

Questions and Answers About the Iraq Securities Law

1. Why does Iraq need a stock market?

A stock market can provide many benefits. It helps channel savings into investment and promotes capital formation. It is the best way for many businesses to establish a permanent capital base and to raise money for new equipment and projects. By selling shares that represent partial ownership, a company can quickly and efficiently raise a large sum of money from a wide group of investors.

Faster and more efficient access to capital will make it easier to form businesses and create jobs in Iraq. Large projects that might not get funded without a stock exchange will become feasible. All Iraqis will benefit from increased economic activity.

The stock market is also an efficient way for Iraq's economy to access foreign investment. This can happen in two ways: first, a company listed on the ISX can sell shares directly to foreign investors and use the proceeds in its business. Second, Iraqi investors that own shares of companies listed on the exchange can sell their shares to foreign investors and use the proceeds for their own purposes, such as financing a business or building a home.

A strong stock market makes it easier for companies and investors to share information and engage in mutually beneficial transactions. It provides liquidity to investors, so that they can easily buy and sell their ownership interests (shares). The buying and selling of shares results in transaction prices, which allow management and investors to evaluate businesses by comparing their market value and performance to those of their competitors. A strong stock market also makes it easier to provide the proper oversight and inspections to ensure fair trading and sales practices.

There are stock markets throughout the region: for example, in Amman (Jordan), Bahrain, Cairo (Egypt), Tehran (Iran), Safat (Kuwait), Benghazi (Libya), Muscat (Oman), Islamabad, Karachi, and Lahore (Pakistan), Algiers, Nablus (Palestinian National Authority), Riyadh (Saudi Arabia), Damascus (Syria), Abu Dhabi, and Dubai. The Securities Law will enable Iraq to compete effectively with these countries for business and let Iraqis feel safe investing in their own country instead of taking their money elsewhere in the region. This will make Iraq a stronger market-based economy.

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2. Why is the Iraq Stock Exchange private instead of government-owned?

It is best for Iraq if the stock market develops under private sector leadership. It is widely accepted that the private sector does a better job than government in allocating capital because it is the private sector (investors') capital that is at stake. While government clearly has a role to play in economic development, generally its role should be limited to those projects that are less likely to be supported by the private sector, such as roads and other public services. It will be easier for Iraqi companies to raise capital where the capital allocation mechanism is under the direction of the private sector, including members/owners of the stock exchange who have a vested interest in its success. The stock market grows when shares have higher value, more shares are traded, and more companies are listed on the market. Stock market growth means that more companies are operating in Iraq, creating more stable jobs and income for the Iraqi people. All of this growth requires private sector initiative and investment.

A private, non-profit stock market owned by its members makes money for its members based on market activity, and members suffer if activity declines. Therefore the market's and its members' incentives are aligned with Iraq's national economic objectives. The Iraq Stock Exchange (ISX) is a business whose customers are investors and whose revenue is based primarily on fees from transactions, so the costs of the stock market are paid entirely by those who participate in it, and those that use it more pay more. If the ISX does a bad job, it will not generate enough revenue to operate, negatively affecting the brokers (who own the ISX). A government-owned exchange would not have this type of incentive. The current owners of the ISX are the broker members that trade on it; they are all Iraqi businessmen with good reputations in Iraq.

To further align the interests of the owners and managers of the ISX with those of the national economy, the Securities Law allows the ISX to transform from its current not-for-profit status to a for-profit joint stock company (with the ISC's permission). For-profit status will create further incentives for the owners of the ISX to attain superior performance and efficiency in the operation of the exchange. If the costs paid by investors exceed the costs of operation, plus a reasonable return on the investment, the ISX will face competition from a new exchange or from foreign exchanges.

3. What is contained in the Iraq Securities Law?

The Securities Law is a permanent legal framework for securities markets in Iraq. It was written to meet international standards and best practices for securities regulation. Major provisions of the Securities Law include:

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- Establishing the Iraq Securities Commission as an independent commission responsible for licensing, monitoring, and regulating capital markets participants.
- Providing basic rules for companies offering securities for sale to the public and the responsibilities of companies whose securities are held by the public.
- Providing basic rules for the governance, operation, and oversight of securities markets, including the Iraq Stock Exchange.
- Providing basic rules for the licensing and regulation of market participants such as brokers, underwriters, and investment managers.
- Recognizing professional associations including the Iraq Association of Securities Dealers and permitting the ISC to delegate some of its licensing authority.
- Providing basic rules for the licensing, regulation, and oversight of securities depositories, including the Iraq Securities Depository.
- Providing authority and basic rules and procedures for the ISC to conduct investigations and sanction violators of the Securities Law and supporting regulations.
- Establishing certain activities (such as fraud and market manipulation) as violations of law subject to civil and criminal penalties.

