Stanford
Law School

THE AMERICAN UNIVERSITY OF IRAQ
SULAIMANI

Introduction to the Laws of Kurdistan, Iraq

Working Paper Series

Commercial Law II: Banking and Investment Law

Pub. 2013

Iraq Legal Education Initiative (ILEI)
Stanford Law School
Crown Quadrangle
559 Nathan Abbott Way
Stanford, CA 94305-8610

American University of Iraq, Sulaimani
Kirkuk Main Road
Raparin
Sulaimani, Iraq
www.auis.ed.iq

TABLE OF CONTENTS

I. Introduction to Banking and Investment Law 3
II. Banking Law 4
  A. The Role of Banks in Iraq 4
  B. Sources of Banking Law 4
  C. Summarizing Iraq's Banking Law 5
  D. Authorities of the Central Bank of Iraq 5
  E. Risk Management Practices and Financial Soundness Requirements 7
  F. Other Important Statutes and Sources of Banking Law 11
III. Investment Law 13
  A. Investing in Iraq 13
  B. Sources of Investment Law 14
  C. Summarizing Iraq's Investment Law 14
IV. Conclusion 17

Commercial Law II: Banking and Investment Law

I. Introduction to Banking and Investment Law

We will learn in this chapter about the key rules and laws in Iraq and the Kurdistan Region that govern banking regulation and investment incentives. As we'll see, investment laws provide benefits to investors willing to use their capital in Iraq. Banking laws establish rules designed to ensure that financial institutions operate soundly and responsibly. An effective and functional banking sector can help provide financing that is necessary to buy or build a house, or expand a business. If banks fail to operate effectively, the cost of doing business can increase, as organizations will need to find alternative ways to store money and facilitate payments and transfers of capital. Problems can arise if banking licenses are given by the government to institutions that lack qualified management or risk management strategies. In addition, banks can run into major problems if they do not maintain proper records or give out loans based on factors other than business judgment. Similarly, banks can falter if they do not maintain enough resources to support their lending and investment activities.

Two fictionalized but realistic scenarios highlight the importance of banking and investment laws.

Merwan owns a small cement manufacturing company in Duhok and is considering investing $15 million USD in a new factory that would be located in Shaqlawa in light of the region's economic growth potential and increasing demand for the construction supplies for new houses, office space, and factories. In addition to signing **contracts** with vendors to help build his new facility and hiring **labor** to construct the factory, Merwan will need to find an appropriate piece of land, or **real estate**, upon which he can build the factory and **capital** to finance the project. Even though Merwan has significant personal savings, he does not have enough available **assets** to expand the business using his own personal cash. In addition, Merwan is assessing the **risks** of investing resources. For instance, he is evaluating whether economic growth will slow and cause demand for cement to decrease. He is also considering whether there are already too many existing cement producers in the Shaqlawa area. In addition to these **business risk factors**, Merwan will also consider whether the government will provide **essential services** (like water, electricity, and communications) for the facility, the **tax rate** on the factory's earnings, and whether his **financial institution**, or bank, will be able to lend him the resources he needs to maintain business operations.

Alberto is a senior vice president at a large food manufacturing company headquartered in Lausanne, Switzerland. The company is considering expanding its operations in the Middle East in order to gain a foothold in a large market that will demand more packaged foods as incomes and wealth rises. The chief executive officer of the company has asked Alberto which countries in the region would be suitable for an investment of $75 million to build multiple food manufacturing facilities, warehouses and distribution centers. As a well-financed multinational corporation, the company (unlike Merwan's cement business) is not concerned about accessing capital through Iraq's banks. However, Alberto's CEO has several questions about the

investment potential of the region. First, what are the risks that the government will **expropriate**, or take over the facility once the investment has been made and the factories are constructed? Second, how will the company be taxed and will it be able to move its **profits** back to Switzerland? Third, will the company be able to employ skilled workers from Switzerland and ship **raw materials** like milk from the dairies it owns around the world? Fourth, will it be challenging and expensive to **register** the company and receive **licenses** it needs in order to operate?

The questions above are fairly common issues that businesses encounter as they decide whether to make new investments or expand their operations.

II. Banking Law

A. The Role of Banks in Iraq

Banks are institutions that offer various services to the public. They provide a place to safely deposit and store money until individuals need to withdraw it. Often times, banks enable customers to write checks, pay bills, or transfer money to other people. They also make loans to people and businesses. When banks lend money, they generally charge interest until the loan has been repaid. Examples of loans may include money to help purchase an automobile, invest in a new business, or construct housing projects. Banks earn profits by using the interest they receive and the deposits of customers to make investments. At the same time, banks must be careful to ensure that they are able to return deposits to customers when they want their money back from the bank.

