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Compensation for Bank Depositors in Iraq

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Abstract. This paper attempts to explain Compensation of bank depositor In Iraq. It relies on the regulation no 33 of 2016 in its definition of a company which must be established in accordance with that regulation. Accordingly, there is an Iraqi judicial company named Iraqi Deposit Insurance Company (IDIC). With its autonomous entity as well as own capital, the company manages to achieve the purposes of its establishment. It has a net worth of 100,000,000,000 Iraqi Dinars which facilitates its ability to invest from its financing sources. The main motive for the establishment of this company was to instill confidence in people and to stabilize the country as the academics have advised. In conclusion, taking advantages from many other countries, we recommend that an act be enacted by the Iraqi legislature to strengthen bank deposit guarantee.

Keywords. Bank deposit guarantee, compensation of depositor, depositor

Introduction

Savings and liquidity are vital aspects of any modern bank. As the primary collateral a bank could possess is money in order to perform its functions, The Iraqi banking laws have given an important consideration when they formulate the laws, in order to protect customers interests at the same time allowing a smooth performance for the banks themselves. For example the Central Bank Act 56/2004 and Banking Law 94/2004 regulates the banking administration and the operation whilst, Prevention of Money Laundering Act 93/2003 acts as an oversight on the aspects of financial fraud and money laundering. On the other side of the spectrum the Regulation 3/2016 acts as a safety net for the depositors in the instances where a bank declares bankruptcy or goes insolvent. A provision in the said regulation authorises the Iraqi Central Bank to establish a legal entity to observe the rights and guarantees assured by the banking laws are implemented. All these laws work in tandem complementing the entirety of the Iraqi banking system.

One could notice that the said legal entity to guarantee bank deposits is beyond the mandate of the Iraqi Company Law 21/1997. The reason for that is the Iraqi Company Act is seen inadequate in addressing the issues of a modern day banking system. Without proper legal oversight and regulatory monitoring, both the banks and the customers deposits cannot be guaranteed and protected consequenting the demise of the entire system.

For this very reason a concrete and modern solution is needed in order to stabilise the banks and the financial system as a whole. The solution could only work if it addresses both from the depositors concerns as well as from the banks operations perspective. This type of

solution would not only increase the depositors confidence in the system, rather it would increase the revenue for both the financial sector as well as for the banks.

Research Question

1. What is the applicable system in order to protect depositors' right in Iraq?
2. How did the Iraqi deposit guarantee system solve the depositor's right in case of bankruptcy?

Research Objective

1. Identify the system which is applicable in order to protect depositor's right.
2. Clarify the current solution in order to protect bank deposit in Iraq.

Scope

There is reliance on the laws enforceable inside Iraq in order to achieve the purpose of this paper.

Research Methodology

The main goal in undertaking this doctrinal research is to clarify the regulation no 3 of 2016 as well as to develop an analytical research approach to examine some issues relating to this paper. Moreover, this research is purely doctrinal in identifying and analysing the Iraqi legal system. In addition, we depend on some secondary library sources in the field of law research to conduct this research.

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1. The Establishment of Bank Deposit Guarantee Company

The main purpose of establishing bank deposit guarantee is to guarantee depositors. In order to gain stabilization in the banking industry, there may be necessity to establish such kind of guarantee.

1.1. Importance of Establishing a Bank Deposit Guarantee Corporation:

With relevance to the importance of deposit guarantee corporation, there is no a particular article in the Iraqi Bank Deposit Insurance Regulation no 3 of 2016 alluding to the importance of establishing a deposit guarantee system. However, researchers have highlighted some important aspects which can be enumerated as follows:

1. Stabilizing the financial sector: This may cause reduction in the deposit withdrawn by the depositor. When there is no deposit guarantee, depositors may withdraw their money from bank due to loss of confidence in them. This phenomenon has previously affected the banking sector in the whole Iraq. For this reason each bank must seek to have an effective deposit guarantee system to motivate depositors to put their money in banks, and thus developing the financial sector. This system could lead to the rehabilitation of banks when they cannot repay depositors money by providing them with some money.¹ (Ibrahim & Naje, 2016).

2. Increasing the competition among the financial industries and provide a better service. When there is no guarantee for depositors, banks that have lots of capital become more

¹ Ibrahim, I. I., & Naje, H. M. (2016). Muasasat daman alwadayie almasrifia (drast mqarn). *majalat almuhaqq alhaliy lileulum alqanuniat walsiyasia*, 4,108-109.

appealing than their counterparts with insufficient capital. However, if this guarantee is available, the differences among financial industries may decrease, including the risks that the depositors may face. So, they can influence the depositors who have a few amounts of money.² (Taema, 2019).

