

# IFN FORUM

KUWAIT

2017

#IFNKuwait17

## POST-FORUM ANALYSIS REPORT



19<sup>th</sup> November 2017

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## Kuwait: The unsung success story of Islamic finance?

**With the fifth-largest share of Islamic banking assets and the sixth-largest share of Islamic funds in the world, Kuwait has succeeded in growing its Islamic finance market share to 39%, according to the latest data from the IFSB. So what, asks LAUREN MCAUGHTRY, has this quiet success story achieved to outpace its flashier fellows?**

The latest figures from the IFSB show that just four countries in the world have a market share for Islamic finance of over 50% — including Iran and Sudan at 100%, Brunei at 57% and Saudi Arabia at 51%. After these countries however, Kuwait stands tall with 39% — compared to 26.6% for Qatar, 23.8% for Malaysia and 19.6% for the UAE. So how has Kuwait achieved this success, and what does this mean for its position in the regional and global Islamic financial market?

### **Banking strength**

The first and foremost driver of Kuwait's success is its strength in terms of systemically important Islamic banks. From just four local banks in 1994, Kuwait now has 11 of which six are Shariah compliant, compared to just one out of 12 branches of foreign banks, making its domestic banking system strongly biased toward Shariah finance. The largest Islamic bank in Kuwait, Kuwait Finance House accounts for 23% of the total banking system and over 70% of Islamic banking assets, with substantial cross-sector and cross-border operations.

However, the Islamic system has attracted even conventional players to the fold. In 2010 for example, Ahli United Bank (AUB) (formerly Bank of Kuwait and Middle East) converted to a fully Shariah operation. Since then, the bank has seen net profit grow by 186% from KWD14 million (US\$46.13 million) in 2009 to KWD40 million (US\$131.8 million) in 2016, along with a 63% growth in total assets (from KWD2.26 billion (US\$7.45 billion) to KWD3.69 billion (US\$12.16 billion)) and a 61% growth in total deposits (from KWD1.99 billion (US\$6.56 billion) to KWD3.19 billion (US\$10.51 billion)) over the same period — demonstrating the strength and success of its strategic move.

"Increasing market demand for Islamic finance products and the risk-averse nature of Islamic banking motivated the bank to convert to a fully Shariah compliant Islamic bank," explained AUB CEO Richard Groves. "Kuwait has a majority Muslim population, which shows a preference for Shariah compliant products, resulting in a higher degree of acceptability and awareness of Islamic finance products within Kuwait. The risk structure of Islamic finance products and the survival of most Islamic financial institutions through the 2009 financial crisis also motivated new players to enter the Islamic finance market or convert from an existing institution to a Shariah compliant structure."

Additionally, the implementation of the National Development Plan has led to the awarding of contracts and allocation of a significant share of new project financing to Islamic banks by the government of Kuwait, which has further supported the growth of the Islamic banking industry.

### **Regulatory support**

In December 2016, the Central Bank of Kuwait (CBK) also issued new rules concerning the internal and external oversight of Shariah compliant lenders, to be implemented by 2018. "The regulatory authorities have enacted several changes to improve governance standards in Shariah compliant financial services in the country," noted Raghu Mandagolathur, the head of research at Kuwait Financial Center (Markaz). "These changes are promoting the growth of a more transparent and accountable industry."

“The government of Kuwait is extending its full support to the Islamic finance sector, evidenced by the separate rules and regulations and governance structure for Islamic financial institutions and government support for conversions,” agreed Groves. “[The] CBK has also developed separate rules such as a Shariah governance structure which we hope will assist in further enhancing customer confidence on Shariah compliant products. [The] CBK has provided further assistance by creating Murabahah products to accept and absorb the liquidity available in the Islamic banking sector and serve cash reserve needs.”

## **Grass roots growth**

But this maturity would not be possible without consumer demand from the ground up, and it is this that has driven the growth of the industry. “A large proportion of Kuwaitis will only use Shariah compliant banking, both for their deposits and their financing, and this demand has only increased over time,” confirmed Alex Saleh, a partner with Al Tamimi. “Any significant deal we see will usually have a conventional and an Islamic tranche, because the clients demand it.”

