

أوجه الشبه و الاختلاف

بين القوانين البنكية السعودية و الكويتية

Similarities and Differences

Between Saudi and Kuwait bank laws

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Abstract:

Banking law is a necessity in every commercial, financial environment. Both the Kingdom of Saudi Arabia and Kuwait are commercially motivated countries with financial institutions. Financial institutions must operate with the mandate of the land and be guided by the existing principle in accordance to each country. Without law for financial institutions parties to the transaction may be taken advantage of by the law of the jungle. Bank laws regulate and determine how financial institutions conduct their business. Banks must comply with such rules, procedures and regulations. Banks comply with a variety of local/cultural regulations and principles. This paper seeks to lay down the banking laws of the two countries. It will break down a brief history of its laws, Sharia principles in each country and any other existing bank laws that regulate the country's banking institutions. Their similarities and differences will be outlined to compare what each can take from the next. A conclusion will be afforded together with a recommendation on how to improve both banking systems in the kingdom of Saudi Arabia and Kuwait.

Key Words: Bank , Bank law , Commercial Environment , Financial Institutions.

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ملخص :

إن وجود القانون البنكي في البيئة التجارية و المالية ضرورة لا بد منها. و تعد المملكة العربية السعودية و الكويت دولتين ذات بيئات تجارية و مؤسسات مالية جاذبه و محفزة. لذلك، يجب أن تعمل البنوك و المؤسسات المالية فيها وفقا لمبادئ وقوانين كل دولة تمارس نشاطها على أرضها. و من المؤكد أن عدم وجود قانون بنكي يحكم عمل البنوك و المؤسسات المالية من شأنه أن يجعل أطراف التعاملات التجارية و المالية يبرمون صفقاتهم وفقا لقانون الغاب بمعنى آخر وفقا لمصالحهم الخاصة دون اعتبار لوجود الدولة. تفاديا لحدوث ذلك، فإن القانون البنكي في كلتا الدولتين يقوم بتنظيم و تحديد كيفية ادارة البنوك لأعمالها، وفق اللوائح و القواعد المحلية و الثقافية و الدينية التي تقرها الدولة. و سنقوم في هذا البحث باستعراض القانون البنكي في المملكة العربية السعودية الكويت و تحليلها من حيث تاريخها ، المبادئ الشرعية التي استمدت منها، و القوانين الأخرى ذات الصلة بها لمعرفة أوجه الشبه و الاختلاف بينها. و ختاماً، سيقوم الباحث باقتراح ما يمكن عمله لتطوير النظام البنكي في المملكة العربية السعودية و الكويت.

الكلمات المفتاحية : البنك ، القانون البنكي ، البيئة التجارية ، المؤسسات المالية .

Introduction

Saudi Arabia's banking system has a special Agency called (Saudi Arabian Monetary Agency)¹. Saudi Arabia Monetary Agency (SAMA) operates as the central bank which oversees the local and foreign banking businesses in the Kingdom. The Commercial Court Law which was promulgated by the Royal Decree, identified as ١٥/١/١٣٥٠H operated as the first set of regulations which regulated the banking transactions. Same law had two Royal Decrees firstly, ٢٣/٥/١٣٧٧H and the second being the Banking Control Law it the Royal Decree No. ٢٢/٦/ ١٣٨٦H^٢. SAMAs law has rules and regulations that determine the relationship foreign and local banks have. This extends to it outlining the governing and supervisory roles of banking activity. The Banking Control Law exists to regulate banking businesses in terms of laws of conduct of business in Saudi Arabia. It has provisions that govern activities to be carried out by banks and what is allowed and what is prohibited^٣.

Law No.٣٢ of ١٩٦٨ regulating the Currency that the central Bank of Kuwait and the Banking Trade. CBK, established in ١٩٦٩, controls the system of banking and directs credit policy in the State. This is meant to assist the social and economic progress of the growth of the national income^٤. Law No. ٣١ of ١٩٩٠ governs investment funds in Kuwait^٥. Foreign companies interested in trading in Kuwait must obtain a license from the Ministry of Commerce and

¹ Banafe, A., & Macleod, R. (٢٠١٧). The Saudi Arabian Monetary Agency, ١٩٥٢-٢٠١٦: Central Bank of Oil. Springer.

