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Dr. Adel Mansour Fadel
Assistant Professor, Department of Financial and Banking Sciences, College of Administration and Economics, Al-Iraqia University, Baghdad, Iraq

Dr. Athir Abbas Obaidi
Assistant Professor, Department of Financial and Banking Sciences, College of Administration and Economics, Al-Iraqia University, Baghdad, Iraq

Dr. Saad Hassan Ali
Assistant Professor, Department of Financial and Banking Sciences, College of Administration and Economics, Al-Iraqia University, Baghdad, Iraq

Corresponding Author:
Dr. Adel Mansour Fadel
Assistant Professor, Department of Financial and Banking Sciences, College of Administration and Economics, Al-Iraqia University, Baghdad, Iraq

Banking governance and banking risk reduction (a study of a sample of banks listed in the Iraq Stock Exchange)

Adel Mansour Fadel, Athir Abbas Obaidi and Saad Hassan Ali

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Abstract
The research aimed to assess the extent of implementation of banking governance standards in Iraqi banks. During the years 2016-2023, the banking sector witnessed the issuance of numerous instructions, which Iraqi banks implemented. This commitment by banks to governance has reduced banking risks. The researcher concluded that Law No. (56) of 2004 granted the Central Bank of Iraq significant independence, enabling it to perform its duties efficiently and monitor banks in accordance with governance and international standards. Therefore, the sample of (10) banks achieved good results in reducing banking risks in terms of return on assets and market trading ratio. This indicates that commitment to governance has made progress in reducing banking risks in Iraq, and that banks are compliant with regulations and adherence to the instructions of the Central Bank of Iraq and international standards. Important recommendations include increasing field inspections, activating periodic field visits to banks, attracting international expertise, and cooperating with other central banks or international financial organizations to exchange expertise.

Keywords: Banking governance, banking risks, Iraq stock exchange

Introduction
The banking sector is undergoing radical transformations in light of technological, economic, and regulatory developments, making banking governance an imperative necessity to ensure financial stability. Governance is a regulatory framework aimed at improving bank efficiency by promoting transparency, accountability, and good management. This contributes to mitigating the financial risks faced by banks, such as credit, liquidity, market, and operational risks.
In Iraq, the banking sector faces significant challenges due to political and economic instability, which increases the importance of studying the impact of banking governance on financial risk management. This study aims to analyze the role of governance in mitigating financial risks in a sample of banks listed on the Iraq Stock Exchange, focusing on theoretical and applied aspects.

1. Importance of the Study
1. Enriching the literature on banking governance and risk management in the Iraqi context.
2. Providing recommendations to decision-makers in banks and regulatory bodies to enhance financial stability.
3. Contributing to enhancing investor and depositor confidence in the Iraqi banking sector.

Second: Study Objectives
1. Evaluate the extent of implementation of banking governance standards in Iraqi banks, namely: National Bank of Iraq, Iraqi Islamic Bank, United Investment Bank, Ashur International Bank, Commercial Gulf Bank, North Bank, Mansour Bank, and Baghdad Bank.
2. Analyze the impact of governance on financial risk management (liquidity, market turnover).
3. Provide recommendations to enhance banking governance in Iraq.

1. Banking Governance in Iraqi Banks

Banking governance is the system by which banks are directed and monitored to ensure the achievement of strategic objectives and the protection of the interests of shareholders and depositors. It includes:

a) Board structure (independence, expertise, diversity).
b) Transparency and disclosure (accurate publication of financial and non-financial data).
c) Internal control systems (audit committees, risk management).
d) Compliance with regulations (adherence to Central Bank instructions and international standards).

