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Review Article

"Review of Banking Regulation with Special Preference to Basel III Program in Saudi Banking Industry"

Nouran Ajabnoor MBA, Ph.D[1*], Zertaj Fatima, MBA, Mphil, Ph.D[2]

[1]Assistant Professor, Management Department, Applied College, Jazan University, Jazan 45142, Saudi Arabia; nyusuf@jazanu.edu.sa
[2]Lecturer, Management Department, Applied College, Jazan University, Jazan 45142, Saudi Arabia; zahmad@jazanu.edu.sa

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***Corresponding author:** Nouran Ajabnoor, MBA, Ph.D
Assistant Professor, Management Department, Applied College, Jazan University, Jazan 45142, Saudi Arabia
Email: nyusuf@jazanu.edu.sa

Abstract

The present study gives a literature overview of banking regulation with special reference to Basel III in Saudi Banking industry. Further the present study gives a view of SAMA and the number of banks in Saudi Banking Industry. The current study focused on presenting a theoretical framework of banking regulation with highlighting the importance of Basel III.

Keywords: Saudi Banking Industry, Banking regulation, SAMA and BASEL III.

INTRODUCTION

Banking Regulation can be defined as a form of regulation governed by central bank of each country which mainly focuses on banks to certain requirements, guidelines and restrictions. The Banking Regulations were designed to create transparency in the market between banking institutions and the individual and corporations with whom they conduct business among other things.

Banking regulation in United States of America: Banking regulation in the United States of America consist of several separate parts, whereas compared to other G10 countries have only one bank regulator. The U.S., banking industry is regulated at both federal and state level. Depending upon the type of documents of rights a banking organization has on its organizational structure, it may be focused towards numerous federal and state banking regulations. The Federal Reserve Board in USA is the regulatory body which monitors the implementation of Basel III program in United States of America.

Banking regulation in United Kingdom: United Kingdom banking has two main parts. The first part is the Bank of England, which influences interest rates, inflation and employment, and it regulates the banking market. Secondly, the other part consists of private banks and some non-shareholder banks. The banking regulations in UK are governed by three main regulators which also implements Basel III program.

1. Bank of England (BoE)
2. Prudential Regulation Authority (PRA)
3. Financial Conduct Authority (FCA)

The FCA and PRA are the main banking regulators, whereas BoE is the resolution authority with primary responsibility of banking regulations

Banking regulation in Australia: The Financial regulation in Australia is divided into two main regulators. The first one is Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulatory Authority (APRA). The Reserve Bank of Australia is the central bank which responsibility includes payment system and setting of monetary policy. The Australian Prudential Regulation Authority implements the Basel III program in Australia.

Banking regulation in Kingdom of Saudi Arabia: The transactions done by money exchangers and banks in the Kingdom of Saudi Arabia are regulated by Saudi Arabian Monetary Agency (SAMA) and Minister of Finance under the Banking Control Law. The Banking Control Law regulates the organization and operation of all money exchangers and banks in the Kingdom.

Basel III is a set of banking internationally developed regulations by the bank for international settlements in order to promote stability in the global financial system. The purpose of Basel III is to reduce the bank's ability towards damaging the economy by taking excess risk.

Saudi Arabian Monetary Agency (SAMA) has been implementing the BASEL III risk based capital regulations consistently with the international standard's timeline and has also applied the transitional arrangement in line with the Basel III program. SAMA's risk based capital rules apply to all 12 nationalized banks in Saudi Banking Industry.

Basel III's main objective is to ensure that banks' risk exposures are sufficiently backed by high-quality capital, i.e. maintain a sufficient level of capital comprising CET1, additional Tier 1 and Tier 2 capital instruments. This is to ensure adequate loss absorbency capacity in the capital instruments, as well as to harmonies capital deductions and prudential filters applied at the common equity level. SAMA requirements on the definition of capital adequacy are generally a reproduction of the Basel III requirements. As such, SAMA's implementation of the definition of capital is assessed as compliant with the Basel standards. Saudi Arabian Monetary Agency has introduced a legal standard for Ratio of Capital Adequacy based on BIS Capital Adequacy standards. The SAMA common standard recommends a minimum 8% ratio of capital to risk weighted assets, including off-balance sheet risk for the banks in Saudi Banking Industry.

