The Opening Address of the Forum on Corporate Governance and the Banking and Financial Institutions

I would like to welcome you to the opening of this forum on "Corporate Governance and the Banking and Financial Institutions", which has been organized by the Central Bank of Kuwait in cooperation with the Union of Kuwaiti Banks. This forum takes place within the Central Bank's continual efforts to shed light on the significance of good governance in companies generally, and in banks and financial institutions in particular. Good governance has been in the forefront of the concerns of the banking industry.

The subject of corporate governance has gained increased attention as a result of substantial changes in the role of the private sector in economic development and in providing job opportunities, in addition to increased awareness of the important role of companies in the economy. In recent years, corporate governance has received special attention from the economic managements of various countries, as a result of the financial crises which have befallen major shareholding companies, which has cast doubt on the credibility of their management and the authenticity of their posted financial results. These outcomes are in the forefront of the causes which have led to the rapid tendency worldwide towards stronger management for companies, aiming at the main dimensions on which good governance is based, especially with regard to increasing efficiency of internal supervisory controls, strengthening aspects of financial disclosure, determining the responsibilities of the boards of directors and executive managements, and setting independence standards of the external auditor, in addition to emphasizing the significance of professional values and ethics.

Consistent with international directives, it is possible to define company management as “the group of interrelationships among the executive management of the company and its board of directors, shareholders, and others of related concerns”. Accordingly, good corporate governance includes the structure through which it is possible to determine the company’s objectives and the means to achieve them, supervising performance and providing proper incentives for the board of directors and the executive management to implement the objectives in the interest of the company and its shareholders, within regulations which can facilitate effective supervision and encourage institutions to use resources effectively. Consequently we may say that the objectives of good governance are to establish and reinforce accountability, credibility and transparency, and to ensure the accuracy of data and information. The interests of shareholders, employees and customers, as well as the public and supervisors, are thereby protected.

You may agree with me that good governance in banks has a special nature whose significance is based on two main dimensions. The first is represented by the nature of the role played by banks in the economy. The great risks and repercussions of improper banking practices impact not only the shareholders of the companies, but depositors and savers. Such effects could impede the payment mechanisms of the economy. Needless to say, these would mean substantially greater costs for any attempt at financial reform. The second dimension is represented by the nature of the banking and financial business. The complexity of these activities is increasing, with the result that their risks cannot be overseen by supervisory authorities alone, nor can banking and financial regulations respond to each financial innovation. Hence, the safety and soundness of banks and financial institutions require good governance to supplement the role of the supervisory authorities in protecting banking and financial systems, and achieving monetary and financial stability. Alan Greenspan pointed out in this context that good governance in banks is the front line of defence for a secure and reliable banking system. Similarly, Lee Long, Chairman of the Monetary Authority in Singapore, emphasizes that effective banking supervision should be accompanied by corporate governance principles, especially in the areas of disclosure and market control.

In recent years the Kuwaiti economy has witnessed a number of changes which have stressed the significance of corporate governance more than at any time in the past. These developments and events may be summarized as follows:

1– The directives of the economic management of this country toward developing Kuwait as a financial center reveal the prerequisites needed to strengthen the principles of good governance in the banks and investment companies of Kuwait, as corporate governance is one of the basic elements in the growth and success of financial markets. In this regard, Andrew Sheng, Deputy Chief Executive of the Monetary Authority in Hong Kong, sees that applying corporate governance principles was one of the main factors in his country's becoming a leading international and regional center for financial services. He also refers to the role of the government in providing legal bases, which are considered to be among the main requisite principles of corporate governance, to protect the interests of depositors, investors and shareholders. Jean-Pierre Roth, Chairman of the Governing Board of the Swiss National Bank, affirms that corporate governance is among the requisite elements of successful financial markets.

2 – The second aspect is represented by the expansion in the base of the banking and financial system in the country, along with the growth in the volume of its operations, to keep pace with the developments in the performance of macroeconomics. I see that it is appropriate at this point to call attention to the increase in the number of investment companies subject to the supervision of the Central Bank of Kuwait from 38 at the end of 2002 to 52 at the end of August 2005. Also, investment funds registered at the Central Bank have increased from 33 funds to 66. Furthermore, the banking base has been expanded through the establishment of new banks, in addition to permitting the operation of branches of international foreign banks.

The increasing significance of the role played by investment companies in the national economy is shown by the tangible growth in these companies' assets, and by the rapid growth in their systematic accounts, reflecting the significance of the volume of money managed by these companies in the form of customer investments. These developments have been accompanied by an increasing level of company involvement in activities of local and international markets, and by the increasing relations among these companies and the banking sectors locally and internationally. All these are aspects of the rapid development in the key financial indicators of these companies' performance, all of which requires strengthening the principles of corporate governance.

3– The third aspect is represented by the requisite enforcement of the principles of corporate governance in Kuwaiti companies generally, and especially in banks and investment companies. This can be seen reflected in the performance of the Kuwaiti economy and the key indicators of the Kuwait Securities Market (KSM), which appears in the increasing number of listed companies. There has been a sharp hike in the market price indicator, which has given rise to the capital value of company shares, from KD 10.5 billion at the end of 2002 to KD 38.5 billion at the end of October 2005. In US dollar equivalents, this has been an increase from $36 billion to $133 billion. Such a sharp rise in the capital value of company shares in less than three years reflects the substantial increase in the value of assets and wealth, with its impact on spending for consumption and investment, and on the levels of economic activity, including the establishment of new companies, and the increase in the number of listed companies. All these matters are among the variables which have, now more than at any other time, come to emphasize the significance of the principles of corporate governance in all its aspects, especially on the levels of financial disclosure, accuracy of company financial information, listing requisites and regulations, and the role of the external auditor, who ought to carry more responsibility now than in the past.