11: Principles of Internal Banking Governance in Iraqi Banks

The Central Bank of Iraq was granted independence under the new Law No. 56 of 2004, which granted it financial, administrative, and legal independence and expanded its duties and powers. These include achieving sustainable growth, maintaining financial soundness and stability, and monitoring bank activity in the stock market, thus contributing to improving the monetary and financial environment. The Central Bank of Iraq is responsible for implementing governance across the financial system in Iraq, both with regard to shareholders' rights and the responsibilities of the Board of Directors, as the Central Bank of Iraq is the supervisory authority over banks and other financial institutions. This task has been assigned to the Banking Supervision Department, one of the main and central departments of the Central Bank of Iraq. This department will monitor the compliance of banks and other financial institutions with the requirements of prudential tools and standards that ensure banks' financial conditions are consistent with international standards, such as the Basel Accord and international governance guidelines. The objective is to mitigate or eliminate factors affecting banking performance and soundness and mitigate the risks arising from banks' financial mismanagement. This is why Banking Law No. 94 of 2004, Banking Law No. 56 of 2004, and Companies Law No. 97 of 1997 stipulate the following:

1. The bank's board of directors is responsible for managing the bank's business and setting its policies. In particular, the board of directors is responsible for setting risk management standards, investment policies, minimum prudential ratios, accounting standards, and internal control systems for the bank.
2. The board of directors must have no fewer than five members. Members of the Board of Directors are appointed at the general shareholders' meeting for a term not exceeding four years; they may be reappointed for subsequent terms. At the general shareholders' meeting, the bank's shareholders may determine the remuneration of the board members. The board of directors shall elect a chairman from among its members:
3. The chairman of the board of directors and all members of the board of directors must:

Have legal capacity and be a fit person
Be at least 30 years of age

A member of the board of directors may not be an official or employee of another bank, unless the bank is a subsidiary of that other bank or both banks are under common control, provided that in this case, such members may not constitute a majority of the bank's board of directors, or a government official who heads a ministry or holds a ministerial position. Board decisions are made by a majority vote of the members present. If the vote is equally divided, the chairman's vote shall be the decisive vote.

The board of directors of a local bank shall appoint one of its members as the bank's managing director. The managing director is responsible for implementing the board's decisions and managing the bank's day-to-day operations. 5- The board of directors of any major local bank appoints internal auditors according to the following criteria:

- They must be qualified members of a recognized professional association with extensive experience
- Experience in the field of accounting or auditing (Banking Law No. 94: 2004, Article 104)

The number of members of the local bank's audit committee must not be less than three. Members are appointed by the shareholders at the general meeting.

The chairman of the board of directors, the managing director, and any other officer or employee of the bank may not be members of the audit committee. Shareholders at the general meeting must appoint the chairman at the general meeting. Audit committee decisions are made by a majority vote of the members present. If the vote is equally divided, the chairman's vote shall be the decisive vote.

The number of board members shall not exceed 9 and not be less than 5, elected by the members of the general assembly.

To resolve conflicts between shareholders and executive directors, senior management uses financial compensation (monthly salaries and annual cash bonuses) in the form of shares, linking the director's performance to the performance of the stock. (94 Banking Law of 2004, Article 24).

2.1 Principles of External Governance in Iraqi Banks

Companies Law No. (21) of 1997, as amended, addresses the basic principles emphasized by the Organization for Economic Cooperation and Development (OECD). This law was reinforced by Iraqi Banking Law Nos. (56) and (94) of 2004. This law was reinforced after financial institutions in Iraq adopted a series of measures after 2004, including amendments to the institutional framework (the infrastructure of the banking sector), regulatory (amending the law), and supervisory (instructions issued by the Central Bank, the Securities Commission, and the Iraqi Association of Securities Dealers), to align with financial liberalization. This law includes legal texts binding on banks as joint-stock companies listed on the stock market. The most important measures implemented as an external framework for banking governance in Iraq are as follows:

First - Infrastructure of Iraqi Banks

1. Bank Oversight. Oversight of private banks in Iraq includes the following main levels:

- The bank's internal oversight through control and oversight systems, including internal audit departments. The external auditor is appointed pursuant to the provisions of Article (46) of Banking Law No. (94) of 2004. He is selected with the approval of the bank for a term of five years.
- The banking oversight tools used by the Central Bank are as follows:
- **Licensing:** The Central Bank has sole authority to

license banks and their branches inside and outside Iraq.

