

ISLAMIC FINANCE IN KUWAIT
**BROADENING
HORIZONS**

بنك الكويت المركزي
CENTRAL BANK OF KUWAIT





**H. H. Sheikh Sabah Al-Ahmad
Al-Jaber Al-Sabah**
The Amir Of The State Of Kuwait



**H. H. Sheikh Nawaf Al-Ahmad
Al-Jaber Al-Sabah**
The Crown Prince Of The State Of Kuwait

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INTRODUCTION

Foreword



Dr. Mohammad Y. Al-Hashel
Governor
Central Bank of Kuwait

The Central Bank of Kuwait (CBK) is proud to present the Islamic Finance in Kuwait: Broadening Horizons Report, demonstrating our continued commitment to support the growth and development of the Islamic finance industry. This report provides an overview of the development of the industry in Kuwait, with analyses, insights, case studies and interviews with Islamic banks operating in the country.

Over the last decade, Kuwait has strengthened its position as one of the region's fastest growing and most dynamic economies. With careful planning and investments in key sectors, we are working to create a stable and prosperous future for our citizens and the broader region. This is formally reflected in the 'New Kuwait' national development plan, which sets the nation's long-term development priorities to transform Kuwait into a regional financial, cultural, and institutional leader by 2035.

The financial sector in Kuwait is one of the foundations that will help in building a diversified economy, and Islamic finance is set to play, as it has in the past, a vital role in Kuwait's financial ecosystem, promoting financial inclusion, fostering shared prosperity, and supporting economic development. The CBK, being the lead regulator of Kuwait's bank-centric financial system, devotes considerable resources and attention to ensuring a sound and stable financial system in the country.

Kuwait has played a pioneering role in the global Islamic finance industry, with its first Islamic bank, Kuwait Finance House, established back in 1977. What started in Kuwait 40 years ago as a single branch with just four employees has grown to over US \$76.9 billion

in assets across five Islamic banks with 188 branches and 5,596 employees.

Over the last four decades, we have gone through several valuable experiences and achieved numerous milestones. First and foremost, we are proud of our dual banking model, which has supported the growth and development of both the Islamic and conventional banking sectors. Through this model, both sectors have grown in size and depth to create one of the most stable financial systems in the region. One of the underlying reasons for the success of this model has been the CBK's global cooperation with international institutions, including international Islamic finance bodies such as the Islamic Financial Services Board (IFSB), the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), the International Islamic Financial Market (IIFM), and the International Islamic Liquidity Management Corporation (IILM).

Within Islamic banking itself, our experience has been vast and diversified. We have seen the growth of one of the first Islamic banks in the world; we have witnessed the conversion of two conventional banks into Islamic banks; we have observed new Islamic banks being established in recent years; and we have witnessed the branch operations of foreign Islamic banks. These rich

experiences offer important lessons that the global Islamic finance industry can benefit from. This report captures such experiences in detail, providing the international community with valuable insights into the transformational journey of our Islamic finance industry.

I hope the information and analyses in this report will guide you through the Islamic finance landscape in Kuwait, helping you to make informed strategic decisions in your respective markets. In the coming years, you will continue to see contributions from Kuwait as a key international player in supporting the growth and development of the global Islamic finance industry.

We pray to Allah the Almighty to grant success in our efforts and endeavors and to enable us to heighten the welfare of our beloved country, under the patronage of His Highness the Amir, Sheikh Sabah Al-Ahmad Al-Jaber Al-Sabah; His Highness the Crown Prince, Sheikh Nawaf Al-Ahmad Al-Jaber Al-Sabah; and His Highness the Prime Minister, Sheikh Jaber Al-Mubarak Al-Hamad Al-Sabah, may Allah bestow on them good health and continued success.



Executive Summary

Kuwait has been an international trading and commerce hub for centuries. The country's stability, strategic location on the Arabian Gulf and entrepreneurial spirit created a prosperous, peaceful society even before the discovery of oil.

Now with a new era of lower-for-longer crude prices, Kuwait's leaders and institutions have launched an integrated development plan that will diversify and expand the economy, reduce the reliance on hydrocarbon receipts, and establish the country as a global leader across multiple disciplines. Central to economic growth is financial services, in particular Islamic banking, for which Kuwait already is internationally recognised.

Playing a Vital Role in the Financial Sector

Kuwait Finance House, established in 1977 and the world's second-oldest Sharia-compliant bank, is a giant of the industry, with the third-largest deposits among Islamic banks globally and operations in seven countries.

A nation of 4.5 million people, Kuwait is home to five domestic Islamic banks, plus one foreign Islamic bank branch. The industry achieved rapid growth following the CBK's introduction of specific regulations to govern Islamic finance in 2003.

So successful were these rules that two of Kuwait's conventional banks opted to become fully Sharia-compliant, while two more Islamic banks were created from scratch. All are profit-

able and stable, and have financial ratios comfortably above international benchmarks. As a result, customers' confidence in these banks is high, and they know their money is both safe and will be used for purposes that obey the tenets of Islam.

In just 15 years, Kuwait's Islamic banks have won a huge slice of the broader financial sector, today holding 41% of the country's total banking assets. That compares with 29% for Islamic banks in Bahrain, 26% in Qatar and 22% in the United Arab Emirates.

Leader in Sharia Scholarship

Kuwait's outsized influence on global Islamic banking extends far beyond banking metrics and the impressive achievements of its Sharia-compliant banks. Islamic finance, of course, is founded upon acquiescence to Islam's rules and traditions, and deciding its adherence to Sharia depends on the knowledge and expertise of Sharia scholars.

Kuwait is a world leader in Sharia scholarship, ranking first globally for the number of institutions (68) employing at least three Sharia scholars. In addition, Kuwait is home to 86 Sharia scholars who hold at least one board membership, a number eclipsed only by Malaysia, Bangladesh and Indonesia, which are all countries with vastly larger Muslim populations.

Founding Member of Major Islamic International Organizations

As a centuries-old trading hub, Kuwait has long maintained an outward-looking, international

focus and has been an unstinting supporter of Islamic finance worldwide. A founding member of the Organisation of Islamic Cooperation (OIC), the IFSB and International Islamic Liquidity Management Corporation (IILM), Kuwait also supports numerous initiatives to train and educate tomorrow's Islamic banking executives.

In May 2018, Kuwait hosted the IFSB annual meeting and Islamic finance conference. Kuwait is also founder, funder and host of the International Monetary Fund's (IMF) Middle East Center for Economics and Finance (CEF), which runs courses for thousands of financial sector employees each year. This year alone, CEF will stage about 50 courses, many of which have a specific Islamic focus.

Supporting Economic Growth

Kuwait's Islamic banks are poised for another bumper year supporting the country's economic growth and meeting residents' banking needs. Financing growth is accelerating but non-performing financing is in decline, an indicator of the prudent approach of Sharia-compliant banks under the astute stewardship of the CBK, which has helped Islamic banks achieve record profits.

Kuwait Islamic Finance at a Glance

POPULATION

4.5
MILLION

2017 GDP VALUE

US\$ 33,725.2
MILLION
(at constant prices)

BANKING ASSETS

US\$ 189
BILLION

Islamic Banking in Kuwait (2017)

No. of Islamic Banks
5 FULL-FLEDGED
1 FOREIGN BRANCH

No. of Islamic Banking Branches
188

Total Assets
\$76,906
MILLION

Shares of Banking Assets
41%

Total Assets CAGR (2013 - 2017)
6.7%

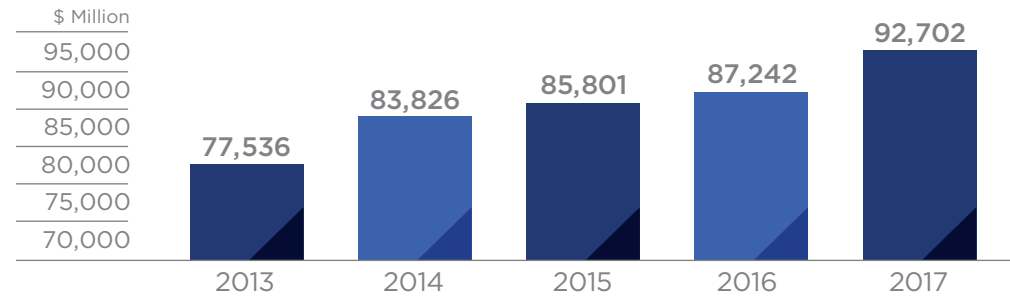
Total Islamic Banking Assets to Nominal GDP
58%

Total Credit
\$50,670
MILLION

Total Deposits
\$63,059
MILLION

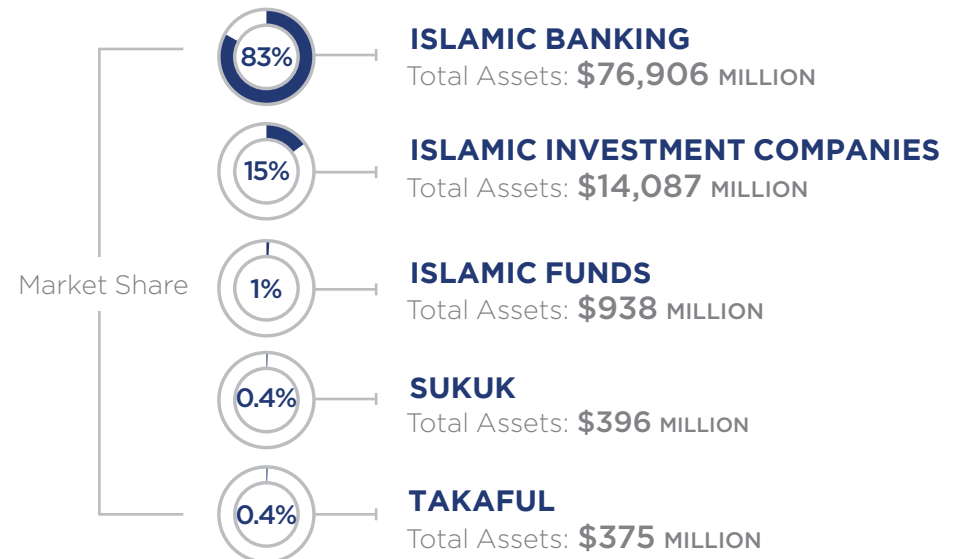
TOTAL ISLAMIC FINANCE ASSETS TO NOMINAL GDP **70%**

Islamic Finance Assets in Kuwait



Islamic Finance Assets Breakdown (2017)

Total Islamic Finance Assets **US\$92,702 MILLION**



KUWAIT OVERVIEW

Country Overview

Sustained Growth

Like all members of the Gulf Cooperation Council (GCC), Kuwait's hydrocarbon revenues have been affected by the lower-for-longer oil price era, which began in 2014. Yet the decline in crude prices is proving beneficial to Kuwait in the long term as the government trims state spending and successfully invests in further diversifying the economy.

The country's GDP will expand 2.6% in 2018, economists polled by Reuters on average forecast, while the World Bank predicts Kuwait's economy will grow 3.5% in both 2019 and 2020, which would make it the fastest-growing economy in the GCC.

The non-oil sector, which in the fourth quarter of 2017 accounted for 52.5% of GDP at current prices, will help power this expansion, as will consumer confidence, which is at a two-year high.

Instead of significantly running down Kuwait's vast financial reserves, the government has wisely exploited low interest rates to issue debt that in turn is being used to upgrade the country's infrastructure as part of a comprehensive development program better known as the New Kuwait 2035 initiative.

Government debt will be about 41% of GDP by the end of 2021-22, S&P Global Ratings forecasts.

For context, that would still be considerably lower than the European Union and countries such as Japan, India and Singapore. "We project the government will remain in a comfortable net asset position when we account for its assets at the KIA," S&P Global Ratings wrote, estimating the assets held by state-owned Kuwait Investment Authority (KIA) are worth nearly four times the country's annual GDP.

Prudent Spending

Kuwait is expected to be the only GCC country to achieve a fiscal surplus in the 2017 financial year, according to the International Monetary Fund, due to careful management of the nation's spending, which gives confidence to investors and citizens alike.

Monthly inflation was benign at 1.0% in January versus a year earlier, while real estate sales — a barometer of consumer sentiment — were up 26% over the same period.

A-Grades

Kuwait's finances are standing out among most governments globally, and the country's public and external balance sheets and enormous financial assets were by cited by S&P as the ratings agency affirmed Kuwait's AA/A-1+ long- and short-term foreign and local currency sovereign credit ratings, giving Kuwait a stable outlook.

“

The World Bank predicts Kuwait's economy will grow 3.5% in both 2019 and 2020, which would make it the fastest-growing economy in the GCC.

To put that in perspective, no sovereigns outside North America or Europe have a higher rating than Kuwait apart from Australia, while Kuwait's ratings are equal to those of France, the United Kingdom and New Zealand, and higher than those of Saudi Arabia and China.

Stable Outlook

The government's policy response to the sustained decline in oil prices has been swift, decisive and effective. Kuwait has raised fuel prices along with electricity and water tariffs, while public sector wage rises have been capped as part of measures to better balance the budget and increase non-oil revenues.