Banks dominate Iraq's financial system. In many economies, companies manage their money through a variety of mechanisms – they can raise **capital** by selling **stock** to the public that is then traded on **stock exchanges**, purchase **insurance** policies that protect against risks, and issue **bonds** to large investors. Iraq, on the other hand, depends almost exclusively on banks for financing – bank credit far exceeds the stock market as the principal outside source of funding for businesses, there are no private bonds issued, and the insurance market is very small. Banks account for 75 percent of the country's financial assets.[1]

Iraq's banks are overseen and regulated by the Central Bank of Iraq (CBI), which issues **licenses** to banks and manages the country's **monetary policy**. Iraq's three largest banks (Rafidain Bank, Rasheed Bank, and Trade Bank of Iraq) account for 96 percent of the country's **banking sector assets**.

B. Sources of Banking Law

Because of the significant role that banks play in Iraq, bank regulation is critically important to the country's economy. The Iraqi Constitution assigned banking regulation to be an area of exclusive federal authority. As a result, there is one important federal statute in this area and no

[1] World Bank Report, *Republic of Iraq: Financial Sector Review* (Sept. 2011), available at http://siteresources.worldbank.org/INTMENA/Resources/Financial_Sector_Review_English.pdf.

Kurdistan Regional Government legislation. (Remember the discussion of exclusive and shared jurisdiction in Working Paper: Federalism). Banking Law No. 94 establishes that the Central Bank of Iraq (CBI) is the exclusive government agency in charge of regulating the banking system. This exclusive grant of authority in the law can be contrasted with a number of government functions that are shared by the federal government and the regions, such as regulation of the oil and gas sector. The key reason for this difference is found in the Constitution, which assigns exclusive and shared areas of authority.

C. Summarizing Iraq's Banking Law

Iraq's Banking Law consists of 108 Articles that provide the government with authority to regulate banks, the standards and rules that banks must follow to be licensed and operate, and the steps that banks and the government can take when banks fail. The statute can be broken into two main themes:

(1) Authorities of the Central Bank of Iraq to regulate banks; and
(2) Rules governing the **risk management practices** and **financial soundness** of banks

The following sections will analyze and summarize the specific provisions of the banking law that fit in the two categories above and will briefly discuss other statutes that are related to the banking law.

D. Authorities of the Central Bank of Iraq

As with many pieces of legislation that establish standards for a **regulated industry** (such as telecommunications and oil and gas), Law No. 94 of 2004 provides the government with a number of authorities to ensure that the law is being followed. Among the tools normally assigned to a **regulatory agency** are the powers to review records and operations, issue regulations, investigate violations of statutes and regulations, and penalize individuals that break the law (penalties can often include **criminal penalties** as well as **civil penalties** that may include fines).

The statute provides the Central Bank of Iraq (CBI) with a number of different tools that are designed to ensure that banks follow the law. Among these powers is the authority to issue licenses for banks and set standards for licensing, review records and financial statements, publish regulations, and penalize violations of the law.

1. Licensing

One of the most important authorities of the CBI is to set standards for bank licensing. Banks are not permitted to operate in Iraq unless they have been issued a license by the CBI. This requirement has several purposes, including: (1) Ensuring that the government has knowledge of all of the institutions engaged in banking; (2) Providing a way for the government to inspect the financial soundness and proper management of a bank before it begins operations; and (3) Reducing the risk that banks will engage in illegal practices by making the bank aware of its legal requirements at the time it applies for a license.

Article 3 of the banking law establishes that banks cannot operate in Iraq unless they have received a license from the CBI. Article 5 establishes a number of specific requirements for bank license applications, such as the amount of the bank's capital, biographical information on the bank's managers, annual financial statements, a list of shareholders and owners, and a business plan. In addition, banks must pay an application fee.[2]

Article 8 specifies the procedure that the CBI will follow in reviewing applications. The law states that the CBI will determine the completeness of the application within two months and will approve or deny the application within six months of determining it is complete. The CBI's final determination depends on the results of criminal and professional background checks of the managers, the financial status of the bank, and the adequacy of the capital structure and business plan, among other factors.

In addition to granting the power to issue licenses, the law also authorizes the CBI to revoke or terminate licenses. Licenses can be revoked if a bank violates a CBI order, operates in an unsound fashion, engages in criminal activity, or files for **bankruptcy**.[3]

2. Records Access

The banking law provides the CBI with a number of different specific authorities to request records and information on banking operations. Viewing bank records can help the CBI's staff (the regulators) understand whether a bank is pursuing risky or unsound banking practices or engaging in criminal activity. For instance, viewing records can help the CBI uncover activities that support criminal enterprises, money laundering, or terrorist financing. In addition, bank records show the investments that banks are making and the way that banks are using money deposited by customers.

