Islamic banking and finance in Kuwait is now systemically important in the domestic financial market as well as in the global Islamic finance landscape. Kuwait operates a dual system where Islamic financial institutions and conventional banks co-exist. Over the years, Islamic banking has constituted a major component of Kuwait’s national banking and of the overall financial system. Unlike other jurisdictions, Kuwait is home to Islamic banks that have cross border operations and/or conglomerate structures that include both financial and non-financial corporates as subsidiaries or associates.
SNAPSHOT OF ISLAMIC FINANCE IN KUWAIT

GDP (2015)
US$ 114 BILLION

Population
3.9 MILLION

Economic Growth
2%

Number of Islamic Banks
6

Largest Islamic Bank
Kuwait Finance House
Branches 65 (LOCAL)
Assets KWD 16.5 BILLION

Ahli United Bank Kuwait
Assets KWD 3.7 BILLION

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KUWAIT:
A KEY PLAYER WITHIN THE GLOBAL ISLAMIC FINANCE INDUSTRY

Islamic banking and finance in Kuwait is now systemically important in the domestic financial market as well as in the global Islamic finance landscape. Kuwait operates a dual system where Islamic financial institutions and conventional banks co-exist. Over the years, Islamic banking has constituted a major component of Kuwait’s national banking and of the overall financial system. Unlike other jurisdictions, Kuwait is home to Islamic banks that have cross border operations and/or conglomerate structures that include both financial and non-financial corporates as subsidiaries or associates. For example, the biggest Islamic bank in the country, Kuwait Finance House (KFH), has 16 subsidiaries that span across banking, investment companies, real estate development, infrastructure and industrial developments, computers, aircraft leasing and management consultancy. It also has substantial cross border banking operations in Turkey, Malaysia, and Bahrain.1

Economy of Kuwait

Like so many other countries in the Middle East, Kuwait’s economy is based heavily on its energy sector, particularly crude oil production. Oil and petroleum account for almost 50% of the gross domestic product (GDP), 95% of export revenues, and 80% of government income. However, Kuwait’s large sovereign wealth fund, significant financial reserves, scope to borrow and negative net debt leaves Kuwait in a better position than its regional partners to cope with the plunging oil prices since the first half of 2014. The government ran its first deficit in 17 years with revenues declined by 45% in 2016.

The Kuwaiti government has started focussing on economic reforms aimed at increasing foreign investment, supporting economic diversification and reducing state subsidies. In 2016, the government approved several reforms in an effort to reduce the fiscal deficit and address other imbalances in the economy in the medium term. These included cutting subsidies and

the introduction of a corporate income tax and a value added tax (VAT). The National Assembly also approved increases in electricity tariffs to take effect in September 2017. At present, electricity and water subsidies constituted over half of the subsidy bill. As a measure to broaden its tax base, the government has proposed a 10% corporate income tax on local and foreign companies, which is expected to replace existing taxes on corporate earnings.

In a bid to diversify its national economy away from dependence on oil revenues, the government launched the country’s long term development plan early this year, dubbed as ‘New Kuwait’. This new strategy sets out to transform the country into a regional financial and cultural hub by 2035 through 164 strategic development programmes. The transformation plans aim to attract investments with the private sector leading economic activities. Other short-to medium-term objectives include to increase foreign direct investment by 300%, positioning Kuwait as a global hub for petrochemicals industry, and develop the tourism sector to generate additional revenue streams and create a new jobs market. This new plan also calls for restructuring the population composition such that 40% of the total population consists of Kuwaiti citizens instead of the current 32%.

Regulations Governing Islamic Banking and Finance

Kuwait’s involvement in developing Islamic banking and finance can be dated back to the early 1970s, when Kuwait played a key organising role in establishing the Organisation of Islamic Cooperation (OIC). Under this body, the government of Kuwait organised and hosted a number of international conferences on the topic of Shari’a-compliant finance throughout the 1970s. Islamic banking and finance in Kuwait started with the establishment of the country’s maiden full-fledged Islamic bank, Kuwait Finance House (KFH) in 1977, which continued to be the sole Islamic bank in the country for the subsequent few decades. The law providing for the establishment of the Central Bank and regulating the banking system was passed in 1968. However, KFH was set up under a special decree of the ruling emir at that time and hence, KFH did not come under the regulatory purview of the Central Bank of Kuwait (CBK).