Already, Kuwait has reduced energy subsidies from 11% of GDP in 2014 to 8% in 2016, the IMF estimates. S&P also commended the government for prioritising improved revenue collection, selling off underused assets including land, and privatising state-owned enterprises.

Other global institutions have also taken note as Kuwait's reforms have made a material improvement to its already enviable financial position. Moody's in May 2017 upgraded its outlook for Kuwait to stable from negative after the country successfully increased the strength of its institutions. The ratings agency cited improved communications between the likes of the Ministry of Finance (MoF), CBK and the Kuwait Investment Authority, as well as a new Debt Management Unit (DMU) at the MoF.

Another key initiative is the anticipated introduction of a three-year budgeting framework

that aims to cap spending at around 2017-18 levels. "The planned move to multi-year budgeting marks a significant institutional improvement," Moody's wrote.

New Kuwait 2035 Initiative

The Kuwait National Development Plan, launched in January 2017, aims to transform Kuwait into a regional financial, cultural and institutional leader.

The country will gauge its success based on 20 key global indicators, which will benchmark Kuwait against other nations. Its target is to be in the top 35% for all indicators.

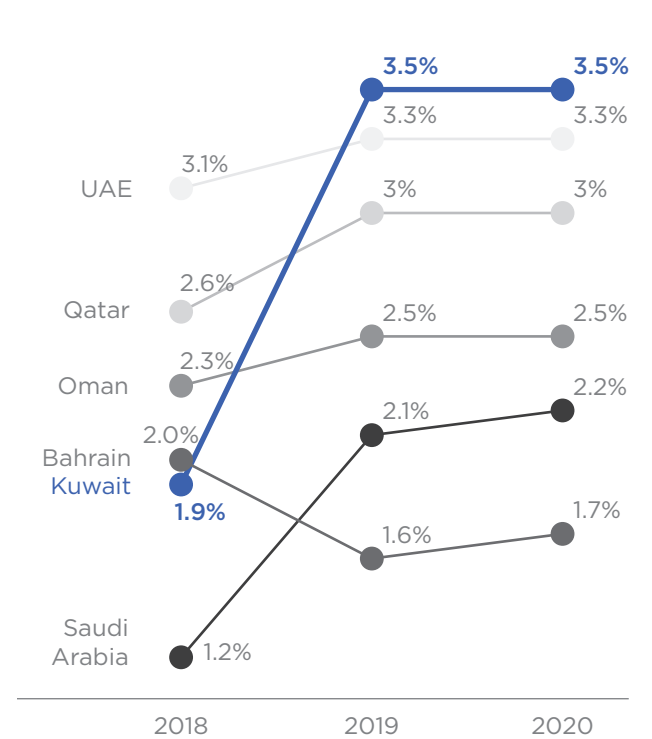
The plan is divided into seven pillars — global position, infrastructure, human capital, public administration, healthcare, economy, and living environment.

In particular, Kuwait is revamping its transport and logistical infrastructure to better serve its residents and support expansion of its tourism sector. Among 10 major new projects are:

- Kuwait International Airport's \$4.64 billion Terminal 2, which is 22% complete and will be finished in 2022
- A regional highway, estimated to cost \$911.32 billion, which is 87% built and will be completed in 2022
- The \$3.3 billion Mubarak al-Kabeer Port, due to be finished in 2019

- A metro and rail system that combined will cost around \$14.6 billion
- The 36-kilometre Sheikh Jaber Al-Ahmad Al-Sabah causeway, which is 79% built and is expected to be completed this year at a cost of \$3.1 billion

GCC GDP Forecast 2018 - 2020



Source: World Bank

Financial System Overview

Fifty Years of Solid History

The CBK, which commenced operations in 1969, is one of the oldest governing bodies in the Middle East. Its astute leadership throughout its 50-year history has steered the country's economy through myriad global crises that have shaken the Middle East.

As a regulator, the CBK governs Kuwait's domestic banks, foreign banks operating in the country, finance companies, and exchange companies.

Over the past decade, in response to the global financial crisis and volatile oil prices, the CBK has implemented a comprehensive set of macro-prudential measures to minimise systemic risks in the banking system, adeptly keeping a balance between pre-empting a build-up in risks and stifling credit growth.

A New Regulator is Born

Having adroitly governed Kuwait's stock market since its inception in 1977, the CBK has handed over regulation of the bourse to the Capital Markets Authority, which was established in 2011. The CMA also oversees Kuwait's myriad investment companies and investment funds.

Financial regulation is constantly evolving in response to new technologies and trends. In 2015, Kuwait's laws were amended to strengthen the CMA's financial and administrative independence and enhance its ability to regulate capital markets with complete transparency and neutrality.

Boursa Kuwait

Kuwait's stock market is one of the oldest in the Gulf, although its extensive history has proved

no barrier to reform and improvement. The CMA in 2014 founded Boursa Kuwait, a new company that took over operations of the Kuwait Stock Exchange in 2016 and which plans to go public in early 2019.

Nearly 180 companies are currently listed on the bourse. In 2017, Kuwait was upgraded to emerging market status by FTSE Russell after the stock exchange and CMA instigated major reforms to improve the trade settlement cycle and custodial services, better manage failed trades, and boost market liquidity.

"The reclassification of Kuwait is in recognition of the recent market enhancements," FTSE Russell said in a statement.

In 2017, Kuwait was the Gulf's best performing bourse, with a rise of 14.1%. Market capitalisation was \$92 billion as of April 3.

Healthy Competition

Kuwait's vibrant banking sector sees conventional and Islamic, foreign and domestic banks compete for retail and corporate customers. The country's 23 banks — 11 domestic, of which five are fully Sharia-compliant, and 12 foreign — have been steadily swelling their balance sheets despite bearish oil markets. Combined, banks' assets totalled \$189.6 billion at the end of 2017, up 23% on 2013's \$154.4 billion.

All of Kuwait's domestic banks are listed on Boursa Kuwait and these publicly traded lenders had a combined market capitalisation of \$40.6 billion as of April 3. That is about half the total value of the stock exchange, demonstrating

the outsized importance of banking to Kuwait's economy. Biggest banks include National Bank of Kuwait, Kuwait Finance House, and Commercial Bank of Kuwait.

Investment Companies and Financial Services

While banks dominate Kuwait's financial industry, the sector is also home to a thriving non-banking segment. The country's 29 investment companies had assets totalling \$10.8 billion at the end of 2017, while their 39 Sharia-compliant counterparts were even bigger, with assets valued at \$13.9 billion.

Financial services are in fact the fourth-largest sector on Boursa Kuwait — after banks, industrials and telecommunications — with a market capitalisation of \$8.0 billion as of April 3, 2018.

Kuwait Investment Authority (KIA)

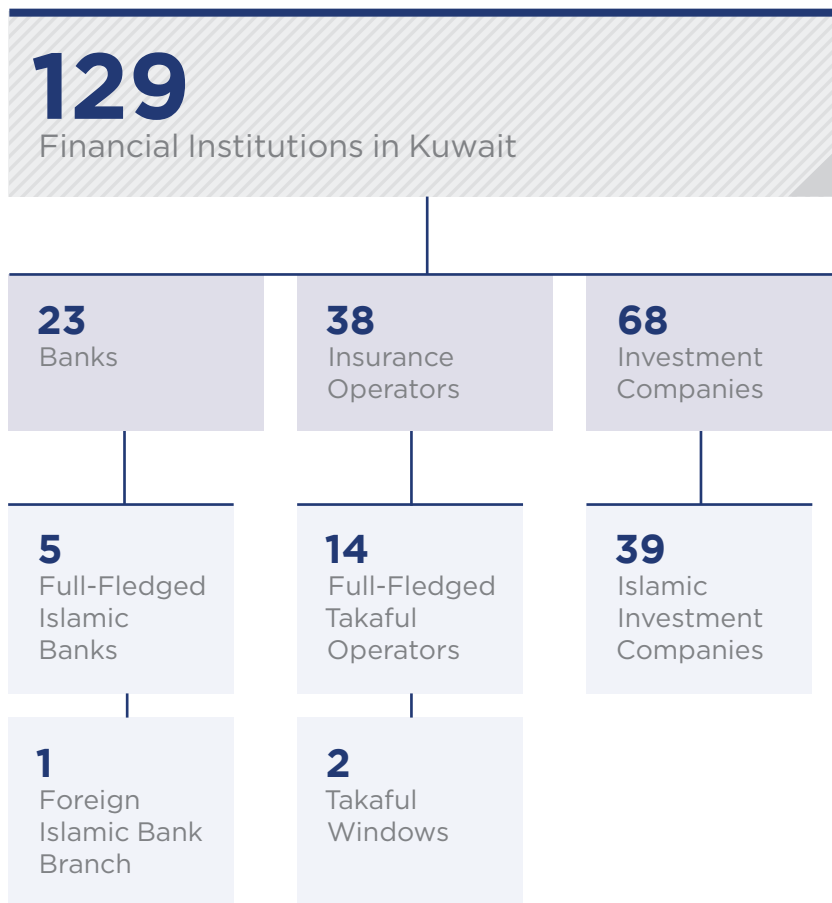
Although it does not publicly disclose its investments, Kuwait's sovereign wealth fund, Kuwait Investment Authority (KIA), is widely thought to be among the largest in the world, and its vast array of carefully managed assets anchor the government's finances.

The KIA manages the Kuwait General Reserve Fund and the Kuwait Fund for Future Generations, with the latter receiving 10% of state oil revenues.

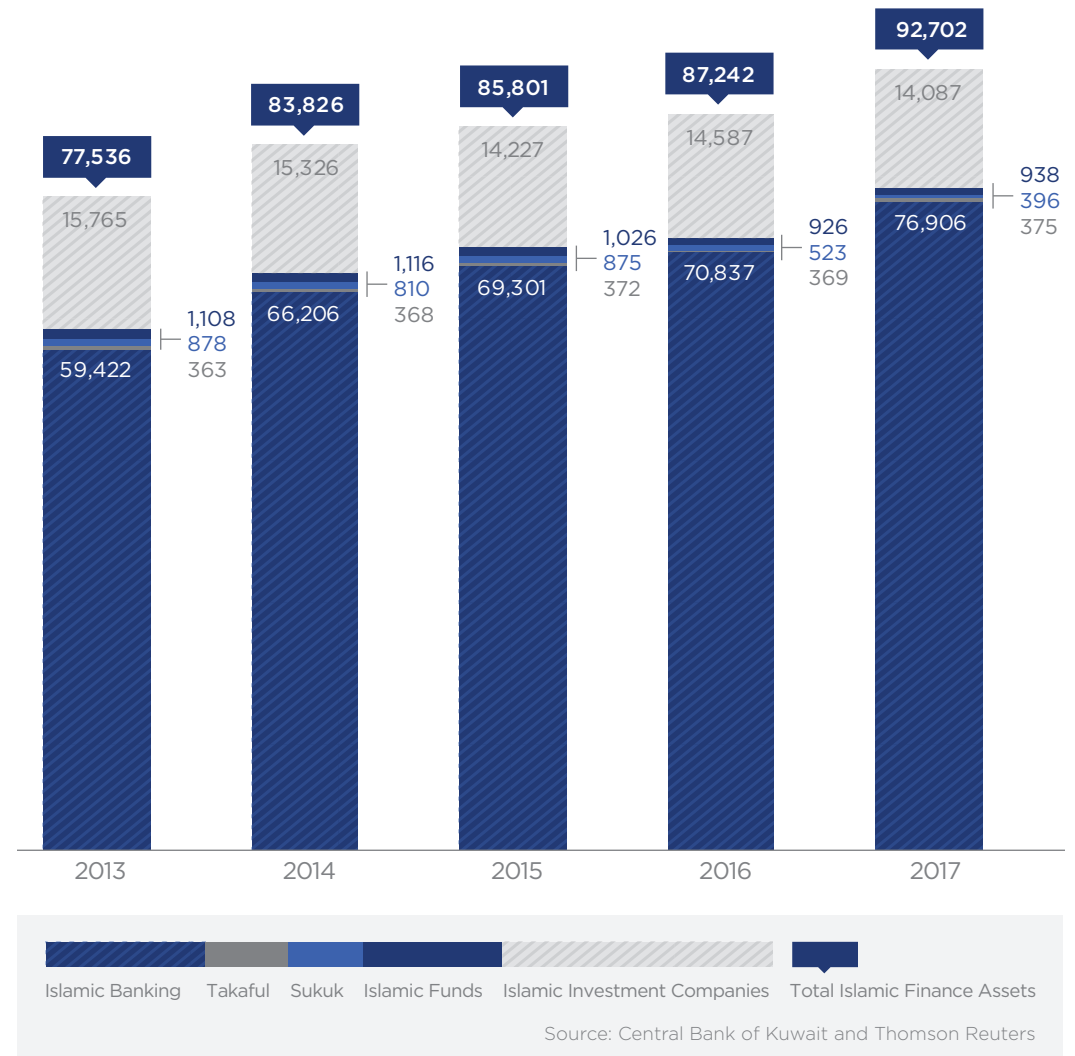
Reducing Risk

Kuwait's fledgling Sharia-compliant insurance sector is developing, although it represents below 1% of market share.