Sections 6 to 9 of the statute provide the CBI with specific tools to inspect and review records and operations. For instance, Articles 41 and 43 requires banks to submit detailed business records to the CBI on a periodic basis. Article 46 requires banks to hire an independent **auditor** to monitor bank activities to ensure it is complying with the law and not engaging in **fraud** or other illegal activities. Article 53 establishes that the CBI can request information from banks that it deems necessary and that the CBI can perform on-site examinations of bank records. The law states that the CBI will examine all banks at least once per year.

3. Regulation Authority

Another important tool that the statute gives the CBI is the power to issue regulations, which are specific requirements that banks are required to follow. This is an important feature of the law because many of the provisions in the law are vague or need to be explained in further detail.

[2] For those who are more interested in understanding the licensing process, a copy of the five-page application instruction can be found on the CBI website: http://www.cbi.iq/. The application instructions provide a higher level of detail on the license application requirements than the text of the law.
[3] Bankruptcy is governed in Iraq by the Bankruptcy Law. However, Article 70 of the Banking Law states that the Bankruptcy Law does not apply to banks. Articles 70-102 of the Banking Law determine the procedures governing insolvency of banks, which is governed largely by the CBI and a special court called the Financial Services Tribunal.

This is a common dynamic with regard to the relationship between statutes and regulations – often times, laws are passed that contain broad language or are difficult to understand. A regulatory agency (in this case, the CBI) will then interpret the statute and issue specific regulations that inform individuals of their specific legal requirements.
For example, Article 30 of the law prohibits banks from making extremely large investments in only a small number of companies, but does not specify the exact level of investment that is prohibited. Similarly, Article 32 prevents banks from investing exclusively in foreign currencies, but does not establish an exact level of foreign currency exposure that is prohibited. These specific questions must be answered in subsequent regulations or orders from the CBI.

The statute provides the CBI with very extensive authority to issue these types of regulations. Article 104 establishes that the CBI "shall have the power to issue regulations, orders, guidance, and information to facilitate the implementation of this Law." These documents are to be published in the Official Publication and the law directs CBI to publish a draft of the proposal before it takes effect. This requirement is designed to give banks and the public a chance to review the proposal and make comments before it takes effect.

Since the passage of the law in 2004, the CBI has issued several regulations and orders. In July 2010, the CBI issued a regulation establishing standards for small and medium-sized banking companies. The CBI also issued additional guidance on capital reserve requirements and policies to assist banks that are failing. Some of these documents can be found on the CBI's "laws and regulations" website but others are not listed there.[4] Understanding Iraq's banking law fully requires a review of the regulations published by the CBI.

4. Penalty Authority

In addition to its many investigative tools, the CBI is authorized by law to issue penalties when it discovers violations of the laws or regulations. These penalty authorities are important because they increase the potential risk of failing to follow the law. One of the key authorities available to the CBI is to suspend a license, which terminates a bank's ability to operate. Article 56 lists a number of other actions the CBI can take when it finds a violation. These range in seriousness from sending a written warning to a bank to dissolving a bank's board of directors (this is a serious penalty because it will likely cease a bank's ability to operate while it finds a new board of directors). In addition, the CBI can give orders to a bank, direct a bank to cease certain operations, and order the firing of bank employees. Article 56 also provides the CBI with the authority to penalize a bank up to 5 million dinars per day if a bank submits false information to the CBI or fails to comply with a CBI order, until the violation has ceased. Article 57 establishes that operating a banking business without a license constitutes criminal fraud. In sum, the statute provides the CBI with significant penalty tools that can significantly disrupt a bank's ability to operate.

E. Risk Management Practices and Financial Soundness Requirements

One of the major purposes of banking regulation is to ensure that banks are making wise investments and properly managing risk. This is an important goal, because **unsound lending**

[4] http://www.cbi.iq/index.php?pid=LawsRegulations.

decisions or **inadequate risk management practices** can expose banks to the possibility of major losses. As discussed in Section II(A), banks earn profits by lending money to individuals and businesses and charging interest until the money is repaid. In addition, banks make money by investing the deposits made by customers in businesses and ventures they believe will be profitable. The central challenge faced by banks and bank regulators is to ensure that banks do not engage in lending or investing behavior that makes it difficult for banks to repay the deposits of its customers or that result in significant losses. Significant bank losses can result in bankruptcy or a bank failure.

A bank failure can threaten the credibility of the banking system and lead people and businesses to withdraw their resources and transfer them to banks located in other countries. It can also raise the cost of borrowing money across the country, if investors begin to believe that Iraq's economy is more risky. In addition, shocks to banking system confidence can raise the overall cost of doing business by increasing reliance on more costly mechanisms of storing and transferring assets.