Although banking operations are the main source of income for Kuwait’s Islamic banks (contributing over 60% as of 2016), investment activities are growing and since the financial regulator released new rules covering the issuance of Islamic bonds back in 2015, the private sector has gradually been gaining momentum in the debt capital market. Financial institutions have led the way — with Tier 1 Sukuk issued by Boubyan Bank, Warba Bank and AUB in 2016.

However, the corporate market is gradually picking up the pace, and the Sukuk market is gaining in maturity and sophistication. Sukuk sales of around US\$700 million have been approved since the new Sukuk framework was enacted in 2015, while according to the Capital Markets Authority (CMA), the country currently has around US\$2 billion-worth of bonds and Sukuk in the pipeline.

“The Sukuk market is emerging in Kuwait and issuers are increasingly using Sukuk deals as [a] capital management tool, especially the financial institutions in order to comply with CBK regulatory limits like Basel III ratios and concentration limits,” said Groves. But corporates outside of the financial sector are also starting to consider the use of Sukuk. For example, IFN has learned that National Real Estate Company plans to issue a US\$500 million Sukuk facility this year to help fund new projects and refinance existing debt.

“Islamic structures are becoming standard with the passage of time,” said Groves. “However, more creative but strictly Shariah compliant financial products need to be introduced in the market.”

And development is not moving as fast as expected. “We have done a few small Sukuk issuances that have not been listed, but in terms of larger Sukuk, outside the bank issuances the market has been a bit slow. Corporates are raising money, but it has mostly been through traditional bank lending. We might see a couple of offerings this year, as the market improves,” noted Alex. “The challenge on larger transactions is finding good scholars to issue Fatwas. As our deals become more complex and more sophisticated, there is a need to bridge the distance between Shariah scholars and lawyers in terms of understanding how these deals work.”

## **Corporate cooperation**

While Sukuk remain a slow burner, other forms of financing are proving more popular — in particular securitization and structured finance. “Shariah compliant corporate finance is just as strong as the conventional now,” confirmed Alex. “We now do more Shariah compliant securitization of receivables than on the conventional side. We have developed new models for this that I do not believe are being used in other countries yet.”

Kuwait’s corporate sector has a high volume of consumer receivables (such as auto leases and small corporate loans) to the point where investment companies reach their limit in terms of lending or leasing. They then need to off-sell these in terms of securitization — but as many of these firms are Shariah compliant, they cannot buy or sell debt.

“Using the Murabahah structure, we have developed a transfer of those receivables which has proved very successful,” explained Alex. “We have had a lot of success in structured finance over the last few years, and that has been the largest growth area we have seen.”

## **Project finance push**

In comparison, the big fanfare for Kuwait’s much-vaunted public-private partnership (PPP) market has failed to translate into Islamic finance appeal. Why? Because of miscommunication, misinterpretation and misunderstanding. “The only frontier we haven’t really crossed into in Kuwait yet is Shariah compliant project finance, through the large PPP infrastructure deals,” commented Alex.

The recent PPP law in theory allows project developers and companies to own the assets of the project (which allows Islamic banks to offer a wider range of financing than just Murabahah, such as Istisnah and Ijarah, based on the assets at hand). However, the new regulatory body for PPPs, the Kuwait Authority for Partnership Projects (KAPP) has thrust yet another spanner in the works.

“In spite of our negotiations, KAPP says that the assets still belong to the government if they are on government land,” explained Alex. “This makes it harder to utilize Shariah compliant structures, so we have not proceeded as we had hoped. We are in negotiations however, and we hope to see some progress soon.”

## **Benchmark boom**

Of course, a game-changer for the Kuwaiti market would be a sovereign Sukuk issuance — something the world has long been waiting for and which has so far yet to materialize. So what is taking so long?



Kuwait made a successful debut in the international bond market in March, raising US\$8 billion from regional and international investors, which is expected to finance more than 80% of the 2017-18 budget deficit, with the remainder covered by drawing down reserves.

“Kuwait may therefore take some time to return to the debt market,” warned Raghu. “Moreover, the lack of a specialized legislative framework covering Islamic bonds made global investors wary of new Sukuk issuances. Now that the government has tested the appetite from the response received for the bond issuance, however, they are more likely to consider sovereign Sukuk issuance next.”