3. Establishing the Deposit Guarantee System: This has a very effective role in the supervision of banks, culminating in monitoring of banks by the Deposit Guarantee Corporation. Therefore, the Iraqi Deposit Guarantee Regulation no 3 of 2016 states that every bank must submit the Deposit Guarantee Company monthly reports about deposits³ and that the IDIC can appoint a supervisor upon obtaining permission from the CBI to audit and review each account.⁴

1.2. The meaning of Guarantee in Iraq:

It is worth noting that Iraq adopts the meaning of guarantee based on the Regulation no 3 of 2016 which establishes a mixed-joint stock company to guarantee bank deposit. However, it can be said that there is no any prohibition against any bank to make an insurance contract to its deposits in the interest of its depositor. Consequently, in this case, the Iraqi Commercial Act no 30 of 1984 and Banking Act no 94 of 2004 as well as Civil Act no 40 of 1951 is deemed applicable.

1.3. The Nature of the Company

The Regulation no 3 of 2016 has stated that the CBI can confer a license to establish a mixed joint-stock company to guarantee bank deposit according to the Iraqi Company Act no 21 of 1997. Here, we can find that it has determined the nature of the company that must become a mixed joint-stock company. Therefore, when we return to the Iraqi Company Act no 21 of 1997, it defines it as a private or mixed-joint company composed of some persons that must be not less than 5 people who have subscribed to its shares in the public subscription and they are responsible in the company's liability according to the nominal value.⁵

It can be said that:

1- The CBI can issue a license to establish the IDIC so that this company is under its supervision.

2- The IDIC is a mixed-joint company in which the state sector must participate. So, this company seeks to obtain public interest while it has a private nature.

3- Banks' contribution in the IDIC is compulsory and each one must take a part in that company as well as the CBI which can determine the level of participation depending on economic conditions.

There are some exemptions in the provision of the Iraqi Regulation no 3 of 2016 that can be enumerated as follows:⁶

1- Iraqi bank branches operating outside Iraq.

2- Development and investment banks, as well as Islamic banks, depending on the law in the financing projects and investments inside Iraq and the ones which accept limited purpose deposits.

3- Government deposits in government banks.

² Taema, S. s. (2019). The Role of Bank Deposit Security Companies in Compensating Depositors (A study in Iraqi law). *majalat aleulum alqanunia*, 1, 444-445.

³ Article 7 of Iraqi deposit insurance no 3 of 2016.

⁴ Article 9 of Iraqi deposit insurance no 3 of 2016.

⁵ Article 6, Iraqi company Act no 21 of 1997 as amended in 2004.

⁶ Article 2 term 1, Iraqi regulation no 3 of 2016.

With regard to the exemption of Iraqi banks' branches working outside Iraq, it can be said that the regulation was enacted to develop the banking industry inside Iraq so that those branches will operate in accordance with this regulation, they may not gain the purpose of the regulation⁷ (Aleawadi & Alkhizaei, 2019). It can be suggested that the branches outside Iraq should adhere to the legal system in that country and when it has the Deposit Guarantee Corporation, the bank branches must adhere to this Act, making one branch to follow two legal systems. However, based on corroborative evidence, there are some criticisms against the foreign bank branches working inside Iraq that they are not compliant with the Regulation no 3 of 2016 (for more detail look at⁸ (Aleawadi & Alkhizaei, 2019). Consequently, the reality is that the foreign bank branches are subscribing to the IDIC as its membership has increased to 63 banks all operating within Iraq, of which 7 are public banks, 40 private banks and 16 foreign banks respectively⁹ (Alforatnews, 2019). This increasing number can be found in the IDIC website (https://icdi.iq/member_banks/index/1). As a result, the regulation provides that the banks that are not obliged to subscribe to the IDIC are the investment and development banks as well as Islamic banks, while the reality can tell us something else.

The development and investment banks as well as Islamic banks operate in accordance with the law in financing projects and investing inside Iraq with the acceptance of limited purpose deposit. This implies that those banks agree with the depositor to utilize deposit in a limited area so that these deposits are not compliant to a guarantee.

Many deposits which do not undergo this regulation's provisions are;¹⁰

- 1- Mortgage cash in the value of credit facilities.
- 2- Bank's deposits inside CBI.
- 3- Legal reservoir for banks inside CBI.
- 4- Deposits of the members of the board of directors participated bank.
- 5- Non-asked deposit which are in a participated bank.
- 6- Bank deposit inside any other banks.

The mortgage cash in the value of credit facilities means that banks are giving money to people to practice their activities whether for consumption or for investment and they must pay a small amount of money to the bank and that this amount is not covered with deposit guarantee.¹¹ (Rikabi, 2019).

