VI. CAPITAL MARKETS

A. Capital Market: the Current Position

Trading appears to be concentrated on the ISX. The stock exchange is small and under-developed but has potential to provide access to sources of permanent and long term capital via the issuance of equity and corporate bonds to institutional and retail investors, domestic and foreign. Access to capital for productive purposes and the provision of investment and savings mediums are dominated by the state owned banks. For major institutional investors such as the state owned insurance companies, real estate and direct equity investment in mixed companies (where the state owns 25 percent of the equity) are also viable alternative investment vehicles. The current regulatory position limits the possibility of developing a range of investment products particularly for retail investors, such as Iraq based collective investment schemes.

Since its foundation in 2004 (under Interim Law No 74) ISX has made progress and has begun to attract international attention, but it has a long way to go to fulfill its potential as an agent for growth in the Iraq economy. As at February 2011 there were 85 companies listed on ISX. They are a mix of privately owned joint stock companies and mixed companies. Total market capitalisation was approximately ID 3.5 trillion (USD 3 billion) which is very small; in comparison for example the Amman Stock Exchange has a market capitalisation of USD 31.5 billion and Dubai totals USD 54 billion. As a percentage of Iraqi GDP the market cap of ISX is approx. 3.5 percent. In 2010 the market traded a total value of ID 400 billion (USD 339 million) or USD 1.4 million per day. In comparison,
Amman in 2009 (last data available) traded USD 40 million per day (it has 3 times the number of listed companies) and Dubai traded USD 37 million a day but had fewer companies listed (65) than ISX. Trading in the shares of the private banks (22 percent of the listed companies) accounted for over 80 percent of turnover by volume and value.

**Table 6.1: Market Capitalization - Major MENA Equity Markets + ISX**

<table>
<thead>
<tr>
<th>Major MENA Markets</th>
<th>Market Capitalization</th>
<th>% of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2005</td>
<td>2006</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>646</td>
<td>327</td>
</tr>
<tr>
<td>Kuwait</td>
<td>142</td>
<td>144</td>
</tr>
<tr>
<td>Qatar</td>
<td>87</td>
<td>61</td>
</tr>
<tr>
<td>Oman</td>
<td>13</td>
<td>13</td>
</tr>
<tr>
<td>UAE</td>
<td>231</td>
<td>169</td>
</tr>
<tr>
<td>Bahrain</td>
<td>17</td>
<td>21</td>
</tr>
<tr>
<td>Jordan</td>
<td>37</td>
<td>29</td>
</tr>
<tr>
<td>Egypt</td>
<td>81</td>
<td>95</td>
</tr>
<tr>
<td>ISX</td>
<td>3.0</td>
<td>3.5</td>
</tr>
</tbody>
</table>

*Source: Bloomberg, Zawya, Global Research and ISX (2010).*

Although share prices overall have remained flat in the last three years (see chart below) there are indications that investors are becoming more aware of the market and more optimistic about its prospects. The ISX’s own index was up over 27 percent in the first three months of 2011. In 2010 foreigners were strong buyers. They bought 36 billion shares worth ID 62.8 billion and sold ID 5.8 billion shares worth 8.5 billion ID. Some emerging market funds have begun to invest in Iraqi stocks and one US broker which specializes in so-called “frontier markets” now promotes the market in the US. Other than percentage restrictions in the ownership of the banks, non-Iraqis are free to invest in the market.
Table 6.2: Average Daily Market Value Traded Major MENA Markets + ISX