Financial Institutions in Kuwait (FY 2017)



Kuwait Islamic Finance Assets (2013-2017, \$ Million)



Banking Sector

Kuwait's Banking Sector is Diverse and Competitive

Among the 11 Kuwaiti banks, six are conventional and five are Islamic. There are also eleven foreign conventional bank branches and one foreign Islamic bank branch operating in Kuwait.

Such a broad offering — from National Bank of Kuwait's 65-year history of excellence to the recent establishment of Warba Bank, which helps ensure that the banking needs of both retail and corporate customers are comprehensively served.

"The banking sector is sound, with high capitalisation, steady profitability, and good asset quality. The CBK has been proactive in improving supervision and regulation," IMF wrote in a January 2018 report. Banks represent 82.9% of Kuwait's financial sector, while investment companies, investment funds, insurance companies and exchange companies constitute the remaining 17.1% as of 2017.

Banking Adoption — Financial Inclusion

Bank accounts provide greater security for one's money, plus the chance to borrow, save or invest, so it is a testament to the inclusive policies of CBK that 73% of Kuwaiti residents aged 15 or over hold a bank account. This is the highest banking penetration in the Gulf.

With Kuwait's banks on hand to ably meet the needs of commercial and retail clients alike, the nation's banking sector achieved a 5% increase in total assets to \$189.4 billion last year. Bank

assets' compound annual growth rate (CAGR) from 2013-17 was 5%. Over the same period, deposits increased to \$150.0 billion thanks to a CAGR of 5%.

Lending Growth

With a fast-growing, young population, real estate in Kuwait is in high demand and banks are helping citizens buy improved housing. Overall, loans achieved a CAGR of 2% from 2013-17 to reach \$122.8 billion last year, yet this lending has been responsibly deployed, with non-performing loans (NPLs) falling to a historic low of 1.6% in 2017, compared with 12.1% in 2009, which has been possible by the banks' strenuous efforts in line with CBK's instructions and through its active engagement. The coverage ratio — available provisions to NPLs — was a comfortable 322.3%. Loans are the bedrock of Kuwait's financial sector, accounting for 65% of bank assets at 2017-end, while investments — in government securities, fixed income instruments, equity and real estate investments — represented 17.3%.

Profit Boom

The banks were able to increase profits amid reduced government spending as Kuwait adjusted to the lower-for-longer oil price era, which is testimony to the astute stewardship of the regulator and lenders' senior management.

Banks' combined net profit rose 8% year-on-year to \$2.2 billion in 2017. Of this net income, conventional banks accounted for 52.2%.

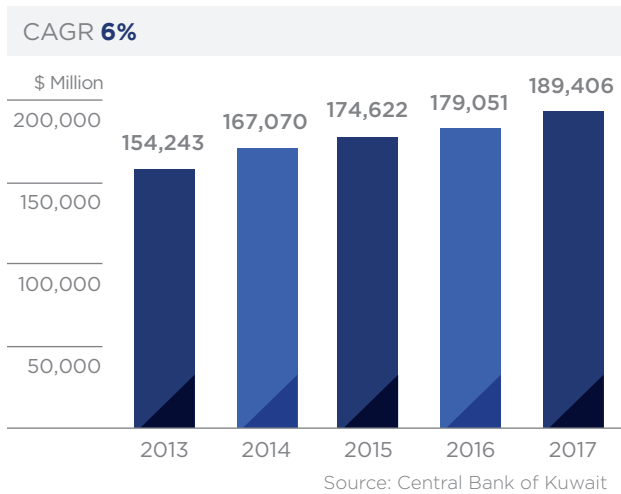
Islamic banks, however, are growing their bottom line faster, achieving an aggregate annual profit increase of 12.3% in 2017, versus 8.4% for the whole banking system.

"The gap between industry-wide returns and those enjoyed by the Islamic banks has continued to shrink, reaching a level where return ratios for Islamic banks have become similar to their conventional counterparts," CBK wrote in its 2016 Financial Stability Report.

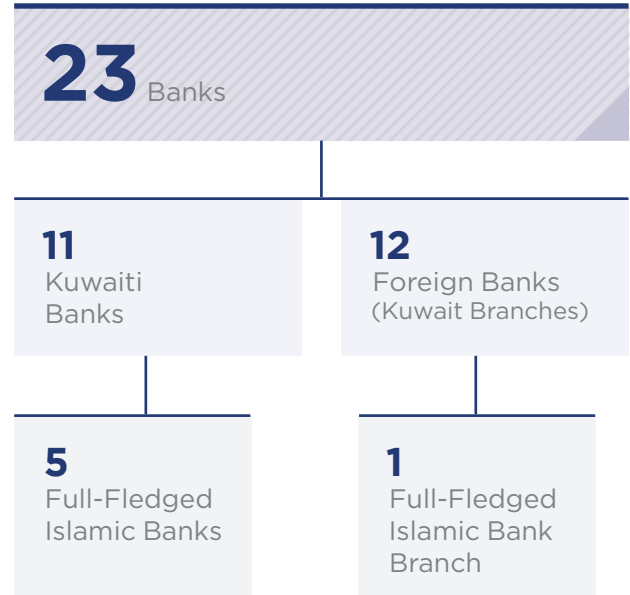
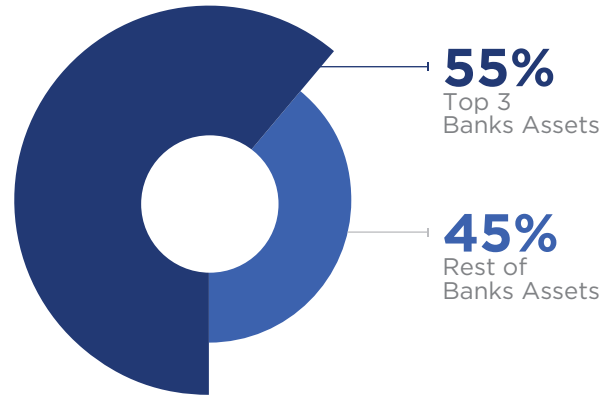
That is all the more remarkable considering Islamic banks have a higher cost-to-income ratio than conventional banks because of Sharia restrictions on products and services that do not apply to their conventional counterpart and which make even standard operations such as liquidity management more difficult. Transaction costs are also higher due to tougher legal and Sharia requirements.

Banks are somewhat well balanced in terms of corporate and retail as these two divisions provided 56.3% and 43.7% of lenders' loan interest income in 2017. Overall, financing income surged 13.5% versus a year earlier.

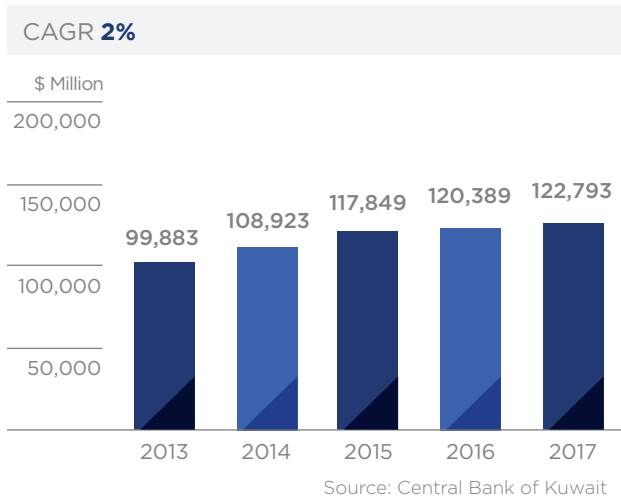
Kuwait Banking Assets (2013 - 2017)



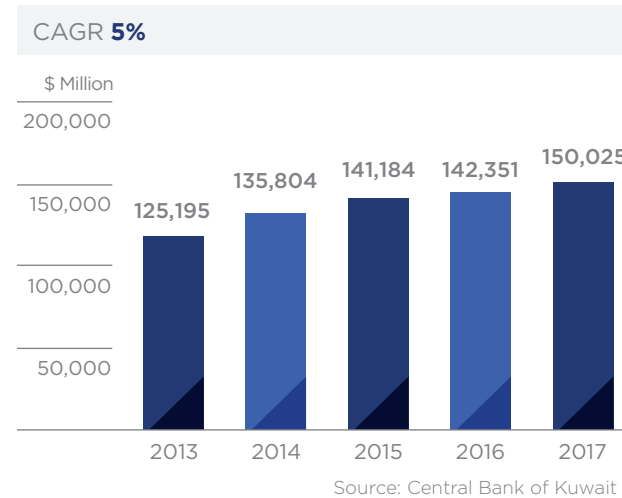
Top 3 Banks in Kuwait Assets Concentration (2017)



Kuwait Banking Loan (2013 - 2017)



Kuwait Banking Deposit (2013 - 2017)





TOGETHER WE **LEAD,** BECAUSE OF YOUR **TRUST**

Baitak extends its sincere gratitude to all people who have granted us their trust. Our leadership in Islamic Finance is a tribute to you.

EXECUTIVE INSIGHTS

Kuwait Finance House



Hamad Abdulmohsen Al-Marzouq
Chairman
Kuwait Finance House

1. Kuwait Finance House (KFH), being one of the pioneers of the global Islamic finance industry, was the first Islamic bank in Kuwait. How do you describe the journey of KFH since its foundations?

KFH has taken the lead since its foundations in 1977 amongst the well-established Kuwaiti banking institutions. KFH translated a deep corporate insight, crystallised its shareholders' ambitions and opened new horizons for superior customer service to achieve leadership in the world of Islamic banking and finance.

With our focus on innovation, KFH-Group offers a wide range of Islamic products and services across several regions, with 484 branches, 1,500 ATMs and over 15,000 employees.

2. Given that you are celebrating your 40th anniversary this year, what have been the key milestones for KFH over the years and do you feel that your universal banking model has supported the development of the broader Islamic finance industry locally, regionally and globally?

KFH paved the way for the inception of the Islamic finance industry not only locally but globally as well. Today, we celebrate our 40th anniversary after fascinating achievements realised during four decades and qualitative moves.

KFH has continued its previous approach in implementing its vision to lead the international development of Islamic financial services. For this reason, many have called KFH "the Harvard of Islamic Banking".

3. In your opinion, what are the key steps that need to be implemented by different stakeholders, including yourselves, to support the continued development of the Islamic finance industry in Kuwait?

It is significantly important to develop the right curriculum to prepare graduates for the market, and what the market needs is to have further leading experts in this field as there is high demand for a specific skill-set in Islamic banking which should be the focus of academic institutions, such as accounting, credit underwriting and risk management; also, developing the Islamic finance products.

We've seen a significant amount of Sukuk issuances because of their acceptability by the issuers and by governments, so much so that Western governments have been attracted to this market and began issuing Sukuk. Moreover, regulators are to work to improve the legal groundwork of Islamic banking practices as far as they can.

KUWAIT ISLAMIC FINANCE LANDSCAPE

Islamic Banking Landscape

Global Player

Kuwait is an important player in the Islamic finance industry, accounting for 6.1% of world-wide Islamic banking assets. Such holdings place it fifth globally, behind only Iran, Saudi Arabia and Malaysia — all countries with vastly larger populations than Kuwait — and the United Arab Emirates.

“Kuwait is expected to remain a key contributor to global growth in participation banking,” EY wrote in a 2016 report.

Sharia Authority

Kuwait’s outsized influence over Sharia-compliant financial services is further shown through its Islamic expertise. The country is home to 19 Sharia scholars who hold at least one board membership in its five Kuwaiti Islamic banks, some of which have multiple Sharia board representations, as per CBK regulations.

Domestic Boom

The foundations for Kuwait’s Islamic finance boom were laid by the CBK in 2003 when it introduced specific regulations to govern Islamic finance, sparking rapid growth in Sharia-compliant banking.

Islamic banks are winning market share across many industry metrics:

- Islamic banks held 41% of Kuwait’s total banking assets at 2017-end
- Islamic banking assets grew at a CAGR of 6.7% from 2013-2017
- With \$50.7 billion in financing assets as of 2017, which accounted for 40% of the domestic market
- Islamic banks held 42% — or \$63.1 billion — of Kuwait’s total deposits accounts in 2017.



Islamic banks in Kuwait are gaining ground and winning market share across many industry metrics.

