

# An Insight into Islamic Banking in Iraq

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There are now just over a dozen such banks in Iraq and the capital managed by them has grown considerably.

The establishment of usury-free Islamic banks, which aim to conform to Muslim Shariah Law, creates significant new investment opportunities to attract religious investors.

## **Why Islamic banks?**

Usury-free banking is essential for countries that wish to cater to their religious investors and aid them in investing their money in ways that goes along with their beliefs. Islamic banks offer such services within the Islamic sharia boundaries, for example Murabaha, Mudarabah, and Sukuk.

In comparison with the conventional banking, Islamic banks do not deal with 'toxic assets', such as those that resulted in the financial crisis of 2008 (i.e. assets that consist of a bundle of debts, some of which are bad). Islamic banks also do not deal with non-existing assets (e.g. they do not trade in debt or interest).

The Central Bank of Iraq (the "CBI") governs Iraqi banks, whether Islamic or traditional, on the same basis. This has enabled Islamic banks to prosper among the more conservative investment sectors of the Iraq market.

## **The issuance of the Islamic Banking Law**

Islamic banks have, since the early years of their operation in Iraq, been required to comply with the Iraqi Banking Law number 94 for the Year 2004 (the "Banking Law"), despite the fact that the philosophy of Islamic banks does not fall within the same structure.

The Banking Law addresses commercial banking regulations, whereas Islamic banks work within conventional banking structures while applying Shariah Law at the same time. This has contributed to the limited growth of the Islamic banking industry in Iraq.

An unsuccessful attempt by the CBI to issue regulations for Islamic Banks was faced with objections from the State Consultation Council (the "Council"). The Council stated that in the absence and non-existence of a relevant governing law, it is not possible to pass such regulations.

In 2011, positive development took place in the Iraqi Banking industry. The CBI approved the opening of two Islamic windows and approved the incorporation of a governmental Islamic Bank. Islamic windows are separate departments within a conventional bank, which operates under strict guidance by an independent Shari'a Advisory Board (comprising Muslims scholars of repute, credibility and due social recognition) to develop and offer Islamic financial products to the clients that demand such products. An Islamic Window may offer its products and services through conventional branches or dedicated Islamic branches of the conventional bank.

During the same year the CBI issued the Islamic Banking Regulations number 6 for the Year 2011. These Regulations expanded on Article 104 of the Banking Law's definition of Islamic banks. Under said Article,

an Islamic Bank is “any legal entity certified or authorized hereunder to conduct Islamic banking business in accordance with Sharia, and does not deal with given or taken interest”. As such, these Regulations gave Islamic Banks the right to fund and invest in accordance with Islamic Sharia, and forbade them from dealing in usury, in any manner, whether for its own interest or for a third party’s interest.

The Regulations further specified the authorities that may grant Islamic Bank licenses. Also, now these Islamic Banks were granted the right to open onshore and offshore branches, and offices in accordance with an annual plan to be submitted to the CBI for the purpose of acquiring the necessary approvals.

In addition to the above, the Regulations stipulated the activities that can be conducted by the Islamic Banks. These activities include but are not limited to investing and funding activities through Musharaka (an equity partnership investment), Mudarabah (profit sharing partnership, similar to traditional trust management), Salam sell, Istisna’a (Manufacturing Finance), Ijara (Hire Purchase), and bargaining; incorporating companies; entering many activities with a shareholding not to exceed 20% of the capital; the right to own movable and immovable assets necessary for its investments or for leasing; funding internal and external trading activities; participating in agricultural, industrial, and architectural projects.

The Regulations specify activities which the Islamic Banks (and Islamic windows within conventional banks) are prohibited to carry out, such as the prohibition towards dealing with interest and issuing saving accounts. Moreover, the Regulations also illustrates funding and dealing mechanisms regarding the purchase of foreign currencies, foreign currency exchange companies, commercial papers, stock market and sets out conditions on how to offer loans from the bank within the allowed rates to fund any natural or legal entities and the imposed obligations pertaining to dealings in foreign currency.

The Regulations also set out the procedures for establishing a Sharia Board. Based on the Regulation, Islamic banks (and the Islamic windows) must have a Sharia Board which shall carry out the responsibility of providing a Sharia view on the operations of the bank in order to ensure its compliance with the Sharia Law. One of the main activities of the Sharia Board is to suggest to the General Assembly of the bank or its Board of Directors all the necessary steps that need to be taken or carried out to achieve compliance with Sharia Law. The decisions of the Sharia Board are binding on the executive management of the bank.

Finally, the Regulations give the right to conventional and investment banks to open an Islamic window or to establish an Islamic branch. The Body entrusted with the authority to grant such license is the CBI. The license gives conventional banks the ability to establish Islamic banks or corporations, affiliate with Iraqi or non-Iraqi Islamic banks, or to open an Islamic window within the conventional bank.

## **How To Establish an Islamic Bank in Iraq**

Pursuant to the current Banking Law, Regulations and the CBI, the following are three processes to set up an Islamic Bank in Iraq:

### **1. Opening an Islamic window affiliate within a conventional banks**

It is permissible for a conventional and commercial banks to open an Islamic window according to the terms and conditions specified by the CBI. These terms and conditions require the CBI’s prior consent. The bank may open an Islamic window after including such plan in the bank’s annual strategy that is submitted to the CBI, or by converting the activity of an already existing branch to conduct Islamic Banking activities. In addition, the bank must allocate independent capital for these windows, making clear that the source of said capital is not connected with any usury dealings

### **2. Setting up a branch for a Foreign Bank**

The Regulations grant a Foreign Bank the ability to set up an Islamic bank in Iraq because Islamic Banks have the right to register branches and offices onshore and offshore. In order to being the process, the Islamic Bank must include said plan in the annual strategy that is submitted to the CBI in order to obtain

the latter's approval. Further, in addition to the supervision of the competent authorities in the country of origin of the Foreign Bank, these Iraqi branches shall be subject to the direct supervision of the CBI in accordance to an agreement prepared for said purpose.

### **3. Establishment of an Islamic Bank as Shareholding Company**

The aforementioned Regulations have given the right to set up an Islamic Bank by a shareholding company. As such, after finalizing the registration procedures of the Shareholding company in Iraq, it must submit a written request to the CBI accompanied with required supporting documents to establish an Islamic Bank. The CBI shall then review the submitted documents to provide its initial approval. After fulfilling all the requirements and obligations, the CBI shall then grant the license upon registration as a Shareholding Company.

### **Future Islamic Law**

As for the governmental side, the General Budget of 2015, has exempt the establishment of Islamic Banks from the capital increments imposed by the CBI in order to encourage the use of Islamic Bank products.

In addition, there is a draft Islamic Banking Law under review to be passed sometime this year. This law will regulate the operations of the Islamic Banks in a more thorough manner. One of the important articles in the draft law aims to exclude Islamic Banks and their branches from the taxes and fees arising from dealing in contracts relating to estate, land, cars, Murabaha deals and Ijara deals.

### **Conclusion**

The current Regulations and laws (current and proposed) offer real and significant encouragement for the Islamic banks and their activities. It is important to note that the CBI, in many announcements, has encouraged the establishment of Islamic Banks and their growth, having recognised that they are an attractive solution to attracting the conservative public who are un-willing to deal with usurious and conventional banks. All in all, we believe that Iraq is a very promising market for Islamic bank investment.