The Central Bank Law No. 32 of 1968 was later amended in 2003 placing KFH under CBK. In addition, the law included a new section specific to Islamic banks, which provided for the Islamic banking regulatory and supervisory framework and sets the requirement for Shari’a governance framework. Although Kuwait’s Islamic banking regulation is only a part of its regulatory framework for conventional banks and financial institutions, it has comparable detail on Islamic financial issues.\footnote{Wilson, Rodney. “Shari’a Governance for Islamic Financial Institutions.” ISRA International Journal of Islamic Finance 1 (2009): 61-70.} There is no central Shari’a board set up by the financial regulator, but the law provides for referring the disputes to the Fatwa Board of the Ministry of Awqaf and Islamic Affairs, whose decision is binding on the disputing parties.

Takaful companies (including conventional insurance companies) are regulated by the Ministry of Commerce and Industry in accordance with Law No 24 of 1961 (Kuwait insurance law). The law provides little recognition of or provision for takaful as a distinctive type of insurance. A number of changes have been made since 2011 to the existing insurance law, which also include plans to create an independent regulator for the industry as well as plans
to include specific sections within the law to cater for takaful. Despite what may seem to be a positive development in the insurance sector, the Kuwait’s Ministry of Commerce and Industry had recently rejected a proposal to establish a separate body to oversee the industry.³

The lack of a specialised legal framework for sukuk has been a key factor in the limited issuance of sukuk in Kuwait. Coupled with two defaults on Kuwaiti corporate sukuk during the global financial crisis in 2009-2010, many investors became wary of new issuance without a legal basis for sukuk issuance in the country. Recognising this, the Capital Markets Authority (CMA) of Kuwait issued new regulations on sukuk in November 2015, which many observers believed would be a significant step in reinvigorating Kuwait’s sukuk market and opening the door for issuance by corporations. The rules outlined conditions that sukuk must meet to be tradeable, and described specific formats such as instruments with perpetual tenors and those which can be converted into shares. Sukuk issuance must be approved by both the CMA and CBK, according to the rules, which set out the obligations and powers of custodians of the instruments. The CMA Law amended the Kuwaiti Companies Law 10/2012 by cancelling Articles 178 to 207 of the Companies Law and effectively removed restrictions on the size of sukuk issuance and provided greater clarity on sukuk issuance with regards to structuring and governance.

**Shari’a Governance Framework**

The Shari’a governance practice in Kuwait is regulated by virtue of Article 93 of the CBK Law, which provides a legal basis for the regulations of the Shari’a board. Article 93 requires all Islamic financial institutions to establish an independent Shari’a board, which shall be appointed by the bank’s General Assembly. Unlike other Shari’a governance approaches that allow the appointment of Shari’a board by the Board of Director (BOD), Article 93 specifically requires the appointment to be made only by the General Assembly. In terms of its composition, the CBL Law puts a condition of a minimum of three members, which is similar with the AAOIFI governance standard. Islamic financial institutions are also required to mention the establishment of the Shari’a board in their articles and memorandum of association and both documents must specify the powers, workings and governance of the Shari’a board.

There is no Shari’a board in the CBK to act as the highest Shari’a authority in all matters related to Islamic banking and finance. This may raise an issue of dispute settlement in case of conflict of opinions amongst members of the Shari’a board. Hence, to address this issue the CBK Law recognises the Fatwa Board in the Ministry of Awqaf and Islamic Affairs as the final authority for any Shari’a disputes involving Islamic banking and business. The BOD of the Islamic financial institutions has the responsibility to refer such dispute to the Fatwa Board. The CBK Law nevertheless is silent about the status of decision of the Fatwa Board in which it should be made binding to all Islamic financial institutions. Interestingly, Article 100 of the CBK Law clearly provides the supremacy of Islamic law where it states that Islamic financial institutions shall be subject to the provision of the CBK Law but subject to the Shari’a principles. This is a strong legal proviso which placed Shari’a as the supreme law in relation with Islamic banking and finance in Kuwait. As regard to the reporting structure, the Shari’a board has the duty to submit a Shari’a report to the bank’s General Assembly since they are also appointed by the AGM. The CBK Law specifies the content of Shari’a report to contain the Shari’a opinion on the Islamic banks’ operations in terms of Shari’a compliance including comments and views upon the Shari’a issues. This Shari’a report must be included in their annual report.

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In December 2016, the CBK issued instructions on “Shari‘a Supervisory Governance for Kuwaiti Islamic Banks”, which replaces the CBK’s instructions regarding “Rules and Conditions for the Appointment and Responsibilities of the Shari‘a Supervisory Board in Islamic Banks” issued in 2003 and complement the instructions related to “Rules & Standards of Corporate Governance in Kuwaiti Banks” issued in 2012. The new instructions are to take effect on January 1, 2018; and Islamic banks in the country are given until December 31st, 2017 to fulfil the requirements as per the instructions. The requirements include principles of Shari‘a supervision governance including oversight, accountability and responsibility, roles of the board of directors, executive management and Shari‘a supervisory board, independence requirements, “Fit and Proper” requirements for the board members, and internal and external Shari‘a auditing, including the scope and objectives of the audit, and the qualifications required of Shari‘a auditors. Islamic banks will also be required to provide the CBK with a quarterly report including policies, procedures and actions taken to comply with the instructions.