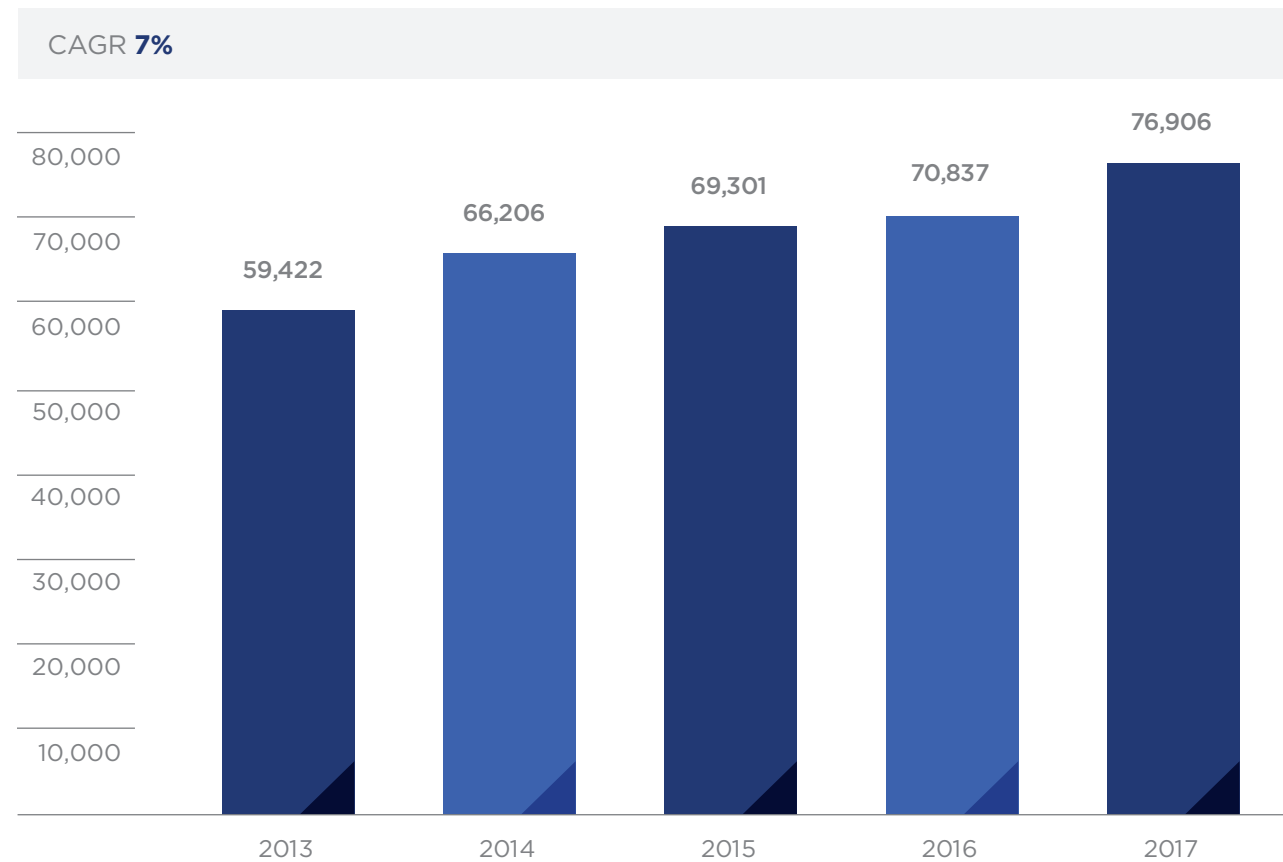
41%

Share of Islamic Banking to the Banking System Assets

58%

Total Islamic Banking Assets to Nominal GDP

Kuwait Islamic Banking Total Assets (2013 - 2017, \$ Million)



Source: Central Bank of Kuwait

Diverse Portfolios

Islamic banks in Kuwait have diversified revenue streams. A wide spectrum of banking activities provides 60% of income, such as property purchases and sales, leasing and trading. The remaining 40% is largely derived from treasury and investment activities. Real estate, personal financing and inter-bank financing provide about 60% of Islamic banks' total assets. The majority of transactions are *Murabaha*, while *Tawarruq* is the second most popular transaction type. Off-balance sheet commitments represent 10-20% of Islamic banks' assets. These are mostly letters of credit, acceptances and guarantees.

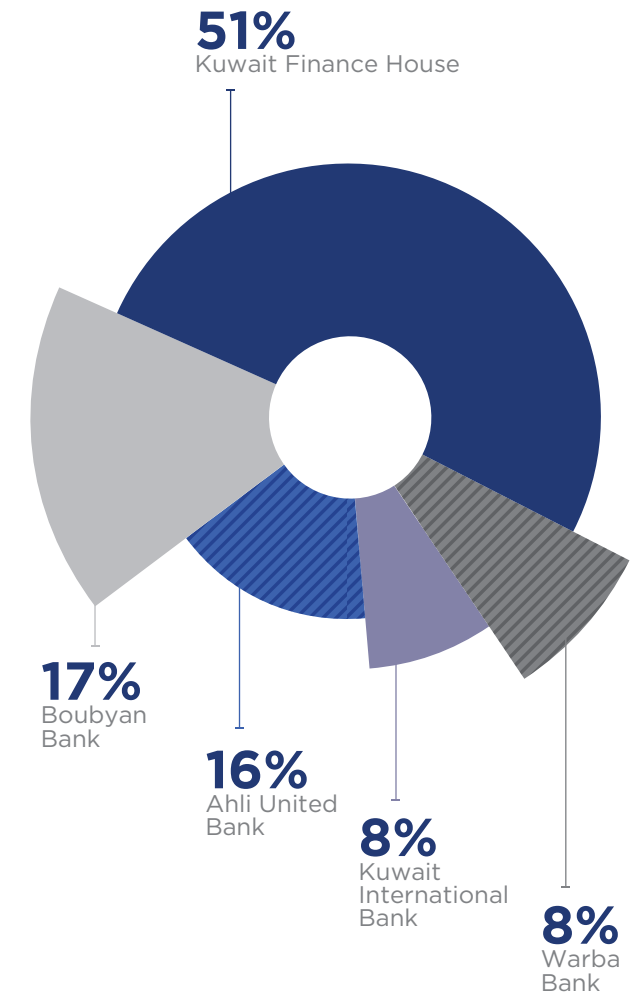
Risk Management

As a prudent regulator, CBK ensures its Islamic banking regulations align with the latest regulation of the Basel Committee and IFSB edicts. The IMF in its Article IV has praised Kuwait's Islamic banks for strengthening their risk management systems such as by undertaking group-wide capital and liquidity planning and stress tests. Banks use various tools to manage liquidity such as commodity *Murabaha*.

- Kuwait Finance House, established in 1977. KFH is the world's third-largest Islamic bank by assets, with operations in seven countries including Bahrain, Germany, Malaysia, Turkey and Saudi Arabia. Domestically, the state-backed banker had a 51% share of Kuwait's Islamic banking assets as of 2017.

- Ahli United Bank was founded in 1941, then converted to an Islamic bank in 2010 and by 2017 had a 16% share of Kuwait's Islamic banking assets.
- Boubyan Bank, which is majority-owned by National Bank of Kuwait, was founded in 2003 and is now Kuwait's second Islamic bank by assets.
- Kuwait International Bank, another bank that converted to a full-fledged Islamic bank, has a 45-year record of accomplishment and holds 8% of Kuwait's Sharia-compliant bank assets.
- Warba Bank, is another Islamic bank established in 2010 which quickly accumulated 8% of Kuwait's Islamic banking assets by 2017.
- Al Rajhi Bank (Kuwait) is a foreign branch of Saudi's Al Rajhi Bank, the world's biggest Islamic bank. It launched operations in Kuwait in 2010.

Islamic Banks in Kuwait and their Market Share in Total Assets (2017)



Source: Central Bank of Kuwait

Snapshot of Islamic Banking Players
in Kuwait



6 Islamic Banks

5
Kuwaiti
Islamic Banks

1
Foreign
Islamic Bank
Branch



Best Islamic Digital Bank – Global



GLOBAL
FINANCE

EXECUTIVE INSIGHTS Boubyan Bank



Adel Abdul Wahab Al Majed

Vice-Chairman & Chief Executive Officer
Boubyan Bank

1. Boubyan Bank was established in 2003, and subsequently became part of NBK group in 2012. How would you describe the journey of the bank since its inception, and in particular, what has been the impact of the acquisition on the development and performance of the bank?

During the initial years of its operations and before the NBK acquisition, Boubyan's focus was on wholesale and investment banking. During 2009, the bank was materially impacted by the financial crisis and other issues which led to significant impairment provisions.

The bank entered into a new phase with the entry of NBK as the major shareholder by the end of 2009 and having a new management team on board. A new five-year strategy was developed in 2010 which

emphasised on building Boubyan's franchise in Kuwait. During this phase, the focus changed to the core banking operation by providing superior services along with innovative products, including digital channels, to specific consumer and corporate segments. This strategy has resulted in a growth in financing market share from 2% to 8% now along with having one of the lowest NPL ratios in the market. The consumer financing market share also increased from 1% to 11% now with a steady growth in profitability. Now, the bank maintains leadership positions in innovative banking products and has received awards from various reputed organisations for its services.

2. Boubyan Bank has been a key promoter of leveraging digital channels. What has been the impact of this strategy of the bank and how important do you think digital channels will be for banks in Kuwait in the future?

The bank in its determination to establish itself firmly as a modern Islamic bank decided to embark on a digital transformation with a combination of customer-centric, world-class products brought in with continuous innovation and cutting-edge technology to attract young upscale and affluent customers and differentiate itself by delivering superior customer service.

Our digital and innovation journey started not by design but by trying to focus on customer service and customer convenience. Innovation and technology are core values at Boubyan. We want to enable the customer to fulfil his banking needs "where he wants, when he wants and how he wants". We have transformed the way we work. Everything is approached from a customer-centric approach. We want to transform employees into problem solvers.

In Kuwait, the same as in the world, banks are looking to make their mark to get a glimpse of what is to come over the next three to five years and to prepare for this. Lifestyle changes, demographic shifts and new regulations, to name only a few. Scientific and technological breakthroughs can be triggers. The age of

disruption demands that we develop a closer understanding of what's producing value for our customers, and how today's value proposition might be made obsolete by new offerings that give customers greater choices.

3. In your opinion, what are the key steps that need to be implemented by different stakeholders, including yourselves, to support the continued development of the Islamic finance industry in Kuwait?

To ensure the success of the Islamic finance industry in Kuwait, Islamic banks should be well managed to meet customer objectives and aspirations without compromising on Sharia principles.

The key steps needed from Islamic banks to achieve this are as follows:

- provide a high level of retail banking services with a variety of products and services that cater for their faith-based needs,
- invest in technology to develop digital services and products to compete with conventional banks,
- develop Sharia-compliant corporate and SME project financing products.

The government, regulator and banking union need also to take some other steps as follows:

- initiatives by government to introduce Sharia-compliant Sukuk to manage excess liquidity for banks,
- development of human resources that are knowledgeable in both Sharia matters and the finance industry,
- organising public campaigns for a wider understanding of Sharia practices and of the differences between the Islamic financial system and the conventional system.

KUWAIT ISLAMIC FINANCE LANDSCAPE CONTINUED

Credit Growth

Islamic banks are writing more financings than ever before. Combined, the country's five Islamic banks had provided borrowers with financings worth \$50.7 billion as of the end of 2017, up from \$48.4 billion a year earlier. Of last year's financing book, 44.7% was from Kuwait Finance House, 19.7% from Boubyan Bank, 18.3% from Ahli United Bank, 9.0% from Kuwait International Bank and 8.4% from Warba Bank.

CBK data show that in 2017 income from financings accounted for 86.0% of banking sector interest income. Financing to retail clients generated for 61.9% of profit income, with the remainder derived from corporate borrowing. Profit income growth is also accelerating, achieving a 10% increase in 2017 versus 9% in 2016.

Customer Confidence

The total deposits amounted to \$63.1 billion including due to banks and other financial institutions. More Kuwaitis are choosing to keep their cash savings at the country's Islamic banks, which saw private and governmental deposits reach a record high of \$51.5 billion at the end of 2017, up 6.7% from a year earlier. Of these deposits, Kuwait Finance House holds 52.1%, Boubyan Bank 18.0%, Ahli United Bank 15.6%, Kuwait International Bank 7.8% and Warba Bank 6.5%, respectively.

Growth has been the strongest among smaller Sharia-compliant banks, with Warba more than quadrupling its deposits since 2013, Boubyan Bank's deposits have more than doubled over the same period.

Islamic banks have also been succeeding in expanding without deterioration of their asset quality (non-performing financing have tumbled since 2013). At Kuwait Finance House, for example, NPFs were 1.6% last year versus 3.7% in 2013. Likewise Ahli United Bank's NPFs dropped to 1.4% from 2.8% over the same timeframe. The Islamic sector average is now 1.6%, down from 2.9% in 2013.

Increasing Returns

As noted earlier in the report, Kuwait's Islamic banks achieved an aggregate profit increase of 12.3% in 2017 from a year earlier as combined profits reached a record \$998.3 million.

Other metrics also demonstrate banks' improving performance: total revenues were \$2.6 billion in 2017, from \$1.7 billion in 2013, while return on assets averaged 1.05% in 2017, up from 0.60% in 2013.

While all Kuwait's Islamic banks increased profits for the period 2013 to 2017, Boubyan Bank stands out as an overachiever. The banks' profit last year was \$158.1 million, nearly quadruple its 2013 net income of \$43.2 million.

Warba Bank turned profitable in 2014, just four years after launch, and in 2017 made a profit of \$22.5 million as revenue rose 76% from a year earlier.