In fact, IFN understands that the government is already in the process of looking at sovereign issuance, which is likely to take the form of both conventional and Shariah tranches, and may take between six to 12 months to come to market.

“We believe the delay in [the] Kuwait sovereign Sukuk is due to dynamic market conditions, especially market rate volatility,” agreed Groves. “We may expect the issuance to appear in early 2018 once the volatile conditions are stabilized. We understand that the legal framework for the government to issue Sukuk is currently in the final stage and will be approved by the Kuwaiti Parliament most probably during this year.”

## Legal loophole

“The CMA has done an excellent job in terms of creating Sukuk regulation. There is very little we would want to change in that respect, and we have not seen any roadblocks in recent deals using the framework they have put in place,” emphasized Alex.

However, the market still faces challenges that must be addressed. For example, the recent Dana Gas controversy has highlighted a worrying factor. “Ultimately, we may need some long-term assistance in Kuwait to make sure the Sukuk documents are valid and enforceable from a Kuwait law perspective,” warned Alex. “Right now, they are largely silent on this point. There are the AAOIFI restrictions but these are not codified anywhere in the civil law. As the industry develops, it would be good to see more codification of Islamic regulations into the civil code.”

“We believe that there is further room for improvement in [the] Shariah supervisory structure and the Shariah monitoring structure can be further strengthened, possibly through the formation of a central shariah board and/or an audit division,” suggested Groves. “This will have a positive impact on the growth of Islamic financial institutions. In addition, the completion of the government plans to issue sovereign Sukuk will enable diversification of the investments within Kuwait and enhance profitability of the sector.”

However, there is a caveat. The cost of funding is expected to increase as the banking industry faces a liquidity crunch due to deposits withdrawal by government entities and investment in government debt by the banks.

Moreover, the US Federal Reserve’s recent rate hike, if emulated by Kuwait’s central bank, could result in deposits shifting to profit-sharing investment accounts from non-remunerated current accounts. If this happens, it could raise the cost of funding even further.

## Looking ahead

So what does the future hold for Islamic finance in Kuwait? There is no denying the opportunity, which is developing in leaps and bounds.

“I am sure the Islamic finance industry will hit 50% at some point,” predicted Alex. “More than 50% of our shareholding companies in Kuwait are Shariah compliant, both listed and unlisted. Islamic finance is always determined by preferences on a local level, and in Kuwait many people will only invest in companies that are Shariah compliant themselves. That is not going to change, and will only drive growth. All that needs to change is that advisors need to come up with more innovative products to meet that demand, and that the law keeps pace with the demand.”

“Our strategy going forward aims at increasing corporate business through further capitalizing on the Government Development Plan for the period 2015-20, tapping reputable Tier 1 contractors and multinationals pre-qualified for the mega projects, tapping medium-sized contractors with less sensitivity toward pricing within acceptable risk parameters, soliciting new business in relatively non-elastic sectors such as food, healthcare and services,” said Groves. “We expect some major changes in the Islamic finance market competition structure over the next five years due to the conversion of conventional banks to [the] Islamic structure. We will see business combinations in the form of mergers, acquisitions and alliances, along with increasing use of Islamic debt instruments in various forms and structures.”

“The government has proactively supported economic growth through measured fiscal adjustment and growth-enhancing capital expenditures. This will facilitate diversification of the Kuwaiti economy and support business opportunities in sectors such as petrochemicals, logistics, manufacturing and tourism,” predicted Raghu. “Growing appetite for Islamic finance both domestically and internationally and overall low financial penetration levels in Kuwait present opportunities for [the] Islamic finance industry.”

With systemic importance and a growing share of the overall market, it looks as if Kuwait’s Islamic banking system is in pole position to consolidate its influence and reach market dominance within the short to medium term. Could it follow in Saudi’s footsteps to become one of the first jurisdictions to top a 50% market share? We can only wait and see.