The deposits of the bank's members of board of directors safeguard those persons in the advantages of the guarantee in order to take the precautionary need to manage their banks. Perhaps the exemption of those persons may be because of the aim of establishing the deposit guarantee to guarantee the small number of depositors having lots of money¹² (Aleawadi & Alkhizaei, 2019). It can be noticed that the regulation exempts something relating to banks or deposits. Hence, it is recommended that those deposits put in banks be included in order to prevent money laundering.

Bank's deposits inside CBI are not compliant with the guarantee because the aim of establishing Bank Deposit Guarantee is to ensure that small-scale depositors' money is well

⁷ Aleawadi, M. K., & Alkhizaei, S. M. (2019). qura'at qanuniat fi nizam daman alwadayie almasrifiat aleiraqii raqm 3 lisana 2016 (drasat mqarn). *majalat alqadisiat lilqanun waleulum alsiyasia*, 1(10), 480.

⁸ Ibid, 480-483.

⁹ Alforatnews. "albank almarkazi: Manh Shahadat Tasis {Alsharikat Al-Iraqiat lidhaman Alwdaye}." *AlForatNews.com*. October.26,2020. https://alforatnews.com/news/216311?fbclid=IwAR183PI9zFZ1FKDJNy_95xVVbILSpinwof6Bq8S3Fnq8E84qk5331wNrnjN0 (accessed February 16, 2020).

¹⁰ Article 2 term 2, Iraqi regulation no 3 of 2016.

¹¹ Rikabi, S. H. (2019, 2 10). Bank Deposits Insurance under Iraqi Legislation. *majalat 'ahl albayt ealayhim alsalam*, 23, 160.

¹² Muhamad Aleawadi ; Safa' Alkhizaei, 485.

managed and protected by the banks. In addition, subscribing banks in the IDIC include guaranteeing depositors, not the banks¹³ (Al-Araj, 2009). In addition, another way of getting an exemption for this guarantee is to establish the IDIC to increase consumer confidence and to stabilize banking industry while the CBI is representing the country and dependent on Iraq's sovereignty cash policy so that the bankruptcy of CBI is almost impossible and that there is no need to guarantee bank's deposit inside CBI¹⁴ (Aleawadi & Alkhizaei, 2019). As a result, we can say that all deposits may not be covered by the Deposit Guarantee Company and that there are some deposits which are exempted by the Regulation no 3 of 2016.

2. Compensation for Depositors

In general, the system to compensate depositors has been created against bankruptcy in order to protect the bank's depositors. Additionally, when a bank faces bankruptcy the IDIC must compensate the bank's depositors. However, the Regulation no 3 of 2016 has stated that when there is a decision from the CBI regarding conservator, insolvency or bankruptcy a bank is dependent on the Banking Act no 94 of 2004 which provides that the customer's deposit account must be audited in accordance with the article 14 of the regulation.¹⁵ In addition, as earlier stated, the conditions where the CBI must appoint a conservator to a bank, there are some situations that are optional upon the CBI in the appointment of a conservator for a bank in the aforementioned article. We are not supporting this article because appointment of a conservator does not mean the declaration of bankruptcy for the stated bank. The bank can rehabilitate its activities depending on the procedures that have been determined in accordance with the Banking Act no 94 of 2004. Thus, there is need for the Iraqi government to amend this article for an Act to be enacted by the legislative authority.

The company must pay the coverage amount to the depositors within 30 days which begin from the day on which the petition is submitted to the bank conservator or liquidator. Consequently, as aforementioned the CBI conservatorship's decision does not mean the banks liquidation because the bank can reform its activities according to the procedure in the Banking Act no 94 of 2004.¹⁶ Subsequently, it means that the conservatorship may be terminated while the bank is not liquidated and it will restart its activities.

In addition, the conservatorship may be terminated due to the completion of the term specified in the decision regarding the appointment of the conservator or extension of the term of the conservator as well as a decision by the CBI or the Financial Services Tribunal to that effect. Moreover, the appointment of a receiver is in accordance with the article 78. 2 in the Banking Act no 94 of 2004. Thus, upon termination of the appointment of a conservator, he/she shall immediately return the control of the bank and its assets, books and records to the authorized manager of the bank.¹⁷

When there is no one to receive the coverage amount or deposit amount or there is no one to ask, it shall be submitted to the CBI as a trusteeship in accordance with the article 37 of the banking Act no 94 of 2004.¹⁸

In general, we can say that the appointment of the conservator does not mean the bankruptcy of the bank and the depositors do not have the right to gain the coverage amount as per stated in the Regulation no 3 of 2016 in determining conservator with bankruptcy or

¹³ Al-Araj, R. A. (2009). *madaa 'ahamiyat daman alwadayie fi tadeim shabakat al'aman almalii dirasat maydaniat ealaa aljihaz almasrifii alfilastinii*. alghaza: aljamieat al'iislamia, 58.