^٢ Ibid

^٣ Iqbal, M., & Molyneux, P. (٢٠١٦). Thirty years of Islamic banking: History, performance and prospects. Springer.

^٤ Ajili, H., & Bouri, A. (٢٠١٨). Corporate governance quality of Islamic banks: measurement and effect on financial performance. International Journal of Islamic and Middle Eastern Finance and Management, ١١(٣), ٤٧٠-٤٨٧.

^٥ Ibid

Industry (MCI) which is done through an agent. CBK operates as a public institution with an independent juristic personality. Management is composed of the Governor who acts as the Chairman, a representative from the Ministry of finance, another from the Ministry of Commerce and four other members who are Kuwait Nationals¹. The Board decides on the organization and control of the business and draws up monetary credit policy. It determines to discount and rediscounting. It determines matters on circulation and withdrawal of currency.

The research will seek to answer three key issues which include

- What is the historical background of Saudi Arabia and Kuwait Banking Law?
- What type of regulation do both countries use in analyzing and handling their banking systems?
- Do both countries use conventional and Islamic Banking?

¹ Ajili, H., & Bouri, A. (٢٠١٨). Corporate governance quality of Islamic banks: measurement and effect on financial performance. International Journal of Islamic and Middle Eastern Finance and Management, ١١(٣), ٤٧٠-٤٨٧.

History of Saudi Arabia and Kuwait Banking Law

The Banking sector in Saudi Arabia is organized by rules that stem from Royal Decree in ١٩٦٦. The Council of Ministers issues bank licenses after recommendations from the Finance Minister, which receives a review from SAMA^١. The government has a ١٠ percent stake in commercial banks because; monetary flows allow fair price funding. The Kingdom of Saudi Arabia has ١٣ domestic banks that are licensed. The Capital Market Authority has ٩١ foreign and local companies that are licensed that provide financial and brokerage services. SAMA acts as a bank regulator even in online transactions which ensures that commercial banks and financial institutions follow^٢.

Historically speaking, there have been instances in which foreign financial institutions issuing funding to local entities in Saudi Arabia have done their business without issuing SAMA with notification with regulators knowing this^٣. However, no regulatory action was ever brought up. Other disputes have been brought before the BDSC, which have been determined by courts of law in favor of foreign lenders.

The year ٢٠٠٥, trading nations approved Saudi Arabia accession to the World Trade Organization. As part of this process, the kingdom made commitments and concessions on the terms which were to be imposed on services on

^١Hanieh, A. (٢٠١٦). Capitalism and class in the Gulf Arab states. Springer.

^٢ Ibid

^٣ Baz, R., Samsudin, R. S., Che-Ahmad, A., & Popoola, O. (٢٠١٦). Capability component of fraud and fraud prevention in the Saudi Arabian banking sector. International Journal of Economics and Financial Issues, ٦, S٤.

wholesale trade and retail¹. With such instances, it is difficult to confirm the legality of financing that is related to cross the border. Most experts believe that there would exist an understanding that SAMA would be more tolerant in matters of cross border financing if financial institutions operated as a party.

History of Islamic banking stems from centuries of Muslim communities practicing credit methods and finance techniques. This created a simple credit system that inspired an international movement that covered the Middle East to Southern Europe before any other system in Europe came up. This informal trade method facilitated Islamic communities which created a platform for credit to be informed of investments. In the 10th century, Iraq recorded the development of banking and semi-banking activities. Countries of Islam use a reasonably complex banking system that encompassed credit instruments of credit and loans which included Hauula and Sultana. This encompassed forms of trade credit that create capital trust financing². This spread among the Muslim countries before another form of financial instruments came along. By the end of the 18th-century credit, institutions did a revolve which developed the role of the creditor.

Before Kuwait gained independence, the Indian Rupee before 1961 was in circulation in Kuwait. After independence, the dinar was introduced, with it came the currency board that issued dinar notes. In 1909 the Central Bank was formed which took over the function of the currency board. 1941 saw the first bank in Kuwait being established by the British

¹ Iqbal, M., & Molyneux, P. (2016). Thirty years of Islamic banking: History, performance and prospects. Springer.