<table>
<thead>
<tr>
<th>Country</th>
<th>Daily Market Turnover (US$ bn) 2009</th>
<th>% Change from December 2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Saudi Arabia</td>
<td>1.300</td>
<td>-37.9</td>
</tr>
<tr>
<td>Kuwait</td>
<td>0.150</td>
<td>-71.9</td>
</tr>
<tr>
<td>Qatar</td>
<td>0.100</td>
<td>-48.1</td>
</tr>
<tr>
<td>Oman</td>
<td>0.006</td>
<td>-82.8</td>
</tr>
<tr>
<td>UAE</td>
<td>0.120</td>
<td>-79.8</td>
</tr>
<tr>
<td>Bahrain</td>
<td>0.001</td>
<td>-88.1</td>
</tr>
<tr>
<td>Jordan</td>
<td>0.040</td>
<td>-60.0</td>
</tr>
<tr>
<td>Egypt</td>
<td>0.110</td>
<td>-62.5</td>
</tr>
<tr>
<td>HK</td>
<td>7.922</td>
<td>-28.2</td>
</tr>
<tr>
<td>Sing</td>
<td>3.239</td>
<td>-24.7</td>
</tr>
<tr>
<td>ISX</td>
<td>0.0014</td>
<td></td>
</tr>
</tbody>
</table>

Source: Bloomberg, Zawya and ISX (2010)

ISX was established as a not-for-profit, member owned self regulatory organization in 2004. It is the only securities exchange currently operating in Iraq and enjoys a monopoly of trading in securities although the current law permits off-exchange trading if the ISC has made the appropriate regulations. No such regulations appear to have been made. There are currently 48 licensed brokerage companies with two applications pending. Banks can be members of the exchange via subsidiaries but the state owned banks are prevented from joining as their legal form prevents them from owning subsidiaries. This issue has not, it is understood, been finally resolved. The ISC currently limits new licenses to five a year and gives first priority to applicant firms from the regions.

Figure 6.1: Broker’s Proprietary Index

Source: Rabee Securities, Baghdad (2011). The upper line is the broker’s proprietary index in ID and the lower in USD.
ISX’s trading platform is technologically modern. Since 2010 all shares can be traded electronically although the physical floor has been maintained for those brokers who wish to use it. ISX is open for trading on five days a week. ISX uses an integrated trading, clearing and settlement platform provided by NASDAQ OMX, one of the world’s leading providers of such systems.

All trades are settled in the Iraq Depository Center (IDC). All brokers must be members of the depository. There are no clearing members who act for other brokers. Day to day monitoring of brokers cash and securities positions, and therefore the setting of daily trading limits in compliance with the ISX’s trading rules is carried out by IDC which reports to the ISX. IDC is in the process of dematerialising securities (as paper certificates are delivered on sold trades they are not reissued to buyers who receive a record of their holdings instead). This process is also facilitating a clean-up of company share registers as regards ownership.

Trading rules are conservative as is not uncommon in the region, such as Dubai. Buyers must have funds in their brokerage account before their order is entered and sellers must have the shares in their accounts. The risk of a failed trade is therefore very small. Settlement is same day (T+0) which places a very high priority on cash and securities being in position when a trade is executed, but it also acts as a constraint on the level of trading business. ISX is considering extending the settlement period to T+2 or T+3 which provide greater flexibility. Plans are also well advanced for the creation of custodian banks which will make it easier for foreigners (and large domestic investors) to trade while keeping the restrictions. Short selling is not permitted and there are no derivatives contracts traded.

Trading in Government securities is currently carried out on separate system operated by the CBI. Government securities consist of 365 day treasury bills auctioned on a regular basis via an electronic system - the Government Securities Registration System (GSRS)\(^\text{17}\). Currently access is limited to the banks acting on their own account and for customers. There are plans to link the GSRS to the trading platform of the ISX (via IDC) in order to develop the primary market and encourage a secondary market. It is intended that a greater range of government and government guaranteed securities will be issued via the GSRS, such as bonds issued by the State owned banks. Currently the CBI plans to continue to limit access to the system to the banks. There does not appear to be a market in corporate debt.

**B. Preconditions for Developing the Capital Market**

Much academic research\(^\text{18}\) over the last twenty years has demonstrated that capital market development is highly dependent on there being a

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17. The Central Bank issues its own 91 and 182 day bills.
fair, equitable and transparent civil society. This is necessary if investors are to be able, with confidence, to invest in productive enterprises on their merits and without believing that they have to be “insiders” or majority shareholders. These include legal systems characterized by certainty of contract enforcement, protection of shareholder and creditors rights and an honest judiciary knowledgeable in commercial law and the practice in financial markets. Speed of dispute resolution, as well as fairness, is also an important element. High levels of transparency, completeness, timeliness and accuracy of financial statements and other disclosures by companies are also essential criteria, as is a fair and equitably enforced taxation system. A securities market regulator, even if equipped with all of the tools set out in the IOSCO Objectives and Principles of Securities Regulation will not be effective, nor will its work be seen as credible by investors and issuers if these preconditions are not in place.

