A Central Banker in Iraq

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I. INTRODUCTION

As the world knows, in the spring of 2003, the United States and other allied forces (the "Coalition") invaded the Republic of Iraq and toppled the regime of Saddam Hussein. In doing so, the Coalition assumed control over and responsibility for a country whose many problems included a virtually collapsed banking system. Recognizing that a functioning banking system would be important for Iraq's long term stability and prosperity, the Coalition Provisional Authority (the "CPA"), headed by Ambassador Paul Bremer, established a team of advisors to work with the Central Bank of Iraq, the state-owned banks, and the private banks (the "Banking Team"). This article describes life as a member of the Banking Team, reports on the Iraqi banking system, describes the new Banking Law and Central Bank Law, and concludes with a commentary on Iraq's future.

II. LIFE AS A COALITION ADVISOR IN IRAQ

The staff of the CPA is comprised of civilian and military personnel who are assigned to staff units that in general mirror the different Iraqi ministries (the Oil Ministry, the Justice Ministry, the Finance Ministry, the Health Ministry, etc...). Most of the members of the Banking Team are commercial bankers who have been hired either by the Department of Defense or by the Treasury Department's Office of Technical Assistance specifically to work on the Coalition Staff. The Banking Team also includes full time Treasury staff members and representatives from other government agencies and instrumentalities, including the Federal Reserve and Office of the Comptroller of the Currency. In addition, there are representatives from the United Kingdom...
(including the Bank of England), Poland,\(^4\) Australia, Canada and Italy. All civilian CPA staff members are volunteers and most have signed up for three or six month assignments.

Whatever your parent organization is, a deployment to Iraq as a CPA staff member begins with a blizzard of paperwork and issuance of military travel orders, an official government passport, and Kuwaiti visa. You also visit the Pentagon for a series of shots and Fort Belvior, south of Washington D.C., to be sized for military fatigues, helmet and body armor, receive a medical screening, and be issued a military Combined Access / Geneva Convention Identification Card. Once you have completed your state-side processing, you fly commercially to Kuwait City where you are met by CPA staff members and driven to a Hilton Hotel right on the Gulf which the CPA utilizes as its “rear area.” The CPA has contracted a number of villas at the hotel which are used to house CPA personnel while they receive their final processing before flying to Baghdad. As is the case with virtually all CPA logistical support, the CPA rear area in Kuwait is run by Kellogg, Brown and Root (“KBR”), a civilian contractor which is a subsidiary of Halliburton.

Rear area processing generally takes two days and starts with the issuance of the military equipment you were sized for in Washington plus a gas mask, canteen, web belt, bed and a duffel bag to carry everything in. Next, you receive yet another medical screening, gas mask training, and a briefing on threats and security in Baghdad. The advice given includes helpful guidance like “never pick up anything you did not drop because it might blow up” and “always stay as flat as possible against the ground during a rocket or mortar attack because most of the explosive force and shrapnel spreads upward and outward from the impact site in V pattern.”

After you have completed your rear area processing, you are scheduled for a flight to Baghdad International Airport (“BHI”) in a U.S. Air Force C-130 military transport. Military transport is currently the only way to fly to BHI because the only civilian airline which was flying to BHI, Royal Jordanian Airline’s affiliate Royal Wings, suspended service after a DHL cargo aircraft was hit by a missile in November of last year while operating out of BHI. You travel by bus to the Kuwaiti air base that the C-130s depart from and in the process you get your first experience with multiple layers of defense and security checks that are a staple of life in Baghdad. Once your aircraft is ready to receive you, you board and try to get as comfortable as you can sitting on top of each other on web netting in a windowless aluminum tube that is deafening loud and alternately roasting and freezing as you climb and descend. The arrival at BHI can be quite memorable because the Air Force crews use a very steep, maneuvering descent (not unlike an alpine skier cutting back and forth as he descends steeply) to make themselves a more difficult target.

As you exit the aircraft, you are immediately struck by two things (at least from May to October): the heat and the dust. Depending on the day, it can

\(^4\) As of this writing, the Banking Team is supervised by Marek Belka, a former Minister of Finance for Poland who is currently serving as the CPA Director of Economic Development.
feel like walking into a blast furnace. Compounding the heat is a very fine dust
hanging in the air. The dust in Iraq has the consistency of talcum powder and is
as easily stirred up. By the time you have claimed your luggage from the large
pile on a pallet that rode in with you on the C-130 and loaded your luggage onto
the bus that will take you to the CPA's headquarters in Baghdad, you are
thoroughly sweaty and dusty and wondering how our troops ever fought in
conditions like this. As the bus departs the airport, you realize this will not be
an ordinary bus ride. The driver tells you to put your body armor and helmet on,
there are U.S. Army Humvees with machine guns escorting the bus front and
rear, and the whole procession drives at breakneck speed from the time it leaves
the security of the airport until it reaches the secure area around the CPA's
headquarters known as the "Green Zone".

The CPA utilizes one of Saddam's former palaces in the very center of
Baghdad on the west bank of the Tigris as its headquarters (the "Palace"). The
fact that many of the government buildings around the Palace were bombed into
rubble while the Palace was left untouched suggests that the Coalition planned
all along to use the Palace as its headquarters. The Palace is built of marble,
stone, and concrete and, until recently, was adorned with four huge busts of
Saddam looking down on the Palace grounds. The Palace grounds, which no
doubt used to be very lush and manicured, are now overgrown and unkempt and
filled with trailer camps which house the vast majority of the CPA staff. These
trailers are each surrounded by sandbag walls which protect them from all but a
direct hit on top by a rocket or mortar. There are also sandbag fighting positions
spread around the Palace grounds to defend against any "bad guys"5 that
infiltrate the Green Zone.

The interior of the Palace is largely marble. There is a large rotunda at
the main entrance, several dozen two and three room suites, and three very large
halls. The various CPA staff units, which, as stated above, largely mirror the
various Iraqi ministries (i.e., Oil, Finance, Health, Trade, Justice, etc . . . )
occupy the various suites. Of the three large halls, one now functions as the
CPA cafeteria, another has been turned into a 250 person dormitory, and the
third has been divided into dozens of plywood offices. There is only one kind of
light fixture in the Palace (chandeliers) and only one kind of plumbing fixture
(gold plated). Like the Palace grounds, the interior of the Palace has seen better
days. It is very crowded, there are computer network and power cables running
everywhere, and it has been gerrymandered by plywood walls installed to create
additional office space. The Palace is also a highly militarized environment.
Approximately half of the Palace staff consists of military personnel, most of
whom carry weapons at all time. In addition, a significant percentage of the
civilian staff carry weapons. Any "bad guys" who managed to gain access to
the Palace would be walking into a shooting gallery.

5 Between supporters of Saddam, disgruntled former members of the Iraqi Army, religious
extremists, and foreign terrorists, the mix of parties that attack Coalition forces is so diverse that the
CPA staff generally just refers to them with the catchall phrase "bad guys".
There is no such thing as a typical day for a member of the CPA Banking Team, but there is at least something resembling a typical schedule. Most advisors generally arrive at the Banking Team’s Palace office between 8 a.m. and 9 a.m. and start their day by checking for overnight e-mail from Washington. Following that, on every day except Friday, which is the Muslim Sabbath, most of the Banking Team departs the Green Zone for the specific Iraqi entity that they advise: the Central Bank, the Ministry of Finance, one of the state-owned banks, or the private commercial banks. While at these entities, the various Banking Team members collectively work on a very large range of matters, including assessing the financial condition of various institutions, exchanging old currency for new (a major undertaking that was successfully completed on February 15, 2004), restarting the check clearing system, auctioning dollars for dinars to stabilize the value of the dinar, developing monetary policies and mechanisms to implement that policy (including a government securities market), developing an electronic funds transfer system, training bank examiners, promoting modern banking practices, and cataloguing Iraq’s external debt. Banking Team members generally work at the Iraqi entities that they advise until about 2 p.m., which is when the Central Bank, the state-owned banks and most other businesses close for the day. Most Banking Team members usually arrive back at the Palace between 2 p.m. and 3 p.m. and the first half of their work day is complete.