² Ibid

investors¹. In 1971 the British concession came to an end, which made the government of Kuwait purchase 91 percent. In 1972 the National Bank of Kuwait was founded. Other banks were founded after this. By the need of 1980, Kuwait's bank was among the best. However, this did not last for long, as in 1982, the Sun al Manish stock market crashed².

Revenues in the 70s left individuals with liquid cash, which led to speculation in the official stock market that led to a crash in 1977. The government bailed out the affected investors and introduced strict regulations. This led to the crash in the 80s³. It is leading the risk-averse speculators into illegal alternative markets. Share dealings that dealt with checks that were postdated created an unregulated credit expansion. In 1982 the stock crashed which prompted the recession. The recession affects individual families and society⁴. The debts left all banks insolvent except the National Bank of Kuwait which survived the crisis. The government afterward created policies embodied in the Difficult Credit Facilities Resettlement Program.

¹ Trendowski, J., Rustambekov, E., Al Shamaa, J., & Alonazi, A. (2018). Risk Preference Changes in the Kuwait Banking System's Effect on Profitability. *Journal of Applied Business and Economics*, 20(9).

² Ibid.

³ Abu Rumman, S., & Al Shayji, A. (2018). *Country Report 2018: Kuwait*.

⁴ Ibid.

Analysis

The current legislation in Saudi Arabia lacks sufficient provisions of defining bank businesses and how banks should operate. This has made SAMA issue out many rules and instructions through circulars to local and foreign banks that are likened in Saudi Arabia. The misfortune is that such circulars are not publicly available. In Saudi Arabia, all banking transactions must adhere to the Sharia principles of Islam. It has been noted in recent times that various bank transactions that are conducted in Saudi Arabia do not conform to Islamic Sharia. The creation of the Banking Disputes Settlements Committee (BDSC) dares contemporary banking issues¹. The BDSC adjudicates banking disputes inflexible and experienced manner better than how disputes were brought through regular courts.

BDSC is more pragmatic as it accepts interest. However, some of its judgments and principles fail to identify instances in which interest was asked for as payment. It accepts what is paid as a commission and does not include such payments in calculating the principal amount owed. BSDC operates under SAMA which sometimes is referred to as the SAMA Committee². BDSC composition has three members, a professor of law who acts as a legal advisor with experience in the private and public sector, an accountancy professor and a former Sharia judge who has experience in General Courts.

Cross-border financing is an issue that has not been resolved as the Banking Control Law outlines that it is prohibited to conduct any banking businesses without having a license that is issued by SAMA. Rules of applying Banking

¹ Hanieh, A. (٢٠١٦). Capitalism and class in the Gulf Arab states. Springer.

² Hanieh, A. (٢٠١٦). Capitalism and class in the Gulf Arab states. Springer.

Control Law ensures that banks that are local should notify SAMA of their involvement in facility arrangement that is provided by non-residents in the Kingdom.

There lacks a distinction between Islamic financial institutions and those of a general nature; this is because there is no local bank that identifies as an Islamic bank¹. The reason for such phenomena is because all banks in the Kingdom of Saudi Arabia are required to be Sharia law compliant concerning Islam. Therefore, identifying as an Islamic bank explicitly may indicate that other banks are non-Islamic which is a scenario that SAMA tries to avoid.

Products that are Sharia compliant are provided by Islamic banks in which the Sharia committee guides all transactions. The Sharia Committee has the supervisory role overall banking business and guides all Islamic channels with conventional banks. The issue with not recognizing Islamic banking is that people fail to see the official body that provided unified rules and regulations in terms of what could constitute a Sharia-compliant transaction. What is considered as Sharia compliant is not acceptable from one Sharia Committee to another?

Islamic Banking in the Kingdom of Saudi Arabia is dominant as compared to conventional banking. It has matured and developed as an industry as it represents almost two-thirds of the total banking finance. This means that ۶۸% come from Islamic banks and ۲۸% stems from conventional banks. Four among the ۱۲ banks in Saudi Arabia are Sharia-compliant while the rest is a mix of Sharia and conventional banking facilities of products and services^۲. The lending market is that of an Islamic financial nature which means the

¹ Iqbal, M., & Molyneux, P. (۲۰۱۶). Thirty years of Islamic banking: History, performance and prospects. Springer.