You are undoubtedly aware of the intensive efforts exerted by the Central Bank of Kuwait since the early 1990's in the area of directing banks to develop their supervisory techniques, in order to conform to successive developments in international standards and practices in banking. These efforts serve the best interests of the role of the Central Bank as well, as it strives to protect the banking and financial system, and bring it into line with institutions known for efficiency and distinguished financial reputations.

Although our supervisory instructions issued in the early 1990's covered most of the basic aspects of corporate governance, on May 3rd 2004 we issued comprehensive directives to all banks and investment companies, directly covering the "principles of corporate governance in financial institutions", in conformity with international directives and standards.

Our directives to these banks and companies defined corporate governance, emphasizing the significance of reinforcing its principles, and stressing, as we have said earlier, that its purpose is to build up and reinforce accountability, credibility, transparency, and the accuracy of data and information. In this way protection is secured for shareholders, employees, customers, and supervisors, as well as the public. Also, these directives cover, comprehensively, the main elements of good governance, involving the presence of a board of directors, whose members have the qualifications and experience required to fulfil their duties. They define the board's responsibilities and those of the executive management regarding strategic objectives, annual performance plans and continual evaluation of this performance, and designate values, supported by standards of professional conduct and ethics, which can help clarify conflicting interests and ensure integrity and justice in the protection of shareholders' rights and those of others connected with the institution. Additionally, the directives outline the corporate organizational structure, with clear lines of responsibility and accountability, effective control systems backed by qualified and independent internal audit, transparent management, a high auditing committee which reports to the board, and comprehensive systems to manage and supervise all aspects of risk, ensuring adherence to policies and regulations. The directives also establish compensation systems that provide incentives for the attainment of the institution's objectives.

Furthermore, the Central Bank of Kuwait hopes to apply the adjusted standard of capital adequacy (Basel II), effective December 31, 2005. The application of this standard will certainly yield effective participation in strengthening important aspects in the area of good governance in banks.

I have on other occasions indicated that the main foundation on which the principles of corporate governance rest is elevating the values and ethics of professional conduct in all corporate managers and staff, along with endeavouring to firmly establish these concepts in every aspect of our lives and positions. This will call for introducing comprehensive changes to the customs, culture and concepts which have emerged and accumulated over years of practice.

Although the directives issued by the Central Bank of Kuwait to banks and investment companies have covered that aspect, I see in this forum an opportunity to shed light on the importance of elevating such values, consistent with the international directives about the board of directors' responsibilities in setting standards for professional and ethical conduct as an important element in strengthening the principles of corporate governance. These standards ought to be written down, and to represent "values" for these institutions through which ethical conduct can be elevated, with regard to integrity and honesty, resistance to corruption, and encouragement for employees to take their fears regarding any illegal practices to the board of directors or the concerned committee or the executive management, without hesitation. Also, the responsibilities of the board of directors regarding the elevation of values include the application of policies related to conflict of interest, specifically its definition and prevention, the independence of its implementation, and its disclosure according to appropriate rules, whether this conflict of interest occurs among members of the board of directors and the corporation or between the executive management and the corporation. The responsibilities of the board include enforcing the obligation to abide by these policies, and submitting a report about any infractions.

Banks and investment companies ought to start setting the standards of professional and ethical conduct with the understanding that these standards enhance the well-being of the corporations, strengthening their credibility and the trust in the integrity of the daily operations of the corporation and its long-term strategies, in addition to increasing the efficiency of the role played by these companies within the working mechanisms of macroeconomics.

In that context, Jean-Pierre Roth, Chairman of the Governing Board of the Swiss National Bank, sees that honesty and integrity are among the most critical factors in a successful banking system, and adds that "the most significant factor for a successful banking system is the assurance that the public, and the bank customers in particular, be honestly and fairly treated".

Additionally, Roth considers that setting and applying codes of professional and ethical conduct favours the well-being of the financial system, financial centers and supervisory authorities. His reasons for this view stem from the idea that market globalization and the free flow of capital bring true risks for banks. These risks include the probability of the banks being unintentionally involved in illegal transactions. Roth sees that the risks which are related to reputation are the main challenge facing financial centers in this century. He also stresses the importance of the rule "Know your customer", and of fighting money laundering operations and their connected crimes. Also, Roth points out that effective resistance to money laundering requires cooperation among financial institutions and supervisory authorities.

Finally, I see in this forum, and this gathering of experts and specialists, the best assurance that the subject of corporate governance is receiving increasing international importance, as it is from the Central Bank of Kuwait. This stems from our aspirations in regard to applying international banking standards, and bringing our banks to the level of banks which are known to be efficient, and which enjoy good reputations.

Therefore, I hope that this forum, with its diversified assigned topics, will contribute to the enrichment of knowledge and sound comprehension of the significance of corporate governance in companies generally, and in banks and other financial institutions specifically.