Kuwait has witnessed phenomenal changes over the past few years, especially in terms of legislation. The establishment of the Capital Markets Authority (CMA) in 2010 and the introduction of the new Companies Law in 2013 are just some of the actions that have contributed to building a solid foundation for the financial services industry to flourish. The Islamic sector has certainly benefited from this progress but, as LAUREN MCAUGHTRY discovers, it is not all plain sailing.

Optimistic environment

There is no question that the Kuwaiti banking sector has thrived on the back of strong government support, and is expected to deliver a robust performance this year in the middle of regional economic gloom and despite the oil price problems and commodity volatility. Sustained levels of government spending have kept the system stable, while huge reserves (estimated at around US$600 billion) and relatively low debt levels drive continued growth. The IMF estimates that Kuwait’s GDP will grow by around 3% in 2016 despite the drop in oil prices, while non-oil GDP is expected to rise by over 3% in 2016-17 compared with just 1.3% in 2015, as the state investment program gains momentum and a record number of projects provide business opportunities for the banking sector.

“Spending by the Kuwaiti government, even as oil prices stay low, will maintain growth momentum and support operating conditions for the country’s banks. Execution of the government’s new five-year development plan will drive new business for banks, while domestic consumption will remain strong, supporting our projections of [a] 7% credit growth,” said Alexios Philippides, an assistant vice-president at Moody’s.

With Islamic banks now accounting for six out of the country’s 11 institutions, this is good news for the sector — which has grown and diversified in recent years to break away from the former monopoly held by KFH. “Islamic finance has always maintained prominence in Kuwait, during market and economic ups and downs, and today is no different,” said Tariq Al-Rifai, CEO of the Quorum Center for Strategic Studies. “Competition among Islamic banks has become fierce.”

The retail segment dominates the market with loans growing by double digits in 2016. In particular, smaller banks such as Warba and Boubyan are making waves — Boubyan posted a strong profit growth of KWD29.7 million (US$97.9 million) for the first nine months of the year, and a growth rate of 18%. “The Islamic banks, as with all the banking sector in Kuwait, are doing extremely well and are very liquid,” confirmed Issam Al Tawari, the managing director of Newbury Economic Consultancy.

Cause for concern

Yet challenges still remain, particularly in the form of low oil prices — which have reduced government spending and meant lower salary increases (with around 75% of Kuwait’s employed in the public sector) as well as contributing to concerns around political instability.

On the 16th October, the Emir, Sheikh Sabah Al Ahmed

continued on page 3
Kuwait: A spark of new life in the desert?
Continued from page 1

Al Sabah, dissolved the National Assembly early — before its final session in July 2017 — thus setting the stage for early elections that will take place on the 26th November. “This was due to government in-fighting and corruption charges, something not new to Kuwait,” explained Tariq. “The recent row, however, has been blamed on the fall in the country’s income and the government’s reaction to it… ie by trying to reduce some of the government subsidies, such as petrol.”

Moody’s highlighted these issues in a research note issued last week: “The dissolved National Assembly was likely the most cooperative that the government could hope for because most opposition candidates had boycotted the last election in July 2013. Nevertheless, legislators had voiced strong opposition to the government’s unilateral move to hike the price of petrol, which ultimately led to the surprise dissolution.”

These developments highlight the institutional challenges that Kuwait faces in reducing its economic and fiscal dependence on oil — with reforms urgently needed and yet slow to arrive. “Slow or only very limited implementation of fiscal and economic reforms could over time erode Kuwait’s medium-term economic and fiscal prospects and lead to a deterioration of the country’s credit profile,” warned Moody’s.

In a simple no-reform scenario, with government expenditure fixed at around 60% of GDP from 2016, and with no changes to our other baseline assumptions (oil price and production, growth and inflation), Kuwait’s fiscal deficit is expected to average 2.7% of GDP between 2016-20 while government debt would rise to around 32% of GDP by 2020.

**Tight controls**

Concerns have also been raised over increasingly restrictive regulations that are stifling the financial sector. For example, in late 2015 the government tightened regulation on consumer borrowing — capping the limit to KWD15,000 (US$49,442.9) per citizen on consumer loans and auto finance. On home finance and remodelling, the limit remains the same at KWD75,000 (US$247,215) but proof is now required via quotations, and receipts are required before issuing the loans. “Banks are now feeling the pain,” warned Tariq. “All are suffering as a result.”

On the equities front, investment companies in Kuwait were badly burned by the financial crisis, and the sector is still suffering from a lack of liquidity, a lack of funding and legacy issues — meaning that the sector now has only a minor impact on the market, which has suffered as a result. In addition, new regulations introduced by the CMA have made it increasingly difficult for firms to meet their compliance and reporting obligations. “We have seen a number of companies pulling out of the stock market, because the requirements are too cumbersome,” warned Issam. Brokerage firms in particular have suffered — in the first week of October, three brokerage companies were forced to suspend business after failing to meet the CMA condition of raising their capital to KWD10 million (US$32.96 million). These issues have also impacted the Kuwait Stock Exchange, which saw trading volumes decline by 9.34% in September and turnover fall by 8.68% in the same period.