^۲ Hanieh, A. (۲۰۱۶). Capitalism and class in the Gulf Arab states. Springer.

performance and credit matrix of the Islamic and conventional banks are almost similar. In the kingdom, Al Rahji bank stands as the most prominent Islamic bank locally and internationally. The Kingdom hosts the most extensive Islamic bank asset base which allows conventional banks such as commercial banks to operate alongside Islamic banks. Banks are subject to a single supervisory authority with similar disclosure requirements. According to Cranston & Van Sante (٢٠١٨), SAMA acts as a regulatory in sharia complaints banks in the same capacity it regulates conventional banks^١. There is no special treatment that is accorded to Islamic products or support to their banks. However, it is hard to ignore the predominantly Muslim market with similar retail products existing in both conventional and Islamic banks.

Banks in Saudi Arabia benefit from the local currency, which is in vast amounts in terms of liquid assets. This extends to government securities and deposits that are guided by SAMA. The main difference of conventional and Islamic banks is the way their liquidity and investment portfolio is structured^٢. The reason for this is that Islamic banks have fewer sharia-compliant investment options. This includes cash and deposits in central banks which include *mutajara* and *murabaha*. These two are at low risk and have low returns.

According to Moussalli (٢٠١٨), there is a difference between conventional and Islamic banking. Islamic banking focuses on Islamic teachings while conventional banking focuses on established legislation on the conduct of carrying

^١ Cranston, R., & Van Sante, T. (٢٠١٨). Principles of banking law. Oxford University Press.

^٢ Banafe, A., & Macleod, R. (٢٠١٧). The Saudi Arabian Monetary Agency, ١٩٥٢-٢٠١٦: Central Bank of Oil. Springer.

out financial transactions¹. Islamic banking focuses on three aspects. The first aspect outlines that when it comes to products and services, the business should find alternatives if they say are prohibited. The second aspect touches on values and moralities such as fraud, injustice and ambiguity. The third aspect focuses on achieving balance. The banks rely on achieving God and everyone together.

The Al Rahji Bank dwells on the principle of Sharia law. Its fundamentals are spread in its functions. The Sharia board governs its dependence on Sharia. This means that all its products and services must adhere to the teachings of Islam that focus on ethics. It prohibits *Riba* which touches on taking, giving, assisting or witnessing financial transactions². It highlights that money is not the only source of money growth. Rather than work and effort should play a part in it such as intellectual effort. Therefore, the development process must be as a result of capital and labor. When it comes to risk, the bank believes that risk should be shared between the bank and the client. The purpose of this is to ensure that the entrepreneurs do not bear the risk alone regardless of the resulting project. In this bank, there is no guaranteed gain or loss.

In Kuwait banking procedure, CBK supervises and controls banking activities such as receipts of deposits, discounts, granting of lands, dealing on foreign exchange and other credit operations. It is concerned with the registration of banks, registration of investment companies. CBK registers Islamic banks are registered in a special Register for Islamic Banks at CBK. CBK lays down rules and regulations that

¹ Moussalli, D. (٢٠١٨). Do Islamic banks perform better than conventional banks? A financial ratio analysis approach.

² Mansoor Khan, M., & Ishaq Bhatti, M. (٢٠٠٨). Islamic banking and finance: on its way to globalization. *Managerial finance*, ٣٤(١٠), ٧٠٨-٧٢٥.

must be complied with when it comes to the operation of foreign banks¹.

CBK supervises banking and semi-banking activities. No financial institution other than those registered by CBK should practice banking business. No institution should receive money from third parties unless registered by the Register of Banks. The Minister of Finance decides to affect registration from a recommendation of the Board of Directors. After such recommendations, the Minister of Finance issues regulations for registration of banks and everything that comes with such a process.

Banking institutions practice their business if they are publicly traded shareholding companies. However, some foreign banks do not have to be publicly traded. The minimum paid-up capital for banks should be KD ٧٥ million whereas for foreign banks it should be KD ١٥ million. Board of Directors draws up procedures and guidelines from time to time to ensure liquidity and solvency in banks^٢.