When they arrive back at the Palace, Banking Team members sometimes run personal errands (like picking up laundry, checking for snail mail, getting a haircut, cashing a check, and buying toothpaste) and return to the Palace office about 4 p.m. to begin the second half of their day. 4 p.m. in Iraq is 8 a.m. on the east coast and Washington is beginning its day. Shortly thereafter, the daily blizzard of questions, comments, suggestions, and instructions begins. In between responding to these messages, Banking Team members try to do the substantive work associated with their various projects. There is generally a team meeting at some point each night to discuss that day’s developments. Most Banking Team members work until at least 10 p.m. and often until midnight or later. They then head to their trailers for a few hours of sleep before rising and starting it all over again, seven days a week.

Living conditions for the CPA civilian staff have always been much better than living conditions for troops in the field and those troops deserve tremendous respect and thanks for the privations they have endured. That said, life in the Palace has not always been a bed of roses. The first wave of CPA staff members who arrived at the Palace immediately after the invasion worked and lived without air conditioning in temperatures that frequently reached 120 degrees or more during the day and rarely got below 90 degrees at night. They slept on cots under mosquito netting, ate military rations, and bathed by pouring bottles of drinking water on themselves. Fortunately, conditions in the Green Zone have improved considerably in the year since the invasion. The Palace is now air conditioned, as are the trailers where most CPA staff members sleep two to a room in real beds. There is a laundry trailer where CPA staff members can drop their laundry and get it back in two or three days, a post office trailer to
receive and send snail mail, and even a well stocked “PX” to buy personal incidentals.

As mentioned above, one of the large halls in the Palace has been converted to a cafeteria that serves four meals a day complete with trays, plastic utensils, and a choice of desserts. Other amenities in the Palace include a barber shop for men, a beauty salon for women, a military finance office that cashes checks, and a medical clinic. A hanger adjacent to the Palace which used to house helicopters for use by Saddam has been converted into an excellent gym with treadmills, exercise bikes, and weights. One advantage of living and working in a federally designated war zone is that everything is free. Food, housing, haircuts, laundry, transportation. All free. Even sending letters is free. You just write “free mail” where the stamp would ordinarily go and drop it in the mail slot. The only thing civilian CPA staff members pay for are personal incidentals like shaving cream and toothpaste.

There are many unique challenges associated with working in Baghdad. Chief among these are communication, transportation, and attacks by the bad guys. Communications may be the most frustrating challenge faced by CPA staff members. As of this writing, the Central Bank has only recently received very limited phone service and only a small percentage of the branches of the state-owned banks and private banks even have limited service. To talk to each other, all of the CPA staff and a very limited number of Iraqi government officials and private sector representatives rely on a local mobile phone network established by the CPA which has mediocre coverage at best and is frequently overwhelmed by volume. It does not take very much imagination to conceive how difficult it is to run a country when simply trying to contact Iraqi officials to schedule a meeting is a major production. While the CPA staff has a robust e-mail system in the Palace, e-mail outside of the Green Zone is very limited and is generally satellite based (which is slow and expensive). Many modern banking practices - such as wire transfers, ATMs, and direct deposit - are of course impossible in a stone age communications environment like this. Not only that, but individual branches of the same state-owned bank often will not even honor checks drawn on each other because they can not talk to each other and confirm balances.

Transportation is a close second to communications in terms of frustrating challenges faced by CPA staff members. Because of the threat of car jackings, kidnappings, and roadside bombs, CPA staff members generally do not travel outside the Green Zone without a security escort of some kind. If requested to do so in advance, the U.S. military will supply an escort consisting of two Humvees with mounted machine guns and five to eight heavily armed troops to proceed and follow a Suburban carrying CPA staff members. The whole procession is very impressive and no person with any hope of survival would ever attack it. The problem is that the bad guys don't always care about survival and the procession of firepower that is meant to deter the bad guys just highlights the presence of a potential target. On top of that, all of the Suburbans and most of the Humvees utilized to escort and transport CPA staff members are "thinned skin", which means they have no armor plating and can be pierced by a
reasonably high powered BB gun, much less an AK-47 round or improvised explosive device. A final disadvantage of the U.S. military escort service is that it must be arranged two full days in advance and can not easily accommodate last minute changes in destination, desired arrival times, and numbers of persons to be transported.

Because of the drawbacks of the military’s escort services, a number of the civilian contractors and foreign delegations working in Baghdad have retained their own commercial security services. The Banking Team ultimately retained the same commercial security service that the British government uses to protect the U.K. members of the CPA staff. Comprised largely of former members of the British Army, this service has an entirely different approach to security. They use unmarked Landrovers which have heavy armor plating and are much smaller than the Humvees and therefore do not get stuck in traffic on the narrow Baghdad streets as often as Humvees do. The Landrover carrying the "protectees" has a driver in the left front seat and a "shooter" in the right front seat and is followed by a second Landrover which carries two more "shooters" to defend the protectee vehicle if it comes under attack and to serve as an escape vehicle if the protectee vehicle is disabled. All the escorts wear plain clothes and keep their weapons concealed. Body armor is worn, but it has to be blue or tan and not the camouflaged type the U.S. issues. The result is much lower profile procession which attracts a lot less attention, has a better chance of surviving an attack (because of the vehicle armor), and is better suited to a rapid escape from the scene of an attack.

A final challenge faced by CPA personnel trying to work in a war zone is war. Even car bombs which detonate at some distance from the Palace can be clearly heard in the Palace and frequently create a very uncomfortable moment of uncertainty as to what has just happened and what may be just about to happen. The sound of automatic gunfire is also very common in Baghdad and can likewise create uncomfortable moments of uncertainty. Gunfire can mean anything from the imminent detonation of a large car bomb to an Iraqi who is simply shooting into the air because he is either very angry or very happy. Much to the disquiet of the CPA advisors to the Central Bank, the Iraqi guards that protect the Central Bank have been known to use their AK-47s to shoot at suspected shoplifters in the crowded market place across the street from the Central Bank.

While the vast majority of attacks on Coalition forces have occurred outside of the Green Zone, there have been numerous mortar and rocket attacks against the Green Zone itself. While these attacks are completely inconsequential from a military perspective, they can still be very unsettling from an individual perspective – especially if you happen to be caught outside the Palace or sleeping in your tin-roofed trailer during one. Mortar and rocket attacks on the Green Zone often occur between nightfall and midnight so that the attackers can benefit from the cover of dark while still also benefiting from sufficient traffic and other activity on the streets of Baghdad to disappear into. Attacks typically consist of one to four mortars or rockets whose detonations can
be remarkably loud even at a distance of several hundred yards. One ironic aspect of mortar or rocket attacks on the Green Zone is that they typically last such a short period of time that the “Giant Voice” alert system installed by the military to warn personnel about an attack often does not blow its siren and audibly announce “Attack, Attack” in its loud androgynous voice until well after the attack is over. Palace personnel generally take cover in the Palace basement during attacks and sometimes have to spend as long as two hours there while the military locates the launch site, confirms that another attack is not imminent, and checks the Green Zone for any bad guys who may have infiltrated under the cover of the attack.

While living and working in Baghdad is not easy, and can even be hazardous at times, every CPA staff member would tell you that it is still very satisfying to play even a small role in helping the Iraqi people to achieve peace, stability, and prosperity.

