

5- CLASSIFICATION POLICY FOR INVESTMENT AND FINANCE TRANSACTIONS WITH CUSTOMERS

- A) Rules and regulations for classifying investment transactions with and finance accorded to customers according to Islamic investment and finance formulas, the computation of their provisions and the manner of the accounting treatment of income generated therefrom.
- B) Circular No. (2/IBS/199/2007) concerning the unification of concepts for preparing investment and finance transactions classification tables in accordance to the instructions issued on 3/11/2003 with regard to the rules and regulations for classifying finance and investment transactions and computing their provisions.
- C) Circular No. (2/IBS/204/2007) concerning the amendment of the ratio of general provision for investment and finance transactions for which no specific provisions have been made.
- D) Circular No.(2/BS,IBS,IS,IIS/221/2008) concerning the preparation of consolidated financial statements.
- E) Circular concerning the manner of classifying customers' irregular credit facilities in table No.(5) by secret Number, complementing the Central Bank of Kuwait rules and regulations for classification of investment and finance transactions accorded to customers in accordance with Islamic finance formulas, computation of their provisions, and the manner of the accounting treatment of income generated therefrom.

Instructions No.(2/IBS/148/2003)*

The Rules and Regulations For Classifying investment transactions with and finance accorded to customers according to Islamic investment and finance formulas, the computation of their provisions and the manner of the accounting treatment of income generated therefrom.

Section One: Rules & Regulations Concerning The Classification of Investment and Finance Transactions:

For the purpose of implementing these instructions, Islamic banks shall observe the following:

- 1- Investment transactions with and finance extended to customers are meant to be the cash and non-cash investment and finance transactions banks conclude with their customers. Cash investment and finance transactions mean the transactions in which the bank provides to the customer monies for their execution, whether directly (such as Musharaka and Mudaraba, which are among the formulas of funds investment with customers), or in the form of assets (such as Murabaha and lease financing). On the other hand, non-cash transactions mean those transactions which create contingent liabilities on the part of the bank, including letters of guarantee, documentary letters of credit, acceptances and other types of these transactions.
- 2- For the purpose of classifying investment and finance transactions, the types of transactions shall be differentiated as follows:

First: Investment and finance transactions with customers (Resident & Non-Resident).

Second: Consumer finance transactions and other types of personal installment finance.

Third: Sovereign risk transactions .

Specific rules and regulations must be followed for classifying each type of the aforesaid types, in the following manner:

* Instructions issued by Central Bank of Kuwait Board of Directors at its meeting of 3/11/2003, and must be complied with from the date of notification.

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First: Investment and Finance Transactions with customers (Resident & Non-Resident):

Investment and finance transactions with customers are classified into “Regular” and “Irregular”.

1- Regular Transactions:

Balances of utilized investment and finance transactions shall be regarded as “Regular” as long as no event rendering them “Irregular” has materialized, in the manner to be mentioned in detail hereinafter.

2- Irregular Transactions:

Balances of utilized investment and finance transactions shall be regarded as “Irregular” in the event any of the conditions rendering them “Irregular” materializes and/or in view of other considerations associated with the customer’s conditions as follows:

2/1 Conditions of Irregularity:

- (A) Investment and finance transactions which create debts include Total balances of sales transactions (Murabah – Musawama...), Istisna’a transactions installments; lease financing due payments; the amount of Mudaraba and share of the bank in the profit, of the Mudaraba transactions, if any, after the end of their term; the share of the bank in the value of Musharaka transactions as well as its share in the profit thereof which should be paid, if any, according to the terms of the contract, any other debts that result from other investment and finance transactions (such as liquidated letters of guarantee). The irregularity of these transactions materializes in the event the customer does not honor his commitment to pay the balance due or any of the periodic installments that fall due.
- (B) For Musharaka and Mudaraba transactions which tenor has not expired, irregularity materializes in case the value of net equity in the transaction – which represent the realizable value – decline permanently below its book cost by 10% or more.

