

Global Developments in Banking Supervision and Aspects of Kuwait's Experience

I would like to welcome our honourable guests here in the State of Kuwait to this gathering jointly hosted by the Institute of International Finance and the National Bank of Kuwait. Also, I would like to thank the organizers of this meeting for the opportunity to address this distinguished audience and touch on some experiences and developments in the area of banking supervision.

Reflecting on banking supervision in Kuwait over the last decade, I can realize the significant developments which took place since then, and I wish we have had, at that time, the same knowledge we do now in this area. But, as we all know, in banking supervision, it is only through experience that learning is achieved. In fact, the evolutionary nature of the banking environment continually leads to new situations and challenges, which, in turn, bring about new supervisory dispositions and developments. In banking supervision, like in any other field, experience is a bizarre teacher: it first puts us to the test, then teaches us the lesson. Yet, learning from experience in banking supervision also has a collective dimension, as knowledge gained through experiences in individual markets and sectors is shared and disseminated globally.

Certainly, most-if not all- regulators went, like us, through the same learning processes. The upshot is that all regulators nowadays are much better equipped to confront supervisory challenges. Furthermore, this development process is ongoing.

Two basic factors underlie this progress:

First: Over the last ten to fifteen years, tremendous technological advances have intensified communication within both distinct pools of bankers and regulators, along with maximizing interaction between them, at the national, regional and global levels. Much learning has been achieved in this way, especially as we live in times of increasing cross-border interdependence. Nowadays, the world looks more and more like a 'global village' where information, developments, and even problems and solutions are shared by all participants almost as they happen. International meetings, like ours today, represent an integral part of this learning process.

Second: Crises, which are salient traits of mankind history- let alone the history of banking supervision- are also promising events, as they cause us to continually update, improve and redirect our course of action, hence ending up in better shape and able to live up to tougher challenges. Perhaps the sturdy recovery of the banking sector in post-liberation

Kuwait, and the fact that it has succeeded in record time to surpass its pre-invasion levels of profitability, capital adequacy, and quality of assets, stands proof that crises can ultimately be turned into learning and development processes.

The course of events suggests that banking supervision somehow owes its development to reactions to crises. In fact, the creation of the Basle Concordat, its revision in 1983, the 1990 Supplement to the Concordat, and the establishment of the 1992 Capital Adequacy minimum standards by the Basle Committee, were all the results of banking-system crises. I think that crises play an advocacy role in favour of supervision. It is mostly during crises that supervisory authorities, whose role in normal times may be thought of as "intrusive" by many banks and financial institutions, are called upon by these very institutions to save the day.

When I received the invitation to this meeting, I was pleased to realize that the topics scheduled for discussion within its agenda were those, which have attracted our attention and serious consideration in recent years. Through diligent efforts, we went a long way towards elucidating the nature and scope of these regulatory topics, taking relevant supervisory actions as appropriate. As a result, it is not overstatement to say that Kuwait has been following the global progress in this field. **I would like to further elucidate this last statement by addressing certain recent advances in banking supervision, and shedding some light on Kuwait's position in this regard.**

Recently, the Basle Committee published a working paper enumerating 25 core regulatory principles, as minimum requirements for effective banking supervision. The paper was discussed in March 1997 at the Committee's headquarters in Basle, and members were urged to re-appraise their supervisory systems to remedy any potential deficiencies. In general, the Basle Committee paper illustrated the preponderate role of supervision in achieving a sound banking system. Regarding the cost of regulation and supervision, the paper demonstrated that costs associated with losses likely to be generated by inadequate supervision far exceed those of acquiring and operating a proper supervisory system.

In the forefront of the issues addressed by the paper were those concerning credit risk, such as the credit concentrations risk resulting from large exposure to a single borrower or a group of related borrowers. Preferential treatment or 'connected-lending' practices, concerning the extension of personal credit facilities to bank executives or members of the boards of directors or lending to firms connected to the bank, were also discussed. Transparency, which may sometimes also act as a deterrent, was presented as bearing a particular significance in such cases, especially where market participants have to unravel the maze of financial information associated with the bank being part of a huge

conglomerate. Furthermore, issues of bank shareholders' equity and the consequences of the acquisition by some shareholders of the controlling interest in a bank were also addressed.