III. IRAQI BANKING INSTITUTIONS

a. The Central Bank of Iraq

After the Green Zone, the Central Bank of Iraq (the “CBI”) is probably the second most fortified location in Baghdad. Located on Rasheed Street just a few blocks east of the Tigris River, the CBI is situated in a compound surrounded by a twenty foot-high barbed wire fence, sand-filled blast deflectors, observation towers, and AK-47 toting Iraqi guards. Conveniently (especially in light of the absence of phone service), the head offices of the two largest state-owned banks, Rafidain Bank and Rasheed Bank, are located in this same compound. The CBI occupies three buildings in the compound, all of which were stripped bare during the looting that occurred immediately after the invasion. The completeness of the looting can not be overstated. Every single piece of furniture, every single computer, every single piece of office equipment, and every single office supply was taken. On top of the looting, all of the CBI’s below ground level space, including its vaults, was flooded when the power was lost and the pumps that normally hold back ground water from the Tigris stopped working. The end result of the looting and the flooding was a dark, dreary, dirty building with bare concrete floors and walls that took months to clean up and refurnish.

The CPA’s efforts to resurrect and modernize the CBI swung into high gear on July 7, 2003, when Ambassador Bremer issued an order that declared the independence of the CBI from the government and prohibited the CBI from financing the government. Things began to happen quickly thereafter.

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6 Since the sound of a detonation is not always a reliable guide to its proximity, at one point the Banking Team decided that a detonation would not be deemed “close” unless it shook the Banking Team’s Palace office sufficiently to displace dust from the light fixtures and plaster from the ceiling.

7 This order and almost all of the other assistance provided by the CPA to the CBI was orchestrated by the lead and longest serving CPA advisor to the CBI, Simon Gray from the Bank of England. Simon deserves tremendous credit for his Herculean and effective service as an advisor to the CBI.
With the assistance of the International Monetary Fund, a new Central Bank of Iraq Law was prepared that endowed the CBI with the powers and responsibilities of a modern central bank. In furtherance of its monetary policy responsibilities, in September of 2003, the CBI established a daily dinar / dollar auction intended to stabilize the value of the Iraqi dinar (the "ID") by providing a reliable and transparent supply of dollars in exchange for ID. Beginning with total bids of just $20,000 when the auction was first established, the total value of dollars sold at the daily auction now routinely exceeds $10 million and on occasion has exceeded $20 million. During this period, the ID has appreciated from an exchange rate of ID2300 per dollar to ID1400 per dollar. Concurrently, the CBI oversaw the exchange of approximately 5 trillion old dinars, bearing Saddam's image, for new dinars through 240 exchange sites, mostly banks. This exchange involved the equivalent of twenty-seven 747 plane loads of currency that had to be distributed in the face of significant security risks. An equal amount of old currency had to be gathered and destroyed.

At the same time that it was conducting the currency exchange, the CBI was also soliciting and analyzing applications from foreign banks for Iraqi banking licenses. Three foreign banks were ultimately selected for licenses: Hong Kong Shanghai Banking Corporation, the National Bank of Kuwait, and Standard Charter Bank. The introduction of these foreign banks into Iraq is expected to result in a significant transfer of banking technology, modern services, and best practices.

Another major effort by the CBI and its CPA advisors is to renew and expand the collection of economic data, especially GDP and consumer price statistics. The CBI, the Iraq Central Statistical Office, and various ministries all collected such data during the previous regime, but the accuracy and completeness of that data and the collection methods used to acquire it are dubious at best. Significantly upgrading the accuracy and completeness of economic data is one of the CPA's top economic priorities because of the importance such data plays in formulating monetary policy and also in qualifying for an IMF program. An IMF program will in turn be critical to the resolution of Iraq's tremendous external debt, not so much because of the disbursements that are likely to flow to Iraq under such a program as because an IMF program is one of the requirements for a Paris Club agreement among Iraq's sovereign creditors to forgive and reschedule Iraq's debt.

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8 The Central Bank of Iraq Law is discussed in greater detail below. While almost all of the CBI Law was quickly prepared and agreed to, the resolution of a very few issues delayed issuance of the law until March 6, 2004.

9 Estimates of Iraq's external debt vary, but it is most often thought to be approximately $120 billion. One of the Banking Team's top priorities is to accurately identify and reconcile such debt. Whatever the exact amount of external debt is, it is clearly unsustainable and it is going to be necessary for creditors to grant Iraq significant debt reduction. If Iraq's external debt is indeed in the range of $120 billion, interest payments on that amount alone would equal about 37 percent of Iraq's estimated 2004 GDP. According to Senior Director of Sovereigns at Fitch, James McCormack, "Iraq's total external debt needs to fall approximately 90 percent to $14 billion for its interest service burden to compare with the median for sovereigns rated B+ or lower by Fitch. Fitch: Iraq's $120 billion debt unsustainable, AL-BAWABA NEWS, Feb. 26, 2004, available at 2004 WL
The development of monetary policy for Iraq is one of the Banking Team's greatest challenges. Not only is the economic data necessary for the formulation of monetary policy largely absent, so is any significant mechanism for implementing monetary policy. Currently the only tool the CBI has to influence the supply of domestic money is its daily dollar auction. In the absence of good inflation data, the foreign exchange rate is the only market price that is indicative of inflation trends and the CBI's efforts to contain inflation are limited to utilizing the daily auction to implement a managed float foreign exchange policy. Clearly it would be desirable to have more monetary policy tools at the CBI's disposal and the Banking Team is actively working to develop a primary and secondary market for Iraqi government securities.

One of the major new responsibilities of the CBI is to operate and manage the Development Fund for Iraq (the “DFI”), which was established at the CBI by United Nations Security Council Resolution 1483 (“UNSCR 1483”) of May 22, 2003, to receive and hold international grants to Iraq and the proceeds of Iraq's oil sales. As of this writing, more than $12 billion has been deposited in the DFI and the DFI's current balance is approximately $8 billion. Most of these funds are held in the CBI’s DFI account at the Federal Reserve Bank of New York, where they are immunized from attachment by a Presidential Executive Order dated May 22, 2003. This Executive Order was issued under the International Emergency Economic Powers Act to implement the provisions of UNSCR 1483, which called for nations to prohibit attachment of Iraqi oil proceeds, whether they have been deposited into the DFI yet or not, and all DFI accounts. DFI assets held by the New York Federal Reserve are currently disbursed to Iraq as directed by the CPA on behalf of the CBI, but, in anticipation of the return of sovereignty to Iraq, operational control over the DFI is in the process of being transferred to the CBI.

If all of the substantive challenges facing the CBI weren't daunting enough, the CBI also faces daunting communication and information technology challenges. As of this writing, a full year after the invasion, only a very limited...
amount of external phone service has just recently been restored to the CBI and power disruptions are still common. Likewise, the CBI has only recently acquired a handful of computers and most of these are not networked. External e-mail is available to less than a dozen persons and is satellite based, which is expensive and slow. There has never been an electronic funds transfer system of any kind in Iraq and the Banking Team is hard at work establishing a rudimentary lap-top based system that will depend on satellite communications and feature less than 100 terminals in a country with approximately 24 million people. Most importantly, the CBI still has no SWIFT connection, which will be critical to the CBI’s ability to manage the letter of credit process associated with Iraqi oil sales and also to manage the DFI funds on deposit with the New York Fed.\textsuperscript{12}

b. The State-Owned Banks\textsuperscript{13}

There are six state-owned banks in Iraq. They include the two largest commercial banks: Rafidain Bank and Rasheed Bank, which together have a market share of almost 90% and over 11,000 employees. In addition, there are four special purpose banks: Real Estate Bank, Agriculture Bank, Industrial Bank and the Socialist Bank. These banks were established for the purpose of lending money for the specific purposes implicit in their respective names.