There are two primary areas of risk that must be managed by banks and bank regulators: (1) unsound lending; and (2) risky investment strategies. Unsound lending refers to the idea of banks giving individuals and businesses money that is not likely to be repaid. Imagine that a bank makes 100 loans to businesses seeking to build housing units. If twenty of these loan recipients have no experience in construction or business, there is a reasonable likelihood that some of their projects will fail and they will be unable to repay the loans. If this occurs, the bank will lose a portion of their assets and may be unable to return money to customers who made deposits. Banking practices and several components of the banking law are designed to promote effective lending practices, such as appropriate oversight and supervision of lending decisions, the use of auditors, and prohibitions on lending to immediate family members.

Second, banks must ensure that the investments that they make are not so risky that they endanger their ability to repay customers' deposits. The banking law attempts to reduce the risk of unsound investment strategies by requiring banks to **diversify** their investments, maintain a minimum amount of assets, and use auditors to review investment decisions and risk. Unlike some countries, Iraq lacks a **deposit insurance mechanism** that guarantees that bank deposits will be returned to customers if a bank fails. Therefore, it is very important that banks and bank regulators take steps to reduce risk and ensure that banks do not fail.

1. <u>What are some bank practices that increase risk?</u>

Understanding risk management concepts will help students understand the purpose of many of the risk management requirements in the Banking Law. This discussion goes into a fair amount of detail about financial soundness concepts. It is not necessary to master all of these concepts, but a review of the material may be helpful and instructive to students.

First, it's important to understand that banks can invest their assets in more risky or less risky forms of investment. A common principle of investing states that riskier assets often offer higher returns in order to attract investment. This principle is governed by the fact that investors have many options and seek higher levels of compensation if the risk of losing money increases.

Banks, like other investors, can choose to invest in more **speculative** forms of investment, such as **foreign currency options**. Or, they can choose to invest in safer assets that offer lower returns in general, such as the **debt** (or **bonds**) issued by governments with stable economies or diversified **funds** that track the economy as a whole. Often times, banks invest in both risky and less risky assets. Banks have discretion to invest in the assets they choose, and these choices affect risk level.

In addition to the desired overall risk level of their investments, banks need to determine the percentage of their assets that will be invested in each financial product, or their **allocation**. A common principle of investing states that investments should not be focused wholly in one area or in one enterprise in order to reduce risk. This concept is commonly referred to as **diversification**. Risk increases as banks or investors reduce the number of investments they target. For instance, if a bank invests 100 percent of its assets in the stock of a large construction company and that company experiences significant losses or goes bankrupt, the bank will lose a significant share of its assets. If, on the other hand, only 15 percent of the bank's assets were allocated in the construction company, the bankruptcy will result in more manageable losses for the bank.

Another source of risk is having insufficient criteria for lending and investment decisions. If banks make lending decisions without understanding the likelihood of a person or business paying back a loan, its level of risk will increase. Often times, banks require individuals to submit information on their personal wealth and income in order to determine whether a loan should be granted. For business lending, banks may require companies to submit a **business plan** or financial records. Banks that make loans based on intuition or personal relationships, rather than likelihood of repayment incur additional risk.

Similarly, banks that make decisions without sufficient oversight or supervision are often at higher risk of making unsound lending and investment decisions. If bank managers make large loans or investments without oversight, they are more likely to engage in risky behavior, make decisions based on intuition or personal relationship rather than financial soundness, and even pursue fraudulent activities that enrich themselves or their friends and families.

One form of risk that is related to the concept of insufficient oversight is over-lending or **over-leverage**, in which banks make loans or investments that are far greater in value than the size of its assets. Imagine a scenario in which a bank has $300 million in **assets** from customer deposits and interest. The bank invests $500 million in the shares of a telecommunications company and $500 million in the debt, or bonds, issued by the central bank of a large, stable country. Even though these assets are fairly low risk, there are two potential problems with the bank's activity. First, the bank has invested in a small number of investments (it has not diversified). Second, the bank does not have enough assets to continue operations if both of its investments fail. If both investments fail, the bank will be unable to pay back customers who deposited money at the bank and may fail altogether.

2. <u>How does the Banking Law try to ensure that banks properly manage risks?</u>

The Banking Law seeks to reduce risks by providing government supervision of activities. These mechanisms include records access, reporting requirements, and licensing. In addition, the Banking Law contains a number of requirements for specific bank activities.

The Banking Law promotes diversification (spreading investments across many projects to reduce risk) in Articles 29, 30, 32, and 33. Article 29 requires each bank to develop policies defining risk management practices and "prudential" maximum and minimum levels of exposure to different types of assets. It's important to note (this will be discussed in greater detail below) that the statute does not specify exactly how a bank should do this or what level of risk meets the standard for "prudential" activity, but states that the CBI will issue specific requirements in the future. One specific requirement can be found in Article 33, which prohibits a bank from investing more than 20 percent of its capital in "stocks, shares, or equity-linked bonds" unless the bank has received prior approval from CBI.