Kuwait Finance House remains the sector heavy-weight, accounting for 61% of Islamic banks' combined profits and 67% of their total revenues

in 2017. KFH profits increased by a CAGR of 5.3% from 2013 to reach \$611.4 million last year.

Robust Balance Sheets

Industry metrics show Kuwait's Islamic banks are strong, safe and solvent.

The CBK has set a minimum capital adequacy ratio (**CAR**) — which measures bank capital and is used to protect deposits and support sector stability — of 13% for the country's banks. Among Islamic banks, the average was 18.2% in 2017.

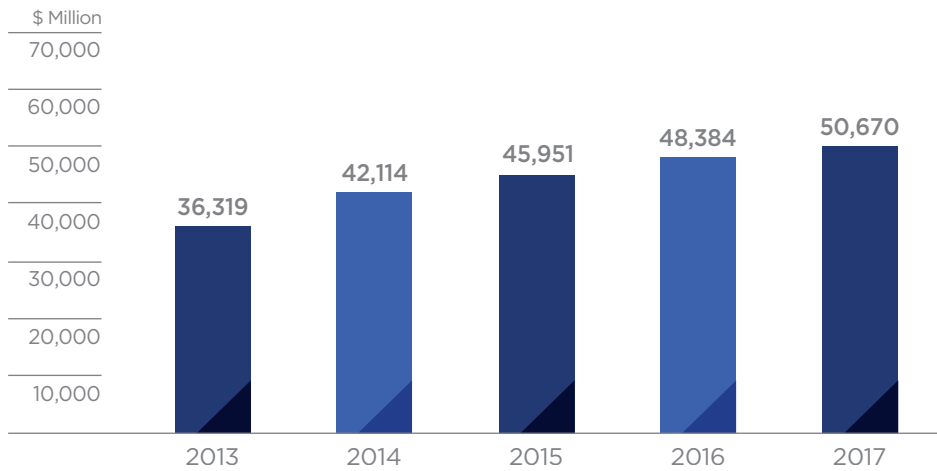
"Results of CBK's **stress tests** reveal that banks, individually and collectively, have been able to broadly withstand various shocks in credit, market and liquidity simulated under a wide range of micro- and macro-economic scenarios," the CBK wrote in its 2016 financial stability report.

Banks' **leverage ratio** was 10.2% for all banks in 2017, CBK data show, significantly exceeding the 3% minimum suggested by the Basel Committee. This indicates banks' strong capacity to extend credit without the risk of breaching the leverage ratio.

Other metrics further substantiate Islamic banks' resilience: Liquidity Coverage Ratio (LCR) range from 160% to 345% and their Net Stable Funding Ratio (NSFR) range from 97% to 121%.

Kuwait Islamic Banking Credit (2013 - 2017)

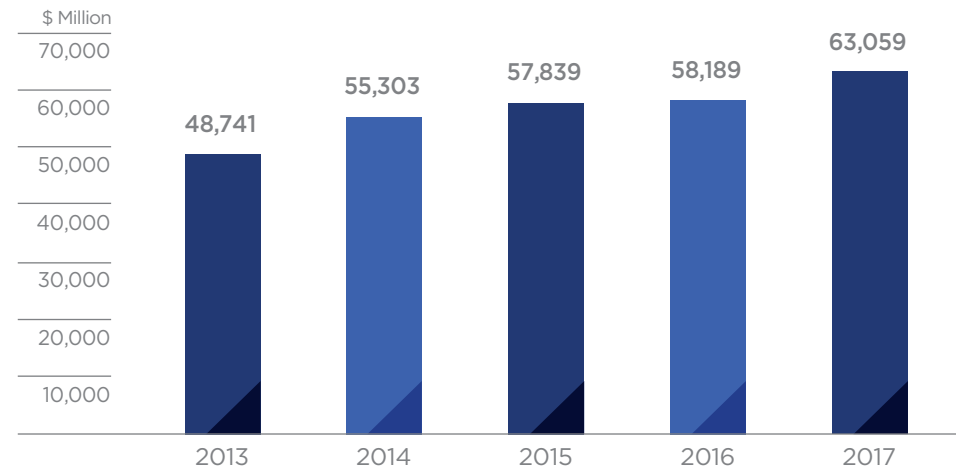
CAGR **9%**



Source: Central Bank of Kuwait

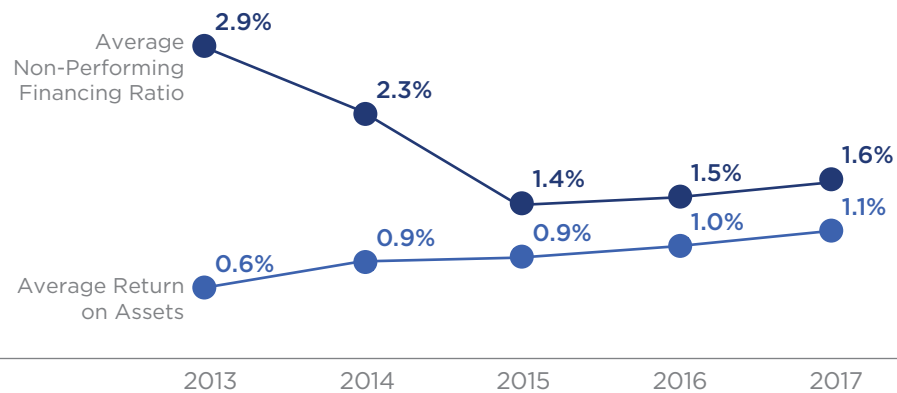
Kuwait Islamic Banking Deposit (2013 - 2017)

CAGR **7%**



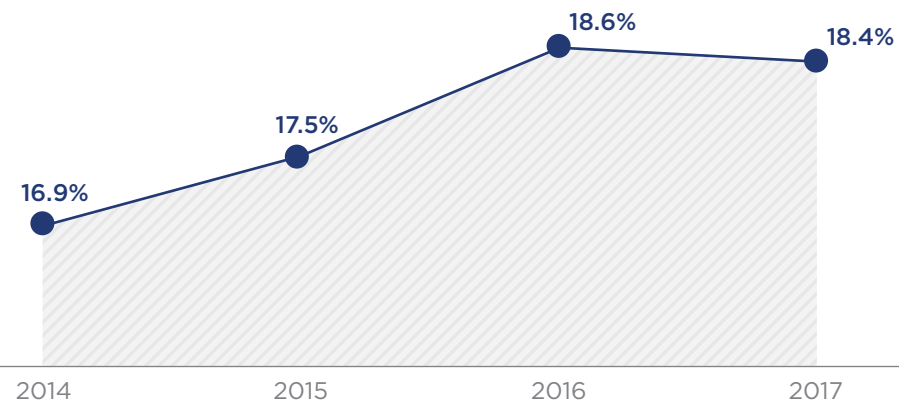
Source: Central Bank of Kuwait

Islamic Banks in Kuwait Financial Performance Ratios (2013 - 2017)



Source: Central Bank of Kuwait

Islamic Banks in Kuwait Average Capital Adequacy Ratio (2014 - 2017)



Source: Central Bank of Kuwait

بتقتكم نستمر بالريادة

بنك الكويت الدولي يحقق 6 جوائز مرموقة في عام 2017



البنك
الأسرع نمواً
في منطقة الشرق الأوسط
وشمال أفريقيا لعام 2017



أفضل بنك متوافق
مع أحكام الشريعة الإسلامية
في منطقة الشرق الأوسط
وشمال أفريقيا لعام 2017



أفضل
إدارة تغيير
في الكويت
لعام 2017



للسنة الثالثة
على التوالي
جائزة المسؤولية
الإجتماعية
لعام 2017



للسنة الثانية
على التوالي
أفضل بنك إسلامي
في دول مجلس التعاون الخليجي
لعام 2017



أفضل بنك
في استقطاب العملاء
في دول مجلس التعاون الخليجي
لعام 2017

EXECUTIVE INSIGHTS

Kuwait International Bank



Sheikh Mohammed Jarrah Al-Sabah
Chairman
Kuwait International Bank

1. As one of the oldest commercial banks in Kuwait, with a focus on the real estate business, what motivated you to convert from a specialised bank to a full-fledged Islamic Bank in 2007?

The transformation decision was based on a profound understanding of the potential, opportunities and challenges offered by the Sharia-compliant banking environment regionally and in Kuwait, due to the absence of competition at that time. We targeted expansion of the bank's activities beyond the limits of specialisation, taking advantage of the increased demand for Islamic banking in addition to the bank's shareholders' belief in the significance of Sharia principles through integration of ethical values in all operations. Moreover, KIB was keen to anchor its extensive specialised experience in real estate "as a perfect asset class" to enhance its offerings as a full-fledged Sharia-compliant commercial bank.

2. How do you describe your conversion experience? Did it help you achieve the goals that initially encouraged you to convert?

The transformation from a specialised bank to a full-fledged Sharia-compliant institution had been a fruitful experience full of challenges. We succeeded in building unique capacities in terms of people, processes and systems and in achieving transformation objectives. Hence, global peers have considered our transformation experience as a model, and KIB has grown into a leading

Islamic financial institution that offers comprehensive and innovative Islamic banking solutions.

3. In your opinion, what are the key steps that need to be implemented by different stakeholders, including yourselves, to support the continued development of the Islamic finance industry in Kuwait?

It is primarily the responsibility of Islamic banks to ensure that their human resources are appropriately trained while systems and processes are streamlined to adapt to the numerous challenges offered by ever-changing technology. Furthermore, developing appropriate frameworks in certain areas and ensuring availability of adequate long- and short-term liquidity management tools will enhance the current Islamic banking environment.

Other Islamic Finance Sectors

Sharia-compliant Debt Securities

In 2015, the Capital Markets Authority (CMA) introduced a regulatory framework to encourage both Sukuk and conventional bond issuance. These rules lay out the conditions that Sukuk must fulfil to be tradeable and detail specific Sukuk types such as instruments with perpetual tenors and those that can be converted into shares. The CMA and CBK must approve Sukuk.

Kuwait's parliament approved a new legal framework that extends Kuwait's borrowing limits, raising the debt ceiling to \$82.0 billion from \$33.2 billion and extending maturities to up to 30 years from the previous limit of 10 years. Kuwait's successful debut in the international bond market in March 2017, where the country raised \$8 billion from regional and international investors — order books totalled \$28.9 billion — is likely to help pave the way for sovereign Sukuk issues in the future. As of 2017-end, Kuwait entities had issued \$396.2 million of Sukuk.

Four Takaful Companies Listed on Stock Exchange

Historically, there was little take-up of insurance in the Middle East, aside from compulsory requirements like vehicle insurance.

In Kuwait, the first Takaful companies were established in the 1990s, and as of 2017-end 16, including two windows, of the country's 35 domestic insurers operated according to Islamic principles. Of the 14 full-fledged Takaful

companies, there are only four listed on the stock exchange. Kuwait's four listed Takaful companies — First Takaful Insurance Company, Wethaq Takaful, Kuwait Insurance Company and Warba Takaful Insurance Company — had \$374.8 million of assets at the end of 2017, while their contributions totalled \$101.2 million.

In terms of market share, Warba Takaful is the dominant player, accounting for 72.1% of assets and 67.5% of contributions in 2017. First Takaful and Wethaq Takaful held 16.1% and 10.6% of assets, respectively, also claiming 17.5% and 14.2% of contributions last year.

Islamic Funds Represent 56% Market Share

Consumer demand for Sharia-compliant investment vehicles has spurred growth in Kuwait's Islamic asset management industry. Of the country's 113 investment funds, 57 are Sharia-compliant and combined these Islamic funds had \$944 million of assets under management at the end of 2017, up from \$931 million a year earlier.

In 2011, the CMA became the regulator for Kuwait's Islamic funds industry, taking over from the CBK.

On a longer timeframe, Islamic funds' assets under management have declined, a drop that coincides with the lacklustre performance of Gulf equities markets, in which these funds are major investors. For example, Saudi Arabia's benchmark is down 29% from a 2014 high — its peak of the past five years. Likewise, Dubai's index has

fallen 41% from its 2014 high and Kuwait's bourse is down 19% from a 2013 peak.

All those closing highs were achieved prior to the steep and sustained drop in oil prices which began in mid-2014, with reduced state crude revenues impacting government spending and denting investor confidence, even if few energy companies are listed on regional exchanges.

A Brent crude price rally from 2017's low of \$47 last June to around \$70 today bodes well for both equity markets and Islamic mutual funds, however.

Islamic fund managers, of course, cannot and will not invest in companies connected with haram activities such as the arms trade, tobacco or gambling. They mostly rely on retail investors for growth, unlike conventional funds which follow an investing mandate but also have a large institutional investor base. As the Gulf pension sector expands, Islamic funds should benefit.