The state-owned banks were hit hard by the economic and financial turmoil associated with the eight year war with Iran, the First Gulf War, the twelve years of economic sanctions that followed the First Gulf War, and the destruction and looting that occurred following the Coalition occupation in 2003. In addition, the financial condition of most bank customers was significantly impacted and a large percentage of the loans on the books of the state-owned banks are non-performing. While the banks are making efforts to help customers restructure and reschedule past due amounts, these efforts are complicated by the reluctance of many customers to service their debts because they hope for a government bail-out at some point.

The state-owned banks are in an archaic state. Twelve years of economic sanctions left bank technology in a rudimentary state and payment systems in disarray. Any such systems that existed prior to the invasion were

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\textsuperscript{11}SWIFT is the standard secure communication system used by central banks and large commercial banks around the world to send authenticated messages to each other and effect international funds transfers.

\textsuperscript{12}It is currently anticipated that the CBI will obtain a SWIFT connection in June. In the absence of a CBI SWIFT connection, the New York Federal Reserve has facilitated communications between the CBI and commercial banks which have issued letters of credit on behalf of purchasers of Iraqi oil. As of this writing, the New York Federal Reserve has facilitated more than $8 billion worth of Iraqi oil sales.

\textsuperscript{13}Most of the information contained in this article concerning any of the state-owned banks in Iraq was drawn from a report prepared in December 2003 by Haydar Al-Uzri, the CPA’s Senior Advisor to Rafidain Bank. A copy of this report is on file with the author. This article specifically does not include balance sheet information for the state-owned banks because the Banking Team is still assessing their financial condition.
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destroyed and looted immediately after the invasion. Land-line telephone systems are still largely inoperable, proving a major obstacle to any modernization efforts. Satellite systems are now available, but their expense limits their use. Checks take up to five days to clear within Baghdad and up to three weeks in the rest of the country. Because banks have no way to confirm balances with each other, customers are only able to cash checks which are drawn on their own branch of the same bank. Credit cards and ATMs are nonexistent. Even cash registers are uncommon.

For the most part, the state-owned banks only offer basic services. These services include current and savings accounts, time deposits, short-term overdraft and bills discounted facilities, short-term loans and advances, and bid, advance payment, and performance bonds. Loans with a term over one year are uncommon. Specialized lending is confined to the respective specialized banks; real estate lending to the Real Estate Bank, industrial loans to the Industrial Bank, agricultural loans to the Agricultural Bank and consumer loans to the Socialist Bank. Credit analysis is limited almost entirely to appraising the value of loan collateral. The overwhelming majority of loans are secured by real estate and it is rare to lend more than 30% of the value of the collateral. Other than real estate appraisal, the credit analysis process is very weak. Cash flow analysis is virtually unknown.

Prior to the Coalition invasion, only state-owned banks could lend to state-owned enterprises ("SOEs"). However, the damage sustained by the SOEs in post-invasion looting coupled with the questionable economic viability of many of the SOEs to begin with, means that public sector debt on the books of the state-owned banks is virtually all non-performing. Paradoxically, while the banks' loan assets are virtually non-performing, bank liquidity is high. As the introduction of the new dinar currency by the CPA drew closer, it triggered a tremendous growth in bank deposits. A substantial amount of these new deposits are expected to remain within the system.

In addition to being heavily involved in SOE lending, the specialized banks were heavily involved in lending to regime-related entities and persons. In practice, at least in recent years, these banks have been conduits for special loans to persons or companies favored by the former regime, especially in the case of the Socialist Bank and the Industrial Bank; for loans on below market terms for farmers and other agricultural businesses (the Agricultural Bank), and housing loans on below market terms (the Estate Bank).

In an effort to kick start the Iraqi economy, the CPA has encouraged Rafidain and Rasheed Banks to establish lending programs targeted at small and medium enterprises ("SMEs"). Initially, loans made under the program were limited to $50,000 with a maximum term of two years. The parameters of the SME lending program were subsequently amended to increase the upper limit to $250,000 and a maximum term of five years. Importantly, the credit approval

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process was reduced from two months to two weeks. As of March 1, 2004, Rafidain and Rasheed Banks had approved over 300 SME loans with a total value of over $8 billion.

i. Rafidain Bank

Iraq's largest bank, Rafidain Bank was founded in 1941. In 1964, the offices of seven foreign banks operating in Iraq were nationalized and merged into four state-owned Iraqi banks, one of which was Rafidain Bank. In 1971, further consolidation reduced these four banks to just two, and subsequently, in 1974, Rafidain Bank became the country's only state-owned bank. In the 1970s, Rafidain was among the top largest 100 banks in the world and was the premier international bank in the region. But years of government directed activities and under investments have dramatically degraded Rafidain's banking skills, systems, and facilities.

Rafidain has 170 branches, 70 branches in Baghdad and 100 in the rest of the country. It also has 10 branches in the autonomous area of Kurdistan, which have operated independently from the head office since 1991. In addition, Rafidain has 9 branches abroad in London (under liquidation), Amman, Cairo, Abu Dhabi, Bahrain, and Sana'a. Because online communication and data transfer between the branches and head office are non-existent, Rafidain's branches operate as independent unit banks. Data is physically transferred monthly by discs and figures are then aggregated. The bank produces a consolidated balance sheet at the end of the year.

Among the many challenges Rafidain faces, two of the biggest are rebuilding its operations domestically and resolving its huge foreign obligations. The bank had been used by the government since the 1980s to finance its growing budget and trade deficits. The Iraq-Iran war drained the government's coffers and it utilized Rafidain's international reputation to raise funds in the markets. The consecutive wars and the international sanctions left Rafidain unable to meet these foreign obligations. Loans and trade obligations were rescheduled, and still not serviced. Now Rafidain has foreign debt in excess of $20 billion, almost all of which was incurred on behalf of the government. The bank's assets are subject to attachment, and its branch in London is under liquidation.

ii. Rasheed Bank

As just discussed, by the late 1980s, Iraq's war with Iran, trade deficits, and growing state budgets had left Rafidain Bank heavily burdened with foreign debt. In its effort to find a new source of financing, the government spun off a new state-owned bank, Rasheed Bank, from Rafidain Bank in 1989. Almost half of Rafidain's branches were utilized to form Rasheed Bank with an initial capital of ID1 billion that was later increased to ID2 billion. The government anticipated that by leaving all of Rafidain's debt with Rafidain while utilizing
Rafidain’s balance sheet to capitalize a new, debt free bank, the new bank would be able to tap new international financing.

Rasheed Bank has 170 branches in Iraq and almost 7000 employees. It also has 10 branches in autonomous Kurdistan that have been operating independently from the main bank since the First Gulf War. Because of communication difficulties, most Rasheed branches operate as independent unit banks. Electronic communication and transfer of data between the head office and its branches is nonexistent. Data is physically transferred by discs every month when balance sheets are aggregated. As with Rafidain, many years of government directed activities and under investment have left Rasheed Bank with deteriorated banking systems and inadequate banking skills.

iii. The Estate Bank

The Estate Bank was established in 1948 to provide long-term home construction loans. It began operations in 1949 with an initial paid-up capital of ID1 million, which was increased to ID1.1 billion in 1992. In 1996, its mandate, together with the mandates of the other specialized banks, was broadened to permit the same loans, advances, and investments which are permissible for commercial banks. While the Estate Bank’s permissible activities have been expanded, its business remains predominantly in personal loans for housing and it is estimated that such loans constitute 80% of the bank’s loan portfolio. The bank also makes loans for commercial building construction.

iv. The Socialist Bank

The Socialist Bank was established in 1990 to provide small and medium sized loans to needy individuals, including government employees, handicapped persons, widows, soldiers, and similarly situated persons. Its initial paid-up capital was ID1 billion. Even though its mandate was broadened in 1996 to permit the same loans, advances, and investments which are permissible for commercial banks, the bank’s business continued to consist primarily of personal loans.