# POST-FORUM ANALYSIS REPORT



**09:40 – 10:40**

## **New Kuwait and Islamic Finance and Investment**

*Considering Kuwait's external borrowing, structural reforms and prospects for privatization in the era of global market volatility and low oil prices, key industry players discuss the future of Islamic finance, capital markets and investment in Kuwait. What opportunities could arise for the industry in the coming year?*

Moderator:

**Qasim Aslam** — Partner, Head of Islamic Finance - Middle East, Dentons

Panelists:

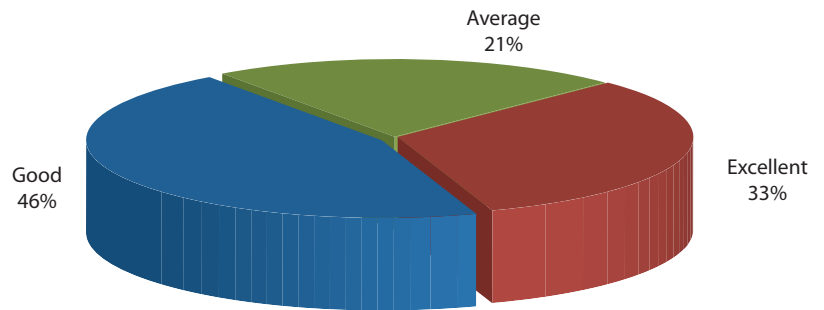
**Bashar Al-Natoor** — Global Head of Islamic Finance, FitchRatings

**Faisal Hasan** — Chief Business Development Officer, Head of Investment Research, KAMCO Investment Company

**Hossam Abdullah** — Managing Partner, Al Hossam Legal

**Tariq Alrifai** — CEO, Quorum Center for Strategic Studies, the UK

**Thuwaini Al Thuwaini** — Deputy Chief Investment Banking Officer, Investment Banking Group, Warba Bank



**10:40 – 11:10**

## **Islamic Banking Roundtable: Hastening Growth through Technology and Innovation in the GCC**

*As the global banking system embraces significant innovation, how are Islamic banks in Kuwait and the region embracing digitization and how does this influence the development and placement of banking products?*

Moderator:

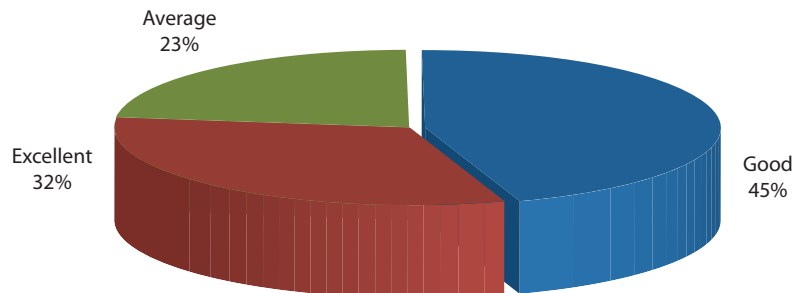
**Sanjeev Gupta** — Retail Banking Consultant and Advisor

Panelists:

**Cassim Docrat** — Director, DDCAP (DIFC)

**Mohamed Ghandour** — Group Deputy General Manager - Products, Kuwait Finance House

**Robert Hahm** — CEO, Mashreq Capital



# POST-FORUM ANALYSIS REPORT



**11:40 – 12:20**

## Opportunities for Infrastructure and Social Welfare Project Financing in Kuwait and the Region

With the launch of the New Kuwait plan and mega projects in the pipeline, we ask deal-makers to examine the role financial service providers — Islamic and conventional - can play to make these plans a reality.

Moderator:

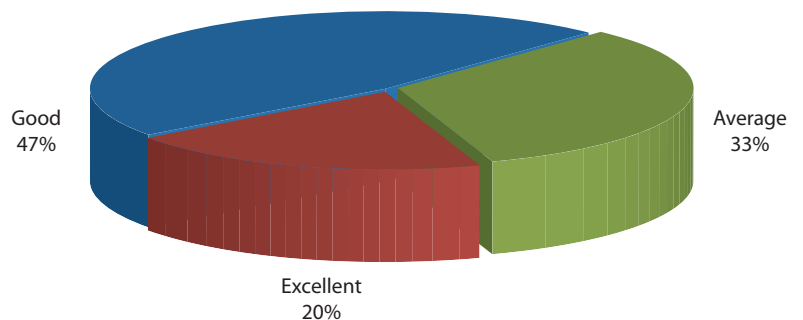
**Rajwah Al Kuhaymi** — Associate, Winston & Strawn