**Economic reforms**

So what is being done to combat these concerns? Unfortunately, according to some players, not enough. “The low oil prices put pressure on the government, and they were panicking when it reached US$25,” one Kuwaiti banker told IFN. “They talked about heavy restructuring for the industry, but then as soon as prices went up again, the pressure lifted. Now there is no concrete intention for any reforms — it was just a reaction to the market.” Although the government has called on the Ministry of Finance and the Ministry of Planning and Development Affairs to create plans to reduce dependence on oil, the public opposition to any reduction in subsidies is likely to make any such steps difficult.

“There is a legacy in Kuwait of enjoying the tax-free environment and public subsidies, and the state has been following an unwise spending policy for decades,” said one civil servant, who asked not to be named. “Of course, economic reforms will be very unpopular. But despite our reserves, if the low oil price continues Kuwait could end up bankrupt two decades from now. The situation has to change.”

**Capital markets push**

One of these changes is a growing focus on the debt capital markets — and this is where some real progress has been made, highlighting one of the few bright spots in an uncertain world.

Although Sukuk has always been on the radar in Kuwait, up till now there have been few real legislative attempts to evolve effective

Issam

continued on page 4
Kuwait: A spark of new life in the desert?

Continued from page 3

market regulation — meaning that many institutions ended up migrating out to more friendly jurisdictions to seek sources of funding. However, the recent introduction of new Sukuk regulations by the CMA is expected to have a genuinely positive impact on the financial sector as a whole — finally providing a strong platform to issue domestically out of Kuwait, something that has been missing for decades. Everything is now in place for issuers, including the introduction of SPVs and the approval of trust mechanisms.

The changes have undoubtedly had a positive effect, and several new Sukuk have already been announced — most recently a US$250 million issuance expected by Warba Bank before the end of the year.

However, it is not all smooth sailing, and issuers have not in fact seized on the new opportunity with the alacrity expected. Since the introduction of the new regulations, issuers — and especially commercial banks — have been active in issuing debt instruments, largely driven by a momentum to diversify their capital funding sources. However, as a market observer explained to IFN: “In fact, we have not seen any local institution issue a fully-fledged facility under the current regulations. They are all using hybrid structures where they go abroad, establish the SPV outside Kuwait and then just come back and seek CMA approval. That is not the same thing as issuing within Kuwait. Issuers are obviously nervous about accessing these new features, and we need someone brave who is willing to try out the new structure.”

Sovereign hopes
So what can be done to encourage this? An obvious step would be a sovereign Sukuk — something that has long been discussed and yet seems no closer to fruition. Even if a full sovereign is not on the cards, the new Sukuk regulation also includes highly favorable exemptions for government-related entities designed to encourage issuance — yet none have yet been forthcoming.

One problem is that a sovereign Sukuk is a sensitive issue that would require close cooperation between the central bank, the Ministry of Finance and the Kuwaiti Investment Authority, as well as other regulators — and communication and collaboration between agencies have long been an issue for Kuwait that has impeded progress.

Yet the corporate market urgently needs a decisive benchmark from which to price debt issuances, and a sovereign issuance would go a long way toward establishing this yield curve. In the current low interest rate environment and with growing demands for diversification and a burgeoning deficit, Sukuk could be just what the doctor ordered to pull Kuwait out of the doldrums. “The market has been waiting for an opportunity like this for years,” agreed Tariq. “All eyes are on the government, but with the recent political turmoil it’s a wait-and-see approach now.” There was even talk earlier this year that the government might avoid tapping the capital market and instead go straight to the sovereign investment fund for financing — sparking vehement protests from local banks desperate to participate in sovereign paper.

“"It will be interesting to see how the PPP regime develops in practice"

Another concern is the expectation of Saudi Arabia coming to market in the next few months — which is likely to suck out a lot of liquidity and make conditions less conducive for a Kuwaiti issuance. IFN has heard rumors that the Ministry of Finance has plans to set up a debt management office this year, with the intention of coming to market in early 2017 to borrow up to US$10 billion, of which around US$2 billion could be structured Islamically. “But the oil prices have gone up again,” warned Issam. “So there is no longer that level of urgency.”

continued on page 5
Kuwait: A spark of new life in the desert?
Continued from page 4

New opportunities
That doesn’t mean that there are no exciting opportunities in Kuwait, and despite the challenges, the government still has plenty of money to throw at infrastructure and development which has led to some huge projects and high spending. In March, the Ministry of Works announced an ambitious US$11.3 billion plan to fund 30 infrastructure projects: including the Jaber causeway, the Kuwait International Airport expansion and Mubarak al-Kabeer port. With a new Public-Private Partnership (PPP) law introduced in 2014, this is one of the most exciting sectors attracting investment and activity into the country.