Notwithstanding the bank’s original charter, its business appears, at least in recent years, to have been dominated by so-called “special loans” made to individuals at the direction of the former government, funded from long term loans to the bank by the Presidential Palace or the Central Bank. Based on information provided by the bank, individual special loans appear to have been substantially greater than those made in the ordinary course of its business. The former were typically in excess of ID5 million (ranging up to ID 15 million) while the latter are typically less than ID5,000 (and range down to as little as ID500).
v. The Agriculture Cooperative Bank

The Agriculture Cooperative Bank was established in 1935 to provide agriculture related lending services. The bank’s main business involves the acceptance of deposits from individuals, private sector and mixed companies, and financial institutions, and lending for agriculture projects and other activities. It has 42 branches. During the period from 2000 to 2002, the bank was also used as an intermediary or agent of the former government to make low interest, short to medium term medium sized loans to farmers to finance farming equipment and to dig irrigation wells and channels. These loans were funded by the Ministry of Finance and made to farmers selected by the Minister of Irrigation or local governor.

vi. Industrial Bank of Iraq

The Industrial Bank of Iraq was established in 1935 to accept deposits from individuals and companies and to mobilize the funds received for investment in industrial projects and companies. The bank’s main business is the provision of current account and time deposit account for individuals, private and mixed sector companies, and financial institutions; and lending to support industrial projects and investing, including taking direct equity holdings, in private and mixed private/state companies. The bank has a head office in Baghdad, a branch in Baghdad and a branch in each of Basra, Mosul and Hilla/Babylon. All five branches were badly looted following the Coalition invasion and only one has reopened. With the exception of the Basra branch, which was totally destroyed, the other branches are being restored.

c. The Private Sector Banks

Following the First Gulf War and its economic consequences for the state-owned banks, Saddam Hussein for the first time authorized the establishment of banks that were not state-owned. The first of these “private banks” was formed in 1992 and, as of March 2004, there are now seventeen private banks in Iraq and two additional private banks are in the process of being licensed. Fourteen of the private banks are headquartered in Baghdad, with one each in Mosul, Arbil and Basra. Currently, these Private Banks operate 89 branches in Baghdad and 50 additional branches scattered throughout Iraq, but few to the west of Baghdad. About fourteen branches have not been reopened.

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15 Most of the information in this article on the private sector banks was drawn from a March 2004 report prepared by the CPA’s lead and longest serving advisor to the private banks, Kevin G. Woelflein. A copy of this report is on file with the author.

16 A complete list of the private banks operating in Iraq, plus contact information, can be found on the CPA’s web site, available at http://www.coalitioniraq.org. There is an eighteenth private bank from the Kurdish area which is in the process of restructuring its balance sheet (which currently reflects nothing but real estate holdings) to one which is more appropriate for a bank.
The biggest challenge currently facing the private banks is a serious shortage of capital. At the time the new Iraq Banking law was passed, none of the private banks were within 50% of the minimum ID10 billion (roughly equivalent to US$ 7.3 million at present exchange rates) capital required by the Banking Law. The Banking Team has advised the private banks that the most practical way for them to raise capital is to seek investment from stockholders or foreign investors. The Banking Team has also advised the private banks to raise more than minimum capital because they will soon be competing against new 100% owned foreign banks which will have minimum capital of ID 50 billion (roughly equivalent to US$ 36 million at present exchange rates). More importantly, these foreign banks will be able to support their Iraq financial presence with the latest bank technology and current market experience and, if needed, with additional capital.

Some of the private banks have indeed partnered with foreign banks. The new Iraq Banking Law allows foreign investors to acquire up to 50% of an existing Iraqi bank without going through the licensing procedure. The first private bank to take advantage of foreign investment was the National Bank of Iraq, which negotiated an investment transaction with the Export & Finance Bank, headquartered in Amman, Jordan. Export & Finance Bank bought 49% of National Bank of Iraq’s equity for a multiple of book value in excess of ten, and, in so doing, signaled that Iraqi private banks have significant franchise value.

The private banks have also sought to improve their competitive position by seeking the revocation of the constraints placed on them by the former regime. In October 2003, discussions with the CBI led to authorization for all private banks to engage in international payments, remittances and letters of credit. For the ordinary Iraqi, October 2003 marked the first time that they were able to make an international payment since 1979. Re-entering the international market also meant that Iraqi private banks could establish correspondent accounts, particularly with the regional banks in the Middle East.

Once their capital is augmented, their branch network extended, and the latest bank technology installed, many members of the Banking Team believe that the private banks will be a very viable and attractive alternative to the state-owned banks. Many of the private bankers themselves believe the state-owned banks have little competitive spirit and that it will be very difficult to get the state-owned bank branches to cease acting independently as unit banks. In the opinion of the private bankers, this condition has been fostered by the monopoly on government deposits and the convenient opportunity to generate over 80% of their earnings by investing in Iraqi Treasury bills. In addition, the former regime destroyed the public’s trust in the state-owned banks and a cash based economy grew while state-owned banks became nothing more than payment outlets for state welfare.

In the author’s opinion, there is every possibility that in the future, most Iraqis will choose a private bank over a state-owned bank and that the private banks will become the core of Iraq’s banking sector.
IV. BANKING STATUTES

a. The New Commercial Banking Law

The new Commercial Banking Law of Iraq (the “Banking Law”) was promulgated by Ambassador Bremer on September 19, 2003 by Coalition Provisional Authority Order No. 40. The primary objectives of the law were to establish a “safe, sound, competitive, and accessible banking system for the purposes of providing a foundation for economic growth and the development of a stable Iraqi economy” as well as maintaining public confidence in the Iraqi banking system.\(^\text{17}\)

The new Banking Law establishes a comprehensive banking system in which the CBI plays the primary regulatory and supervisory role. The CBI’s important role begins with the bank licensing process. Pursuant to the new law, no person or entity may engage in banking business in Iraq without a banking license or permit issued by the CBI.\(^\text{18}\) In fact, the word “bank” or its derivatives may not be used in any language with respect to a business, product, or service, without a license or permit from the CBI.\(^\text{19}\)

Establishing a bank in Iraq, including a majority or wholly-owned subsidiary of a foreign bank, requires a “prior issuance of a banking license by the CBI,” and a banking permit is needed to establish a branch or a representative office.\(^\text{20}\) Banking licenses are issued only to properly registered companies. Licenses and permits are issued for an indefinite time and specify terms and conditions with which the bank or branch in question must continuously comply.\(^\text{21}\) Licenses are not transferable.\(^\text{22}\) Where a new bank, branch, or a representative office is sought to be established by a foreign bank, a banking license or a permit may be issued only if the foreign bank is subject to consolidated supervision in its home country.\(^\text{23}\)

Importantly, the Banking Law guarantees that banks controlled, partially or totally, by foreign persons, will be treated the same way as domestic banks.\(^\text{24}\) Currently the number of licenses for banks controlled by foreigners is limited to six; however, the Banking Law does not contemplate any limits to the number of foreign-owned banks in Iraq after the end of 2008.\(^\text{25}\) 


\(^{18}\) Banking Law of Iraq, Art. 3.1.

\(^{19}\) Id. at Art. 3.4.

\(^{20}\) Id. at Art. 4.1.

\(^{21}\) Id. at Art. 4.2.

\(^{22}\) Id.

\(^{23}\) Id. at Arts. 4.3-4.4.

\(^{24}\) Id. at Art. 4.5.