4. Why are international standards for Securities Markets so important?

The standards are designed to ensure that markets are soundly regulated so that both domestic and international investors will have confidence in investing. Investors throughout the world have come to expect basic rules regarding fairness and investor protection that are found in most stock markets in the world. All stock markets face many of the same problems, so using international standards ensures that the best solutions spread to all markets. Using international standards will make the ISX competitive with other securities exchanges in the region. At the same time, international standards promote foreign investment in stocks listed on the ISX, because they reduce risk through strong regulation and disclosure.

5. How does the Iraq Securities Law protect investors?

The Securities Law establishes an independent governmental regulator whose principal responsibility is the protection of investors, the prevention of fraudulent and manipulative transactions, and the reduction of systemic risk. These objectives are critical to fostering investor confidence in the stock market. The Securities Law also establishes significant disclosure obligations; so that investors can evaluate the companies they are buying and selling. For example, according to the Securities Law:

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- Companies can use the ISX to obtain capital, but they cannot sell shares without a prospectus approved by the ISC. They must also periodically file audited financial reports. These financial reports allow Iraqi investors to examine the health of the business and see how their funds will be used to grow the business. Directors, officers, and representatives of listed companies are held responsible if they mislead the public.
- The ISX must have its internal rules approved by the ISC. It must allow new brokers to join the ISX and protect all investors on the ISX. In the future, the ISC can license other exchanges to compete with the ISX.
- The law includes special protection for investors. For example, new brokers will be required to pass a test to be licensed, disclose all fees and commissions to their clients, and keep their clients' funds segregated from their own.
- The ISC must submit its proposed rules for public comments, so all interested Iraqis can debate the issues surrounding the stock market and make their opinions known. Persons accused of violating ISC rules have the right to present evidence in their defense and to appeal adverse ISC decisions to a court of competent jurisdiction.
- The ISC commissioners are accountable to the Prime Minister. The ISC must provide an annual report to the Prime Minister's Office, including its financial statements. However, commissioners cannot be dismissed except for criminal behavior, substantial ethical violations, or violations of the Securities Law or other laws, so they are protected from political pressure. Commissioners are subject to a code of conduct that prohibits conflicts of interest, and they must disclose their securities ownership.

Without these checks and balances, one of these institutions could grow too powerful and follow its own interests, threatening the health of the exchange, the wealth of investors, and even Iraq's economy. Thus, the law assigns a different role to each and balances each against the others. As a whole, the Securities Law contains all the elements needed to make the ISX a world-class, stable, and free securities market.

The Securities Law makes it easier for Iraqis to invest in the stock market and become owners of businesses in Iraq. Companies in one part of Iraq can use the stock exchange to raise money from investors in another part of Iraq or in another country. Access to capital from many sources will make Iraqi businesses stronger and able to compete in the global economy.

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6. Why are the Central Bank and Ministry of Finance not provided seats on the Iraq Stock Exchange Board of Governors?

The stock market is very important to the economy, and individuals invest significant wealth on the stock market. Therefore, some regulation of the ISX is required by someone who does not have an interest in it. Those bodies include the ISX board of directors, which includes independent members, and the ISC, whose responsibility is to oversee the market and protect investors in the market. Other government institutions have different governmental responsibilities, such as macroeconomic policy and credit regulation, protection of bank depositors, protection of insurance policy holders, collection of taxes, and financing government as distinguished from the private sector. It is important to have a stock exchange that is governed by persons who do not have competing objectives that could compromise the development and growth of the market. It is also best to protect the ISX (and the ISC) from political changes as much as possible. Political interests do not always align with the long-run national interest of having robust, well-regulated, capital markets. For these reasons, the ISX' Board of Governors will be made up of a varied group of five representatives of capital markets participants and four independent persons.

In addition, the ISX is regulated by the Iraq Securities Commission (ISC), an independent government entity (see below). International standards advocate an independent regulator that is free from political and sectoral interests and has the expertise to regulate the market objectively. The ISC does not need a board seat because it has the authority to supplement or abrogate the governing instruments, rules, and procedures of the ISX. The ISX must provide the ISC and the public with an annual report.

