



Faisal Al Mutawa

Key tool

OBG talks to Faisal Al Mutawa, Chairman & MD, Bayan Investment; Salah Y Al Fulaij, Chief Executive, NBK Capital; and Hamed Hamad Al Sanea, Chairman & MD, Kuwait and Middle East Financial Investment Company

How critical is government spending to bolstering the health of Kuwait's financial system?

AL MUTAWA: Since, and partly as a result of, the financial crisis, the value of the Kuwait Stock Exchange has fallen by nearly half of its peak value. This amount accounts only for listed assets. For example, real estate asset values in many cases have fallen by almost 60% from their peak values.

The financial crisis has placed investment companies – and more generally financial institutions that held assets in or were exposed to the real estate market – in a difficult situation. Investment companies need investment opportunities and the financing capabilities required to pursue such opportunities.

The problem in Kuwait is that until now, our government did not ask for a fiscal stimulus programme. Not only have they stayed quiet while most other countries have implemented fiscal stimulus programmes, but they have actually reduced spending. Kuwait is one of the world's richest countries in per capita terms, yet our government did not spend anything of value during the recession. In this respect, Kuwait stands alone in the modern world.

I find it funny that some people say that the private sector in Kuwait is lucky because we do not pay business taxes. In fact, we indirectly pay some of the highest taxes in the world because all assets are owned by the government. Give us access to participate in the oil and utility sectors, free up more land, and spend more on projects in which we can participate, and we will happily pay taxes.

AL FULAIJ: Real estate assets dominate investor portfolios within Kuwait, and new government spending is needed to open up investment opportunities in other sectors. However, execution will be hard and will take time. For major projects, there is a lot of bureaucracy before approval. And even once approved, the first 12-18 months of a project's life is spent on the design stage. Even so, it is still better to do something than nothing.

The hope is that in the meantime there will be some "low-hanging fruit" types of projects that could start right away and give an immediate boost to the contracting and building materials markets.

AL SANEA: Assuming that spending projects materialise, we expect to see an increase in activity across a variety of sectors in Kuwait. Construction and trade activity in particular would be the starting point, expanding later to other sectors.

What are your thoughts on the Financial Stability Law? What would you propose as the best solution for distressed investment companies?

AL SANEA: The Financial Stability Law has imposed stringent conditions and lots of other complicating factors that make it almost impossible for firms to resort to it. The law has so many complicated conditions included in it, including the over-involvement of the Central Bank of Kuwait. It is also taking too much time to be put into action.

AL MUTAWA: In an environment where there is no government spending on stimulus, it is difficult for investment companies not to be affected by the global financial crisis. We have lagged behind and need to do more to catch up. In addition to spending more on projects and infrastructure, we need a special government fund to create a system to purchase toxic assets from the banks so they can go back to the normal business of providing financing.

The Financial Stability Law is a defensive law and has not proven that it is working yet. We need it to accompany an aggressive fiscal stimulus that revitalises our economy. Unless the government provides stimulus and creates a system for purchasing toxic assets from the banks, nothing will change and financial instability will continue.

AL FULAIJ: It is healthy to see some outright casualties, as many investment companies needed to learn the lessons of what they did wrong. At the same time, the government and the Kuwait Invest-



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ment Authority should continue to add liquidity to the market on a consistent and continual basis. But they must do so with a long-term goal of earning returns. My concern is that, if they place and pull money sporadically, fund managers, after seeing short-term profits, will begin to behave as speculators. Another challenge that I see is whether we can calculate an accurate valuation of toxic assets. Investment bankers will be in charge of this process, and they may not be always fully objective.

The bigger problem, though, is that parliament members are under political pressure. They have proposed at various times buying back consumer loans for individuals who have personal debts and continue to live beyond their means. But the parliament is reluctant to bail out investments that it labels as "whales". Whether this labelling is right or wrong, the health of the financial sector has an undeniable impact on the economy as a whole.

How important is the establishment of a Capital Markets Authority (CMA) in Kuwait? Are you optimistic that it will achieve its desired effect?

AL FULAIJ: It is undeniably a step in the right direction. Kuwait has to step up and strengthen its regulations. We need foreign investors in our equity market. At the moment we are at the bottom of their investment wish list because our exchange lacks transparency and is filled with speculative and suspicious trades. Even my own fund managers, whom we hire and train according to global "best in practice" fundamentals, find it hard to trade rationally in Kuwaiti shares. Foreign investors look mostly to Saudi Arabia, Qatar and even the UAE, despite its recent problems, because they each have an authority.