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2/2 Other considerations associated with the customer's conditions:

The board of directors of each bank shall form an internal committee comprising experienced and professional staff, with the responsibility of reviewing and evaluating the existing investment and finance transactions of each customer separately, for the purpose of identifying any exceptional matters related to the customer's conditions and the difficulties the customer may encounter and which may render the transactions conducted with him "Irregular", even if the irregularity conditions do not exist for some of these transactions. Then, the Committee shall determine the size of the provisions required. The board of directors shall approve the bases and criteria which the Committee shall rely upon in the classification process, as well as the outcome of the Committee's activities. The Committee shall discharge its duties while observing the following points in relation to the customer's conditions:

- A) Deterioration of the customer's financial position.
- B) The customer is placed under liquidation.
- C) The customer's bankruptcy.
- D) Legal actions have been taken against the customer by any other creditor party, claiming the repayment of the debt.
- E) Existence of explicit evidences of the customer's inability to repay his debts on maturity date .

The Committee's activities shall be regular and constant. The Committee shall conduct an evaluation of all the customers at least once before the end of each fiscal year, in such a manner that the bank's closing accounts will reflect the effects of the said Committee's decisions.

The banks shall provide the Central Bank, upon request, with the bases and criteria which the said Committee relied upon in the classification process, as well as with the outcome of their application .

The transactions for which any of the conditions of irregularity, or any of the other considerations associated with the customer's conditions, materializes, shall be classified into four categories, as follows:

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A) Monitor Category (Watch-list accounts):

Investment and finance shall be classified in the “Monitor Category”, in the event any of the irregularity conditions has been existing for a period not exceeding 90 days, or if any of the considerations related to the customer’s conditions materializes. Specific provisions shall be made for the debts classified under this category at the management’s discretion.

B) Sub - standard:

Investment and finance shall be classified in “Sub-standard” category, in the event any of the irregularity conditions has been existing for a period exceeding 90 days but not exceeding 180 days, or if any of the considerations related to the customer’s conditions materializes, upto the management’s discretion in this respect.

C) Doubtful:

Investment and finance shall be classified as “Doubtful” in the event any of the irregularity conditions has been existing for a period exceeding 180 days but not exceeding 365 days, or if any of the considerations related to the customer’s conditions materializes, upto the management’s discretion in this respect.

D) Bad:

Investment and finance shall be classified as “Bad” in the event any of the irregularity conditions has been existing for a period exceeding 365 days, or if any of the considerations related to the customer’s conditions materializes, upto to management’s discretion in this respect.

Second: The Consumer Finance & Other Personal Installment Finance Transactions:

These transactions are classified in the following manner:

A- Monitor Category (Watch-list accounts):

In the event the debtor defaults on repayment of any of the due installments for a period not exceeding 90 days.

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B- Sub-standard:

In the event the customer defaults on repayment of any of the due installments for a period exceeding 90 days but not exceeding 180 days.

C- Doubtful:

In the event the debtor defaults on repayment of any of the due installments for a period exceeding 180 days but not exceeding 365 days.

D- Bad:

In the event the debtor defaults on any of the due installments for a period exceeding 365 days. The customers against whom legal actions have been taken, shall also be classified under this category.

Third: Sovereign Risk Transactions:

Those transactions are meant to be the transactions concluded with governments, public institutions and central banks, or transactions guaranteed by them. Banks are required to assess the risks associated with those transactions according to the underlying risks for each country (country risks) , as follows:

- 1- Apply the method of the (Bank of England Matrix) in accordance with the manner detailed in the attached appendix. The banks may refer to the schedules issued by Bank of England in respect of Sovereign Risk Transactions, which provide an appropriate measurement for the size of each country risks.
- 2- Seek guidance in the data of international entities and institutions specialized in this field, as well as international rating agencies.

Respective banks should coordinate amongst themselves in this connection, and should seek the assistance of their external auditors .

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Section Two: The Manner of Computing The Provisions

First: Specific Provisions:

These are the provisions required for the investment and finance transactions which have been classified as “Irregular”, and shall be made at the following rates, **as a minimum**:

A) Specific provisions required for the investment & finance transactions with customers, as well as for consumer financing and other personal installment finance:

The specific Provisions required for the said transactions shall be computed at the following ratios :

1- Transactions entailing debts on customers part: (As detailed in the First Section / First Item 2/1)

<u>Classification Category</u>	<u>Required Provision</u>
- Monitor Category (Watch-list accounts)	Upto management’s discretion
- Substandard	20%
- Doubtful Debts	50%
- Bad Debts	100%

The required provision shall be computed for the total debt balance, excluding the following:

- Value of the collaterals computed on the basis of their current market value, provided that such collaterals are mortgaged / pledged in favour of the bank, and there is no obstacle whatsoever which could impede execution thereon. The value of such collaterals should be computed at rates lower than their actual market value, by reasonable percentages, in coordination with the external auditors, in order to cover the market risks, exchange rates risks and any other risks, depending on the type of each collateral separately.
- Transactions revenues and profits which have not been treated as income, in the manner to be mentioned under the Third Section.

