

## Discuss the Banking Regulatory and Market Framework in Kuwait Using SWOT Analysis

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### Abstract

This paper discusses the banking regulatory and market framework in Kuwait. SWOT Analysis of Kuwait Banking Sector addresses the strengths, weaknesses, opportunities and threats. As a major oil exporter, it has enabled Kuwait to erect strong exterior and financial balance sheet situations. The government is a large net creditor and has a high flexibility to respond to external shocks. Since the institutional framework works as an obstruction to effective decision-making in the country with regards to transparency and accountability, political risk is considered as a weakness. Kuwait faces geopolitical risk, similar to its peers in the Gulf Cooperation Council (GCC). Credit risk is high for the Kuwaiti banking sector, as the banks have historically operated with significant exposures to cyclical sectors such as real estate and construction. Finally, Kuwait's legal framework regarding bankruptcy law, creditor rights, and process remains less developed when compared to other parts of the world.

**Keywords:** Banking; Regulatory; Market framework; Kuwait; SWOT analysis

### Introduction

The Central Bank of Kuwait (CBK) and Kuwait Capital Market Authority are the main regulatory bodies in Kuwait [1,2]. The Central Bank of Kuwait was established for organizing business of the Bank and currency by virtue of the Law No.32 of 1968 [3]. The Kuwaiti Currency Board established by virtue of the Amiri Decree No. 41 of 1960, was replaced by CBK, whose role was limited to the issuance of banknotes and coins [3].

CBK's establishment was in response of the need to keeping pace with domestic and international developments, particularly the increasingly important role of the monetary and financial policy contributing to the advancement of social and economic development in the country. CBK commenced operation on April 1, 1969, stated in Article 15 of its Law No. 32 of 1968 in fulfillment of the following core objectives [3]:

- On behalf of the State, issue the national currency.
- Keep up the stability of the Kuwaiti Dinar, and secure its free convertibility into foreign currencies.
- To express the credit policy<sup>1</sup> and enhance the national income.
- To administer the State's banking system.
- To serve as a banker to the government.
- To serve as a financial adviser to the government.

The paid-up capital of the CBK was 5 million Kuwaiti Dinars, fully paid up by the government. The General Reserve of the CBK may increase the capital amount by a decree. The Central Bank of Kuwait is administered by the Board of Directors encircling the Governor of CBK - chairman, and the Deputy Governor of CBK, both appointed by a decree for a five-year renewable term, a representative of the Ministry of Finance, a representative of the Ministry of Commerce and Industry, and four other members with proven experience in the economic, financial and banking affairs, appointed by a decree for a three-year renewable term.

<sup>1</sup>The aim is to contribute to the social and economic progress (Central Bank of Kuwait, n.d.).

### History

In 1952, National Bank of Kuwait (NBK) started when a famous Kuwaiti merchant went to the British Bank of the Middle East to open a Letter of Guarantee for the amount of 10,000 Indian Rupees, (equivalent today to 750 KD). His request was rejected, as a guarantor was required. This merchant was shocked by the treatment that he had received, and this incident gave rise to the idea of a national bank to serve the national needs of people, help the economic growth of the country, and look after client's savings. Theelate Amir of Kuwait, H.H. Sheikh Abdullah Al-Salem Al-Sabah, promised his complete support [4]. An Amiri decree was soon issued on May 19, 1952 to open the National Bank of Kuwait, and NBK started its operations in November 1952 [4].

NBK was the first national bank in Kuwait and the Gulf region. The board members and founders were renowned merchants of Kuwaiti origin. It was established with a capital of 13,100 shares, each valued 1,000 Rupee equivalents to KD 75 today. Over the years, NBK has proved itself to be a financial leader in the Arab world [4].

Kuwaiti Dinar (KD) is the authorized currency of Kuwait. Each Dinar equals 1000 fils. Kuwait currency denominations are as follows: Quarter ( $\frac{1}{4}$ ) of Dinar, Half ( $\frac{1}{2}$ ) of Dinar, One (1) Dinar, Five (5) Dinars, Ten (10) Dinars and Twenty (20) Dinars). After 9 years, the CBK issued new banknotes for circulation as mentioned below [5]:

1<sup>st</sup> Phase: In November 1970, the new banknotes were of values ten dinars, half of dinar and quarter of dinar. In April 1971, five dinar and one dinar banknotes were released.

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2<sup>nd</sup> Phase: In November 1980, the Central Bank of Kuwait issued new banknotes.

3<sup>rd</sup> Phase: In January 1986, the Central Bank of Kuwait issued a new twenty) Dinar banknote.