Panelists:

**Faisal Hijazi** — Vice-President, Relationship Management, Middle East and Islamic Finance, Moody's Investors Service

**Qasim Aslam** — Partner, Head of Islamic Finance - Middle East, Dentons

**Yusuf Chorghay** — Senior Manager, Structured and Syndicated Finance Department, Investment Banking Group, Warba Bank



**12:20 – 13:00**

## A Closer Look at Kuwait's Investment Flows and Investment Trends

While attracting inward investments is climbing up the regulatory agenda, Kuwaitis invest billions into overseas markets every year. This panel looks at local, regional and international investment flows and opportunities for the year ahead. We also examine the opportunities presented by the inclusion of Kuwait in a leading Emerging Markets Index.

Moderator:

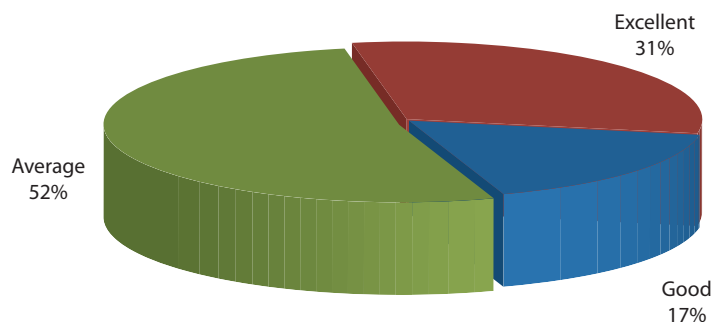
**David Testa** — Executive Director, DDCap Group

Panelists:

**Faisal Hasan** — Chief Business Development Officer, Head of Investment Research, KAMCO Investment Company

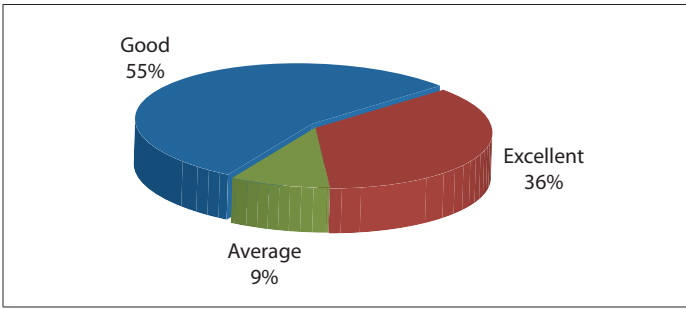
**Raghu Mandagolathur** — Head of Research, Kuwait Financial Center (Markaz)