It appears that in Iraq, in all of these areas, much needs to be done to begin to approach internationally recognised standards in which investors, both domestic and foreign, will have confidence. Discussions with the authorities indicated a range of problems. The law on bankruptcy appears to contain numerous uncertainties and unpaid creditors appear to have limited means of recourse against a defaulting company. The quality and competence of the judiciary in the field of commercial law, the powers available to the courts and the time it take for cases to work through the process are also suspect. Iraq has no laws governing anti-trust or competition issues.

As regards accounting attempts have been made to implement International Financial Reporting Standards (IFRS) but legislative change will be needed to impose it fully. According to the Board of Supreme Audit this will take at least two years to secure. There are numerous differences between IFRS and Iraqi accounting standards and it is highly unlikely that Iraqi accounting standard can be considered to be of an internationally acceptable standard. Accountants in Iraq use the outdated Unified Accounting System, which includes standards that have not been updated since the mid-nineties and others which are about 70 years old.

Auditing standards are also likely to be weak. A detailed examination of the key issue of auditor independence will almost certainly reveal serious inadequacies and lack of effective regulation of the profession. It appears that knowledge of the International Auditing and Assurance Standards Board (part of the International Federation of Accountants (IFAC)) and its International Standards on Auditing (ISA) is slight. Training of local accountants and auditors in new, globally recognized standards, practical and ethical, will also take considerable time. Although it appears that efforts were made to begin the process in 2007 in several universities, it is not known if that work is on-going or how successful it has been.

Two widely followed international indices also indicate the scale of the problems which need to be overcome if the private sector, and in
particular that part based on broadly dispersed public share ownership and the stock exchange, is to flourish. The Transparency International 2010 Corruption Perception Index rated Iraq 175 out of 178, between Afghanistan and Uzbekistan/Turkmenistan. Iraq also scores poorly in the World Bank’s “Ease of Doing Business” Survey – 166 out of 183 globally and similarly poorly on a regional basis. For example, the survey states that in Iraq it costs almost 5 times as much to set up a business than in other Middle Eastern countries and the bureaucracy is excessive.

C. Capital Market Regulations

The current legal and regulatory infrastructure requires significant enhancement if it is to provide a sound basis for the development of the capital market. The issues and recommendations for change are discussed in Annexes 8 and 9. Some necessary measures are in the advanced planning stage and should be actioned as soon as possible. Others need to be initiated or developed fully. This section describes, to the extent possible based on available information, the current regulatory and self regulatory position.

The statutory regulator is the Iraq Securities Commission (ISC). Established under the Interim Law No. 74 ISC is believed to be small (46 employees) and probably under-resourced. It should have a Chairman and four other Commissioners, three of whom are to be part-time. Its web site names only three Commissioners currently, the Chairman and two others. Commissioners are appointed by the Council of Ministers and should be experts in securities markets; the Chairman is a stockbroker by profession. Also according to its web site ISC is organized into 9 departments: Executive, Public Relations and Secretariat, Legal, Inspection and Implementation, Disclosure Department, Chief Accountant, Internal Auditor, Market Organization, IT and Research and Economic Analysis. The web site does not include an annual report of the Commission. As far as can be determined from the web site the ISC’s primary, day to day, role is receiving the annual and quarterly reports that ISX listed companies are required to file with it. It also receives reports from persons who hold more than 10 percent of the voting shares of a listed company and any changes thereto. It has adopted a practice of publicly warning (via its web site) those companies, by name, which have not met their obligations to file quarterly unaudited financial reports within the 60 day deadline, and conversely congratulating those that have.