“It will be interesting to see how the PPP regime develops in practice,” commented Qasim Aslam, a partner and head of Islamic finance at Dentons. “The new 2014 Kuwait PPP law anticipates two new bodies, namely, the Higher Committee for Public-Private Partnerships (Higher Committee) and the Kuwait Authority for Partnership Projects. There are also a number of facilitating changes. For example, it is possible now to take security over project contracts and assets and share pledges with approval of the PPP Higher Committee. Other examples of legal changes are that project companies can also be foreign owned and that the new law permits amendments to PPP agreements during project term. These are positive measures that should help attract international sponsors to Kuwait.”

What will 2017 look like? It is hard to say. I think the market will remain tough. 2016 was a difficult year and a difficult market. Next year will not see a drastic improvement on the current situation and operating conditions will remain challenging.

With the oil price volatility, an uncertain government, a shaky stock market and lack of impetus for government funding there are certainly issues to be worried about. Yet the pace of change and the commitment to legislative review and regulatory overhaul outlines a positive momentum for the country that should support its ambitions. There might not be a lot of noise happening right now, but change is quietly taking place.

Future outlook
So what can we expect for the coming year, and where does Kuwait stand in terms of Islamic finance sector development? Overall, it unfortunately remains a bit of a mixed bag despite the recent progress. “All investors are cautious today and the government’s uncertainty will delay all capital market decisions,” warned Tariq.

“What will 2017 look like? It is hard to say,” agreed Issam. “I think the market will remain tough. 2016 was a difficult year and a difficult market. Next year will not see a drastic improvement on the current situation and operating conditions will remain challenging.”

IFN Kuwait Dialogue 2016
IFN recently conducted its second successful Kuwait Dialogue: a closed-door, high-level panel discussion designed to provide an impartial platform for honest and open debate regarding the progress of Islamic finance within the country.

With nine leading industry experts participating in a vibrant and enthusiastic symposium, the event highlighted the key opportunities and challenges within the sector and provided a uniquely valuable insight into market development.

A summary of the Dialogue can be found on page 6 and the full report will be available to IFN subscribers next month.

Are you using our unique and exclusive

RESEARCH REPORT?

This excellent and easy-to-use service is available only to subscribers.
Generate personalized research reports based on your search criteria. A customized report can be easily generated to a PDF file through 8 simple steps.
Experts emphasize need for further regulatory action to boost Kuwaiti Shariah finance industry

The Kuwaiti Islamic financial market may be lagging behind its GCC peers, but with a thriving banking sector and positive developments within the regulatory structure, change is certainly afoot. However, according to participants in the IFN Kuwait Dialogue held in Kuwait City this week, the legal framework is still far from perfect — and much still needs to be done to make the Islamic sector and in particular the Shariah compliant capital market truly competitive with its regional peers. VINEETA TAN delves further.

Returning to Kuwait for the second time in three years, the IFN Dialogue series gathered together a prestigious group of leading market participants and Islamic finance experts to engage in a high-level discussion on the challenges, opportunities, progress and future of Islamic banking and finance in the country. Designed to provide an independent and impartial platform for discussion and debate, the IFN Dialogue series is renowned for its success in creating paths for real progress, working with key stakeholders to create an action plan for developing and encouraging

Islamic finance and overcoming the specific challenges unique to each market.

Kuwait has come a long way since the first IFN Dialogue was held in 2014, and progress has certainly been positive. Encouragingly, local authorities have taken proactive measures to support the Islamic finance community through enabling regulations, while state involvement in Islamic banks has supported their rapid growth and the retail banking system has developed strongly.

However, there remains an urgent need for a bankruptcy law (both for individuals and institutions), while the experts also highlighted that the regulator should also revisit specific elements of legislation pertinent to Islamic finance and review their efficacy.

Cooperation was another key issue, and the discussion emphasized the importance of communication between the different authorities (including the Capital Markets Authority (CMA), the Central Bank of Kuwait, the Ministry of Finance, the Kuwaiti Investment Authority and the Ministry of Commerce and Industry) in order to align and streamline their processes to better facilitate Islamic financial transactions.

The dialogue participants included Abdulkader Thomas, CEO of SHAPE Financial; Alex Saleh, a partner and the head of the Kuwait office of Al Tamimi & Company; Hossam Abdullah, the legal counsel and managing partner of Al-Hossam Legal; Issam Al Tawari, the founder and managing director of Newbury Economic Consulting; Mohamad Al-Qahtany, the managing director of Abwab Capital; Mubarak Al-Refaei, the director of corporate finance and governance of the CMA; Norashikin Mohd Kassim, CEO of CIMB Principal Islamic Asset Management Malaysia; Qasim Aslam, a partner and global head of Islamic finance at Dentons (UAE); and Tariq Al-Rifai, CEO of Quorum Center for Strategic Studies, the UK.

A full report detailing this insightful and unique debate will be available next month to all IFN subscribers.