- **Off-site supervision:** The Central Bank monitors and follows up on the financial conditions of banks by analyzing bank data.
- **Field supervision:** This is accomplished through field visits to banks.

2. Payment systems: Payment and settlement systems are closely linked to the two primary functions of monetary authorities: achieving financial and monetary stability. Therefore, monetary policy is concerned with the efficiency and integrity of these systems, in addition to the role of monetary authorities as users and supervisors of the payment system. Therefore, they play two important roles:
First, as a system operator, they provide settlement services for payments by banking institutions participating in the system through these institutions' accounts with these authorities. This role also includes providing the necessary infrastructure for these systems, such as hardware, software, and networking.
Second, the role of the supervisor and monitor of these systems, which includes establishing the rules and standards governing the operation of these systems and maintaining the integrity and safety of operations.
The Central Bank established the Iraq Payments System in 2006. The Iraqi Payments System consists of the following subsystems (Central Bank of Iraq, 2009: 38-42):
The Real-Time Gross Settlement System, which ensures the actual settlement of (high-value) payment orders issued by participants on a continuous, transaction-by-transaction basis within the business day.
The Automated Clearing System, which is responsible for exchanging payment orders for low-value payments and direct debit payments between participating banks, calculating the net exchange position for all participants, and submitting net settlement orders to the Real-Time Gross Payments Settlement System.
The Government Bonds Deposit and Registration System, which manages government bonds issued by the Central Bank and the Ministry of Finance. This system was operational in 2008 and is managed by the Central Bank and the Ministry of Finance. The Central Bank conducted (28) auctions worth (2,940) billion dinars, while the Ministry of Finance conducted (28) auctions. By implementing (23) auctions worth (3,190) billion dinars.
Establishing information websites on the Internet and on the European-Asian Financial Services Association (FEAS) website, where information related to the market is published. An agreement was also reached with Thomson Reuters to broadcast trading data and company information online to its subscribers, as a step to assist banks in attracting and disclosing information to foreigners about financial data, such as investment capital and balance sheets, and educating investors about investment opportunities in the market. (First Annual Report of the Iraq Stock Exchange, 2004: 6) [9].
Establishing the Depository Center on April 19, 2009, for Iraqi banks listed on the Iraq Stock Exchange. It began operating as a non-profit economic institution that contributes to promoting safe and stable investment. It supports all economic sectors that benefit from the services it provides, complementing electronic trading as it is affiliated with the market (Central Bank of Iraq, 2010: 64). An integrated database was also established for bank securities owners to enhance the speed of securities turnover through settlement and clearing operations. Its supervisory statistics developed in 2012, with the total volume of deposit, capitalization, and subscription transactions reaching 8.20 transactions. The number of deposit certificates for shares deposited reached (1,734) name certificates, (43) share mortgage transactions amounting to (70.587) billion shares, and (169) ownership transfer transactions from one intermediary account to another (Central Bank of Iraq, 2012: 91).
The Iraqi Banks Interconnection Network, a high-tech wireless network linking the main branches of all government and private banks and the Ministry of Finance with the Central Bank to serve the Iraqi payments system, was operational in 2007.

2. Financial Risks in Banks Listed on the Iraq Stock Exchange

Iraqi banks are exposed to a variety of financial risks, which can be classified according to international standards such as Basel III (Basel Committee, 2017: 43) [1]. The following are the most prominent types of financial risks in Iraqi banks:

1. Credit Risk

The risk that borrowers or customers will be unable to repay debts or financial obligations. Banks suffer from a high rate of non-performing loans due to weak repayment guarantees and poor credit ratings. Reports from the Central Bank of Iraq indicate that the percentage of non-performing loans reaches 20% in some government banks. One indicator of this is the non-performing loan ratio (Al-Hadithi, 2021; 22) [2].