Article 30 sets a maximum level of investment that a bank can make in any single individual or business. The statute establishes that a bank cannot invest more than 15-25 percent of the bank's total capital in any single asset. Article 32 addresses the issues associated with a particularly risky type of asset – investing in foreign currencies. Foreign currencies can fluctuate rapidly, and over-allocation in this form of asset has caused negative consequences in individual banks and even entire national economies. Article 32 states that the CBI may issues regulations setting "maximum foreign currency exposure" for banks. Like Article 29, however, the statute does not set the specific level and banks await specific guidance from the CBI in order to understand this risk management requirement.

Articles 14 and 16 of the Banking Law are designed to ensure that banks have sufficient capital reserves in place to cover their lending and investment decisions. Article 14 requires banks to have a minimum level of 10 billion dinars of net **capital**. Article 16 requires banks to maintain a capital reserve that is at least 12 percent of the total value of its assets. In other words, banks must have a certain minimum level of total resources (net capital) in order to continue operations and to reserve, or set aside, at least 12 percent of its total capital to cover its outstanding investments and lending activity.

A number of provisions of the Banking Law are designed to reduce risk by requiring various forms of oversight of bank practices and decisions. These provisions can be broken into two categories: (1) required internal bank practices; and (2) required information sharing with the CBI.

The internal practices required by the Banking Law to promote internal supervision of banking activities include requiring banks to hire an **independent board of directors** to establish risk management standards and practices. (Articles 17 and 18). Second, the law requires the Board to hire a **chief internal auditor** to verify that the bank is complying with the law and internal bank policies. Third, the law requires banks to form internal audit committees to review bank activities and work with the chief internal auditor. These three requirements are designed to ensure that independent experts establish the bank's guiding principles and oversee its daily activities. The

board of directors sets policies for the bank and the auditors inspect the bank's activities to ensure the policies are being followed by bank staff.

The external oversight mechanisms created by the law require banks to provide annual financial reports to the CBI. The law requires banks to provide statements on a bank's foreign currency exposures, capital adequacy and reserves, and large exposures to the CBI. (Article 41). These reporting requirements are designed to provide the regulator with information related to risky practices that may motivate further investigations. In addition, the reporting requirements may encourage banks to follow less risky strategies, because they know a regulator will be reviewing their practices.

F. Other Important Statutes and Sources of Banking Law

The 2004 banking law cannot be viewed in isolation of other sources of law that affect the way that banks operate in Iraq. Individuals wishing to work at banks, open a bank, or interact with a bank should be aware of several other important statutes, regulations, and constitutional provisions that govern Iraq's banking sector. In addition, we should seek to understand the way that these other laws interact with the banking law, and specifically, how to determine which law **predominates** or takes **precedence**.

1. Company Law No. 21 of 1997 and State Company Law No. 22

Several sections of the 2004 Banking Law refer to Company Law No. 21 of 1997 and State Company Law No. 22. In particular, Article 25 directs banks to follow the 1997 Company Law with regard to the management of the bank by a board of directors and shareholder meetings and orders state-owned banks to follow the rules in Law No. 22 in terms of how the state-owned bank should be organized and managed internally. Lastly, Article 48 directs banks to follow the auditor rules of the Private Companies Law. In a related fashion, Article 42 directs bank audits to follow International Accounting Standards for their annual reporting requirements.

2. Central Bank of Iraq Law of 2004

The Central Bank of Iraq Law was passed on March 6, 2004. It can be seen as a reauthorization of an older statute that first created the Central Bank of Iraq, referred to through this text as "CBI" (Law No. 64 of 1976). The statute establishes the CBI's objectives as achieving domestic price stability and promoting a competitive and stable financial system. The statute provides authority for the bank to serve as the key regulator in charge of maintaining price stability, implementing monetary policy (including exchange rate policies), managing **foreign reserves**, issuing and managing the currency, and (importantly for this chapter) regulating the banking sector to promote a competitive and stable financial system.

Section 3 of the statute establishes the Board of Directors and committee structure that are responsible for managing the CBI. The Board shall consist of nine members including a Governor (Chair), two Deputy Governors, three Senior Managers of the CBI, and three other individuals with suitable experience. The Board Members are appointed by the Head of Government and confirmed by the Legislature for a five-year term of office that can then be extended by re-appointment and confirmation. The Board is charged with meeting at least once

per month and decisions are made based on majority vote of the Board. The statute also provides that the Board can meet with and consult with the Government on issues that can be coordinated (Article 24).