Islamic Investment Companies Outperform Conventional Peers

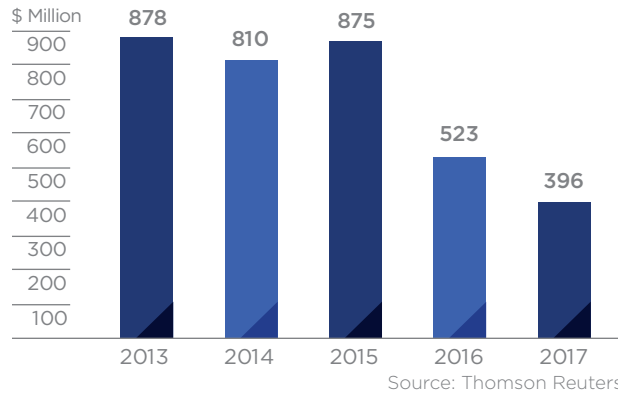
Second only to banks in terms of their share of Kuwait's financial system, the investment company sector is becoming increasingly influenced by Sharia principles.

Of the 68 investment companies, 39 are Islamic, and their share of total sector assets has increased from 44% in 2013 to 57% in 2017.

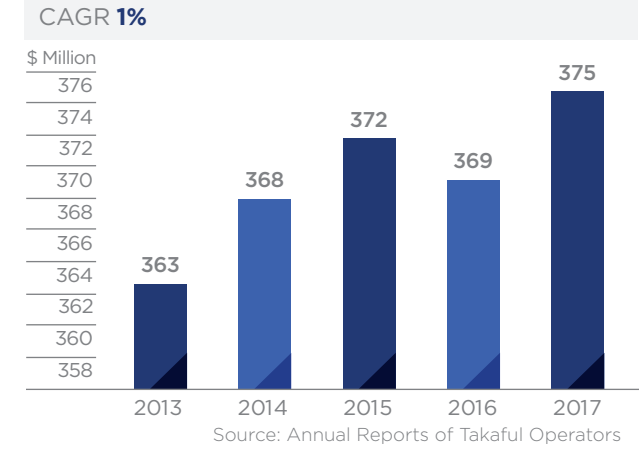
Overall, assets have fallen for both conventional and Sharia-compliant companies during this period, mirroring weak regional stock markets.

But the decline for Islamic investment companies has been markedly less pronounced, dropping 10.7% versus a 45.4% drop at conventional investment companies. This outperformance suggests Islamic firms have been more prudent in their investments and also that in times of market turbulence investors are more comfortable committing their money to investment companies that follow Sharia principles.

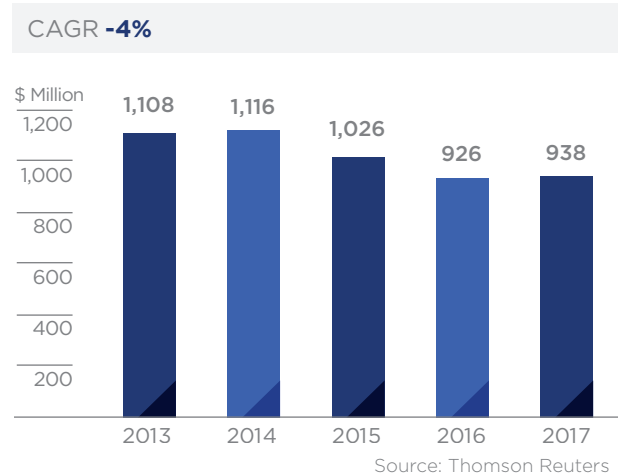
Kuwait Sukuk Value Outstanding (2013 - 2017)



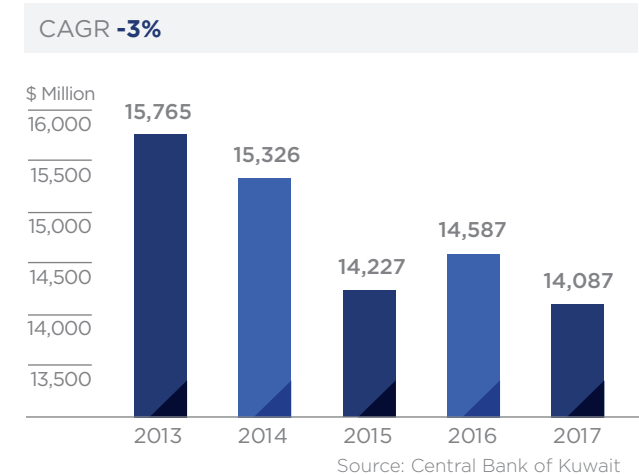
Kuwait Listed Takaful Total Assets (2013 - 2017)



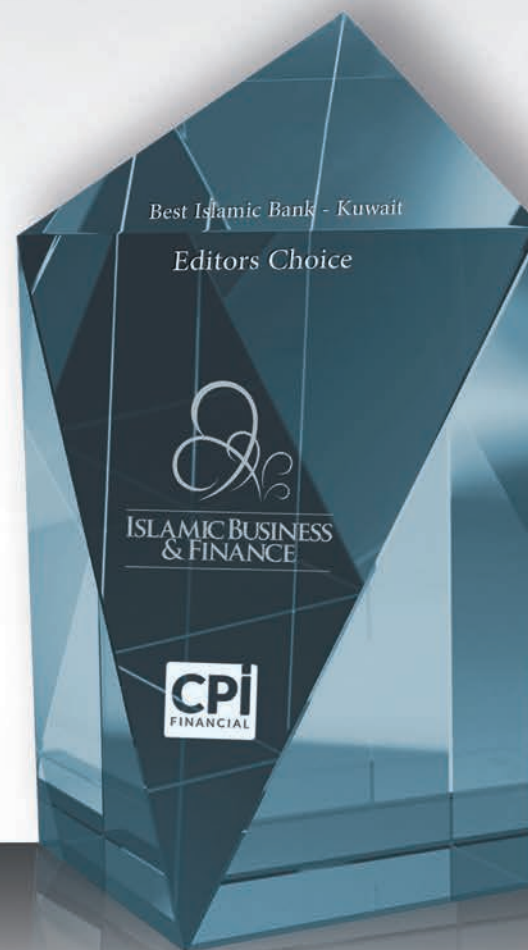
Kuwait Islamic Assets under Management (2013 - 2017)



Kuwait Islamic Investment Companies Total Assets (2013 - 2017)



Best Islamic Bank in Kuwait 2017



As one of the safest Islamic banks in Kuwait with A+/A2 ratings from three international ratings agencies, Ahli United Bank has been awarded the Best Islamic Bank in Kuwait for the year 2017 by *Islamic Business & Finance International Magazine*.

البنك الأهلي المتحد 
ahli united bank

www.ahliunited.com.kw

EXECUTIVE INSIGHTS

Ahli United Bank



**Dr. Anwar Ali
Abdullah Al-Mudhaf**
Chairman
Ahli United Bank

1. As one of the oldest commercial banks in Kuwait, what motivated you to convert from a conventional bank to a full-fledged Islamic bank in 2010?

With the growing demand for Islamic banking in Kuwait and regionally outpacing growth in conventional banking, the shareholders of the then Bank of Kuwait & the Middle East (BKME) approved a strategy submitted by the Board of Directors to convert the bank to become Sharia-compliant. The appetite was evidenced through a survey showing that 85% of existing customers supported the decision to convert.

2. How would you describe your conversion experience? Did it help you achieve the goals that initially encouraged you to convert?

The bank's conversion in 2010 raised a number of critical challenges. The transition commenced two years prior to the conversion date and required careful planning by the board, management and staff to ensure the project was a success for the bank and its customers. Every aspect of customer relationships, with their consent to convert, was addressed along with the regulatory framework, establishment of a Fatwa and Shariah Supervisory Board, IT systems, documentation, and staff training, amongst other requirements.

In terms of achieving financial goals, the number of customers has increased by 60% since 2010, whilst

growth in assets is over 50%. Net profit has grown by 62% since 2010 and return on average equity has been consistently one of the highest in the market

3. In your opinion, what are the key steps that need to be implemented by different stakeholders, including yourselves, to support the continued development of the Islamic finance industry in Kuwait?

- I. Islamic banks: Should develop competitive strategies for new products and market diversification in conjunction with Shariah Supervisory Boards. Further develop staff competencies in Islamic banking.
- II. CMA: Listing of Sukuk locally.
- III. The Ministry of Finance to exclude Islamic products (including *Murabaha*, *Musawama* and *Ijara*) and services from future VAT implementation.

KUWAIT ISLAMIC FINANCE JOURNEY

Development of Islamic Finance

Banking Models

As Kuwait's Islamic banking industry developed over its 40-year history, Sharia-compliant banks have been created according to four different models.

One is to be Islamic from inception; a route followed by market leader Kuwait Finance House, plus Boubyan Bank and Warba Bank.

The CBK introduced pioneering new legislation in 2003 to expand the Islamic banking sector, providing conventional banks with a means to become Sharia-compliant. Kuwait International Bank did so in 2007 after nearly 40 years of real estate specialised operations.

Ahli United Bank did likewise in 2010 but was first taken over by Bahrain's AUB Group, having been founded as a conventional bank in the 1940s.

Kuwait is also open to business for foreign banks, and that includes Sharia-compliant banks. Saudi Arabia's Al Rajhi Bank, the world's largest Islamic bank by assets, opened a full-fledged Kuwaiti branch in 2010, offering retail and corporate banking solutions.

Kuwait Finance House was established in 1977, the world's second Islamic bank, and as of 2015 was the world's third-largest Islamic bank by assets, with operations in seven countries including Bahrain, Germany, Malaysia, Turkey and Saudi Arabia. Unrivalled domestically until the launch of Boubyan Bank in 2004, KFH had a 51.1% share of Kuwait's Islamic banking assets as of 2017, while globally it has 484 branches and 15,000 employees. State-run institutions including Kuwait Investment Authority own around a quarter of KFH's shares. KFH made a net profit of \$611.5 million in 2017, up 11.5% year-on-year.

One of the Gulf's first financial institutions, a group of British investors in 1941 founded, what would be later renamed AUB. Kuwait's government bought the bank in 1971, rebranding it Bank of Kuwait and the Middle East. Bahrain's AUB Group bought the bank in 2002 and converted it into an Islamic institution in 2010. In 2017, Ahli United had a 15.8% share of Kuwait's Islamic banking assets, while last year it made a net profit of \$147.7 million, up 9.5% year-on-year.

Boubyan Bank became the first Islamic bank to be established in Kuwait following the CBK introduction of specific rules to govern

“

The CBK introducing new legislation in 2003 to regulate Islamic banks has expanded the Islamic banking sector, and provided conventional banks with a means to become Sharia-compliant.

Sharia-compliant banking in 2003. Boubyan joined the Kuwait stock market in 2006. Now majority-owned by Kuwait's largest bank, National Bank of Kuwait, Boubyan had a 17.1% share of Islamic banking assets in 2017 as it made a net profit of \$158.0 million, up 16% from a year earlier.

Kuwait International Bank became a Sharia-compliant bank in 2007, having been incorporated in 1973 and formerly known as Kuwait Real Estate Bank. In 2017, KIB had an 8.3% share of Kuwait's Islamic banking assets. It operates 26 branches across the country and made a net profit of \$58.8 million in 2017.

Warba Bank was established in 2010. It generated a net income of \$22.6 million in 2017. The bank had a 7.7% share of Kuwait's Islamic banking assets.



Timeline of the Development of Islamic Finance in Kuwait

1977

1977

Kuwait Finance House (KFH), Kuwait's first Islamic bank and the second globally, is established.



1989

1989

KFH incorporates the first of its six foreign subsidiaries, Kueyvt Turk.



1994

1994

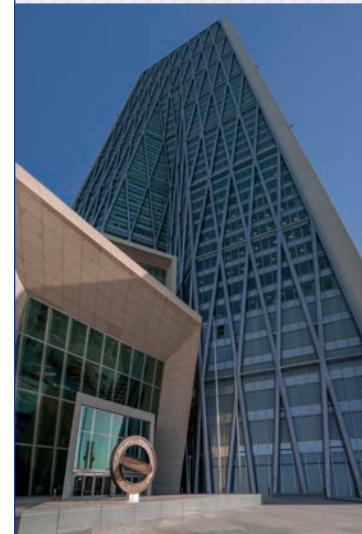
By this year, 14 Kuwaiti Islamic investment companies become active.



2003

2003

Kuwait issues law that explicitly recognises Islamic banking practices, products and institutions. The CBK is re-confirmed as the regulator for Islamic banks.



2004

2004

Boubyan Bank establishes and starts operations.



2007

2007

Kuwait International Bank holds the first General Assembly Meeting after converting to a full-fledged Islamic Bank, having been founded in 1973.



2010

2010

Ahli United Bank, formerly known as Bank of Kuwait and Middle East and founded in 1941, becomes fully Sharia-compliant.



REUTERS/Alamad | Mohammed

2010

Warba Bank establishes and commences operations.



2015

2015

Capital Markets Authority releases Sukuk rules to prepare for and facilitate the sale of sukuk.



2016

2016

Kuwait ranks fourth for governance, according to the *ICD-Thomson Reuters Islamic Finance Development Report 2017*.