Saudi Arabian Monetary Agency (SAMA) on Basel III Program

SAMA, the central bank of the KSA is responsible for the regulation and supervision of the banking sector. SAMA is empowered by the Banking Control Law (BCL) (1966) and SAMA Charter (1957) to issue banking regulations, rules and guidance to licensed banks in the KSA. The Basel II standards have been in effect from 1 January 2008 and, subsequently, Basel 2.5 and Basel III were implemented with effect from 1 January 2013 via the issuance of regulations and circulars SAMA has always considered a strong capital adequacy ratio framework to be the cornerstone of a sound financial banking system. This important principle was embedded in the Banking Control Law which provided for a capital adequacy ratio and a capital leverage ratio for Saudi banks as far back as 1966. In the following years, SAMA led the way in this region, introducing the Basel I Capital Adequacy Accord in 1992, and the Basel II Framework in 2008. Since becoming a member of the Basel Committee, SAMA has introduced Basel III Capital Adequacy rules with effect from 2013, in accordance with the Basel-agreed timelines.

SAMA has always encouraged Saudi banks to maintain high levels of capital adequacy; consequently, since the 1990's, Saudi banks have maintained a Basel capital ratio of on average around 18% to 20%. It is worth noting that about 85% of banks' regulatory capital is composed of Common Equity Tier 1 (CET1).

SAMA regulates Sharia-compliant banks in the same way as it does non-Sharia banks in the KSA. This does not currently lead to any deviation from Basel standards. More generally, the Basel Committee may wish to consider whether the application of its standards take full account of Islamic financial activities.

Saudi Banking Industry

Saudi Banking Industry is classified into 12 Nationalized Banks and 12 foreign banks. The Nationalized banks are again sub divided into four Islamic and eight conventional banks. All banks in Saudi Arabia are operating under the guardianship of central bank called SAMA.

Saudi Banking Industry provides different types of retail and wholesale banking products and services. y, Al Rajhi Bank, Bank Al Bilad, Al Jazira and Alinma Bank claims full compliance with Sharia"s law in the dealings of all their services and products. The remaining conventional banks provide a combination of Sharia"s compliant and conventional banking products and services.

Table-1: Showing banks in Saudi Banking Industry

S. No	Saudi Nationalized Banks	Saudi Foreign Banks
1.	The National Commercial Bank	Qatar National Bank (QNB)
2.	The Saudi British Bank	State Bank of India (SBI)
3.	Saudi Investment Bank	Gulf International Bank (GIB)
4.	Alinma Bank	Emirates NBD
5.	Banque Saudi Fransi	National Bank of Bahrain (NBB)
6.	Riyad Bank	National Bank of Kuwait (NBK)
7.	Samba Financial Group (Samba)	Muscat Bank
8.	Saudi Hollandi Bank (Alawwal)	Deutsche Bank

S. No	Saudi Nationalized Banks	Saudi Foreign Banks
9.	Al Rajhi Bank	BNP Paribas
10.	Arab National Bank	J.P. Morgan Chase N.A
11.	Bank Al-Bilad	National Bank of Pakistan (NBP)
12.	Bank AlJazira	T.C.ZIRAAT BANKASI A.S.

(Source: www.wikipedia.com)

Need of the study

The need of the present study of banking regulation in Saudi banking industry has been made to review the Basel III program evaluation of the nationalized banks in Saudi Arabia.

Statement of the problem

The present research aims to answer a few questions in the Basel regime. What is Banking Regulation? What is the Banking Regulation the Basel III program? Whether all the banks in Saudi banking industry implements the SAMA's Basel III program? Whether the Saudi nationalized banks fulfill minimal capital requirements? What is the impact of SAMA's Basel III program? These are some questions which the present study attempts to answer.