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- 2- For Musharaka and Mudaraba transactions which tenor has not expired, the provision will be calculated by the amount of the difference between the book cost and net equity which represents the realizable value.
- 3- For transactions in which the bank reserves the ownership of the subject properties, as in the case of lease financing, the value of these assets will not be considered as collaterals deducted from the value on which basis the provision is calculated, and which basically lie in the amount of Ijara due payments.
- 4- If balances of the irregular transactions exceed 25% of the total investment and finance deals extended by the same bank, this customer's debt shall be referred to the Committee formed by the board of directors, in order to evaluate the customer's conditions in general and to resolve whether to increase the existing provisions or not. In the event balances of the irregular transactions exceed 50% of the customer's total investment and finance transactions with the customer, the provision shall be computed on the total of investment and finance transactions, as well as Musharaka and Mudaraba transactions which tenor has not expired, in addition to non-cash finance and investment transactions, as per the maximum ratio determined for any of the irregular transactions of the customer.
- 5- For international trade transactions (i.e. investment and finance transactions extended to non-residents but other than sovereign risk transactions), in the event the provision computed in the above manner exceeds the difference between the market value of the transactions in the international financial markets, if any, and their book-value, the case shall be referred to the said Committee to assess the required provision, which should not be below the amount of difference between the market value and book-value of the transactions. The market value of the transactions shall be computed at the rates prevailing in the international financial markets, at least twice in one fiscal year (at the end of June and December of each year).
- 6- No provisions shall be made against the irregular transactions with institutions and companies fully owned by the Government of Kuwait. But this will be the case only if the Government guarantees such transactions, or if the borrowing parties articles of associations explicitly provides that the Government shall guarantee any losses such a borrowing party may incur.

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B) The Provisions Required for The Sovereign Risk Transactions:

- 1- Banks are committed to determine the size of risks associated with each country, as per the rules of Bank of England Matrix, and to seek guidance in the data published by specialized international bodies and institutions, as well as in bulletins of international rating agencies (in the manner described under Item “Third” of the Section One of these instructions), all in coordination with their external auditors.
- 2- Irregularity conditions applicable to the customers investment and finance transactions, shall also be applied to the sovereign risk transactions, i.e. they shall be classified into regular and irregular (in the manner described under Item “First” of the “Section One” of these instructions).
- 3- As for the irregular Sovereign Risk Transactions, the necessary specific provision shall be made at the ratios of provisions commensurate with the size of the country risk, as detailed in the attached Appendix, or the ratios of the provisions required for each category of the irregular transactions with those customers, as detailed under the Item “First /A” of the “Section Two” of these instructions.

The regular Sovereign Risk transactions shall be presented to the Committee formed by the board to assess and resolve, in coordination with the external auditors and guided by the rules of item (1) above, whether relevants provisions are needed for such transactions or not, in the light of the risks associated with each country separately .

C) Rescheduled Debts:

This item addresses customers debts resulting from their investment and finance transactions. The following rules must be observed in this respect:

- 1- The previously made provision shall be retained against the rescheduled debts. As regards the debts which have a market value in the international financial markets, the retained provision should not be less than the amount of the difference between the debt’s market value and its book-value.
- 2- The provision shall gradually be decreased by the amounts collected under the reschedulement programme. Upon settlement of 25% of balance of the rescheduled debt, the Committee shall study the status of such a debt and determine the ratio of the provision required to be retained, provided it should not be less than 20% of the debt balance as minimum, after excluding the value of collaterals, returns and profits which have not been treated as income according to the rules of section two (Item First/A).

