



KUWAIT: FOSTERING SUSTAINABLE INVESTMENT THROUGH MODERN COMMERCIAL LAW SYSTEMS

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Transformation requires a significant expansion of our private sector, financial sector modernization and a robust and attractive investment climate reinforced by a world-class legal and regulatory infrastructure.

– H.E. Anas Al-Salah, Minister of Commerce & Industry²

Introduction: The Government of Kuwait (GOK) is now moving decisively to reform its insolvency and creditor/debtor regime (ICR). The Government's reform agenda flows from a review of the country's ICR framework (ICR ROSC) conducted by the World Bank at the Government's request and presented in May 2012 to representatives of the financial, enterprise, and state sector stakeholders.

Starting point: Stakeholders recognize that Kuwait's ICR system had fallen behind that required for a modern economy. For instance, the World Bank's Doing Business 2013 ratings ranked Kuwait at 92nd (out of 185 economies) in terms of its efficiency in resolving an insolvent business. Doing Business 2013 estimates that it would take 4.2 years to resolve an insolvent

business in Kuwait (versus an average of 1.7 years among OECD countries) and that creditors could expect to recover only 32 percent of their claims (versus OECD average of 71 percent). The formal insolvency system has been used infrequently, and then oriented more toward liquidation than toward rehabilitation. Insolvency is governed by Kuwait's Commercial Law, which derives from an Egyptian code dating to the 1940s – designed to serve a simpler economy. Modes for taking a security interest in movable property are outdated, and there is no registry for security interests in movable assets. Although the consumer credit bureau appears to function well, credit providers have limited access to commercial credit information.

GOK motivations: The GOK's effort to establish a modern insolvency and creditor rights system is driven by several considerations:

First, consistent with its traditional strengths, Kuwait is seeking to transform itself into a regional financial and trading center, as expressed in the Amiri Vision 2030 and the GOK's most-recent five-year development plan. Credit is the bedrock for a nation's financial sector and for modern capital markets. Without reasonable protections and information, however, creditors would be reluctant to extend credit to any but the safest borrowers (e.g., auto loans, home mortgages). As noted by Minister Al-Saleh, "access to finance requires that credit providers assure themselves that the risks of default can be effectively managed, which requires effective and functional registries, credit information

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²"Kuwait Needs to Foster Sustainable Development," Arab Times, 29 May 2012

systems and efficient enforcement and resolution procedures.”³

Second, many of the difficulties afflicting the country’s investment company sector, which started surfacing in 2008, still await fundamental resolution. For Kuwait’s investment companies to serve as reliable investment vehicles for domestic investors and to help finance the Five-Year Development Plan, it will be important for many to implement restructuring plans that establish sound asset bases, capital adequacy, and counterpart reliability.

Third, development of small and medium enterprises (SMEs) is essential to help the GOK meet its goals of “diversifying the sources of income and encourage[ing] young people to work in the private sector, in order to reduce the burden of the public sector.” Strong and efficient insolvency mechanisms and creditor/debtor frameworks are important to support a flourishing SME sector. The existence of strong creditor rights, reliable credit information, and a dependable collateral registry provide greater comfort to banks considering whether or not to lend to SMEs. If an SME becomes insolvent, it is important to have an efficient exit mechanism that distributes the SME’s remaining assets and allows the individual entrepreneur to make a fresh start and return to commercially-productive activity as soon as possible. Lack of an efficient exit mechanism stifles entrepreneurship, which is essential to a dynamic modern economy.

International standards: The GOK’s reform agenda aspires to world-class standards, balancing international norms with solutions rooted in Kuwait’s unique local customs. Globally-accepted standards for evaluating such commercial law systems were designed to assist countries in strengthening legal mechanisms widely understood as fundamental to credit and investment decisions and commercial relationships. The World Bank’s ICR Principles⁴, developed

following the 1997 East Asia financial crisis, are recognized by the Financial Stability Board as essential to the strength of a country’s financial architecture.

The ICR ROSC, which benchmarked Kuwait’s laws and practices against the Bank’s ICR Principles, identified reform priorities in the following areas: (i) rehabilitation and liquidation law; (ii) out-of-court workouts; (iii) secured transactions law; (iv) registration of movable collateral; (v) commercial credit information; and (vi) strengthening of Kuwait’s commercial court. Kuwait’s reform program is addressing these priority reform needs.

Rehabilitation and liquidation law: Although country approaches vary, effective insolvency systems should seek to accomplish several goals, including maintaining a careful balance between liquidation and reorganization; providing efficiently for both the liquidation of nonviable distressed businesses and the reorganization of those which remain viable; providing for equitable treatment of similarly-situated creditors, whether domestic or foreign; preventing premature dismemberment of a debtor’s assets by individual creditors independently enforcing judgments; providing transparency for information and risk-allocation among interested parties; recognizing existing creditor rights and respecting the priority of claims through a predictable and established process; and establishing a framework for cross-border insolvencies.

The consensus among stakeholders is that an effective insolvency regime would benefit the Kuwait economy. Any new law for Kuwait would need to specify the court’s role and powers, especially in less familiar areas (e.g., business viability assessments).