Evolution of Islamic Finance Regulations

Islamic Banking Regulation — A Meticulous Approach

Kuwait's Islamic banking regulations originate in the 1968 law that led to the establishment of the CBK the following year. Within a decade, Kuwait Finance House had become the world's second Sharia-compliant bank, launching operations in 1977, but it was not until December 2003 that specific rules to govern Sharia-compliant banks entered the statute books following several years of meticulous planning by the CBK.

In 1997, the CBK laid out why specialist regulations were needed to cover Islamic banking in a speech to a seminar co-hosted by the IMF. "Having Sharia boards within each of the Islamic financial and banking units, rather than a central body within the CBK, ensures the compliance of their activities with the provisions of Islamic Sharia and enhances the moral confidence of the public in the activities of these units in terms of their adherence to Islamic Sharia," the CBK said.

This consensual approach also serves to encourage dialogue about Sharia interpretations — also known as fatwa — and can help build a majority view, which is vitally important when notions of Sharia compliance can differ widely and deciding on such matters is beyond the jurisdiction of a CBK.

The 2003 regulations defined Islamic banks as lenders that are Sharia-compliant, providing services through instruments and structures such as *Murabaha*, *Musharaka* and *Mudaraba*.

The law requires each Islamic bank to form an

independent Sharia Supervisory Board (SSB) for Sharia compliance, which will submit a statement for inclusion in the bank's annual report setting out the committee's opinion as to whether the bank's activities conform to Sharia regulations.

Prior to the inaugural Islamic banking regulations, Kuwait's banking sector was opened up to foreign competition in 2001 through Kuwait's Foreign Direct Investment Law.

Competition Intensifies

Following the incorporation of the 2003 rules into Kuwaiti law, the CBK initially only allowed three Islamic banks in order to allow the governing body to steadily build up its capacity and expertise in overseeing this vitally important new segment of the country's banking system. The three-bank limit also served to help new banks to find their feet before more licences were issued and competition intensified.

"The Islamic market share increased rapidly between 2005 and 2010 and has since stabilised," Fitch Ratings wrote in a November 2017 report.

Meeting Global Benchmarks

Following the global financial crisis of 2007-2009, regulators worldwide started discussion about creating a stronger set of rules to govern banks, which became known as Basel III.

In June 2014, CBK ordered banks operating in the country to comply with the Basel III requirements for lenders to maintain a minimum capital adequacy ratio of 13%. Later that year, Islamic

banks were also instructed to maintain a minimum leverage ratio of 3%, also setting a **LCR** to ensure banks possess sufficient high-quality liquid assets should they face a sudden liquidity squeeze. At 2017-end, Kuwait's Islamic banks had an average **CAR** of 18.4%, while their LCR ranged from 169% to 345%.

A further Basel III innovation was mandated in October 2015 whereby banks were required to meet the NSFR range, which is from 97% to 121%, which in tandem with the LCR form the new global liquidity standards.

The CBK also introduced bank stress testing in 2008, enhancing these procedures in 2014. Banks must now conduct biannual financial stress testing and an Internal Capital Adequacy Assessment Process (ICAAP). The results are then analysed to gauge the resilience of individual banks against potential shocks, as well as of the broader sector.

Regulatory Enhancement

Over a decade after the 2003 laws sparked the speedy expansion of Kuwait's Islamic banking sector, the central bank issued new rules concerning internal and external oversight of Sharia-compliant banks, with the aim of boosting customer confidence in Islamic banking.

The Sharia governance instructions were issued in December 2016 and implemented in January 2018. The regulations include requirements for external Sharia audits and set out certain requirements on banks' in-house Sharia scholars. These mandate that a scholar can hold positions with a

maximum of three banks and must have at least five years of appropriate industry experience.

Islamic banks have historically used in-house scholars to decide whether banking products and services are Sharia-compliant, a method of self-policing that raised questions over conflicts of interest.

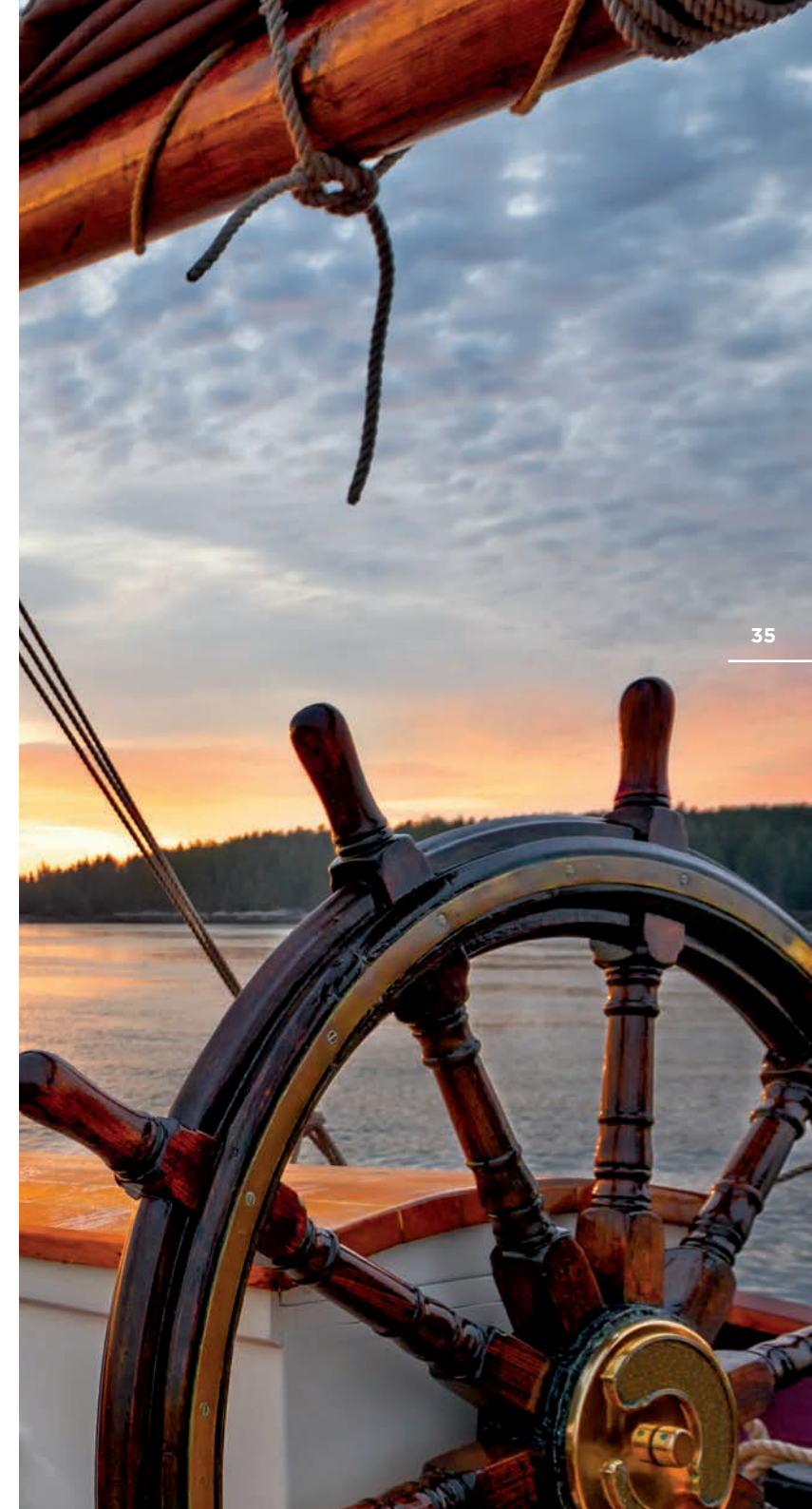
The new rules aim to assuage those doubts. Scholars are now also required to attend a minimum number of Sharia board meetings each year or face exclusion, while Sharia boards must publish an annual report on their activities in a move the central bank believes will enhance consistency and timeliness of Sharia rulings.

“While the CBK is the supervisory authority for Islamic and conventional banks, there is a specific regulatory framework for Islamic banks. CBK regulations are comparable between conventional and Islamic banks, but they take account of Islamic banks’ specificities,” Fitch Ratings wrote. “Financing impairment charges/ average gross financing ratios have been falling due to better underwriting standards.”

More broadly, Kuwait’s entire banking sector, covering both Islamic and conventional banks, has the highest reserve coverage in the GCC, according to Fitch. “Asset-quality metrics are now at their best level since the financial crisis.”

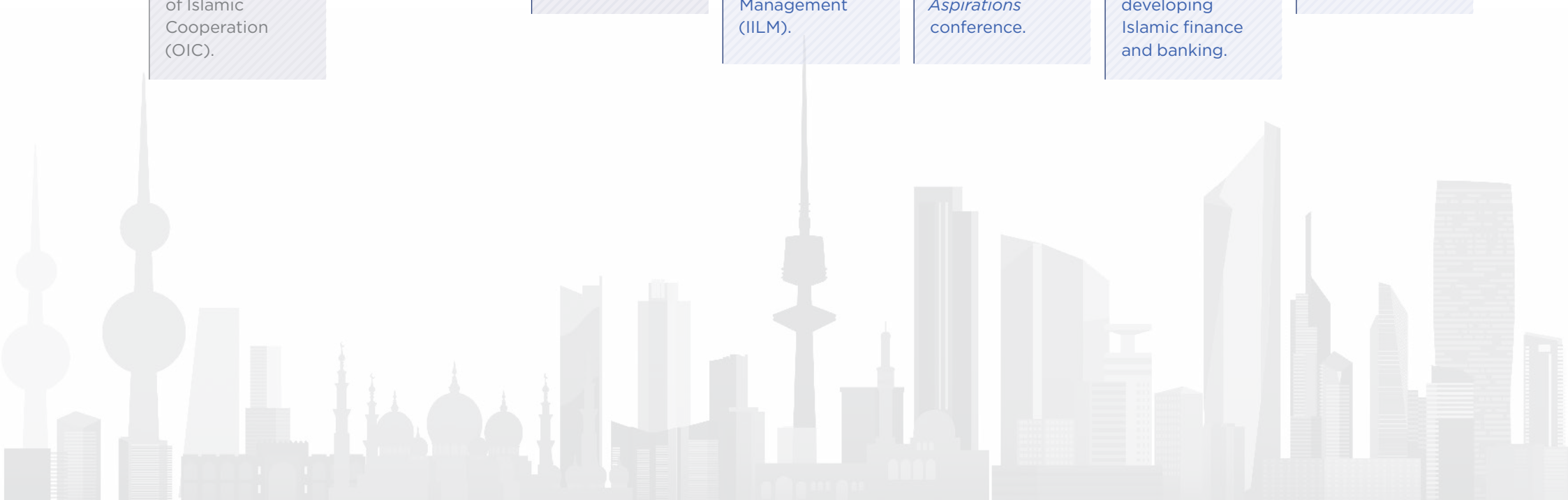
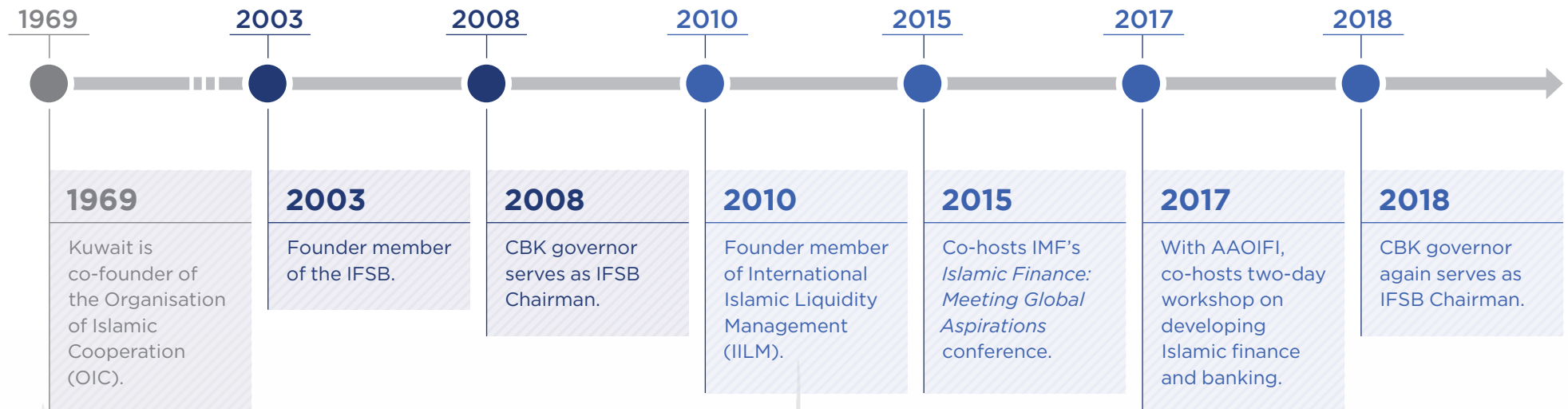
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The CBK new rules concerning Sharia governance instructions for Islamic banks, aims to boost customer confidence in Islamic banking.