4<sup>th</sup> Phase: In March 1991, the new Kuwaiti currency issued had new colors post Iraqi invasion. During this invasion, the Central Bank of Kuwait was robbed of everything. Hence, the new issue came in different shape and colours to prevent the benefits to Iraqi invaders.

5<sup>th</sup> Phase: In April 1994, new release of national banknotes circulated which was distinguished by the high technology and security techniques used in the domain of manufacturing and printing the banknotes.

6<sup>th</sup> Phase: Issue of the Kuwaiti currency was revealed at a celebration event on May 19, 2014, and was into flow on June 29, 2014. This issue of the Kuwaiti Dinarbank notes employs significant elements and economic accomplishments that are grounded on unified background of the Kuwaiti flag. The banknotes illustrate the accomplishments and economic milestones of Kuwait's history [3]. The new banknotes were designed to help the visually impaired by having larger values in size and the raised print aids in distinguishing each banknote from the other. These include the most advanced security measures such as innovative printing processes, color changing features and visual elements that become visible upon tilting the banknote [3].

Kuwait Finance House (KFH) is considered as an innovator in the banking industry known as Islamic Finance/Shari'a Compliant Banking [6]. It is the first Islamic bank established in 1977 in the State of Kuwait and it's one of the foremost Islamic financial institutions in the world. KFH has steadily managed to expand its business and achievements to lead the Islamic banking industry and is one of the biggest lenders in both the local and regional markets [6].

## Discussion

The Central Bank of Kuwait (CBK) announced Basel III implementation of capital adequacy standard by Kuwaiti banks in February 2014. CBK undertook schemes like: a) formation of direction-finding committee comprising representatives of local banks and led by CBK, b) sourcing a consultancy firm to co-develop the draft regulation for Basel III norms, c) conducting quantitative-impact study for implementation of standards for capital adequacy, leverage, and two liquidity items, and d) organize training programs for local banks and CBK staff [7].

## Regulations governing foreign investments

Major barriers to foreign investments remain, including regulations barring direct involvement of foreign entities from the petroleum and real estate sectors, long bureaucratic delays in starting new enterprises, agency and sponsorship requirements, and a local business culture heavily based on clan and family relationships that often preclude foreign participation. The Amir enacted a new Commercial Companies Law by emergency decree in order to ease the process of doing business in Kuwait, which is currently pending parliamentary approval and are listed below [8]:

- Setting up a "one-stop-shop" to reduce waiting time with regards to new business setup in Kuwait;
- The shareholders of a firm agree to share profits and losses in a ratio rather than their percentage shareholding in the company;
- Certain types of companies or specific sectors do not necessarily

need to maintain 51% requirement of Kuwaiti shareholding in the capital of the firm, which shall be known once laws are established and;

- Encouraging the growth of the Islamic Finance market by allowing incorporation of special purpose companies such as those relating to sukuks, bonds and convertible bonds [8].

The Direct Foreign Capital Investment Law was designed to encourage foreign investment in Kuwait through authorization of tax holidays up to ten years for incoming foreign investors; facilitating the entry of expatriate labor; authorize land funding and duty-free import of equipment; give guarantees without compensation against expropriation; ensures the right to send back profits; and protect the confidentiality of proprietary information in investment applications, by penalizing the government officials who reveal data to unauthorized people. Incoming investors are protected and any changes in law do not affect them [8].

The number of banks currently operating in Kuwait is 21:5 conventional banks, 5 Islamic banks, 10 overseas banks, and 1 unique bank. The Kuwaiti banking sector opened to foreign competition in 2001 via Kuwait's Foreign Direct Investment Law. In 2004, the National Assembly expanded permitted 100% foreign ownership of banks. The Central Bank has granted licenses to 10 foreign banks (Export, 2013).

## Regulatory standards for banking sector

The local bank's quality varies from international recognition to weak or no recognition. The balance sheets of some banks are weighted heavily towards lower-yielding government bonds (Export, 2013). The legal, regulatory, and accounting systems are not clear, but are consistent with international norms (Export, 2013). The Central Bank of Kuwait insists that annual reports from banks should meet international accounting standards [8].

## The new regulations for investment sector in Kuwait

1. Leverage Ratio: The Company's leverage ratio (Total Liabilities/Equity) cannot exceed 2:1 [9].

2. Quick Ratio: This ratio (known as the Acid Ratio) is a stern measure of a company's ability to check short-term obligations. The CBK circular commands careful and precise calculation of the ratio. The ratio normally requires dividing quick assets (Cash and Equivalents., Marketable Securities, and Accounts Receivable) by Current Liabilities. The CBK regulation constricts the numerator by only allowing the following to be included:

- Cash and Equivalents
- Government and other sovereign debt (provided it is rated triple B or above)

Many companies fail to remove accounts receivables and marketable securities. Furthermore, the Central Bank requires the use of Total Liabilities. CBK wants all companies to have a minimum ratio of 10% [9].