Sections 6 and 7 of the statute bear the closest relationship to the banking sector. Article 28 allows the CBI to purchase or sell different types of **financial instruments** (bonds, foreign exchange positions, bills of exchange, fully secured loans). Article 29 establishes that the CBI will maintain minimum **cash reserve requirements** for licensed banks and to assess penalties if banks fail to maintain these required reserves. The legislation does not specify how the CBI will determine the proper cash reserve level. Article 30 establishes the CBI as **lender of last resort**, authorized to provide financing assistance to licensed banks for up to three months if such assistance is required to preserve the stability of the financial system. Article 39 grants the CBI the authority to regulate, register, license, and supervise systems for clearing and settling payment transactions. Article 40 pertains directly to the supervision of banks, establishing the CBI as the exclusive regulator of banks and allowing the CBI to conduct on and off-site visits and examinations of banks and their records, requiring banks to submit all records to the CBI, and authorizing the CBI to enforce compliance.

The CBI may order non-licensed individuals to cease banking activities and to levy penalties for failing to comply. The statute also establishes mechanisms for the CBI to report its activities and be audited. Lastly, the law bars currency forgery and establishes criminal penalties for such actions.

3. How Do These Various Laws Interact?

It's not totally clear to the casual reader how the terms of these various statutes should interact. There are several strategies that lawyers and those wishing to understand the banking sector should follow. First, it's important to become familiar with the references in the Banking Law to other statutes and to understand where to find those laws. Second, a good strategy is to review the related statute in order to understand where the two bills overlap or intersect. Third, students should search for a provision in the statute that provides instructions on how to interpret these intersection points.

Articles 103 and 107 of the Banking Law serve this interpretation assistance goal. Article 103 states that "The provisions of the Public Companies Law . . . shall apply to banks to the extent that these provisions do not conflict with the provisions of this Law . . . ." This means that banks must follow the terms of the Banking Law as well as the Public Companies Law. In cases of conflict between the Banking Law and the Public Companies Law, Article 107 provides guidance in stating, "In case of inconsistency with a provision of any other law of Iraq, this Law (the Banking Law) shall prevail." So, in cases where the Banking Law and Public Companies Law have inconsistent provisions or requirements, banks should follow the terms of the Banking Law.

III. Investment Law

A. Investing in Iraq

Investment refers to the activity of committing money to a project in the hopes that it will grow, earn revenue, and eventually result in a profit. There are various forms that investment can take – the government can invest in new roads or hospitals (public investment); and individuals and companies can invest in private businesses like cement factories or housing developments (private investment). This chapter is concerned with private investment, and the government's attempt to increase investment by individuals and businesses in projects.

According to the 2013 Doing Business report, the World Bank ranked Iraq 165 out of 185 countries in its overall "ease of doing business" category. This means that the World Bank found Iraq to be one of the most difficult countries in the world to operate a business or invest money. Challenges to investment include the presence of sectarian violence and acts of terrorism, **regulatory hindrances**, difficulties finding **financing**, and other practical barriers to doing business ranging from corruption to electric power shortages. Firms report challenges interpreting procedures for **business visas** and **new business registration**, long payment delays on some government contracts, and **dispute resolution mechanisms** that are neither reliable nor transparent.

Despite these challenges, in 2011, foreign firms and investors reported over $55 billion in investments, service contracts, and other commercial activities across Iraq, an increase of 80 percent over 2010.[5] Another report suggested that **foreign direct investment (FDI)** increased by 52 percent from 2007 to 2011.[6] A number of domestic and foreign investors are attracted by the significant growth potential of Iraq's economy, which grew approximately 10 percent in 2012, making it one of the fastest growing economies in the world.

In an effort to diversify Iraq's economy, create jobs, and attract investment, Iraq's central government and the Kurdistan Regional Government (KRG) have passed legislation to try to improve the business climate. In particular, Iraq passed the National Investment Law (Law No. 13 of 2006) and formed an organization called the National Investment Commission (NIC) to facilitate investment. The KRG passed an investment law of its own (Law No. 4 of 2006) and formed its own investment commission called the Kurdistan Board of Investment (KBOI). The specific provisions and sources of law governing these areas will be the focus of the Investment Law component of this chapter.

Attracting foreign direct investment and encouraging domestic investment can have a number of positive developments. Encouraging investment can create jobs and additional tax revenue. Projects can also lead to the training of Iraqi employees. Consider the following scenario:

---

[5] U.S. State Department, 2013 Iraq Investment Climate Statement (Feb. 2013), available at http://www.state.gov/e/eb/rls/othr/ics/2013/204661.htm.
[6] International Trade Centre, Trade Competitiveness Map (Iraq), available at http://www.investmentmap.org/prioritySector.aspx?selCtry=IRQ&selInds=&selOpt=inward&selYear=.