Review of literature

A review of research has been done on Basel III program and its probable impacts on banks. Went [11] in his research analyzed that how the Basel III program effects on banking business. He concludes that to reduce the potentially devastating effects of banking crises, Basel III has combined liquidity standards and risk-based capital. Hence, to have higher liquidity, banks will have to have a higher amount of low-yielding liquid assets than they currently possess.

In their current research, Blundell-Wignall and Atkinson [5] have analyzed Basel III and its possible effects. They concluded that higher leverage of banks causes the main damage during the crisis. Finally, they suggest that instead of a capital requirement, there should be a leverage ratio which should be appropriately designed. This is to eliminate the tendency for banks to design their balance sheet items in order to reduce the capital requirement.

In his research paper, Hellwig [10] states that the excessive leverage by large organizations and the shadow banking system, which was developed before the crisis, were the main reasons for the 2007 crisis. Further, the fundamental question raised was that under Basel II accord, the focus on risk was so much that the governance angle was left un-attended. Hellwig suggests two major changes viz: regulatory capital should not be tuned to detail according to the risks banks are taking and the capital requirement should be higher, even up to twenty or thirty per cent.

Khan and Winder [9], in their paper, state that tighter regulations and heavy scrutiny in weaker economic zones may push away the weaker banks with lower capital reserves. Besides that, the ROE and profitability will be adversely affected overall.

Alsharif, Nassir, Kamarudin & Zariyawati [13] in their current research discussed the possible impacts of the new Basel accord on GCC Islamic and conventional banks. However, they observed different behaviors among GCC banks in response to Basel III announcement. While conventional banks have increased their regulatory capital ratios, Islamic banks have decreased their regulatory capital ratios.

Dr. Yousef Padganeh, Professor Mohammad Mehdi Osku Nejad, Nayyereh Jafar Asl [14] in their research analyzed the impact of Basel III implementation on UAE banks. They concluded in their research that, implementation of Basel III will lead to a higher loan pricing, and decrease profitability. Basel III is an international regulatory standard on bank capital adequacy and liquidity risk published by Basel Committee on Banking Supervision in 2010.

Aniss Boumediene [15] in his article attempts to confront the new requirements to these specificities. Financial statements of Al-Rajhi Bank are studied under the new framework. He concluded that the move of Basel frameworks from debt-based to equity-based instruments is fully in line with the business model of Islamic Banks. However, excess liquidity detained by these banks is, actually, an advantage under Basel III.

According to Sultan A. Al-Bogami [3] Basel iii places stricter norms for the banks in terms of capital adequacy and risk management in order to overcome any type of financial crisis. The Kingdom of Saudi Arabia holds a significant place among the Gulf countries in the implementation of Basel III regulations. Saudi Arabian Monetary Agency as being a member of the Basel Committee has been actively formulating framework for the full and timely implementation of Basel III by all the banking institutions... Further he concluded that external assessments of the compliance indicate that the level of compliance is good.

Saudi Arabia along with many other countries in the Middle East is implementing the Basel III regulations according to Diemers, *et al*. [12].

Mrs. Elham Qawariri1 & Mrs. Zertaj Fatima [4] in their research analyzed the Saudi banks which are under the guidance of SAMA. The aim of their research is to analyze the capital adequacy ratio and its impact on Saudi Arabian Banking Sector. They compared the

Capital Adequacy Ratio of Islamic and Conventional banks listed in Tadawul Stock in their research. After analyzing the financial statements of the banks for five years (2013-2017) they concluded in their study, that Alinma Bank was the highest mean attaining among the Islamic Banks while Samba Bank was the highest mean attaining among the Conventional Banks. Finally they also studied the BASEL III norms of banks in Saudi Arabia.

CONCLUSION

Most of the researchers in their studies compared Islamic and Conventional banks under the guardianship of SAMA's Basel III program in Saudi Arabia. Few of the studies have been done on the Basel program of SAMA in Saudi Arabia. Some other researchers compared the banking regulation Basel III program in Saudi Arabia with other countries banking regulation the Basel III program. Hence the present study fills the gap of comparing the banking regulation Basel III program in Saudi banking industry with other countries banking regulation Basel III program. Finally this study is proposed to evaluate the impact of Basel III program on nationalized banks in Saudi Arabia.

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