I have read the first drafts of the CMA bill and still want more clarity about some of the bylaws and what they will entail. But the law itself should not be that complicated and we do not have to reinvent the wheel. Of course, we may need to make certain

modifications to make it suitable for the Kuwait market, but for the most part we can simply copy and paste what other markets have done.

AL MUTAWA: We need and have been demanding an authority for a long time, but we want the right one. I have gone through some of the articles of the law and my main concern is that it seems overly authoritative, inflexible and a bit too harsh. There seems to be no relationship between the crime and the punishment. The punishment must be in proportion to the crime, just as the punishments for speeding and manslaughter are very different.

Laws need to be refined and tested before being rolled out. I worry that people may unintentionally get into trouble. I fear that overreactions will occur to the point that people will avoid dealing with the authority at all. We are all humans, and, in fact, we are all capable of making mistakes.

AL SANEA: The establishment of a CMA is crucial to the success and advancement of the Kuwait Stock Exchange. However, as people are key in any institution, the CMA as a regulatory body should have on board the "crème de la crème" of professionals in this field. Bureaucracy should be both smartly and strictly avoided in order for such an institution to function properly and correctly.

Has there been a change in mindset when talking to clients with regard to seeking more long-term and stable returns from the market?

AL FULAIJ: Asset management and investment companies would be well advised to re-focus efforts on meeting with clients to understand their expectations and feelings. In Kuwait there are over 100 investment companies and people today are questioning the validity of many of them.

In 2006 during the boom, clients would come to us saying they wanted 20% returns at low risks. If we could not in good conscience provide these, they went elsewhere to those who claimed that they



Hamed Hamad Al Sanea

could. We might have lost business then, but today we are winning customers back.

Clients have come to understand the basic reality of risk and return. They now even want to know about a product's risk first and only afterwards do they ask about the expected income this product could generate. There has been a dramatic shift in expectations on the part of customers.

AL SANEA: Rumours, rather than research, are still at the core of investment decision-making. Despite being a painful era, the crisis was beneficial as investors have become more rational. This could be bolstered further if we were to see more institutional investing within the exchange.

Broadly speaking, from the company's point of view, there is now more emphasis on compliance and risk management. In addition, the role of internal auditors has increased. IT solutions are also now being used for additional control purposes.

Why have investors and lenders focused on short-term debt? Why are bonds, in particular *sukuk*, or Islamic bonds, not used for financing?

AL SANEA: The amount of short-term debt versus long-term investments is a problem that must be resolved one way or another. The availability of short-term substitutes to long-term debt was tempting to both investors and lenders before the crisis, especially with the lack of ratings and the long list of regulations imposed on lenders or issuers of *sukuk*.

No one wanted to consider the risks as no one expected such a painful crisis in the credit markets. While it is up to borrowers now to face up to their obligations one way or another, lenders need to impose more stringent conditions. They must implement internal regulations and risk measures before they grant facilities to clients.

AL FULAIJ: There has been very little bond activity regionally and most of the uptake has been from institutions. Bond issuers are reluctant to pay high inter-

est. However, expectations have changed. For example, now that the Saudi, UAE and Qatari governments have been paying such high bond premiums, corporations are now starting to accept the reality that if a government issuer has to pay high rates, so do we. Those that cannot get senior debt are starting to consider bond issues more seriously.

AL MUTAWA: Because banks' collateralised assets have declined, they are overly worried and are for the most part avoiding granting facilities, including bonds. I know of a case of a company seeking \$300m financing for the Ahmed Al Jabar hospital, which is a government-guaranteed contract. They shopped around for a long time for fundraising in Kuwait, and eventually had to go outside. It is up to the government to support the banking system, especially for financing safe and prudent bonds and projects.

What are the obstacles to mergers and acquisitions in Kuwait? What changes would encourage merger and acquisition activity?

AL MUTAWA: Corporate law in Kuwait is old and does not facilitate mergers and acquisitions. It badly needs to be updated. The government has been talking about it for a very long time, but unfortunately it is still pending in the parliament. The government is not giving it a priority. I really look forward to seeing this law updated, as it will make it easier to facilitate mergers and acquisitions.

AL SANEA: While there are many good opportunities in the market, the lack of liquidity is currently an obstacle. Financing investments through credit facilities is a key tool that companies use instead of tying up capital in new investments. As long as the banking sector remains conservative in lending, which certainly is justified in these times, merger and acquisition activity is not going to flourish soon.

AL FULAIJ: Actually, merger and acquisition activity across the entire region has dried up because sellers are not willing to sell at distressed rates.