Islamic Banking and Finance

At present there are six Islamic banks – 5 Kuwaiti banks and one foreign bank, with a combined market share of 44% of the domestic banking industry, coming only second after Saudi Arabia, which has the largest market for Islamic banking in the GCC. Commercial Bank of Kuwait – a conventional bank, announced in 2014 that it plans to convert into a full-fledged Islamic bank. But this has yet to materialise. The bank’s decision follows the footsteps of Boubyan Bank, Ahli United Bank Kuwait (AUB) and Kuwait International Bank (KIB) in converting from a conventional lender. Kuwait also has one of the largest Islamic banking penetration rates in the GCC at 46%.

In 2016, there have been some downward pressures in the growth rates as Kuwait’s Islamic banking industry experienced contractions in both total deposits and financing (Figure 1). Islamic banking assets have shown steady growth in recent years, but at a declining rate and recorded a compounded annual growth rate (CAGR) of around 5% from 2012 to 2016. A similar trend was observed for Islamic banking deposits. Total deposits of Islamic banks reached KWD21.5 billion by end of 2016 while total financing was KWD15 billion.

Financing items, which are mainly concentrated in real estate, personal loans and inter-bank lending, accounted for between 50% and 70% of the total assets of banks. Majority of these transactions are in the form of murabaha and wakala transactions, followed by ijara and to a limited degree istisna transactions. Similar to Islamic banks in other jurisdictions where Islamic banking is prominent, the share of equity and other partnership-based instruments such as musharaka and mudaraba is negligible on the banks’ balance sheets.

The KFH remains the largest Islamic bank in Kuwait with the bank’s assets totalling KWD16.5 billion and deposits of KWD10.7 billion as at 31 December 2016 (Figure 2). By end of 2016, KFH holds about 62% of the Islamic banking market share in Kuwait and 27% of the overall banking system. The Islamic banking market share of the second largest Islamic bank, Ahli United Bank Kuwait, stands at 14% followed by Boubyan Bank with 13%. Warba Bank is the smallest Islamic bank in Kuwait in terms of assets, but has the highest CAGR rate amongst its peers. For the last five years to end-2016, Warba Bank’s total assets grew at a CAGR rate of 38% to reach KWD1.13 billion.

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4. Boubyan Bank was established through a royal decree in 2004 and was initially owned by the Kuwait Investment Authority. Since then National Bank of Kuwait has acquired just over 58% of shares of Boubyan Bank and Commercial Bank of Kuwait holds about 11.6%.

5. Warba Bank is a government-owned institution and was established by a royal decree in 2010.
Similarly, the bank’s total deposits grew at a CAGR rate of 57% to reach KWD750 million in 2016. As the largest bank in Kuwait, KFH topped the list of Islamic banks in terms of net profit in 2016, earning KWD165.2 million. Boubyan Bank was in second position with KWD41.1 million of net profit and followed closely by AUB with net profit of KWD40 million. In recent years, some conventional banks have been expanding into the Islamic sector by buying stakes in Islamic financial institutions. The National Bank of Kuwait, for example, has a 58% stake in Boubyan Bank, while Commercial Bank of Kuwait holds a further 11.6% of Boubyan.

Figure 1: ISLAMIC BANKING ASSETS, DEPOSITS AND FINANCING (KWD MILLIONS)

Source: Boursa Kuwait, Various Annual Reports

Figure 3: NET PROFIT OF ISLAMIC BANKS (KWD MILLION)

Source: Boursa Kuwait, Various Annual Reports
Figure 2: 
FINANCIAL PERFORMANCE OF ISLAMIC BANKS 2012 – 2016 (KWD MILLION)

Source: Boursa Kuwait, Various Annual Reports
**Takaful Industry**

Within the GCC countries, Kuwait has the lowest takaful penetration rate of less than one percent. There are 12 takaful and retakaful companies in Kuwait with Boubyan Takaful Insurance as the largest takaful insurer in the country and number five within the overall Kuwaiti insurance market. Boubyan Takaful Insurance holds a market share of about 4.7% in 2015 and recorded gross premiums written of KWD15.4 million, which represents a 7.8% growth in its premiums from KWD12.0 million in the previous year. With an overall market share of 3.6%, KFH Takaful is ranked as the second largest takaful and the sixth largest overall insurer in Kuwait. In 2016, the first retakaful company, Al Fajer Retakaful Insurance, was set up while the Arab Islamic Takaful was launched in December of the same year.

