	3	29	4.9%	2.8%	5.2%	75.9%	13.8%	10.3%	100.0%
2	Babel	19	2	2	23	4.2%	1.4%	3.4%	82.6%	8.7%	8.7%	100.0%
3	Baghdad	165	77	40	282	36.5%	53.1%	69.0%	58.5%	27.3%	14.2%	100.0%
4	Basrah	29	9	2	40	6.4%	6.2%	3.4%	72.5%	22.5%	5.0%	100.0%
5	Daiala	20	1	0	21	4.4%	0.7%	0.0%	95.2%	4.8%	0.0%	100.0%
6	DhiKar	14	2	0	16	3.1%	1.4%	0.0%	87.5%	12.5%	0.0%	100.0%
7	Dohok	9	6	0	15	2.0%	4.1%	0.0%	60.0%	40.0%	0.0%	100.0%
8	Erbil	16	6	4	26	3.5%	4.1%	6.9%	61.5%	23.1%	15.4%	100.0%
9	Kadisia	14	0	0	14	3.1%	0.0%	0.0%	100.0%	0.0%	0.0%	100.0%
10	Kerbalaa	18	3	1	22	4.0%	2.1%	1.7%	81.8%	13.6%	4.5%	100.0%
11	Maysan	11	2	0	13	2.4%	1.4%	0.0%	84.6%	15.4%	0.0%	100.0%
12	Mothana	7	0	0	7	1.5%	0.0%	0.0%	100.0%	0.0%	0.0%	100.0%
13	Najaf	15	8	1	24	3.3%	5.5%	1.7%	62.5%	33.3%	4.2%	100.0%
14	Ninawa	33	13	3	49	7.3%	9.0%	5.2%	67.3%	26.5%	6.1%	100.0%
15	Salahalden	15	2	0	17	3.3%	1.4%	0.0%	88.2%	11.8%	0.0%	100.0%
16	Sulymania	14	6	0	20	3.1%	4.1%	0.0%	70.0%	30.0%	0.0%	100.0%
17	Tamim	16	3	2	21	3.5%	2.1%	3.4%	76.2%	14.3%	9.5%	100.0%
18	Wasit	15	1	0	16	3.3%	0.7%	0.0%	93.8%	6.3%	0.0%	100.0%
		452	145	58	655	100.0%	100.0%	100.0%				





The State Owned Banks of Iraq By Location As of March 2007



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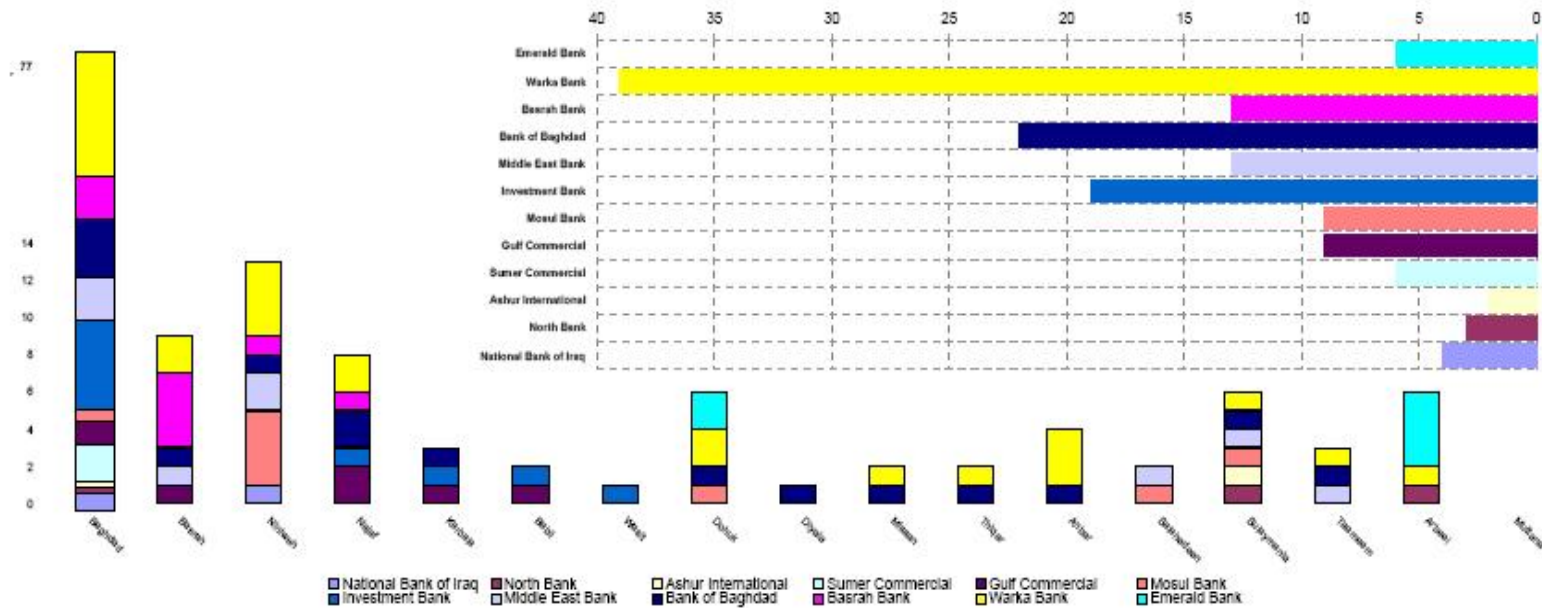
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Iraqi Company for Bank Guarantees
Member Banks by Location
As of March 2007