Since 2007 ISC has issued a total of 14 “instructions” to brokers and issuers; some have simply modified previously issued instructions. These are generally short, one or two pages, and set out regulatory matters in outline only. As regards brokers it has issued instructions concerning minimum capital requirements (a highly simplified version of the Net Capital Rule of the US SEC); disclosure of financial statements to the Commission; information to be given to non-Iraqis seeking

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19. Russia, at 154 is the only economy which breaks the rule that high levels of perceived corruption and a thriving stock market do not positively correlate.
to trade on the ISX; procedures to be followed for the suspension and cessation of ISX membership of brokerage companies; procedures for the segregation of client accounts at brokerage companies; and procedures for opening branches of brokerage companies in the provinces. As regards listed companies the ISC has issued instructions concerning conditions and requirements for listing companies at the stock exchange; dates of suspending and re-allowing trading for shares of listed companies; financial disclosures by listed companies; disclosure of significant holdings and the procedure for delisting companies. It has stated that it will not issue “regulations” (which it presumably sees as having more force than instructions) until the permanent Securities Law is brought into force.

Although the Interim Law states that no stock exchange may operate without a license from the ISC, the ISX (as successor to the Baghdad Stock Exchange) was licensed and operates by virtue of the Interim Law and is thus in a privileged position vis-a-vis the ISC. It is however subject to regulatory oversight by the ISC although it has not been possible to establish how that operates in practice. It would not be surprising, if, as in many emerging markets where the exchange pre-dates the statutory regulator and has many informal and long-standing relationships within the executive and industry, the ISC finds its oversight power is limited should it wish to exercise that power in a vigorous way. Stockbrokers who were in business prior to April 2004 were also grandfathered without having to go through a re-licensing process, which compounds the problem.  

As a self regulatory organization ISX has the main responsibility for on-going regulation of its 48 members. From discussions with the Chairman of the Governors and the General Manager it appears that ISX takes its self regulatory role as a market operator seriously. The Chairman stated that when the law requires the Exchange to take action, this has been done. Sanctions have been imposed on brokers, and companies have been delisted, though not frequently. He subsequently provided various application and reporting forms which provide documentary support to some elements of his assurances. The General Manager provided further examples.

Although the conservative nature of the trading rules coupled with the automated integration of electronic trading and settlement probably secures a degree of automatic enforcement of rules and limits systemic risk, the ISX has only five staff to supervise the brokers and carry out market surveillance which is too few. The trading rules appear satisfactory although consideration should be given to moving to a real time last trade tape. The Chairman noted that brokers are inspected on a semi-annual basis although it was not possible to establish how thorough that process is. Copies of the inspection manual or sample inspectors’ reports have not been provided. The recent move to electronic trading integrated with clearing and settlement, while not eliminating risk, should provide supervisors with better and more immediate warning signals. The ISC appears to have accepted that ISX should take the lead in day-to-day supervision of its members.

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20. Although all brokers are subject to an annual review of their IT capabilities by ISX.
Shares are in the process of being dematerialized and the registers of ownership are being updated and problems resolved. Under the current law there is a significant degree of transparency of share ownership. Share registers are open to the public, listed companies have to disclose their five largest shareholders in the annual report and shareholders owning 10 percent or more of the voting shares of a joint stock company must report this to the ISX and the ISC which have an obligation to make this information public. These provisions, if fully enforced, should, over time, add to the integrity of the market and increase investor confidence in participating in it.

D. Issuers and Infrastructure

Only one company listed on ISX in 2010 and 5 delisted. New admissions to listing are the lifeblood of any stock exchange. On that basis ISX is at a critical stage of its development. It is not clear why growth in listings has come to a halt. It may be that ISC has attracted the majority of private and mixed companies in Iraq that are: (i) interested in listing and having their shares freely traded by public investors; and (ii) capable of meeting the criteria for listing. It may also be the case that currently listed companies do not have any great need for additional capital which would cause them to issue more shares. On the other hand, owners of closely held private companies may need incentives to encourage them to accept outside shareholders via a listing on ISX.