**Umera Ali** — Partner, Michelman & Robinson

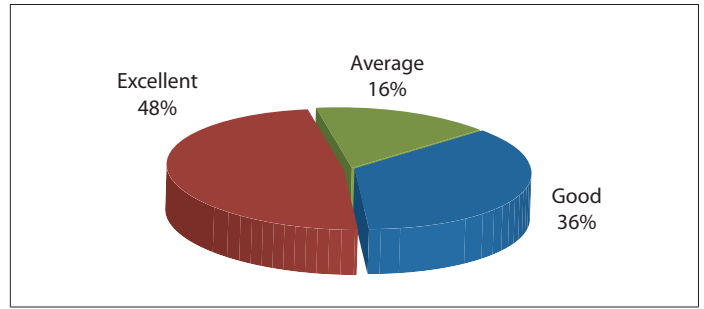


# POST-FORUM ANALYSIS REPORT

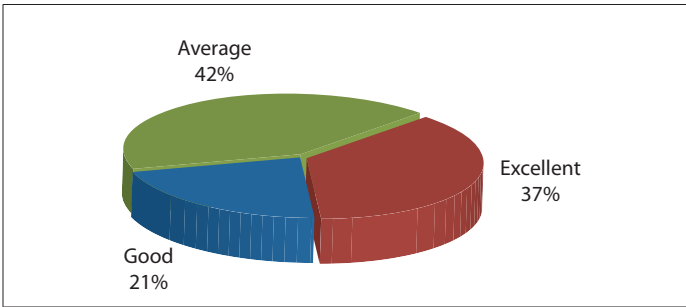
## Pre-event Contact



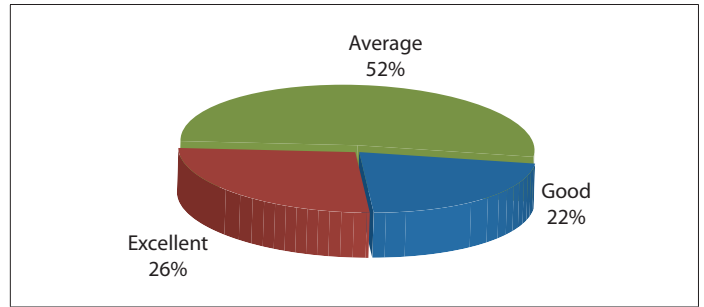
## Overall Evaluation of the Event



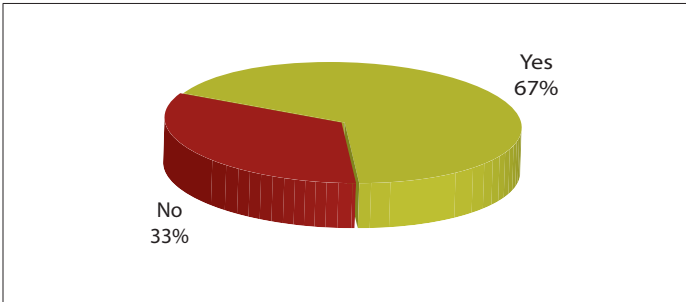
## Venue and Facilities



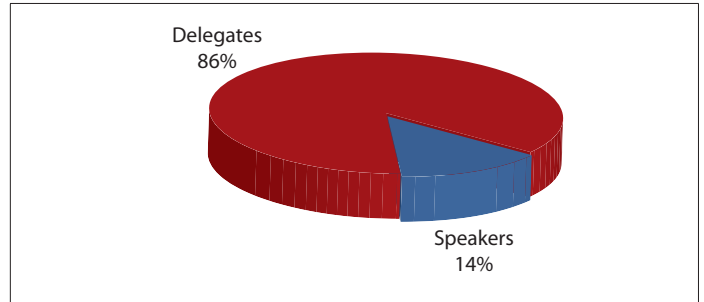
## Overall Evaluation of the Speakers



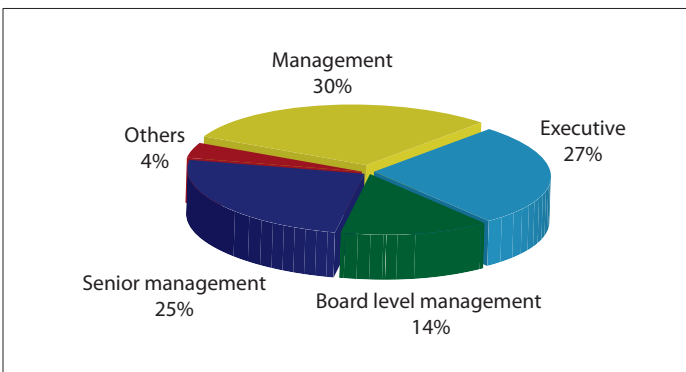
## Delegates Who Would Like to attend IFN Kuwait Forum 2018



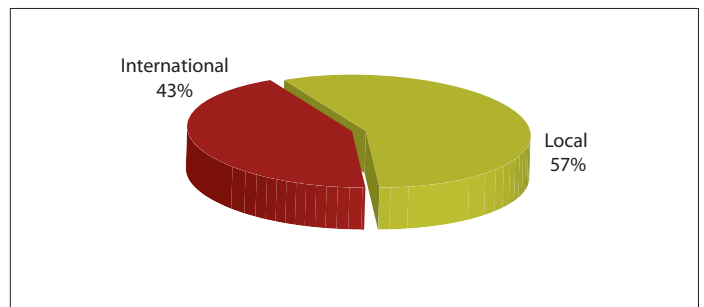
## Delegate Breakdown



## Delegate Job Title Breakdown



## Delegate Breakdown (International and local)



Board Level Management	11
Senior Management	19
Management	23
Executive	21
Others	3
<b>Total</b>	<b>77</b>