¹⁴ Muhamad Aleawadi ; Safa' Alkhizaei, 484.

¹⁵ Article 14, regulation no 3 of 2016.

¹⁶ Article 15, regulation no 3 of 2016.

¹⁷ Article 66, Iraqi banking Act no 94 of 2004.

¹⁸ Article 15, regulation no 3 of 2016.

insolvency. In addition, there are some ways determined in the Iraqi Banking Act no 94 of 2004 as grounds for opening bankruptcy proceedings which upon receipt of a satisfactory petition under Article 72 and the appointment of a conservator by the CBI, the Financial Services Tribunal shall grant the petition and open bankruptcy proceedings against a bank on one or more of the following grounds:¹⁹

The bank is not paying its financial obligations, including deposit liabilities, as they fall due or the CBI determines that the capital of the bank is less than 25 percent of the capital required as stipulated in the Act no 94 of 2004. In addition, another situation is when the CBI determines that the value of the assets of the bank is less than the value of its liabilities or when the CBI determines that any of the grounds for the appointment of a conservator identified in Article 59 exists. In this case, it can be said that conservator's decision does not mean the bank experiences bankruptcy.

The IDIC will legally replace the depositors according to the amounts paid to them in liquidation of the bank.

2.1. The Compensation Amount

The Regulation no 3 of 2016 determines the following compensation amount for the depositor²⁰:

1. If the deposit amount is less than (100,000,000 ID), the compensation amount is 51%.
2. If the deposit amount is more than (100,000,000 ID), the compensation amount is 25%.

We can find that there is a huge difference between the two amounts. However, the Regulation no 3 of 2016 seeks to protect depositors who have a small amount, while accordingly the depositors who have a huge amount will incur lots of loss. Besides, it can be enumerated that the Regulation no 3 of 2016 does not stipulate whether the depositors should submit a petition in the court to gain their deposits in order to prevent them by being compensated two times (first is the coverage amount and second is the deposit)²¹ (Taama, 2019). Subsequently, according to the public provisions, it is worth noting that the depositors can turn to the banks and request from them the payment of their respective amount. Moreover, the CBI can amend these amounts depending on the public economic condition and the IDICs economic circumstance.²² Therefore, one can conclude that all the amount deposited may not be covered by the IDIC as per the Regulation no 3 of 2016 which stipulates a limited amount. What is more, the regulation does not have provisions for deposits in foreign currency. There is a need for foreign deposit currency which may need to be covered by the IDIC. Accordingly, although there is no provision related to the depositors whether they can turn to the court as per the Regulation no 3 of 2016, it can be concluded that based on public provisions, the depositor can request from banks their rightful access to their deposited funds.²³ In conclusion, it is suggested that the coverage amount should cover small amount of deposits such as when the amount of deposit is 10 million ID, the coverage amount would cover it entirely.

¹⁹ Article 71, Iraqi banking Act no 94 of 2004.

²⁰ Article 13 term 1, the regulation no 3 of 2016.

²¹ Siham Taama, 470-472.

²² Article 13 term 2, the regulation no 3 of 2016.

²³ Article 239-247, Iraqi commercial Act no 30 of 1984.

3. Conclusion

3.1. Results

- The Iraqi regulation no 3 of 2016 has determined the nature of the companies that can be given a status of mixed joint-stock.
- The CBI can confer a license to establish the IDIC so that this company is under the supervision of the CBI.
- The regulation does not embrace any provision for the new banks to be established after the establishment of the IDIC.
- There is a huge difference between the two amounts. However, the Regulation no 3 of 2016 is seeking to protect depositors who have a small amount, while according to the same regulation the depositors who have a huge amount will incur colossal loss.
- The regulation does not have provisions for deposits in foreign currency. There is a need for foreign deposit currency which may need to be covered by the IDIC.
- Depending on public provisions, the depositor can request a rightful access to their deposited funds from the bank.

3.2. Recommendation

- We recommend the Iraqi legislature to void the regulation no 3 of 2016 and enact a new act related to the bank deposit guarantee.
- We recommend that the amount of the compensation be modified in order to keep balance among the two amounts as earlier mentioned.
- We recommend that the depositor can file a lawsuit against the bank as an attempt to retrieve their violated rights.
- We recommend having an article on the deposits which put away inside banks by foreign currency.
- We recommend that the IDIC should have a serious supervision on all member banks

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