2. Liquidity Risk

The bank's inability to meet its short-term obligations due to a lack of liquidity. Many banks rely on short-term deposits while offering long-term loans, creating an imbalance.
Reports indicated that 40% of Iraqi banks face challenges in managing liquidity.
One indicator of this is the liquidity ratio, the return on equity (Iraqi Institute for Banking Development, 2021) [3].

3. Market Risk

Losses resulting from fluctuations in market prices (such as exchange rates, interest rates, and stocks). Sharp fluctuations in the exchange rate (such as the depreciation of the dinar against the dollar) have impacted banks' balances. One indicator of this risk is the value at risk (VaR). (IMF, 2023: 15)

4. Operational Risk

Losses resulting from human or technical errors or fraud. In Iraq, the technological infrastructure is weak. The spread of fraudulent operations (such as illegal transfers), and a 30% increase in banking fraud cases was recorded in 2022.

3. Analysis of the Impact of Banking Governance on Banking Risks in Iraq

Banking governance is a crucial factor in reducing financial risks and ensuring the stability of the banking sector. In Iraq, there are still gaps in the implementation of governance standards, which requires intervention by regulatory authorities. By strengthening governance, Iraqi banks can achieve greater efficiency and attract more investment. Despite this, some banks have achieved an acceptable rate of risk reduction due to their commitment to international governance standards, as follows:

1. Return on Assets

Table (1) displays the return on assets rate for the banks in the research sample. We note a discrepancy in the profit rates achieved by the banks surveyed. Three banks achieved a rate higher than the intended general rate for comparing the results, which amounted to (1.7) throughout the research time series. This indicates the high profitability rates of these banks, due to the bank management's exploitation of the funds invested in its assets. Ashur International Bank achieved The highest rate on assets was (2.26), followed by the Bank of Baghdad with a return on assets rate of (1.92), then the National Bank of Iraq with a rate of (1.76), and Mansour Bank achieved a return on assets rate of (1.41), and the Iraqi Islamic Bank achieved a return on assets rate of (1.41). We also note from the table that there is fluctuation in the rates of return achieved by the banks in the research sample, as the rates started high in 2016 and then this rate decreased to 2022 due to the state's austerity financial and monetary policy and the impact of the Corona pandemic on the Iraqi economy in this period. This rate rose in 2023 to (1.37), which is higher than the general rate, indicating the recovery of the banking sector in this period. The Bank of Baghdad recorded the highest rate of return on assets in 2023, amounting to (5.67), followed by the National Bank of Iraq with a rate of (4.77), then Mansour Investment Bank with a rate of (3.49), and the North Bank achieved values The negative return on investment rate was due to the decrease in investments from the assets held by the bank, which led to a deterioration in profits. The United Investment Bank came in second place among the banks that achieved low returns on investment, with a percentage that is the lowest in 2018, with a percentage of (-3.26) and an average over the time series of the research amounting to (-0.51), followed by the Gulf Commercial Bank with a return on investment rate of (-0.18) as an overall average. This indicates the reliance of the banks' management on their commitment to the standards and instructions related to governance, especially in recent years.

Table 1: Return on assets for the research sample banks.

Average	2023	2022	2021	2020	2019	2018	2017	2016	Bank Name	ت
1.76	4.77	1.14	1.43	2.23	1.45	-1.50	0.49	4.06	National Bank of Iraq	1
1.41	1.43	1.66	0.72	1.89	1.53	1	1.51	1.56	Iraqi Islamic Bank	2
-0.51	-0.41	0.02	0.24	0.06	-0.34	-3.26	-0.60	0.20	United Investment	3
2.26	2.12	1.65	1.24	3.13	1.42	1.01	3.59	3.93	Ashur International	4
-0.18	-0.12	-0.93	-0.94	-0.0002	-0.72	0.10	0.70	0.73	Commercial Gulf	5
-2.43	-2.49	-1.22	-1.75	-0.67	-3.15	-3.64	-2.72	-3.76	North	6
1.41	3.49	1.72	1.16	0.54	0.57	1.35	1.13	1.30	Mansour Investment	7
1.92	5.67	3.08	1.95	1.42	0.64	0.37	0.56	1.69	Baghdad	8

Source: Based on the annual financial statements of the research sample banks for the period 2016-2023.