In any case, the greatest number of companies which could potentially transform ISX is to be found in the state owned sector. According to ISX there are up to 296 companies which could be transferred to the private sector. The Ministry of Finance has established a committee structure charged with taking the process forward. One constraint appears to be that currently there is no clear authority in the law to enable a privatization program to be undertaken. It is understood that there is also an unresolved debate on the extent to which ownership should be transferred to private investors by means of public offers of securities and listing on ISX, and the extent to which significant stakes in major companies should be sold directly to foreign companies.

Presumably the expectation, if the second course is adopted, is that these foreign direct investors will bring needed expertise and additional technical and financial resources to develop their Iraqi subsidiaries. As discussed below, to the extent that state owned companies need new capital when transferring into the private sector, there is also a question as to whether domestic Iraqi investors, whether institutional or retail, can provide sufficient funds. The fact remains that even if shares in only a minority of state owned companies were offered to the public in Iraq, whether for free or for cash, the ISX would be transformed into an exchange better capable of standing comparison with its regional peers such as Cairo (313 listed companies), Amman (272) and Saudi Arabia (135).

Achieving a successful privatization program poses many challenges. As Iraq transitions from a largely state owned command economy to a free market in
which the securities market will play an increasing role in capital formation and allocation and a place for savings, it will be vitally important for the authorities to learn from the mistakes in other countries which went through this process. In many cases investors, particularly retail investors were inexperienced and naïve and regulators were poorly resourced and inexperienced. The clever and unscrupulous made fortunes. Flawed privatization methods coupled with poor regulation (such as the voucher schemes used in much of Eastern Europe and Mongolia) and extra-statutory criminal activities, such as Ponzi schemes masquerading as legitimate investment products, severely damaged investor confidence and destroyed savings. In some countries the development of the capital market was set back by a decade or more. Similarly, while the privatization of 296 state owned companies potentially opens up great opportunities for the ISX and its members it will require significant steps by ISX to increase investor confidence in the integrity of its market and to enhance expectations that they will be treated fairly. This will require:

■ Close attention to be paid to the quality of the service provided to investors by brokers, from the suitability of advice, the handling of client orders and the safekeeping of client securities and cash

■ Enhanced market surveillance and prosecution of insider dealers and other manipulators

■ Securing technological enhancements when necessary, particularly in clearing and settlement, to minimize the risk of a market collapse from a surge in trading which exceeds the ability of the system to process.

ISX wishes to develop a Second (or Junior) Market to provide access to equity capital for SME with short trading histories. It has identified 23 companies interested in listing. Many exchanges globally have established such markets. ISX’s preferred model appears to be based on that adopted by the Amman Stock Exchange where a company can be listed and have its shares publicly traded as soon as it receives its permission to trade from the authorities rather than having to first establish a two year trading history which is the norm for a listing on the First Market in Amman, ISX and many other exchanges. This could provide a further stream of new listings although the average size of each company is likely to be small.

Second tier companies are inherently riskier than those admitted to listing on the First Market. They are smaller and have little or no track record on listing. Their failure rate is therefore likely to be significantly higher. That need not be a concern as long as investors fully understand the risks to which they are exposed and have the resources to withstand sudden and sometimes total losses on their investment. It also requires a regulatory framework with a strong emphasis on brokers “knowing their customers” and having an obligation to propose only those investments suitable to the risk profile and other needs of the client. Currently it is not evident that either ISX or ISC have the capacity to supervise licensees with sufficient intensity to secure a reasonable level of
compliance with such rules. In this situation ISX needs to be very mindful of its responsibilities towards investors and the need to protect its reputation before creating a Second Market.