The Central Bank of Kuwait regulates the Islamic banks which set out the requirements for Sharia law governance. The Central bank of Kuwait has four chapters in which Islamic banking is located under section ١٠ of Chapter III. These deal with the organization of banking businesses. The CBK provides specific provisions of Sharia principles that must be part of the business. It outlines banking activities that must adhere to Sharia principles and customary practices and Sharia law compliance should recognize such activities. Article ٨٦ outlines that all bank activities in Islamic banks. These include the precision of banking and financial services, conduct investment operations, use Sharia contracts such as

¹ Al-Shammari, B., & Al-Sultan, W. (٢٠١٠). Corporate governance and voluntary disclosure in Kuwait. *International Journal of Disclosure and Governance*, ٧(٣), ٢٦٢-٢٨٠.

^٢ McLaughlin, S. (٢٠١٨). *Unlocking company law*. Routledge.

Murayama and accept all types of deposit in terms of savings or investment accounts¹.

Islamic banks have the Independent Sharia Supervisory Board during registration. Article ٩٣ of CBK outlines its structure which must have not less than three members; its articles of Association shall specify its establishment^٢. During the conflict of opinions, the board may transfer the matter of Sharia Law, the Fatwa Board. The board shall submit annually to the General assembly report on the bank's operation.

¹ Central Bank of Kuwait regulation.

^٢ Ibid.

Scope of Comparison

The banking laws in The Kingdom of Saudi Arabia and Kuwait have similarities and differences in their operation and regulations. Both countries apply federal laws created to regulate banks. They are regulated by the Central Bank, which acts as a regulatory and supervisory system for banks in both countries.

Similarities:

Both countries apply the rules of Sharia law. Sharia law follows the teaching of the Quran. Banks must adhere to these principles while conducting their business. Banks in both countries are divided into conventional and Islamic banks. This allows the system not to be fully Islamic for various reasons. Therefore, in conducting business parties must analyze which banks they use. However, conventional banks still use Sharia law principles to an extent. If cases go to court, the judges have the discretion to apply Sharia principles of Islam.

Differences:

In Kuwait banks Sharia principles are very specific therefore courts of law and Board sitting to decide whether violation is prohibited have provisions to refer to. This means that judges cannot interpret in accordance to the facts of the case only. Judges must interpret the provisions on Sharia Law principle accordingly. On the other hand, in the Kingdom of Saudi Arabia provisions on Sharia law are not specific and seem vague. This is because Saudi Arabia does not operate on precedent s. Therefore, judges interpret decisions based on the current case and cannot make inference to previously decided cases.

Kuwait has historically undergone financial crisis one after the other. It has been insolvent with banks being unable to pay debts. However, one of its banks has been able to

survive through the period of recession that is the National Bank of Kuwait. This has led the government to restructure its procedures and policies on banking to ensure that it does not undergo another financial crisis. The Kingdom of Saudi Arabia has had a better standpoint financially speaking in its banks. This can be somewhat be attributed to it nationalistic approach to everything. Historically, the first King brought the country's unity through Islam. Therefore, banks operate under the teaching of the Quran and Islam's Sharia law principles.

Conclusion

In conclusion, Saudi Arabia and Kuwait operate through federal laws and are governed by the Central Bank in both regards. They both apply the Sharia principles of Islam. Their application differs in that Kuwait has specific provisions on Sharia's law of Islam while the Kingdom of Saudi Arabia. Sharia laws are vague and therefore, the judges have the discretion since the country does not rely on precedence.

Recommendations

Bank laws are very important as they have guided the Kingdom of Saudi Arabia and Kuwait in regulating and supervising banking institutions. The two systems of banking laws remain similar and different in their operation and regulation. However, there is still room for growth in both countries.

In the Kingdom of Saudi Arabia, there is a need for specific provision on Sharia law on Islam that guides banks. Their teaching are applied vaguely which can lead to different forms of interpretations by court judges. In extension, Saudi Arabia needs to adopt precedence as this can sufficiently improve the jurisprudence on bank laws. Courts, legislators, and business individuals can look at the thinking of courts in the interpretation of bank laws and make appropriate steps in moving the bank systems forward.

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