Hawre has $25 million in assets in a Lebanese bank, which he earned by investing in real estate in Iraq in the 1970s. During the Iran-Iraq war, he decided to move his assets to a bank outside of Iraq because of the security situation. Now, he is considering returning these resources to Iraq to invest in the country's stock market, banks, and a new real estate business. If he makes this transition, Iraq's banks will have access to new capital. They will be able to lend businesses money and to earn returns on Hawre's deposit. These developments may create jobs at the businesses to which the Iraqi bank lends. In addition, if Hawre invests a portion of his resources in a real estate business, the new company will need to hire workers and pay them a salary. It will purchase construction supplies and hire construction workers. The individuals hired by the new business will need to be trained and may learn new skills and technologies that can strengthen the country's human resources capability. Lastly, the new business will pay a certain percentage of its earnings in taxes to the government, which will support investments in education and infrastructure and security services. In sum, investment can support the creation of jobs and economic activity, the strength of the financial sector, and the government's capacity to accomplish its policy objectives.

B. Sources of Investment Law

The two key sources of investment law in Iraq are the National Investment Law (Law No. 13 of 2006) and the Kurdistan Investment Law (Law No. 4 of 2004). As discussed in Working Paper: Federalism and Working Paper: Constitution, Iraq's Constitution provides the central government with exclusive authorities, and the central government and regions with certain shared responsibilities. One of the areas of shared authority in the Constitution is economic planning. Thus, the regions retain the authority to pass their own legislation and make regional policy. For this reason, we see two laws in force across Iraq in the area of investment.

C. Summarizing Iraq's Investment Law

Now that we've reviewed some of the reasons why investment is important to Iraq and where to find the terms of the investment law, let's look at the key provisions in some detail. The KRG and central government laws follow very similar patterns. Because the two statutes are so similar, this section will focus on summarizing the central government's law and note areas of difference with the KRG statute in footnotes.

In large part, there are three essential components of the statutes:

(1) Scope (which companies can receive investment benefits and the application and review process for benefits);
(2) The specific types of benefits the government will make available to investors; and
(3) The obligations of the investor.

This section will summarize and analyze the key provisions that fit inside the three categories, discussing where they appear in both the central government and KRG laws. In addition, the following sections will highlight areas where the two statutes are inconsistent.

1. Scope of the Statute

As a starting point, it's important to consider which industries and which types of projects can benefit under the terms of the investment law. Article 29 of the National Investment Law establishes that all fields of investment may receive assistance under the law, except for oil and gas extraction and investments in banks and financial companies.[7]
The second scope issue is related to the size of the investment. Article 7 of the federal law establishes that qualifying projects shall meet a minimum capital requirement before being considered for investment benefits. This level is not established in the statute and the Council of Ministers has not yet issued a regulation specifying a minimum amount.

The third and final issue to be addressed in this subsection is how investors can apply for benefits and how the government will review applications. To understand this process, we'll also need to review the government agencies created by the laws and the standards that they use when considering applications for licenses.

Government Authorities: The federal investment law creates a new government agency responsible for administering the provisions of the law. The new agency is given the responsibility of establishing a national investment strategy and policies, issuing regulations, reviewing applications from investors wishing to receive benefits under the law, and streamlining government services for investors.

Articles 4 and 5 of the federal investment law describe the structure of the new federal investment agency, called the National Commission for Investment (NCI). The Commission is to be managed by a nine-person Board of Directors. Indicating the close relationship between the NCI and the Prime Minister, the statute establishes that "the National Commission for Investment shall be connected to the Prime Minister," and allows the Prime Minister and Council of Ministers to dismiss board members.[8]

Licensing Process: Whether an investor qualifies for special treatment under the investment law depends on the approval of a license application. Article 7 of the federal law establishes that applications will be reviewed within 45 days. Article 19 of the statute lists the required criteria for an investment license application. Applications must include a statement of financial competency from an accredited bank, a list of projects managed by the investor, details of the project and its economic feasibility, and a timetable for completing the project.[9]

[7] The KRG law also provides support for a broad range of industries in Article 2. The key difference is that the KRG statute allows the regional government to provide investment incentives to banks and financial institutions. In addition, the KRG law allows the regional government to provide assistance to oil and gas companies, whereas the National Investment Law prohibits assistance to oil and gas companies.
[8] The KRG law establishes an agency called the Investment Board of the Kurdistan Region in Article 10. Unlike the federal law, the regional statute does not specify the composition of the Board. Like the NCI, the work of the Investment Board of the Kurdistan Region is overseen closely by the Prime Minister of the region.
[9] The KRG investment law does not list the required criteria for an investment application. Interested applicants are directed by the KRG investment website to contact the regional offices in Erbil, Sulaymaniah, and Duhok to learn more about the application process.