2. Trading Rates of Banks in the Iraq Stock Exchange

Table (2) shows the results achieved for the trading rate of the banks in the research sample during the research period. The banks collectively achieved an overall average of (2.15), which is the adopted rate as a basis for comparing and analyzing the results. The results show that nine banks achieved a rate higher than the overall average for the research period. The Trans-Iraq Bank came in first place with the highest trading rate of (4.94), followed by Sumer Commercial Bank in second place with a rate of (3.63), and then Elaf Islamic Bank came in third place with a trading rate of (2.97). This indicates the strength of the financial position of these banks by providing financial liquidity that gives them the ability to meet their short-term financial obligations. This explains their reliance on equity to finance their investment operations more than their reliance on debt. Meanwhile, eleven banks achieved a liquidity rate lower than the overall average for the research period. The Bank of Baghdad ranked first among the banks studied as the bank with the lowest retention of financial liquidity, with a trading rate of (1.20). Mansour Investment Bank came in second place with a ratio of 1.28, followed by the International Development Bank in third place with a ratio of 1.32, and then the Middle East Bank in fourth place with a ratio of 1.38. This indicates the weakness of these banks in providing financial liquidity to meet their short-term dues, making them more vulnerable than others to financial shocks. This explains their reliance on debt to finance their investment operations more than their reliance on equity.

Table 2: Bank trading ratios in the Iraq Stock Exchange

Average	2023	2022	2021	2020	2019	2018	2017	2016	Bank Name	ت
1.50	1.05	1.12	1.17	1.52	1.53	1.83	1.85	1.94	National Bank of Iraq	1
1.71	1.50	1.21	1.27	1.45	1.46	2.39	2.14	2.24	Iraqi Islamic Bank	2
1.74	1.61	1.28	1.27	1.39	1.82	2.16	2.07	2.29	United Investment	3
2.71	2.67	2.71	2.69	2.57	2.61	2.24	3.26	2.92	Ashur International	4
1.78	1.73	1.85	1.91	2.02	1.84	1.77	1.74	1.37	Commercial Gulf	5
2.29	2.23	2.33	2.14	2.17	2.44	2.69	2.45	1.84	North	6
1.28	1.34	1.56	1.60	1.26	1.21	1.09	0.92	1.28	Mansour Investment	7
1.20	1.17	1.21	1.19	1.21	1.26	1.26	1.16	1.14	Baghdad	8

Source: Based on the annual financial statements of the research sample banks for the period 2016-2023.

Conclusions and Recommendations

First - Conclusions

1. Law No. (56) of 2004 granted the Central Bank of Iraq significant independence, enabling it to perform its duties more efficiently in achieving monetary and financial stability and monitoring banks in accordance with international standards.
2. The law imposed strict requirements on bank management, such as the formation of boards of directors, the appointment of independent auditors, and the establishment of standards for risk management and internal control.
3. The Central Bank established advanced systems such as the Iraqi Payments System (IPS), the Real-Time Gross Settlement System, and the Automated Clearing House System, which enhanced the efficiency of banking operations.
4. The sample of (10) banks achieved good results in reducing banking risks in terms of return on assets and market turnover. This indicates that commitment to governance has made progress in reducing banking risks in Iraq, and that banks are compliant with regulations and adherence to the instructions of the Central Bank of Iraq and international standards.

Second - Recommendations

1. Increase field inspections: Activate regular field visits to banks to detect any violations or gaps in compliance with standards.
2. Enhancing transparency in financial reporting by requiring banks to publish their financial statements periodically and clearly to ensure shareholders and investors have the right to know.
3. Attracting international expertise: Collaborating with other central banks or international financial organizations (such as the International Monetary Fund) to exchange expertise.

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