Current rules governing the conditions under which buy and sell orders can be entered onto the trading platform of ISX are restrictive and are likely to be acting as a constraint in increasing volumes as ISX recognizes. In essence, before entering a buy order a broker must have sufficient funds from his client in his account. Similarly, a sell order can only be entered if the securities are in the account and unencumbered. Given that settlement is same day (T+0) this may be necessary given the current situation with regard to the payment system and the role of the IDC. It has the effect of virtually eliminating the risk of failed trades which is a virtue in its own right as a means of reducing systemic risk, even if the settlement period was extended, such as to T+3. Where this conservative approach to trading has been adopted its disadvantages (limiting the speed with which investment decisions can be carried out and therefore limiting daily trading volumes) have generally been ameliorated by the creation of Custodian Banks. These banks maintain cash and securities holdings for investors, generally foreign and institutional investors, and are closely linked to the clearing and settlement system, thus enabling active intra-day trading by their clients while keeping the risk of failed trades to a minimum. ISX is in an advanced stage of introducing the custodian bank system to its market. According to the Chairman, a major international bank is ready and is waiting for the necessary licenses to be granted. Others have also expressed interest in offering the service. The Chairman of the ISC has recommended that other measures in this area should be examined to further improve automated cash settlement of securities trades and to encourage market financing facilities by the banks.

Trading in Government Securities can be a valuable source of revenue for exchanges in emerging markets. There are plans to integrate current issuance and trading in government debt, organized by the CBI, with the ISX’s trading platform and the Iraq Depository Center (IDC), although the CBI wishes to continue to limit direct access to the banks. ISX would prefer to see access broadened to investors more generally. If its members are able to give advice on trading of government securities and then execute orders on the ISX’s trading platform it seems likely that secondary market trading volumes would increase. However, currently the government issues debt with a maturity no longer than one year. This limits, but does not eliminate, the opportunities for profitable trading.

The absence of a yield curve based on government debt beyond one year acts as a constraint on the pricing of longer term debt and the development of fixed income products generally. In particular it hampers the development of a corporate bond market as there are no baseline yields (the so called “risk free rate”) on which to price corporate debt.  

21. There are few examples of deep, liquid corporate bond markets in emerging markets. The World Bank and IOSCO have recently initiated a project to seek to develop better understanding of the challenges in developing such markets and mechanisms by which their growth can be encouraged.
for a corporate bond market exists. Company Law No 21 Section 8 sets out the legal basis for the issuance of corporate bonds. They are also defined as securities in the draft permanent Securities Law; the ISC has prepared draft rules for issuers. There is however no specific legal structure governing the issuance of Sharia compliant securities (sukuk). Currently a corporate bond market does not exist in Iraq and its development is not on the ISX’s agenda. It is probably also the case that uncertainty concerning bankruptcy law and related matters such as the status of mortgaged assets, and the perfection of title over collateral in the event of an insolvency are factors preventing this market from developing at the present time.

Additional factors to which the authorities should give consideration are improving the efficiency of the process by which new businesses can be established and enhancing the confidence among customers, suppliers, creditors etc when dealing with privately owned businesses. Currently Iraq scores poorly in the World Bank’s “Ease of Doing Business” Survey–166 out of 183 globally and similarly poorly on a regional basis. For example, the survey states that in Iraq it costs almost five times as much to set up a business than in other Middle Eastern countries; it takes, on average, 77 days to set up a company and there are 11 different procedures to go through; The Middle East average is 20 days and eight procedures. On the enforcement of contracts Iraq stands at 141.

E. Developing the Capital Market Investors

For a stock market to make a significant contribution to economic growth it needs investors as well as issuers, domestic as well as foreign, and in particular it needs a range of significant domestic institutional investors. Classically that would include state and private pension funds, insurance companies (especially life companies) and collective investment schemes such as mutual funds and the European equivalent, Undertakings for Collective Investments in Transferable Securities (UCITS). Such professional investors are generally regulated as to their qualifications and conduct, knowledgeable, take a medium to long term view, monitor the performance of their portfolios and are prepared to rebalance their portfolios to reflect their changing perceptions of issuers’ prospects. They are thus likely to be active participants in both the primary and secondary markets. Retail investors who trade on their own account can also be very active if they perceive the market to be transparent, well regulated and not biased in favor of insiders. But they are likely to take a more short term and speculative interest in share prices and be driven to act collectively as a result of rumors, press speculation etc.

