

# Free essay on legal and regulatory framework for islamic banking and finance in k...

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Kuwait is a country which is situated in the western part of Asia. It is formally known as the State of Kuwait, and it is an Arabic speaking country, largely under the Islamic Law rule. It is a nation that relies heavily on the production of oil and petroleum products. Kuwait is considered to be one of the richest countries in the world. This is because it has a gross domestic product of approximately one hundred and sixty nine billion dollars. In addition to that, it records a per capita income of approximately eighty one thousand eight hundred. This makes the country to be ranked as the fifth wealthiest nation in the Universe (IMF, 2010).

Kuwait is a nation that relies heavily on exports. The following comprise some of the major exports of this nation: financial services, petroleum products, and fertilizers. Considering that Kuwait is a nation that largely experiences desert climatic conditions, one of its major imports is food products. This is because types of climatic conditions, which are prevalent in the country do not, in any way promote agriculture. Over and above that, Kuwait also imports other products such as machinery and textiles. Its main trading partners include, but are not limited to, the following countries: Singapore, South Korea, Japan, China, Saudi Arabia, European Union, United States, and India. The largest customer of Kuwait's petroleum products is Japan.

Kuwait is considered to have one of the most developed banking systems throughout the Arab world. The largest banking institution in the country is The National Bank of Kuwait. Currently, the foreign exchange reserves of Kuwait are estimated to be two hundred and nineteen billion dollars. This renders the nation among the most liberal economies in the Universe. The

stock exchange has a total market capitalization of approximately two hundred and five billion dollars (Ibp, 2011). This market capitalization makes the country to have among the most developed investment banking industries in the Arab world and across the universe. It is estimated that there are approximately two hundred firms, which are listed on the country's stock exchange. It is worth noting that other major financial establishments in the country include the Burgan Bank and the Gulf Bank of Kuwait.

The banking sector in Kuwait is mainly governed by Islamic economics, as well as Islamic law. Due to this, the majority of the banks, which are found in the country practice Islamic Banking. This type of banking is extremely different compared to the conventional banking, which is practiced in many parts of the universe. This is because all the activities of the banks are in line with Shariah law (Oxford BG, 2008). This is a type of legal framework, which is based on the teachings of the Quran. Despite the enormous growth that has characterized the banking sector in Kuwait, there are several challenges, which are experienced in the banking sector.

One of the major challenges that are experienced by the banks operating in Kuwait is the lack of interest income. The Islamic law does not permit the payment of interest or collection of interest. As a result of this, banks in Kuwait are not allowed to charge interest on their loans. This serves as a great disadvantage to them especially when you compare them to the banks, which are operated using the conventional banking practices. For such banks, they generate a substantial amount of money through the collection of interest. Banks charge interest on all of their loans. The debt market is among the most predominant and vast markets within the banking

industry (Ibpus, 2009). Most businesses operate on credit, as well as the majority of the people and businesses finance their activities through loans. Business use loans as a source of capital. They normally acquire loans from commercial banks, which are charging fair interest rates. This is because they want to benefit from the loans while at the same time minimizing the cost of doing business.

Over the years, there has been a significant increase in the population of people who are financing their activities through loans. This is mainly attributed to the general increase in the cost of living. Despite the general increase in the cost of living, the levels of unemployment are at an all time high. In addition, the majority of the employers offers relatively low wages. This situation forces people to acquire loans so that they can afford a decent living. Governments are also key players in the debt markets. Very few countries across the universe normally have budget surpluses. Kuwait belongs to this category of the privileged few because it is estimated that, on average, it records a budget surplus of forty-three billion dollars. However, most of the nations across the world operate on budget deficits (IMF, 2010). This makes such governments to be critical players in the loans market. Governments borrow loans through the issuance of various types of bonds. In many cases, these bonds are usually acquired by banks with the aim of earning interest on the money that they lend. Although the government of Kuwait operates on a budget surplus, most of the banks in Kuwait are missing out on a very lucrative debt market. This is because they can provide loans to individuals and business.

Banks operating in Kuwait are not allowed to invest in certain types of

businesses. This is because there are businesses which are considered to be in contravention to the Shariah law. Examples of such businesses include, but are not limited to, the following: investments involving pork, alcohol and gambling. Some of these businesses provide very good returns on investment such that conventional banks invest a lot of funds into these types of businesses. For instance; most of the conventional banks operating across the world, offer low interest loans to owners of casinos, and reputable alcohol manufacturing companies (Such as Heineken). These companies are considered to be facing low risks because based on the nature of the products they sell (Venardos, 2012). Therefore, some banks invest in such business, or they may offer these loans at a relatively lower interest rate. By so doing, banks are able to diversify their sources of income.

The financial sector in the state of Kuwait is highly regulated. This leads to a situation whereby it is extremely difficult for an individual to start a bank in the country. The laws in Kuwait require that all the banks operating within the country should be owned by a company, which is listed on the stock exchange. In addition, each and every investor who wants to set up a banking institution requires the acquisition of a license from the central bank. This serves to limit the number of banks, which are operating within the country. The existence of a relatively few number of banks operating within the nation does not facilitate the existence of a healthy competition within the banking industry (Usa, 2009). The government needs to put in place mechanisms that will facilitate or promote the existence of healthy competition within the banking industry of Kuwait. This is because the existence of healthy competition leads to the realization of numerous

benefits. For instance; the existence of healthy competition challenges banks to be innovative. Through innovation, the banks will be able to develop products which cater to the needs of its customers. In addition to that, banks will be able to enhance the quality of services which they render to their customers.

## **Importance of Supporting Laws Related to Securities with Respect the Development of A Robust Economy**

Supporting laws relating to securities are of great importance with respect to the development of a robust banking industry. This is because these laws facilitate the development of standards, which are geared towards promoting best practices within the banking industry. The existence of proper laws governing the securities market facilitates the proper regulation of this industry. It is through supporting laws that the regulatory bodies that govern the capital markets are established. A regulatory body plays very vital roles as far as the governance of the capital markets is concerned. The capital market is a critical component in any economy. This is mainly because it is the primary way through which businesses and companies raise capital (Oxford BG, 2008).

Business can raise capital through the issuance of debt instruments or corporate stock. The work of the supporting laws relating to securities is to determine the minimum requirements of any company that wants to raise capital through the issuance of debt securities or corporate stock. By so doing, the supporting laws will be playing a key role in facilitating the development of a robust economy. These supporting laws will make sure that all the companies, which want to raise capital through the capital

markets, have good credit ratings (Venardos, 2012). This will reduce the probability of investors losing their money by investing in companies, which are not in a good financial position.

All governments need to make sure that they have developed supporting laws that relate to the governance of the security markets. They need to put in place a policy framework that facilitates investor education. In order for people to take part in the activities of the security markets, they need to be knowledgeable about the various aspects of the market (Venardos, 2012). By so doing, the government and its stakeholders will have played a pivotal role of increasing the number of people who are investing or listing their companies in the securities exchange. The increase in the number of people who are investing in the securities exchange will lead to an increase in the general growth of the economy. This is because companies will have adequate resources to operate. The increase in the number of companies, which are operating successfully within the nation will reduce the level of reliance that the Kuwait economy has on its petroleum business.

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