\(^{25}\) Id. at Art. 4.6. As of this writing, there is some consideration being given to amending the Banking Law to eliminate restrictions on the number of licenses issued to foreign banks all together. At this time it is not possible to predict with any degree of certainty whether this amendment will be made or not.
also own up to 50% of an existing or new domestic bank.26 There are no limitations for minority ownership by foreigners. Foreign banks must be subject to comprehensive supervision on a consolidated basis in their home country jurisdiction to be eligible to own any shares in a domestic Iraqi bank.27

Just as a new bank may not open without first obtaining a license, an existing bank may not voluntarily terminate its operations without first obtaining the CBI’s prior approval to do so in response to the request for revocation of its license.28 The CBI may also revoke a banking license or permit which it previously issued for reasons listed in Article 13 of the Banking Law, such as where the license was obtained by using fraudulent statements; the license was not used for twelve or more months; where the bank conducted its operations in an unsafe or unsound manner; or where it violated a CBI order, to name just a few.29

The new Banking Law contains minimum capital requirements for commercial banks. All domestic banks are required to maintain paid-in capital of at least ID10 billion.30 A bank cannot declare or pay to shareholders any profit if such payment results in a reduction of its capital below the minimum level.31 In contrast, a subsidiary of a foreign-owned bank is required to maintain ID50 billion of capital.32

Pursuant to the new Banking Law, the responsibility for conducting the business and establishing the policy of a commercial bank in Iraq lies with the bank’s board of directors, which must consist of at least five members, appointed for not more than four years (the board members may be subsequently re-appointed for one more term).33 The members of the board of directors must “act honestly and in good faith with a view to the best interests of the bank,” and in carrying out their functions, they must “exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.”34

The board of directors is required to appoint one of its members as the authorized manager of the bank, “responsible for the implementation of the decisions of the board of directors and for the management of the day-to-day operations of the bank.”35 The authorized manager, as well as other board

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26 Banking Law of Iraq, Art. 4.7.
27 Id. at Art. 4.8.
28 Id. at Art. 12.
29 Id. at Art. 13. As of this writing, there is some consideration being given to amending the Banking Law to move the license revocation procedure to the conservatorship/receivership portion of the statute, discussed below. At this time it is not possible to predict with any degree of certainty whether this amendment will be made or not.
30 Id. at Art. 14.1.
31 Id. at Art. 14.2.
32 Id. at Art. 4.1. As of this writing, there is some consideration being given to amending the Banking Law to require ID50 billion in minimum capital for all banks, foreign and domestic. At this time it is not possible to predict with any degree of certainty whether this amendment will be made or not.
33 Id. at Art. 17.2
34 Id. at Art. 17.6.
35 Id. at Art. 18.1.
members, members of the bank's audit committee, and designated branch managers (referred to in the Banking Law as “administrators”) must disclose annually to the board of directors “any significant personal financial interests” that they or a family member may have. Importantly, prior approval of the CBI is required for appointing and removing an administrator.

Subject to the terms and conditions of its banking license, a commercial bank in Iraq is authorized to provide a wide variety of financial services, such as: (a) receive deposits; (b) extend credits; (c) buy and sell various money market instruments, foreign currencies and precious metals, stocks, bonds, and derivatives both for its own account and for the account of its customers; (d) issue letters of credit and guarantees; (e) provide clearing and settlement services; and (f) perform various other services, such as money brokering, safekeeping, trust services, financial adviser services, and credit reference services, and the like. Among activities prohibited to commercial banks are business activities, such as participation in wholesale or retail trade, manufacturing, transportation, agriculture, mining, building, re-insurance, or insurance underwriting.

In an attempt to control banks’ risk exposures, the new Banking Law contains prudential requirements as well as various limitations on extensions of credit and bank investments. For example, an aggregate outstanding principal amount of a bank’s unsecured credit to any one person may not exceed 15% of the bank’s capital and reserves. An amount of fully secured credit, equal to up to 20% of the bank’s capital and reserves, may be added.

The Banking Law also contains limitations on transactions with affiliates and insiders, as well as investment restrictions. For example, banks may not extend credit to a related person without approval of their board of directors. In addition, credits to an administrator may not exceed 50% of the administrator’s annual salary, and more generally, the aggregate amount of unsecured credit to all insiders may not exceed 10% of the bank’s capital and reserves. Loans to an insider are completely prohibited if they are granted on terms that are “less favorable to the bank than the terms that are offered by the bank to the public.” In addition, banks may not invest in stocks or other equities in an amount that exceeds 20% of the bank’s capital and reserves without prior approval of the CBI.

In accordance with the Banking Law, all commercial banks are required to keep on file proper documentation for every transaction for at least

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37 Id. at Arts. 19-20.
38 Id. at Art. 27.1(a)-(k).
39 Id. at Art. 28.
40 Id. at Art. 30.1(a).
41 Id. at Art. 30.2.
42 Id. at Art. 31.1(a).
43 Id. at Art. 31.1(b).
44 Id. at Art. 31.1(c).
45 Id. at Art. 33.1.
seven years, and must periodically furnish the CBI with financial statements and annual reports. In preparing their financial statements, the banks are required to apply accounting rules in accordance with international accounting standards (IAS). The new Banking Law also contemplates the appointment of an independent external auditor with qualifications and experience acceptable to the CBI. The auditor may not be an owner, affiliate, employee, agent, or representative of the bank for which the auditor is being appointed.

Each commercial bank in Iraq and its personnel, including any administrator, officer, employee, agent, or auditor, is required to maintain confidentiality of the customers’ accounts, deposits, trusts, and safe deposit boxes and may not provide any information without the customer’s written consent. Limited exceptions to this rule permit disclosure of information pursuant to a court’s decision or a public prosecutor’s order, as well as provision of supervisory information to the CBI as required by law.

Under the Banking Law, the CBI performs bank supervision on a consolidated basis. In carrying out its supervisory responsibilities, the CBI is authorized to review commercial banks’ statements, documents and other information submitted by the banks, request any additional documents, and may at any time cause an on-site examination of any bank. The CBI is also empowered to take enforcement actions and impose administrative penalties on a commercial bank if evidence suggests that the bank has violated any provision of the Banking Law, regulations, or a CBI order, or if the bank “conducted unsafe or unsound banking operations.” Finally, the Banking Law governs bankruptcy-related procedures involving commercial banks, such as conservatorship, bank rehabilitation, liquidation, and receivership.

b. The New Central Bank of Iraq Law

The new Central Bank of Iraq Law (“CBI Law”) was promulgated by Ambassador Bremer on March 6, 2004 by Coalition Provisional Authority Order No. 56 to establish a “safe, sound, and independent Central Bank for the purposes of achieving and maintaining domestic price stability, fostering and
maintaining a stable and competitive market-based financial system, and promoting sustainable growth, employment, and prosperity in Iraq.\textsuperscript{59}

Pursuant to the new CBI Law, the CBI, which was previously governed by the old 1976 Central Bank of Iraq Law, is a legal entity with full legal capacity to make contracts, to sue and be sued, and to carry out its functions under relevant laws. In carrying out its functions, the CBI is empowered to hold and administer property, hire staff and define their duties and compensation, and determine and fund the CBI’s budget.\textsuperscript{60} To protect the autonomy of the CBI, the CBI Law prohibits any person or entity from seeking to influence any member or decision-making body of the CBI or from interfering in the activities of the CBI. The CBI Law also bars the CBI from taking instructions from any person or entity, including governmental entities.\textsuperscript{61}

In achieving its objectives, the CBI is charged with performing functions common for modern central banks. For example, the CBI’s functions include:

(a) formulating and implementing Iraq’s monetary policy, including exchange rate policy;
(b) holding and managing of all Iraqi foreign official reserves and gold;
(c) acting as advisor and fiscal agent to Iraqi Government;
(d) issuing Iraqi currency;
(e) establishing and promoting an efficient payment system in Iraq;
(f) issuing licenses and permits to commercial banks, acting as bank regulator and supervisor, and providing liquidity to Iraqi banks; and
(g) compiling and publishing data on Iraqi economy and Iraqi banking and financial system.\textsuperscript{62}