7. Why do you not have investors on the Board of Governors of the Iraq Stock Exchange?

If the ISX becomes a for-profit, public company, it is quite likely that its directors, including independent directors, will be investors in ISX. At present, ISX is member-owned but is required to have four independent directors who represent the public interest, including public investors. It is quite likely that some or all of these directors will themselves be persons with investment experience. However, all directors will be required to avoid conflicts of interest. In addition, the ISC is specifically responsible for protecting investors, and has broad oversight and regulatory powers over the ISX and other market participants.

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8. Why did the Securities Law take so long to propose?

The Securities Law took more than one year to write because we worked very hard to make it a good law that everyone will support. To start, we combined the best parts of securities laws from Jordan, Saudi Arabia, and the United States. We talked with many Iraqi businessmen, lawyers, and government officials to make sure that the law matches the unique circumstances in Iraq. All of these persons contributed to the drafting of the Securities Law.

9. May foreigners invest on the Iraq Stock Exchange?

Yes, foreigners are permitted to invest in stocks listed on the ISX, according to the Investment Law of 2006. This is one of the greatest benefits of the ISX because it gives Iraq's economy access to investment capital from around the world. The ISX has adopted procedures for foreign investment, which have been approved by the ISC.

10. What is the Iraq Securities Commission?

The Iraq Securities Commission is an independent government commission that regulates the Iraq Stock Exchange, brokers, Iraq Association of Securities Dealers, and companies that have publicly-traded stock (as well as any future exchanges, brokers, associations, or public companies). For example, it issues rules and orders, approves some internal rules and decisions of the ISX, regulates corporate mergers, and inspects listed companies. For example, the ISC recently strengthened rules for banks that have brokerages. This protects bank depositors and the banking system from this risk of equity investments.

The ISC has a legal personality but cannot engage in any commercial activity. The ISC is an independent commission: its commissioners are accountable to the Prime Minister but can only be dismissed for significant cause, so they are protected from political pressure.

11. What is the Iraq Association of Securities Dealers?

The Iraq Association of Securities Dealers is a professional association for stockbrokers in Iraq, similar to the Businessmen's Association or the Engineers' Union. Once properly licensed and staffed, it may be delegated certain responsibilities by the ISC, such as education and training for stockbrokers, certification exams, etc.

12. What is the Iraq Depository Company?

A depository clears and settles trades (transfers shares and cash between brokers) and keeps records of ownership and trades in securities of listed companies. The Iraq Depository Company is currently a division of the

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ISX. The Securities Law requires the IDC to separate from the ISX and operate as an independent not-for-profit entity not later than two years after the Law becomes effective. As a separate institution, the IDC will be subject to direct regulatory oversight by the ISC.

13. Why may additional shares issued by listed Companies on the Iraq Stock Exchange be priced at market value rather than only be priced at 1 Iraqi dinar?

A secondary offering is the sale of new shares by a company that is already publicly traded. In the past, secondary offerings were priced at 1 dinar per share. Since the new shares represent the same ownership rights as the old shares, they should be sold at a modest discount from the market price (to allow for sales commissions provide some incentive to investors).

In a secondary offering, all current shareholders have the opportunity to purchase additional shares of stock in proportion to their current ownership of the company. However, some investors may not want to make such a purchase, may not have the funds to do so, or simply may be away from Iraq and unaware of the offer). If the shares sold in the secondary offering are priced arbitrarily at 1 dinar, those shareholders' investments would be unfairly diluted.

Instead, the secondary offering shares may be priced with a modest discount from the current market price as described above. The Securities Law requires the company's board of directors to take these matters into consideration when recommending an offer price, which must be approved by the shareholders.

14. Why does the Iraq Securities Law prohibit insider trading?

Insider trading is the use of confidential information about a company by insiders (such as managers or directors) to profit from buying and selling the company's shares. International standards prohibit insider trading for a variety of reasons, including:

- Inside information is the rightful property of the company or other persons who own the information (e.g. a company considering a takeover bid before the bid is required to be publicly announced), Insiders who profit from the misuse of inside information by trading or tipping others who trade unfairly take value from other investors who do not have access to the inside information.
- In order for investors to have confidence in participating in a securities market, all participants should have fair and equal access to information that affects the value of their investments. If investors believe that insider trading exists, they will be less certain

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of the value of all stocks, and stock market value and activity will be depressed. The participation of non-insider and foreign investors in the market will be reduced. This will damage the liquidity and fundraising functions of the market