2. Benefits for Investors

Both the KRG and federal investment laws provide approved investors with five types of benefits:

(a) Preferential tax treatment;
(b) Exemption from import duties (tariffs);
(c) Access to land;
(d) Streamlined government service; and
(e) Enhanced freedom to use capital.

(a) Preferential Tax Treatment: Article 15 of the federal law provides significant tax benefits to licensed investors. The statute exempts investors from all non-**customs** taxes and fees for a period of ten years from the point at which commercial operations begin. This means that licensed investors pay no taxes or fees on the **income** they earn on the capital they invest in Iraq.

(b) Import Duties (Tariffs): Article 17 of the federal law provides significant exemptions from customs duties to licensed investors. The federal law exempts all imported assets from customs fees for the first three years following the issuance of the license. In addition, after those three years, licensed investors can import materials that will expand the project capacity by at least 15 percent free of duties.[10] The federal law specifies that import duty preference is only available for materials that are used for the project. In other words, goods cannot be imported duty-free and then resold.

(c) Access to Land: The federal law states that the central government will provide land for licensed investment projects. Article 30 of the federal law establishes that "The Ministry of Finance, and the Ministry of Municipal and Public Works . . . are committed to provide lands and properties appropriate for establishing investment projects." The same article goes on to say that the NCI will then assign the land to the investors with the approval of the Council on Ministers.

(d) Streamlined Government Service: The federal law directs the NCI to coordinate with other ministries to ensure that investment projects receive the reviews they require. Article 20 of the federal statute states that licenses should be issued at a "single window" rather than require the applicant to travel from one ministry to the other. The statute further states that the "Commission must help the investor to obtain licenses by approaching the competent authorities and exploring the opinions of the entities concerning the issuance of the formation license." In case there is a disagreement between the NCI and another ministry, issues shall be "brought before the Prime Minister for settlement." These provisions are designed to promote coordination within the government on issues that relate to a licensed investment.

(e) Free Use of Capital: A number of provisions in the federal law protect the ability of investors to freely use their capital. These measures are designed to provide assurances to investors that

[10] Article 5 of the KRG law provides similar customs fee exemptions, but only allows the initial exemption for two years instead of three. In addition, the KRG law allows licensed investors to import raw materials without customs fees for five years. The national law does not include a raw materials provision.

they will be able to access Iraq's **capital markets** and withdraw profits from the company freely. Article 11 of the federal law establishes that investors can withdraw the capital brought into Iraq and proceeds or **income** earned on their investment. Similarly, the statute allows foreign investors to deal in the Iraq Stock Exchange, form investment portfolios in stocks and bonds, rent or lease lands, insure the project, and open bank accounts in Iraq for the project.

3. Investor Obligations

In return for the many preferences given to investors that qualify under the statute, the bill requires certain practices from them. First, businesses are required to notify the relevant investment commission of the date on which commercial operations begin. This is important because many of the preferences in the law begin on this date. In addition, businesses must submit feasibility plans and records related to their operations. Third, businesses are required to adhere to environmental, labor, and public health standards and laws. Fourth, qualified investors must give preference in their hiring to Iraqi workers and provide them with training. Lastly, investors are required to inform the investment commissions in advance of moving their site of operations, transferring ownership to new investors, selling assets, and **merging** their business. These steps are permitted, but licensed investors must first indicate the changes to the investment commissions. In cases where these obligations are violated, the regional and federal investment commissions have the authority to stop work at facilities and liquidate assets.

IV. Conclusion

Banking and investment laws are important components of a country's economic system. Investment laws can provide businesses with incentives to open new facilities and expand operations. Such incentives can encourage businesses to locate their operations in Iraq instead of other countries. This result can increase the number of jobs available to Iraqis, lead to training opportunities for workers, increase economic activity, and generate new tax revenues. Of course, there are also costs associated with giving investors incentives. For a period of time, the state does not generate tax revenues or customs duties on imported goods for licensed investors. In addition, the state donates land and other resources that it could otherwise sell for revenue. In essence, the government has determined that the benefits of the investment law outweigh these costs. Analyzing the relative costs and benefits may be an interesting area for further study.

Banks and financial institutions are an important component of a national economy. They provide individuals and businesses with a secure place to store money and a mechanism to transfer resources. If banks fail, confidence in these institutions can decrease rapidly, leading people to withdraw their money and seek safer alternatives (including banks in other countries). As a result, a banking law is essential to establishing rules that limit the risk of banks failing or pursuing risky or illegal practices. It remains to be seen whether the current law and the CBI's oversight can effectively prevent these types of practices and provide individuals with confidence that Iraq's banks are safe and secure.