The CBI also has power to take any actions it deems necessary to combat money-laundering and terrorist financing, as well as regulate and supervise non-bank financial institutions.\textsuperscript{63} For purposes of implementation of the CBI Law, the CBI may issue regulations through a process involving public circulation of a proposed draft for comments.\textsuperscript{64} It may also issue legally binding orders addressed to specific individuals or entities, as well as its own internal rules and guidelines.\textsuperscript{65}

\textsuperscript{60} CBI Law, Art. 2.1.
\textsuperscript{61} Id. at Art. 2.2.
\textsuperscript{62} Id. at Art. 4.1.
\textsuperscript{63} Id. at Art. 4.2.
\textsuperscript{64} Id. at Arts. 4.3-4.4.
\textsuperscript{65} Id. at Arts. 4.5-4.6.
The capital stock of the CBI is wholly owned by the Government of Iraq. The authorized capital of the CBI is ID100 billion. \(^6^6\) The CBI stock is not transferable, is not subject to encumbrance, and does not pay any dividend. \(^6^7\) In the event of a shortfall in capital, the CBI’s Board of Directors (the “Board”) in consultation with the Minister of Finance may request the Iraqi Legislature to approve a capital contribution to the CBI by the State. \(^6^8\)

The responsibility for carrying out the CBI’s functions lies with the CBI Board, consisting of nine members, including CBI’s Governor, two Deputy Governors, three Senior Managers, and three other individuals “with suitable monetary, banking or legal expertise” who have not been employed by the CBI within one year preceding their nomination to the Board. \(^6^9\) The Governor of the CBI serves as the chairman of the Board. \(^7^0\) Every Board member must be an Iraqi citizen, “a fit and proper person,” and must hold a university degree or have “extensive professional experience in a field related to banking, economics, finance, commerce, or law.” \(^7^1\)

During their tenure, Board members may not hold any employment other than with the CBI, except that they may engage in a limited lecturing and other unpaid academic activity. \(^7^2\) The outside employment prohibition includes public service as well as service in any capacity at any entity supervised by the CBI. \(^7^3\) The prohibition of outside employment with the exception of limited teaching also applies to all CBI employees. \(^7^4\)

Upon their appointment to the Board and annually thereafter, each Board member must disclose in writing any direct and indirect business interests that he or a family member may have; the Board submits such declarations to the Minister of Finance and the Appointing Authority. \(^7^5\) After departing from the CBI, former CBI Governor, Deputy Governor, or chief internal auditor may not serve or represent another bank or entity supervised by the CBI. The Board may establish compensation for its former members. \(^7^6\)

During their service or employment at the CBI, Board members and employees of the CBI may not receive credit from any institution supervised by the CBI. Similarly, neither Board members nor employees of the CBI may accept any gift or credit if the acceptance would result, or give appearance of resulting, “in diminishing [their] impartial devotion to [their] duties to the CBI.” \(^7^7\)

\(^6^6\) Id. at Art. 5.1.
\(^6^7\) CBI Law, Art. 5.2.
\(^6^8\) Id. at Art. 9.
\(^6^9\) Id. at Art. 11.
\(^7^0\) Id. at Art. 11(a).
\(^7^1\) Id. at Arts. 12.1-12.2(a), (b).
\(^7^2\) Id. at Art. 12.3(a).
\(^7^3\) Id. at Art. 12.3(b).
\(^7^4\) Id. at Art. 21.4.
\(^7^5\) Id. at Art. 15.1.
\(^7^6\) Id. at Art. 15.3.
\(^7^7\) Id. at Arts. 21.1, 21.5.
A Board member may resign from office after giving one month's notice. However, if the Appointing Authority does not accept resignation, the Board member may be required to continue serving for up to three months. A member of the Board may be removed from the office by the Appointing Authority if the Board member has been: (a) convicted of a crime; (b) declared bankrupt; (c) found guilty of a conduct involving "lack of probity in financial matters or other serious misconduct"; (d) disqualified or suspended from practicing a profession; (e) declared unfit to manage a company; (f) found to have violated provisions of the CBI law related to the disclosure of interests or prohibition of outside employment; (g) is suffering from a medical condition that, in the opinion of the Appointing Authority, renders him unfit for the position; or (h) has been absent from meetings of the Board for more than three months without Board's approval. The Board member may not be removed, however, without an opportunity for a hearing before the Appointing Authority, and a decision to remove a Board member may be appealed to the Court of Appeal.

In accordance with the CBI Law, the CBI Board meets upon the initiative of its chairman or the initiative of at least one-third of its members, but at least once a month. A quorum for the Board's meetings is required and decisions of the Board are adopted by simple majority. The Governor, as chief executive of the Board, is responsible for the implementation of the Board's decisions.

The CBI Law provides for immunity from legal action for the CBI's Board members, agents, and employees. Such persons are not liable in damages for any act or omission taken in discharge of their official duties that were within the scope of their employment. Moreover, the CBI must indemnify its Board, agents and employees against any legal costs incurred in the defense against any legal action brought against them in connection with the discharge of their official functions within the scope of their employment.

As Iraq's central bank, the CBI is authorized to hold accounts of the Iraqi Government and act as the Government's fiscal agent in domestic and foreign borrowing. The CBI also may, with Government permission, represent the Iraqi Government in negotiations with foreign countries and international institutions on monetary and financial issues, and perform financial operations for the Government based on agreements arising out of international financial arrangements concluded by the Iraqi Government. The CBI is specifically prohibited from lending to the Government.

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78 CBI Law, Art. 14.2(a)-(l).
79 Id. at Arts. 14.3, 14.4(a)-(b).
80 Id. at Art. 17.
81 Id. at Arts. 18-19.
82 Id. at Art. 20.
83 Id. at Art. 23.
84 Id. at Art. 25.1(a)-(b).
85 Id. at Art. 25.1(c)-(d).
86 Id. at Art. 26.1.
In managing Iraq’s official foreign reserves, the CBI, consistent with international best practices, may invest such reserves in monetary gold held in its vaults, foreign currencies, credit balances payable on demand in foreign currencies, special drawing rights held in Iraq’s account in the International Monetary Fund, and in any readily-marketable securities issued by, or bearing the full faith and credit of, foreign governments, central banks, and international financial institutions.\(^8\)

In order to implement monetary policy, the CBI is authorized to perform open market operations, such as: (a) purchasing and selling, either outright or under repurchase agreements, debt securities issued by the CBI or by the Iraqi Government in the secondary market, (b) purchasing and selling foreign exchange, (c) “discounting bills of exchange or promissory notes,” (d) making loans that are fully secured by collateral, and (e) “accepting interest-bearing deposits from banks.”\(^8\) The CBI may also require that commercial banks maintain reserves with the CBI, imposing penalties for failure to maintain such reserves, as well as for overdrafts on the reserve accounts.\(^8\) In exceptional circumstances, the CBI may act as lender of last resort.\(^9\)

The CBI has the exclusive right to issue Iraqi national currency – the dinar.\(^1\) Banknotes issued by the CBI are a first charge on the CBI’s assets.\(^1\) Several provisions of the CBI Law deal with currency in more detail, including Article 37, which provides for freedom of currency in Iraq. In addition, the CBI law contains a separate section that provides for various criminal offenses dealing with counterfeiting.\(^1\)

Among CBI’s functions are establishment and maintenance of safe and efficient payment systems for clearing and settlement of payment transactions in accordance with international standards and best practices.\(^4\) To this end, the CBI may take such actions as it deems necessary to carry out its tasks. The CBI also has the exclusive authority to license, regulate and supervise banks and their subsidiaries to ensure compliance with the CBI Law and Banking Law.\(^5\) This includes the authority to conduct on-site examinations and off-site surveillance, as well as the authority to require the provision of information.\(^6\) The CBI is also empowered to take remedial actions with respect to banks and their subsidiaries, and to enforce compliance with relevant laws and regulations.\(^7\) Moreover, the CBI may, upon obtaining a warrant, enter the offices and examine books and accounts of any person or institution if the CBI has reasonable grounds to suspect that such institution engages in an activity that

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\(^7\) CBI Law, Art. 27.