3. Foreign Exposure Limit: The CBK mandates that foreign exposure (debt) must be limited to 50% of total equity or 25% of total liabilities (given the leverage ratio limit). The regulation defines foreign exposure by the locale of the foreign lender rather than the denomination of the debt [9].

## Corporate governance in banks of Kuwait

In June 2012, the Central Bank of Kuwait ("CBK") issued

“instructions regarding governance rules of Kuwaiti banks”. The new instructions include the following pillars: 1: Board of Directors, 2: Corporate Values, Conflict of Interests and Group Structure, 3: Executive Management, 4: Risk Management & Internal Controls, 5: Remuneration Policies and Procedures, 6: Disclosure and Transparency, 7: Banks with Complex Structure, 8: Protection of Shareholders’ Rights, and 9: Protection of Stakeholder Parties’ Rights [10].

### Corporate governance – capital markets authority

The Capital Markets Authority (“CMA”) in Kuwait issued Resolution No. 25/2013 in June 2013 regarding the corporate governance rules applicable to Kuwaiti companies. The CMA takes account of the companies engaged in securities activity. The resolution acknowledged 11 Corporate Governance Rules (CGR) for companies regulated by CMA [10].

### Mandatory application of corporate governance

Application of corporate governance in the State of Kuwait is

mandatory on shareholding companies, including banks, by virtue of Companies Law Decree No. 25 of 2012 as amended by Law No. 97 of 2013 (Article 216). The respective regulatory authorities represented by the Central Bank of Kuwait, and the Capital Markets Authority, issued instructions to the companies under their supervision, defining the rules and regulations to ensure full agreement with the corporate governance. The CAPITAL MARKETS Authority (CMA) also issued a Circular dated 5 August 2013, where CMA requires the Kuwaiti companies under its supervision to provide it with a quarterly report effective 30th September 2013 reflecting these companies’ compliance with corporate governance rules issued by CMA [10].

The SWOT analysis is given in Figure 1 [1].

### Conclusions and Recommendations

However, whatever the regulatory framework of Kuwait may be, there must be a robust and smooth application of the above regulations and specific rules pertaining to the issuance of specific instruments in the capital markets, such as Sukuk, must be well-defined. This is shown



Figure 1: SWOT analysis.

by the Kuwaiti market's averseness to the issuance of private Sukuk. The regulator should pay attention to the companies that pursue the Islamic Shari'ah may not have access to the cheapest funding opportunities, and therefore must make sure that no time-consuming approvals, long documentary cycles and inefficient applications of the rules are instituted [11].

It is recommended that the Shari'ah Control Board is capable and knowledgeable in financial and business matters with training, to understand the context and the application of the rules. Therefore, it is recommended to introduce further legal certainty in the law applicable to Islamic banks and other institutions operating pursuant to the Shari'ah; a unified reference (i.e., a Code) of the core principles should be adopted by the regulators. Both Kuwait and the region as a whole should strive to be the thought leaders on Islamic Finance, introduce innovative instruments that rival their counterparts while genuinely holding on to Islamic principles. Unlike western jurisdictions like the US and the UK, Kuwait does not have specialized firms or professionals specifically practicing and advising on such transactions [11].

The banking system in Kuwait is one of the most developed amongst its GCC peers with a credit penetration rate of 72% by 2013, compared to around 59% for its GCC benchmark. This implies promising growth potentials for the sector as credit and default risk normalizes. Kuwait banks have been performing well despite the hostile operating conditions, maintaining their acceptable financial standing and continuously growing at satisfactory levels. Kuwait banks had a robust capital with a CAR of 18.9% in 2013 when compared to the GCC average of approximately 18%. The largest risk factor to sector

earnings is high level of provisioning and impairments. System-wide asset quality indicators have seen gradual improvement between 2010-2013, still below its GCC benchmark NPL<sup>2</sup> ratio of around 3.8%. The Kuwaiti banks have managed to improve their coverage of NPLs over the past 3 years to reach 111% by 2013. However, the total Net Interest Income (NII) saw a slight improvement to grow by a CAGR of 4.1%, caused by the increasing lending volume.

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<sup>2</sup>Net Profit/Loss.

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