³ *Arab Times*, 29 May 2012.

⁴ ICR Principles measure effectiveness of commercial law frameworks governing *credit protection* (security and registry systems), *credit risk management* (credit information, wrongful trading, resolution of non-performing loans, and corporate workout regimes), and *credit recovery* (individual execution, collective insolvency enforcement mechanisms, and institutional capacity). Since their introduction in 2001, formal and informal assessments using the ICR Principles have been carried out in over 50 countries, and provide legislators recognizable benchmarks for reforms that meet international business and commercial expectations.

For effective implementation, it will be important for passage of a new rehabilitation/restructuring law to be accompanied by special training programs – including for court personnel, lawyers and other insolvency professionals, and government officials.

Out-of-court workouts: Following the U.K.’s successful experience over the years with voluntary “London approach” workouts of distressed companies under the eye of the financial supervisor, out-of-court workout arrangements were implemented in several East Asian jurisdictions during the late 1990s and in Turkey during the early 2000s.

As noted in the ICR Principles, “An informal workout process may work better if it enables creditors and debtors to use informal techniques, such as voluntary negotiation or mediation or informal dispute resolution. Where the informal process relies on a formal reorganization, the formal proceeding should be able to quickly process the informal pre-negotiated agreement [as through ‘pre-packaged’ reorganization].” Timely resolution of inter-creditor differences will also be important. Within the Kuwait context, the goals include facilitating a more-rapid recovery among investment companies; expediting resolution of banks’ non-performing loans to promote a return to normalized lending and credit access; enhancing credit risk management through the introduction of reliable recovery mechanisms; and preserving viable enterprises.

The GOK adopted a Financial Stability Law in 2009 to stabilize the financial system and promote recovery for investment companies. Only one case has been completed under this law, with another pending. For a case involving one major investment company, a necessary second restructuring in late 2011 was completed under U.K. court supervision. These experiences illustrate the need, for instance, for greater creditor involvement in the process, realistic valuations, and flexibility in the development and implementation of restructuring plans.

Secured transactions law: An overall objective for the GOK’s formulation of a new secured transactions legal framework is to improve SME access to reasonably-priced credit. To achieve this, consultations with stakeholders in Kuwait have highlighted the need for a number of reforms, including the need to reduce uncertainty about the creation (e.g., documentation, notarization) of security interests; dissemination of and access to information on previously-registered security interests; and timely and predictable enforcement.

Movables collateral registry: Enterprises with growth potential, particularly SMEs, may not have sufficient real estate or other immovable assets to offer as collateral in order to raise the necessary funding, and an efficient system for registration of movable collateral (e.g., vehicles, receivables, inventory, intellectual property) could plug this important gap. In general, there should be efficient, transparent, and cost-effective means of providing notice of the possible existence of security interests in a borrower’s movable property.

A registration system should be easily accessible and inexpensive with respect to recording requirements and registry searches, and secure. Registries should be integrated and established nationally with filings made on the basis of the business’s name, ideally in a centralized location. Special registries have been found to be beneficial in the case of certain kinds of assets, such as aircraft, vehicles, and certain types of intellectual property (e.g., trademarks, copyrights).

Commercial credit register: Kuwait has experience with the collection, dissemination, and use of credit information. There is a private consumer credit bureau that provides information on 31 percent of adults – versus an average of 67 percent for OECD countries.⁵ The big gap is in reporting of commercial credit history, and work is underway to address this. The Central Bank of Kuwait operates a system that collects information on commercial loans from various sources, mainly to support banking supervision, and consideration is being

⁵ World Bank, *Doing Business 2013*.

given to enabling better use of this information by stakeholders. General principles to guide this effort consider information accuracy, timeliness, and retention; system security and reliability; support for data-subject and consumer rights; and facilitation for cross-border data flows (if adequate safeguards are in place).

Commercial courts: Kuwait's court system is characterized by independence, impartiality, and a high degree of integrity. However, consultation with stakeholders suggests that better outcomes would result from greater specialization among judges; improvement of professional incentives, including tenure and establishment of a specific career pathway to becoming a commercial judge; and establishment of intensive start-up training and annual continuing education in insolvency law and related topics.

Consultations: The GOK has established a broad-based process to facilitate ICR reform. While these reforms are being driven by the Minister of Commerce and Industry, a February 2013 Council of Ministers decision established an intra-governmental steering committee (including the Ministries of Finance and Justice, the Central Bank, and the Legislative Department) to guide the reform

process. Throughout, the GOK has also welcomed inputs from financial and other private sector stakeholders. For example, approximately 100 public officials and private sector professionals attended the May 2012 workshop to review key findings and recommendations from the World Bank's ICR ROSC.

Reform of such fundamental and long-standing commercial laws is never easy. But Kuwait has made a good start toward modernizing its insolvency and creditor/debtor system to support the Vision 2030 goals of transforming Kuwait into a regional financial center, resolve remaining distress among investment companies, and encourage growth of the SME sector by facilitating SME access to finance.

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