\(^8\) Id. at Art. 28(a)-(e).

\(^9\) Id. at Art. 29.

\(^10\) Id. at Art. 30.

\(^11\) Id. at Art. 31.

\(^12\) Id. at Art. 32.

\(^13\) Id. at Arts. 49-62.

\(^14\) Id. at Art. 39.

\(^15\) Id. at Art. 40.

\(^16\) Id.

\(^17\) Id.
is subject to CBI’s jurisdiction without the appropriate license or permit, and upon determination that such activity has indeed taken place, the CBI may order such person or institution to cease such activity.\textsuperscript{98}

Finally, the CBI Law establishes a Financial Services Tribunal ("Tribunal") which is empowered to review the decisions and orders of the CBI that:

\begin{enumerate}
\item reject an application for a banking license or permit, attach a condition to such license or permit, or revoke a license or permit;
\item impose enforcement measures or administrative penalties under the Banking Law;
\item enjoin a person engaged in unlicensed activity under the CBI Law; and
\item extend the term of a conservator, and more generally, take actions provided for in the Banking Law.\textsuperscript{99}
\end{enumerate}

In addition, the Tribunal has jurisdiction over any dispute between banks and/or financial institutions if agreements between such banks and/or financial institutions provide for resolution of disputes by the Tribunal.\textsuperscript{100} Importantly, however, the Tribunal may not review CBI’s decisions or actions concerning development or implementation of monetary policy, including exchange rate policy.\textsuperscript{101}

The Tribunal is composed of one or more panels of three to five judges, and is headed by a chief judge, appointed by the Minister of Justice.\textsuperscript{102} The chief judge selects judges from a pool of judges, which is comprised of five judges.\textsuperscript{103} Three of them must be professional lawyers, and are appointed by the Minister of Justice.\textsuperscript{104} The remaining two judges are appointed by the Minister of Finance; one of them must be an experienced accountant, and the other must have extensive professional experience in financial transactions.\textsuperscript{105} Judges on the Tribunal may serve full or part-time.\textsuperscript{106} Detailed rules apply to the qualifications required for appointment of judges on the Tribunal, including their employment outside the Tribunal, to rule out any conflicts of interest.\textsuperscript{107} Judges are appointed for a ten-year term, but may resign upon notice; they may not be removed without a hearing before the Minister of Justice.\textsuperscript{108}

\textsuperscript{98} Id. at Art. 42.
\textsuperscript{99} CBI Law, Art. 63.1(a)-(d).
\textsuperscript{100} Id. at Art. 63.3.
\textsuperscript{101} Id. at Art. 63.4.
\textsuperscript{102} Id. at Art. 64.1.
\textsuperscript{103} Id. at Arts. 64.1, 64.2.
\textsuperscript{104} Id. at Art. 64.2.
\textsuperscript{105} Id.
\textsuperscript{106} Id. at Art. 64.4.
\textsuperscript{107} Id. at Art. 64.5.
\textsuperscript{108} Id. at Arts. 64.6, 64.7.
Tribunal proceedings are to be governed by regulations issued by the Minister of Justice.\textsuperscript{109} Decisions of the Tribunal are taken by a majority of the judges and must be recorded.\textsuperscript{110} Final decisions and orders of the Tribunal are subject to appeal to the Court of Appeal.\textsuperscript{111}

V. OUTLOOK FOR THE FUTURE

The author believes that Iraq's banking sector has significant potential to become a modern, sound, effective banking system that promotes economic activity and stability in Iraq. The CBI officials, state-owned bank officers, and private bankers that the author came in contact with were uniformly well educated, experienced, and motivated to contribute to a stable and prosperous Iraq. Another fact that bodes well for the Iraqi banking sector is that the Iraqi people are anxious to have a safer and more productive place to keep their money than under their mattresses and also are anxious to have a reliable source of capital to start new businesses or expand existing ones with. While the Iraqi banking sector is particularly deficient in information technology, it is eager to embrace it and such technology should rapidly take root once the basic essentials of phone service and reliable power supplies are established.

The biggest obstacle preventing the Iraqi banking sector from realizing its potential is the same obstacle that prevents all of Iraqi society from realizing its potential: security. As long as people are dying in the streets, the survivors will be reluctant to put money into banks, businesses will be reluctant to take out loans, banks will be reluctant to make loans, and those loans that are made will be less likely to perform. An additional consequence of security concerns is that the foreign banks which have been licensed to operate in Iraq are unlikely to do so until they are convinced they can do so safely, thereby depriving Iraq of much needed capital, modern banking practices, and information technology.\textsuperscript{112}

If the biggest obstacle preventing the Iraqi banking sector from realizing its potential is security, the next logical question is what will it take to achieve security. In the author's opinion, the determining factor as to whether there will be security in Iraq is the United States' willingness to commit military forces in sufficient numbers and for a sufficient period of time to achieve three objectives. First, prevent foreign terrorists from entering Iraq in numbers large enough to achieve their goal of destabilizing society and turning Iraq into a haven for terrorism. Second, prevent Saddam loyalists and Baathists from becoming sufficiently organized and well armed to terrorize and intimidate the population into restoring them to power. Third, and perhaps most importantly, prevent religious and tribal militia from building up to the point where they are capable of organized, coordinated attacks as opposed to low intensity harassment of Coalition forces and opposing militia. The author believes that

\textsuperscript{109} Id. at Art. 66.
\textsuperscript{110} Id. at Art. 68.1.
\textsuperscript{111} Id. at Art. 70.1.
\textsuperscript{112} As of this writing, none of the foreign banks, which have been licensed to operate in Iraq, have actually started to do so because of security concerns.
achieving these objectives will take at least three to five years and involve armed confrontation of sufficient intensity and frequency to produce, over the course of several years, at least several hundred U.S. casualties; maybe even several thousand. The United States' willingness to pay this price will be the single most important influence on how safe and stable Iraq becomes for the 24 million people who live there.

Just as providing security is the single most critical task for the United States, the Iraqis also have a single most critical task that they must perform in order for Iraq to be successful: they have to learn to compromise with each other. This will be no small challenge. As the world knows, Iraq is a mosaic of ethnic, tribal, and religious factions which have never lived at peace with each other except under the boot of a brutal dictator. However, if the Iraqis are lucky, the horrific pain and suffering they experienced under that brutal dictator will motivate them to compromise with each other over political power, religion, and resources in order to achieve the peace, stability, and prosperity they have so long sought and richly deserve. The author's impression of Iraqi society is that there are enough moderate voices within each faction that are tired of death and privation to form at least a plausible basis for compromise among the factions. But the United States has to provide an environment that is secure enough for those voices to emerge from the shadows they are currently hunkered down in.

It all comes down to security and compromise. If either is not achieved, game over. Iraq will make Afghanistan under the Taliban look like a nursery school playground. However, if the United States does provide security, and if the Iraqis do learn to compromise with each other, then it is likely that Iraq and its huge oil reserves will join Germany, Japan, and South Korea as countries that were once occupied by the United States that subsequently went on to success. It may be less democratic than we might like, it may be more religious than we might like, it may be less tolerant than we might like, it may not be as wealthy as the Iraqis would like, and it may be more violent than anyone would like, but it should be sufficiently democratic, secular, tolerant, prosperous, and safe to be a stabilizing and influential model of a successful Arab society.

113 The military occupation of Germany following World War II lasted four years and the occupation of Japan lasted seven years.