Worthy of note here is that we can find all the core regulatory principles advocated by the Basle Committee adequately incorporated within the CBK supervisory systems. Although the CBK's supervisory systems rely on a constant monitoring of the state of banking and monetary affairs in Kuwait, they are nonetheless in line with relevant worldwide developments. This demonstrates an appropriate perception of 'globality' within Kuwait's approach to banking supervision. In fact, measures taken by the CBK in line with that perception are numerous. For the sake of illustration I shall cite a few of them, as follows:

- For the sake of **transparency**, the Kuwaiti banking units have been legally required to follow the International Accounting Standards (IAS) in the preparation of their accounts, since 1991.

In December 1993, the CBK issued its instructions on the minimum controls that should be adhered to by the Kuwaiti banks **in rationalizing and regulating their credit policies**, such as subjecting the extension, renewal and increase of credit to the receipt of a corresponding client's application; providing credit on the basis of a proper case study; and ensuring that the extended credit is used for the declared purpose.

- In April 1995, the CBK set **the maximum credit concentration limits** for Kuwaiti banks at 15% of a bank's broad capital for any single client, within the framework of the relevant Basle Committee recommendations.
- In November 1996, the CBK issued general guidelines highlighting the requirements for the internal control systems of banks and the external auditors reports regarding the evaluation of these systems.
- The setting, in April 1997, of the required minimum capital adequacy standard for local banks at 12% effective the end of December 1997, from the 8% rate applied as of the end of 1992.
- The adoption, in September 1997, of a rating system for banks based on the "CAMEL" approach. In addition, there is on-going enhancement of the currently applied early warning system.
- The implementation, in October of this year, of a policy for the assessment and management of bank liquidity, based on a maturity ladder approach.

Currently, the CBK is studying the Basle Committee's new dispositions concerning the incorporation of market risk in the 1988 Capital Accord. These amendments aim to apply capital charges to the risk of losses in the on-and off-balance-sheet positions arising from movements in market prices. Such risks are specifically those in the trading book of debts and equity instruments and related off-balance-sheet contracts, along with foreign exchange and commodity risks. Of importance, here, are the comments of the IMF special technical mission, which visited Kuwait earlier this year. The mission considered Kuwait's supervisory system impressive and exceeding international requirements in many aspects.

Furthermore, this level of supervision has contributed to a positive assessment of Kuwait's Sovereign Rating by independent international agencies. In fact, both IBCA and Standard & Poors have assigned Kuwait their single 'A' Sovereign Rating. In addition, Standard & Poors assigned an 'A+' long-term local currency rating to Kuwait. This rating was reported as being *"based on Kuwait's track record of price stability and the monetary authorities' policy credibility that underpinned the rapid recovery of investor confidence in Dinar-denominated financial assets post-Gulf War"*.

Another area which is looked at very seriously by supervisory authorities is the efficiency of bank management. It is actually the close correlation and interdependence between the quality of management and the financial performance of banks, which is eliciting such concern on the part of supervisory authorities. Simply, insufficiency in management will no doubt affect every aspect of a bank's financial position. Generally speaking, supervisory authorities would like to see management in its broad concept, i.e. encompassing key executives and members of the boards of directors, demonstrating competence and efficiency in monitoring determining, measuring, and finally controlling the risks associated with the conduct of banking activities.

Within this context, the adequacy of human resources employed bears a particular significance. Of relevance here is the comment by Mr. Tom de Swaan, Chairman of the Basle Committee, in September 1997, following the Committee's approval of the core principles for banking supervision: *"There should be clear awareness of the fact that if you want to implement core principles you should have sophisticated and trained people who can do the implementation"*.

As far as Kuwait is concerned -based on the Article 68 of Law No. 32 for 1968 concerning Currency, the Central Bank of Kuwait and the Organisation of Banking Business- the CBK applies to all banks under its supervision a set of

minimum professional quality standards to be met by executives and members of the boards of directors, with regard to qualifications, experience, leadership and initiative potential, along with the ability to deal appropriately with changes and developments. What we should strive to achieve through all this is simply 'high-quality' management systems which, in turn, provide the basis for 'value-added' supervision. In the end, the rationale behind 'value-added' supervision is that it is far less costly to prevent crises than to remedy them.

In conclusion, and from a broader perspective, I would like to briefly share with you a perception of mine about what the future of banking supervision requires from us all. The premise underlying this perception is that the current driving forces of liberalisation and globalisation, and the ensuing changes in the banking and financial environments worldwide, make it an imperative for bankers and regulators to cooperate closely. I am confident that through this forum, and your deliberations today, this purpose will be appropriately served.
