

The Evolution of Financial Services in Iraq: Custodian Banks

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Introduction

The dynamics of the financial industry are constantly changing to stay abreast with modern business practices. Iraq had introduced its custodianship system in 2012 via the Custodian Instructions No. (17) of 2012 (the “**Custodian Instructions 2012**”) in an attempt to increase foreign investment in the Iraq Stock Exchange (“**ISX**”) and sustain its economic recovery. A custodian is essentially a regulated financial entity that holds customers’ assets for safekeeping and servicing, with the aim to reduce the possibility of misappropriation, misuse, theft, or loss. Following the recommendations of the White Paper in 2020 and via a decision from the Cabinet of Ministers, the Custodian Instructions 2012 have undergone an overhaul via the introduction of the Custodian Instructions No. (17) of 2012 (as amended in 2021) (the “**Custodian Instructions 2021**”). These changes have made it more accessible for foreign investors to become licensed under the new act in order to strengthen current Iraqi financial institutions, encourage participation from international investors into the ISX, which in turn will incentivize the introduction of best practices at local financial institutions, and provide greater accessibility to finance for companies already listed on the ISX.

Most Prominent Amendments

The Custodian Instructions 2021 have broadened the scope for financial institutions to be licensed under the act and have aligned such Custodian Instructions and restrictions with recognised international practices and data protection laws. The new amendments also regulate the method of safekeeping client monies and assets, including extending the protection to cover not only local assets, but also foreign and international assets.

Requirements of a Custodian Under the Regulations

The Custodian Instructions 2012 limited custodians from global reach which is a significant setback especially for clients or investors with international assets who would require a custodian with the ability to hold assets around the world and not just locally in Iraq. The Custodian Instructions 2021 have therefore broadened the scope of obligations for a custodian allowing for international reach and have extended the functions of a licensed custodian as follows.

Firstly, by ensuring greater transparency and therefore reducing the risk in investing in the ISX, a custodian must:

1. inform the client or investor (in accordance to the agreed upon method of communication) of every

- decision, procedure, transfer or transaction taken in relation to their assets, bearing in mind the client's benefit;
2. open individual accounts for each individual client and creating folders in respect of each client containing the assets and transactions on the account; and,
 3. provide the client or investor with a monthly audited report of every transaction or transfer made on their account and their current remaining balance.

Secondly, by allowing the custodian to exercise discretion to ensure higher returns for clients or investors by:

1. contracting with investors to perform custodial services;
2. safekeeping the assets and all ancillary rights attached to the assets including dividends, attending stakeholder meetings and voting rights;
3. pledging or freezing the assets in accordance with the client's request; and,
4. transferring the assets.

The custodian must, whilst performing his/her services ensure the confidentiality of the data of his clients and not disclose any confidential information relating to his clients or their assets (unless requested by the ISX or ISC), use the latest technology in accordance with accounting standards and keep copies of all records.

New Licensing Requirements for Custodians

In order to be licensed as a custodian as per the Custodian Instructions 2021, the following conditions must be satisfied:

1. The application must be submitted from either an Iraqi banking company (registered as a shareholding company in accordance with all applicable Iraqi laws, or from a foreign banking company (registered as a shareholding company in accordance with all the applicable laws) with an operating branch in Iraq;
2. the financial institution must designate a separate department for conducting any custodian services to ensure the independence of the procedures, reduce any conflict of interest and eliminate any potential asset misappropriation;
3. approval of the Central Bank of Iraq;
4. the share capital of the financial institutions must be paid in full (100%);
5. having the requisite expertise and experience to carry out custodian services;
6. not be charged with a felony or misdemeanour;
7. insure the financial obligations of the clients, in accordance with DVP; and
8. paying all registration dues and fees that are applicable and complying with any other conditions set by the ISX.

Application for Licensing

In order to apply for licensing as a custodian, in addition to meeting the abovementioned the requirements, the financial institution must submit an application to the ISX containing the following information:

1. the name, type, registration number, headquarter location and branches of the financial institution;
2. the registered share capital of the financial institution;
3. documents disclosing any legal obligations relating to custodian services;

4. documents disclosing the manager, internal officer and those qualified to perform custodian services;
5. certificate of incorporation;
6. the articles and memorandum of association;
7. template custodian services contract which includes 1) definition of custodian services; 2) description of the personal data relating to the client; 3) KYC checks; 4) the method of dealing with the client's assets for their benefit; 5) commission rate; 6) obligations of each the client and the custodian; 7) the client will be solely liable for any instructions given to the custodian; and 8) the method for dispute resolution; and
8. and any other information deemed relevant by the ISX or Iraq Securities Commission (the "ISC").

The ISX shall review the application and shall inform the financial institution if further documentation is required or if the application is missing some document and will conduct the necessary due diligence to ensure the accuracy of the information provided by the financial institution. The ISX will then transfer the application to the ISC so that it may either be accepted or declined.

Further, the ISX along with the approval of the ISC reserve the discretion to cancel the license of any financial institution in any of the following events:

1. if any of the conditions to licensing are no longer satisfied;
2. material breach to any obligations of the custodian in accordance with the Custodian Instructions 2021;
3. default in paying annual licensing fees; or
4. judicial decision issued for bankruptcy against the financial institution.

The Custodian Instructions 2021 do not stipulate the period that ISC must issue their decision of approval or decline for obtaining custodian licensing, nor do they stipulate if the ISC provides the unsuccessful applicant of the reasons as to why their application was declined, potential appeal procedures, or the possibility of reapplication.

Conclusion

All in all, the Custodian Instructions 2021 are a massive improvement to the custodian licensing system in Iraq as it (i) broadens the scope of investing in the ISX from local investors to international investors, (ii) enables custodians to have global reach (to local and international assets), (iii) offers greater transparency for investors, and (iv) ensures the confidentiality of information relating to the client and the client's accounts and dealings. The licensing procedure is also in itself, less complex and restricting compared to the Custodian Instructions 2012 which required providing sureties and guarantees to the market.

Al Tamimi & Company's Banking and Finance team regularly advises on financial agreements and transactions. For further information please contact [Dana Abduljaleel](mailto:D.Abduljaleel@tamimi.com) (D.Abduljaleel@tamimi.com) or [Carla Nocerino](mailto:C.Nocerino@tamimi.com) (C.Nocerino@tamimi.com).