# POST-FORUM ANALYSIS REPORT





## **SPEAKERS**

<b>COMPANY</b>	<b>NAME</b>	<b>JOB TITLE</b>
<b>Al Hossam Legal</b>	<b>Hossam Abdullah</b>	Managing Partner
<b>DDCAP (DIFC)</b>	<b>Cassim Docrat</b>	Director
<b>DDCap Group</b>	<b>David Testa</b>	Executive Director
<b>Dentons</b>	<b>Qasim Aslam</b>	Partner, Head of Islamic Finance — Middle East
<b>FitchRatings</b>	<b>Bashar Al-Natoor</b>	Global Head of Islamic Finance
<b>KAMCO Investment Company</b>	<b>Faisal Hasan</b>	Chief Business Development Officer, Head of Investment Research
<b>Kuwait Finance House</b>	<b>Mohamed Ghandour</b>	Group Deputy General Manager - Products
<b>Kuwait Financial Center (Markaz)</b>	<b>Raghu Mandagolathur</b>	Head of Research
<b>Mashreq Capital</b>	<b>Robert Hahm</b>	CEO
<b>Michelman &amp; Robinson</b>	<b>Umera Ali</b>	Partner
<b>Moody's Investors Service</b>	<b>Faisal Hijazi</b>	Vice-President, Relationship Management, Middle East and Islamic Finance
<b>Quorum Center for Strategic Studies, the UK</b>	<b>Tariq Alrifai</b>	CEO
<b>Warba Bank</b>	<b>Thuwaini Al Thuwaini</b>	Deputy Chief Investment Banking Officer, Investment Banking Group
<b>Warba Bank</b>	<b>Yusuf Chorghay</b>	Senior Manager, Structured and Syndicated Finance Department, Investment Banking Group
<b>Winston &amp; Strawn</b>	<b>Rajwah Al Kuhaymi</b>	Associate
	<b>Sanjeev Gupta</b>	Retail Banking Consultant & Advisor



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## COMPANY LISTING

Abwab Capital | Ahli Capital Investment Co | Ahli United Bank | Ahmed Guxholli | Akinade Nigeria | Al Elmam International | Al-Aman Investment Company | Albisher Legal Group | Al-Hossam Legal | Alqabandi Co | Ama University Bahrain | Andalus Capital | Arendt & Medernach | Best Western | Binary Option | Bloom Business Strategies Fze | Capedge Overseas Dmcc | Capita World Me | Capital Markets Authority | Colony Northstar | Commercial Bank of Kuwait | Crestbridge Bahrain | DDCAP (DIFC) | DDCap Group | Dentons | Dhaka Bank | Digitcare Technologies | Dimah Capital | Dux Capital | Ejarah Global | El Soor Fuel | Emirates Islamic Bank | Enertech Holding Company | Enrich Management Consulting | Export and Import Company | Fahad Bou Saleh Est | Fitch Learning | FitchRatings | Foot Anstey | Gatehouse Capital | Global Resolution | Great Bourses | Gulf Associates | Gulf Union Economic Forum | Hassan Légal | Hogan Lovells (Middle East) | Holman Fenwick Willan | International Advocates | International Legal Group | Irfan Chattha Law Associates | Islamic University Ghana | K&L Gates | KAMCO Investment Company | Kbcorp | KFH Capital | KFH Capital Investment | King Abdulaziz University | Kufpec | Kuwait Financial Center (Markaz) | Kuwait University | Maples and Calder | Maples Fund Services | Mashreq Bank | Mashreq Capital | Michelman & Robinson | Ministry of Man Power Public | Moody's Investors Service | Nexus Financial Services | Oxford Business Group | Prince Satam University | Quorum Center for Strategic Studies, the UK | Raqaba | S K Kalra & Associates | Sariibrahimoglu Law Office | SAS Asset Recovery | Shariyah Review Bureau | Somali National University | The Business Year | The Investment Dar Company | The Redemption Health Foundation | Tufton Oceanic Middle East | Universal Group Company | US Embassy | Volaw Group | Warba Bank | Warwickstone Capital | Winston & Strawn