

# Banking Overview In Saudi Arabia

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The banking industry in the Kingdom of Saudi Arabia (“KSA”) embodies one of the main commercial industries that still has a number of issues requiring clarity for the sector and the following will identify and provide a general overview of some important areas.

The Saudi Arabia Monetary Agency (“SAMA”) performs the central bank role in KSA, overseeing the local and foreign banking businesses in KSA. Historically, the Commercial Court Law promulgated by Royal Decree dated 15/1/1350 H (corresponding to 2/6/1931 G) can be considered as the first set of regulations that tried to regulate the banking and exchange businesses in KSA, albeit, the cornerstone of laws regulating the banking business have been issued after the establishing of SAMA in 25/7/1371 H (corresponding to 20/4/1952 G). The first was the Law of SAMA issued by Royal Decree No. 23 dated 23/5/1377 H (corresponding to 16/12/1957 G) (“SAMA’s Law”) and the second is the Banking Control Law issued by Royal Decree No. M/5 dated 22/6/1386 H (corresponding to 8/10/1966 G) (“BCL”).

SAMA’s Law outlines its role and regulates its relationship with local and foreign banks conducting banking businesses in KSA and sets forth the governing and supervisory role of SAMA over banking activity in KSA. The BCL regulates banking businesses in terms of the statutory requirements to conduct banking business in KSA and provides various provisions that govern the activities that a bank is allowed to carry out and those which are prohibited.

However, within the current legislation there are insufficient provisions that define the meaning of banking businesses and also how a banking business is to function. In light of this, SAMA has issued many rules and instructions in the form of circulars to all local and foreign licensed banks in KSA during the past few decades. Unfortunately, such circulars are not usually publicly available.

Further, it can be said theoretically, that all banking transactions have to be Shari’ah compliant. However, practically speaking, it is widely observed that various banking transactions conducted in the KSA are not consistent with Islamic Shari’ah as construed and applied in KSA. Some commentators are of the view that the creation of a quasi-judicial committee called the Banking Disputes Settlement Committee (“BDSC”) was to address contemporary banking matters and the BDSC is a specialized forum adjudicating banking disputes in a more experienced and flexible manner than when banking disputes were brought before the regular courts.

One of the ideas about the BDSC is that it is more pragmatic than any of the other courts in KSA to the extent that it recognizes and accepts interest. However, this view is not entirely accurate. A thorough examination of judgments and principles of the BDSC will fail to locate any judgment requesting the payment of interest. What can be seen however is that the BDSC would accept what has already been paid as commissions and may not include such payments when calculating the principal amount owed. The BDSC is administratively under the auspices of SAMA and therefore the BDSC is sometimes referred to as the SAMA Committee. The current composition of the BDSC is three members, a professor in law who in the same time has lengthy experience working in the private and public sector as a legal advisor; a professor of accountancy and a former Shari’ah judge who worked in the General Courts.

## Cross Border Financing

The true legality of cross border financing is deemed to be one of those issues that have not been clearly resolved, as the BCL states that it is prohibited to conduct any banking businesses without a proper license from SAMA. In addition, the rules for applying the BCL, issued by a ministerial resolution of the Minister of

Finance No M2149/3 dated 14/10/1406 H (corresponding to 22/6/1986 G), requires that locally registered banks must notify SAMA prior to being involved in any facility arrangement provided by a non-resident entity in KSA.

However, in practice, there has been a long history of foreign financial institutions providing funding to local entities in KSA without issuing SAMA any notification; and the regulators are fully aware of this situation. To our knowledge no regulatory action has ever been taken against these banks. More importantly, some disputes have actually been brought before the BDSC and been judicially determined in favour of the foreign lenders in such situations.

Furthermore, in 2005, major trading nations approved KSA's accession to the World Trade Organisation ("WTO Accession"). As part of the WTO Accession process, KSA made a series of commitments and concessions on the conditions to be imposed on services and wholesale and retail trade. A schedule including these commitments is annexed to the Protocol of Accession, included in which, is cross border financing arrangements.

Based on the above, it is difficult to definitively confirm the legality of cross border financing. However, there is an understanding among a number of experts in KSA that SAMA would be more tolerant with cross border financing arrangements if a Saudi financial institution was involved as a party, for example, a syndicated loan that involves Saudi bank(s).

### **Shari'ah Compliant Transactions**

Unlike other GCC and Arab states, there is no distinction between Islamic financial institutions and conventional ones, in the sense that there is no local bank called or identified as an Islamic bank, as we see with Islamic banks in Bahrain and the UAE for example. This could be since all banking transactions, theoretically, have to be Shari'ah compliant and by identifying a specific bank as an Islamic bank may indicate that there are other banks that are non-Islamic, which perhaps SAMA is trying to avoid.

Generally, Shari'ah compliant products are provided from Islamic banks in a manner so that all of their transactions have to be approved by a Shari'ah committee that has a supervisory role over banking businesses or through Islamic channels within the conventional bank.

One of the consequences of not recognizing Islamic banking, as opposed to conventional banking, is that we do not see an official or semi-official body that can provide a unified set of rules or guidelines to what actually constitutes a Shari'ah compliant transaction as we can see in Bahrain. In the current situation, what can be considered Shari'ah compliant from one Shari'ah committee's perspective is not necessarily acceptable to another Shari'ah committee.

Also, if such a body did exist, it could assume the role of overseeing the correct application of Islamic banking to ensure that the Shari'ah compliant products are conducted properly in accordance with proposed mechanisms specified and not merely being furthered through formalities and documents.

### **Conclusion**

Broadly speaking, SAMA is known by its conservative policies and is seen as an efficient governmental body that has a very successful track record during the last few decades; more recently the successful steering of monetary policy resulting in the KSA economy suffering to a lesser degree than many other nations during the global recession.

Considering the current complex nature of banking transactions, new sets of regulations may be seen in the coming years to cover those areas and types of transactions that were developed during the last 40 years. Another issue that could create further stability in the banking industry is to resolve the issue of interest and the extent of its illegality or legality.

### **Footnotes**

1. Generally, a branch of a foreign bank is the legal vehicle of the foreign bank in KSA.