145 Branches
12 Banks
17 Governates

	Baghdad	Basrah	Ninawa	Najaf	Karbala	Babil	Wasit	Dohuk	Diyala	Misran	Thiqar	Anbar	Salaheddin	Sulaymanya	Tamtoom	Arbil	Mutana	Total
National Bank of Iraq	3		1															4
North Bank	1												1			1		3
Ashur International	1												1					2
Sumer Commercial	6																	6
Gulf Commercial	4	1		2	1	1												9
Mosul Bank	2		4				1					1	1					9
Investment Bank	16			1	1	1	1											19
Middle East Bank	7	1	2									1	1	1				13
Bank of Baghdad	10	1	1	2	1			1	1	1	1	1	1	1				22
Basrah Bank	7	4	1	1														13
Warka Bank	21	2	4	2				2		1	1	3		1	1	1		39
Emerald Bank							2									4		6
Total	77	9	13	8	3	2	1	6	1	2	2	4	2	6	3	6	0	145





Iraqi - Private Banks
Prospective Member Banks of the ICBG
 Analysis of Bank Representation by Region
 As of March 2007

58 Banks in 9 Governates

		Governorate	City	Branches
8	Economic Bank	Baghdad	Baghdad	6
		Babel	Hila	1
		Kerbala	Kerbala	1
3	Iraqi Union Investment Bank	Baghdad	Baghdad	2
		Erbil	Erbil	1
9	Iraqi Islamic Bank	Baghdad	Baghdad	3
		Basrah	Basrah	1
		Tamim	Kirkuk	1
		Ninawa	Mosel	1
		Najaf	Najaf	1
		Alanbar	Ramadi	2
12	Credit Bank	Baghdad	Baghdad	10
		Basrah	Basrah	1
		Babel	Hila	1
6	Kurdistan Bank	Baghdad	Baghdad	1
		Erbil	Erbil	3
		Tamim	Kirkuk	1
1	Al-Mansour Bank	Baghdad	Baghdad	1
		Baghdad	Baghdad	6
6	United Bank for Investment	Baghdad	Baghdad	6
		Ninawa	Mosel	1
7	Barakl Bank	Baghdad	Baghdad	5
		Alanbar	Ramadi	1
4	Babylon Bank	Baghdad	Baghdad	3
		Ninawa	Mosel	1
1	Dar Alsalam Bank	Baghdad	Baghdad	1
1	Dejla & Furat Bank	Baghdad	Baghdad	1
1	Al-Belad Bank	Baghdad	Baghdad	1