Central Bank of Kuwait's Role in Promoting the Development of the Global Islamic Finance Industry

Kuwait's contribution to internationalising Islamic finance stretches back 50 years



Founder, Partner

Kuwait has played a pivotal role in the creation of numerous international institutions that guide the Arab and Muslim worlds as well as those that lead Islamic finance.

In 1969, the country helped found the Organisation of Islamic Cooperation, the world's second-largest inter-governmental organisation — after the United Nations — which has a membership of 57 states across four continents.

Kuwait is a founding member of the IFSB, which began operations in March 2003. The IFSB is an international standard-setting body of regulatory and supervisory agencies that are responsible for ensuring the soundness and stability of the Islamic financial services industry.

Kuwait's pivotal role within the IFSB continues. The CBK is a member of the IFSB's Technical Committee, while in 2008 CBK Governor was IFSB Chairman and returned to the role again in 2018.

The CBK was also a founding member of International Islamic Liquidity Management Corporation (IILM), which was established in 2010 to introduce and facilitate effective cross-border Sharia-compliant liquidity management solutions. The CBK governor is IILM's chairman.

Hosting Events

Kuwait is a regular host of the world's most important Islamic finance events. In 2015, the country staged the *Islamic Finance: Meeting Global Aspirations* conference in conjunction with the International Monetary Fund.

Last year, Kuwait hosted a two-day workshop on developing Islamic finance and banking and enhancing professional capabilities and know-how within the industry. This event was held in partnership with the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI).

In May 2018, Kuwait hosted The IFSB's annual meeting and Islamic finance conference, having also staged the event in 2008. Topics debated at the three-day summit included:

- Leveraging Islamic Finance to Build a Diversified and Sustainable Economy
- Building a Dynamic and Robust Regulatory Regime
- Navigating the Disruptive Eco-Systems
- Islamic Finance: What Lies Ahead





بنك وربة
WARBA BANK
نتميز بالحلول

2016

"The Fastest Growing Bank in Kuwait"
"The Fastest Growing Bank in the
MENA Region"
"The Best Investment
Bank in Kuwait"

2015

Moody's assigns
Warba Bank a rating
of Baa2/P-2 with
a stable
outlook

بنك وربة
WARBA BANK
البنك الإسلامي

2014

'Fastest Growing Bank in Kuwait',
'Best New Bank in the Middle East'
and 'Best Bank in Kuwait for
Corporate Finance'

2013

The Bank gets listed on Kuwait
Stock Exchange

2017

Warba Bank Lists its tier 1 Sukuk
on Nasdaq Dubai

2010

Warba Bank is
enrolled into CBK's
Register of
Islamic
Banks

2012

Retail Banking is introduced with the
establishment of Branches
and an ATM network

2011

Investment Banking and Corporate
Banking activities commenced

warbabank.com

Our Vision

To be an Islamic Corporate and Investment Banking Champion in Kuwait with a lean digitally enabled Retail business.

Our Mission

Help our customers fulfil their life ambitions and grow their businesses by providing innovative financial solutions and outstanding experiences.

Provide our staff with rewarding growth opportunities and a healthy work environment.

Deliver steady, growing returns to our shareholders.

EXECUTIVE INSIGHTS Warba Bank



Abdulwahab Abdullah Al-Houti
Chairman
Warba Bank

1. What motivated you to start operations as a full-fledged Islamic bank?

There are multiple factors that motivated the establishment of Warba Bank as a full-fledged Islamic bank:

- the strong and stable Kuwaiti economy, and the government plans to enrich it further across different sectors through the implementation of various projects and investments.
- to avail of the growth opportunity within the Islamic banking industry that is growing at a much faster pace compared to conventional banking in many aspects.

- the desire to create a different perception about the Islamic banks through modernisation and the use of technology for differentiation.
- the continuously increasing demand of the customers to have full-fledged banking operations that are compliant with the Islamic Sharia principles, both at the retail and corporate fronts.
- the need from the customers to have more innovative solutions tailored for them within the agreed principles of banking that are not offered in the market.

2. How would you describe your experience in leveraging this Sharia-compliant debt instrument to ensure adherence with Basel III requirements (or the equivalent IFSB capital requirements)?

The experience encountered during the issuance of Tier 1 Sukuk was a uniquely positive one due to the following reasons:

- the amount of trust that the investors had put in Warba Bank and the Kuwait economy was tremendous. It is evident from the 5-plus times subscription ratio.
- the investors came from multiple geographies that besides Kuwait also included Europe, North America, Dubai and Asia.
- the great praise Warba Bank received during the road show reflected positive investor outlook about the bank's future, based on:
 - the historical achievements and record growth,
 - the financial position, strength and stability,
 - the stable outlook and positive credit ratings from Moody's and Fitch Ratings,
 - the support Warba Bank has received from regulatory bodies in facilitating the issuance of the Tier 1 Sukuk.

3. What are the key steps that need to be implemented by different stakeholders including yourselves to support the continued development of the Islamic finance industry in Kuwait?

There are many ways to support the continued development of the Islamic banking industry in Kuwait. Some of these could be around:

- collaboration among domestic players to position Kuwait as the Global Financial Hub based on the 2035 Vision through collectively supporting the mega projects,
- education of customers around Islamic banking principles and building awareness and trust in the system,
- continuous understanding of customer needs to innovate in Islamic Sharia-compliant products and services along with use of the latest technology trends to simplify Islamic banking operations and provide a superior customer experience,
- establishment of a local Islamic financial research and development centre in addition to the creation of specialised degrees at universities in the field of Islamic banking,
- frequent interaction with other worldwide Islamic banks to gain experience from different regions and see the feasibility of implementing these experiences domestically,
- a national level Sharia governing body for the financial sector will be useful to standardize Sharia principles and expand available options for the development of marketable securities and increase market depth with a view to enable Islamic banks to effectively deploy liquidity.



Unique Islamic Finance Initiatives

Kuwait has worked tirelessly to support the development of Islamic finance domestically, regionally and globally. These efforts include the creation of multiple initiatives. The most notable include:

The Kuwait Center for Islamic Economy

Established in 2014 by the Ministry of Awqaf and Islamic Affairs, the centre provides practical tools and solutions to help enhance the Islamic economy and better establish its presence in wider society. The centre hosts workshops aimed at enhancing economic thought from a Sharia-compliant perspective.

IMF-Middle East Center for Economics and Finance (CEF)



Kuwait funds and hosts the Middle East Center for Economics and Finance, which is run by the International Monetary Fund with a remit to

strengthen the design and implementation of economic policies in the Arab world.

Launched in 2011, CEF stages conferences, symposia and seminars, providing hands-on training for policymakers, and many of its courses are focused on Islamic finance and banking.

Among its many initiatives, the centre runs the MENA-OECD Competitiveness Programme.

CEF's aim is to build capacity through hands-on training for policymakers in Arab League countries. The IMF serves as the principle trainer for economics and finance, while training in other disciplines is provided by bodies such as the Organization for Economic Cooperation and Development (OECD), the World Bank Group (WBG), and the World Trade Organization (WTO).

The CEF also partners with the Arab Monetary Fund (AMF) to deliver training in Abu Dhabi and elsewhere in the Arab world, and with Bank Al-Maghrib for training in Morocco.

This year, CEF will stage about 50 specialist training courses covering myriad subjects including Strengthening Regulation and Supervision of Islamic Banks, Risk-Based Banking Supervision, and Macro-Stress Testing.

In 2018, 8,784 people participated in CEF courses, up from 266 in 2011, its launch year. Roughly one-third of participants are from the six-member Gulf Cooperation Council (GCC), with remainder from the rest of the Arab world.

Kuwait Economic Researcher Award



Launched in 2017-2018, the award aims to support and expand scientific research in finance, economics and banking. It was jointly created by the CBK and Kuwaiti banks and drafted by Kuwait's Institute of Banking Studies. The winner will receive KD10,000 (\$33,200) for the best contribution to the Kuwaiti banking and financial sectors through innovative studies.

Capacity Building

Without skilled and educated executives, experts and scholars, Islamic finance will struggle to realise its full potential, so the CBK has created several programs to build capacity within the industry:

Harvard Business School Executive Education programs



For a ninth consecutive year, Kuwait's Institute of Banking Studies has worked with world-renowned Harvard Business School to run an executive education program for banking and finance executives in the GCC. This year's six-day event in Dubai, entitled "Leading Strategy Execution in Financial Services", consisted of two integrated themes: *Strategic Management and Leadership*. Delegates were from middle/upper management.

The program is one of the strategic developmental projects organised by the IBS and aims to expand the skills of the Kuwait and wider Gulf workforces using Harvard Business School's globally revered case studies.

Participants receive a Harvard Business School certificate, verifying that they have completed the program.

Kuwait Graduate Development Program (KGDP)



This CBK initiative was launched in 2009-2010 to ultimately place Kuwait's brightest university graduates within the country's banks. On the one-year program, graduates are trained and prepared for a fast-tracked, high-flying career at their respective banks.

The London Institute of Banking & Finance, one of the most prestigious international institutions in its field, has accredited the Kuwait Graduate Development Program, giving the scheme its highest recognition of "Trusted Partner Agreement". Such a designation is only awarded to organisations that use the latest training methods and professional techniques.

The main components include in-class training and e-learning, plus local and international field training, which takes place at domestic and global banks and enables students to put into practice what they've learned in class.

Scholarship Programs



The CBK partners with Kuwaiti banks to provide Kuwaiti graduates with annual scholarships for a masters' degree level MBA/MSc in Business, Finance, Accounting and Management at some of the world's best universities. By so doing, the banks are helping expand Kuwait's qualified workforce, who will in turn make a significant contribution to the country's prosperity and economic growth. Scholarship graduates are under no obligation as to where they will work after finishing their studies. Kuwait's Institute of Banking Studies implements, monitors and supervises the scholarship program.

Bank Training Program



In collaboration with the Manpower & Government Restructuring Program, the Institute of Banking Studies runs a scheme to train Kuwaiti university graduates in banking. IBS runs the theoretical part of the program, while Sharia-compliant Boubyan Bank is in charge of the practical training. Together these have enabled 100% of participants to subsequently find employment in Kuwait's banking sector, demonstrating the quality of the preparation and implementation of the training program.

Islamic Banking Courses



Among the many other initiatives provided by the IBS, it also assists Islamic banks with the implementation of the Shariah Supervisory Governance for Kuwaiti Islamic Banks instructions, which the CBK issued in December 2016.

IBS has launched two new Islamic banking certification programs: Certified Islamic Specialist in Sharia Auditing (CISSA), delivered by the General Council for Islamic Banks and Financial Institutions (CIBAFI), and the Certified Shari'a Adviser and Auditor (CSAA), provided by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI).



EXECUTIVE INSIGHTS

Al Rajhi Bank



**Abdullah Bin Sulaiman
Bin Abdulaziz Al Rajhi**
Chairman
Al Rajhi Bank

1. As one of the largest Islamic banks in the world in terms of assets, Al Rajhi has been very selective in its global expansion, with operations in only three countries outside of Saudi Arabia. What opportunities attracted you to expand your business into Kuwait?

When Kuwait launched its 2035 vision, Al Rajhi also set out to expand in Kuwait, making us the first foreign Islamic bank and retail bank in Kuwait. In line with the vision, the government has been working towards attracting foreign investors to help drive sustainable economic development. The depth of the local economy and aim to transform Kuwait into a financial hub is expected to continue attracting investments across a broad range of sectors.

The country-integrated ventures and strong cooperation between Kingdom of Saudi Arabia and Kuwait help drive the rapid movement of trade and capital assets between both countries. It also important to note that the government's efforts in regulating the sector to maintain balanced development and further encourage foreign investors has been an important contributor to the growth.

2. As a global Islamic bank, how do you describe the development of the Islamic finance industry in Kuwait?

The Islamic finance sector is on a growth trajectory, and is undergoing rapid development — not only in Kuwait, but around the world. This was one of the key motivators for us to open our second branch in Jahra in 2017, and it earned us the recognition as the first foreign bank to do

so in the region. Consumers and investors are moving towards a principled Islamic finance solution to manage their investments.

Kuwait's Islamic banking industry has also grown rapidly and become an important part of the domestic and global Islamic financial system. The country operates a dual banking system where Islamic and conventional financial institutions co-exist. According to the IMF, Kuwait's Islamic financial services sector is now the fifth largest market in terms of Sharia-compliant assets.

3. In your opinion, what are the key steps that need to be implemented by different stakeholders, including yourselves, to support the continued development of the Islamic finance industry in Kuwait?

Kuwait benefits from a strong banking sector, which represents a major pillar in the country's economic infrastructure. In line with the country's economic vision, a number of areas are required to continue driving the development of the Islamic finance industry, including: 1) establishment of a centralised Islamic finance hub in the region; 2) driving a central Islamic liquidity solutions centre, and 3) embracing robust digital banking innovation aligned with consumers' requirements. Al Rajhi is constantly seeking to further develop our products and services. Recent examples include centralised blockchain technology, robotics and automated kiosks to provide our customers with market-leading innovative solutions.

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ISLAMIC FINANCE IN KUWAIT
BROADENING HORIZONS