The ISX was able to provide information on shareholdings by foreign investors but was unable to provide a breakdown of shareholdings by domestic investors, such as banks, insurance companies, pension funds, and retail; no other

22. Many hedge funds are the exception to this rule although the trend in recent years is for greater regulation of the sector and the emergence of more conservative “long only” strategies.
comprehensive data was available. In discussion with the Director General of Iraq’s largest insurance company (Iraq National Insurance Co (INI) he observed that the company’s reserves are invested in high quality assets including real estate, bank deposits and equities. In the case of the last the company invests in both mixed companies and fully private companies. Equity investments are extensive and sometimes substantial (over 50 percent in some mixed companies). Although the Director General was not able to provide a total for INI’s equity investments he gave a figure of US$ 4 billion for the company’s real estate investments in Iraq and elsewhere in the region. If the equity portfolio approaches this level it would match or even exceed the total current market capitalization of ISX (US$ 3.5 billion).

The implication is that, as a group, the state owned insurance companies, which dominate the insurance sector, are currently major holders of equity in companies in the manufacturing materials and service sectors. Their contribution therefore, as Iraq seeks to expand the role of the private sector, has major potential. Much will, or should, depend on the split between general and life insurance. The State Pension Fund is believed to have assets of ID 4.5 trillion (US$ 5 billion) although the Review did not establish how these are invested. Investment via the stock market rather than via direct investment, by institutions of this relative size, will also require modifications of the trading mechanisms of ISX. A system which is adequate for executing 300 trades a day for a value of US$ 1.4 million is unlikely to be satisfactory to meet the needs of substantial institutional investors. According to the Director General of INI problems already occur. The ISX and its members will in due course need to add a dealer market to the current brokerage market. This will require members with sufficient capital to be capable of facilitating client orders of substantial size by taking some or all of an order onto their own books until counterparty can be found. The role of an effective and comprehensive risk based regulatory capital regime will then also become of vital importance to minimize systemic risk which might otherwise arise.

If the state owned insurance companies and the State Pension Fund themselves remain under state control, their acquisition of substantial or controlling stakes in privatized companies creates a dilemma. It would give the state a continuing and influential role in productive sectors of the economy and, depending on the precise policy objectives of the program, might create tensions.

As for retail investors there are no collective investment schemes (CIS) currently offered to investors in Iraq nor is there a regulatory structure to support the product. A well regulated CIS sector can provide a valuable means of providing access to the stock market for investors, particularly inexperienced retail investors, and encourage them to recognize the benefits of equity investment as

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23. The long time horizon of life insurance contracts permits responsible investing of reserves in longer term and less liquid investments. It also means that life companies and pension funds have a constant need to back long term liabilities with long term assets.
part of their medium to long term savings. As CIS are professionally managed, they remove the need for investors to seek advice on day to day management of their portfolios, once the initial choice of which CIS to purchase has been made. They can also reduce specific risk by providing diversification for those investors without the financial resources to purchase sufficient individual investments (at reasonable or even any) cost to achieve this end.

Whether a CIS market can develop, or indeed whether direct retail investment can become a significant source of funds in a stock market, depends on the level of savings and disposable income in the society. According to one estimate\textsuperscript{24} Iraq GDP per capita on a Purchasing Power Parity basis in 2010 was USD 3,600. This was somewhat lower than, for example Jordan (4,800) Syria (4,700) Egypt (4,900) or Iran (11,300). Perhaps more significant when considering the resources of individuals available for stock market investment, the 2011 World Bank report Confronting Poverty in Iraq states that “Compared with most other countries, there is relatively little inequality in Iraq. Few Iraqis today are well-to-do, and few are extremely poor.” At the quoted level of GDP per capita this implies that the size of a middle class with a capacity to save a portion of its income is small, and such capacity as exists is likely to be placed in low risk investments, such as savings deposits in the state owned banks. It may be that, at the retail level, ISX will need to look to the diaspora to play the major role in purchasing new issues of securities.\textsuperscript{25}

\textsuperscript{24} CIA World Fact Book (2010).
\textsuperscript{25} At end of February 2011 on the Amman Stock Exchange foreign ownership accounted for 49.6 percent of ASE capitalization, 32.6 percent of which was owned by Arab investors (expatriate Jordanian investors’ percentage unknown) and 17.0 percent by non-Arabs.