Takaful industry’s total assets have grown steadily from US$121 million in 2012 to US$186 million in 2015 (Figure 4) and maintained modest growth rates with a CAGR of 11.35% from 2012 to 2015. In recent years, Kuwait’s gross takaful contributions have continued to grow, rising from US$128 million in 2009 to an estimated US$208 million in 2014.6 Going forward, the next few years may be challenging for takaful companies as they face pricing pressure driven by the over competitive market. Intense competition within the industry has eroded profitability relative to the conventional insurance sector and led to stagnant growth and persistent losses for many takaful companies in Kuwait.

Lack of an independent regulatory framework remains a key challenge for the Kuwaiti takaful sector. The government has been in talks of introducing a new, independent insurance regulator since 2012, when a draft insurance law was put into circulation. The draft legislation reportedly features a separate set of rules and regulations for takaful operators. The law was initially set to come into effect in early 2015 but was later postponed to an undetermined date. Another challenge facing the sector is the limited access to lucrative contracts from the oil sector as regulations require companies to be listed on the local bourse to bid for such businesses. This requirement is only met by two takaful companies – First Takaful Insurance and Wethaq Takaful. However, in the case that takaful companies can bid for such businesses, they lack the backing of a large retakaful industry to spread the risks.

**Figure 4:**

**TAKAFUL ASSETS (US$ MILLION)**

Source: Thompson Reuters

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6. The most recent data available at the time of this publication.
Islamic Funds

There are presently 43 Shari’a-compliant investment companies with assets under management (AuM) totalling KWD4.3 billion as at January 2017. Many Islamic investment companies are subsidiaries of large groups and banks in Kuwait. The number of registered companies surpassed conventional investment companies (Figure 5) but the volume of AuM was less than that of the conventional companies except for 2016 where total assets held by Islamic investment companies was KWD4.4 billion compared to KWD3.7 billion held by conventional companies (Figure 6). The AuM of Islamic investment companies registered a CAGR of 3.6% from 2012 to 2016.

As of the 13th September 2011, the responsibility of the oversight and supervision of investment funds was transferred from the CBK to the CMA in accordance with Law No 7 of 2010 concerning the establishment of the CMA and the Regulation of Securities’ Activity. With this move, CBK’s role is mainly confined to the supervision of their practiced financial activities only, while the CMA regulates all aspects and matters relating to investment funds, whether locally established or foreign funds to include marketing of the funds and the offering and sale of units.\(^7\) The Capital Market Law (CML) does not specify any distinct rules for Islamic funds but references are made in the bylaws. Although the procedures for establishing Islamic funds are the same as conventional investment funds, Islamic funds are subject to another layer of internal approval by the CMA as Islamic fund applications are referred to the “Advisory Council for Shari’ah Supervision”. The Council was established by CMA to be the “reference in all matters related to the Authority’s resolution in Shari’a-compliant activity”.

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Sukuk Market

The sukuk market in Kuwait is still hindered by the lack of a specific legal framework, shortage of expertise in structuring sukuk, and the absence of government sukuk. Corporate sukuk issuance has also been limited due to the sector’s heavy reliance on bank lending, helped by strong liquidity; which has resulted in the almost complete absence of corporate sukuk issuance in 2014 and 2015. In fact, Kuwait is the only GCC domicile that did not witness any sukuk issuance in 2015. The implementation of the new sukuk bylaws which became effective in November 2015, have had tangible results. In 2016, two sukuk worth US$450 million were issued in Kuwait by Islamic commercial banks like Ahli United Bank and Boubyan Bank. These were the first publicly listed sukuk by local corporates since 2007. In February 2017, a US$500 million sukuk with a 7 year tenor was issued by Equate 2024.

Before the global financial crisis, sukuk issuance increased substantially to record a high of US$945 million worth of total sukuk issued in Kuwait in 2007 (Figure 7). However, the global crisis caused a severe impact on the country’s financial market, resulting in several institutions defaulting on their ongoing sukuk obligations. This had subsequently resulted in a virtual suspension of any new sukuk issuance in 2009 and 2010. Although, sukuk issuance picked up again in 2011, the Arab Spring had largely affected investor’s confidence, which is reflected in the subsequent years as the sukuk market witnessed a declined in new issuance.

Conclusion

Islamic banking and finance in Kuwait is poised for continued growth after weathering the global financial crisis, two sukuk defaults - Investment Dar and International Investment Group, and a difficult period linked to the broader economic volatility that has impacted the Gulf region in recent years. A reliance on oil revenues in the economy at large and real estate and equity throughout the financial industry is considered a key issue for financial institutions operating in Kuwait. However, with a raft of large-scale, government-led development projects on the docket, rising retail deposits and strong support from regulators and other authorities, the industry is set for tremendous growth over the coming years.