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If any bank finds that the size of specific provisions for the customers investment and finance portfolio, calculated in accordance with the bases and rules of these instructions, will exceed the size of risks associated with this portfolio according to adopted accounting standards, **such a bank must obtain the Central Bank's prior approval for this case before declaring any surplus in the provisions made for the finance portfolio in the financial statements.** In order for the Central Bank approve such surplus, the respective bank must assess the size of provisions required for all the components of the finance portfolio in reliance on a study of the conditions for each finance transaction apart, regardless of the outcome of classifying and assessing the size of provisions required for that transactions according to Central Bank's instructions. The mentioned study must clarify the objective evidences relied on in deeming a finance transaction as doubtful debt or not., as well as the bases and rules applied in assessing future cash flows expected from the transaction, the timings of these cash flows, the manner of estimating the collaterals, the opinion of the external auditor on the soundness of the bank's estimates in this respect. Detailed statements must be prepared for comparing estimate provisions with provisions required under the Central Bank's instructions. It is to be observed in this regard that the comparison will be between the estimate provisions and the required provisions plus profits and returns in suspense.

Second: General Provisions:

A general provision of 2%⁽¹⁾ shall be made for the investment and finance transactions (cash and non-cash) for which no specific provisions have been made* according to these instructions, but excluding investment transactions (Musharaka – Mudaraba) which tenor has not expired.

(1) The percentage of the general provisions for investment and finance transactions was reduced to a minimum of 1% for cash facilities and a minimum of 0.5% for non-cash facilities, pursuant to circular No. (2/BS/204/2007) issued on 12/3/2007.

* These are the investment and finance transactions (cash and non-cash) classified as Regular, and those classified under Monitor Category (Watch-List), which do not require specific provisions according to management's discretion, as well as the irregular investment and finance transactions with the Kuwaiti-Government owned institutions and companies, for which no specific provisions are required pursuant to the instructions, and also investment transactions with customers (Musharaka-Mudaraba) which tenor has expired but are not settled, and which do not require specific provisions to be taken according to management's discretion.

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This provision shall be calculated for the total balances of the mentioned investment and finance transactions, excluding the following:

- 1) The part of the finance transactions covered by collaterals in the form of deposit accounts or cash securities, or sukuk and financial instruments issued by the GCC governments. These collaterals must satisfy the conditions provided for in the instructions issued with regard to “ the maximum limit for the liabilities of anyone single customer to an Islamic bank”.
- 2) The portion of the investment and finance transactions secured by letters of guarantee issued by any of the reputable banks having an “A” rating from international rating agencies such as Moody’s and Standard & Poor.
- 3) Bills of exchange endorsed and accepted by the banks mentioned in Item (2) above.
- 4) Investment transactions with and finance to GCC governments or those guaranteed by them, or those extended to the institutions or companies 50% or more owned by them, provided that there is an express guarantee from those governments of such guarantees, or otherwise the articles of association of the financed institution or company include an express statement that any of the governments of those countries guarantee the losses the financed institution or company may incur.

Banks existing at the time of starting the implementation of these instructions and which have generated a surplus⁽¹⁾ in the total general and specific provisions of investment and finance transactions, are required to report such a surplus as exceptional income in their operating results for the fiscal year to which these instructions shall apply, provided that Other Reserves (General Reserves or Voluntary Reserves), are increased by the amount of such a surplus.

(1) Banks are required not to dispose of the surplus of the general provisions existing in their records as at 31/12/2006 and resulting from reducing the general provision percentage, except with the prior approval of the Central Bank of Kuwait, as per circular No. (2/IBS/204/2007) issued on 12/3/2007.

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Section Three: Accounting Treatment of The Income Generated From The Investment Finance Transactions

- 1) Investment and finance transactions yields and profits shall be considered as actual profit, in the event they are paid by the customers, or they are not classified as Irregular. This includes transactions classified under “Monitor Category” (Watch-list), and for which no specific provision has been made according to the management’s discretion.
- 2) The yields and profits of the fully secured irregular transactions, shall be considered as actual profit, in the event such yields and profits are settled.
- 3) In the event the yield and profits of investment and finance transactions are not settled according to the rules mentioned in the preceding two items, they shall be blocked in a suspense account and shall not be treated as income for investment and finance transactions classified as “ bad debt”, the returns and profits calculated for these transactions from the date of their classification in this category, plus the existing balance of the returns and profits in suspense for these transactions, shall be reported in separate regular accounts off-the-balance sheet.
- 4) Quarterly review shall be carried out for the yields and profits which have not been treated as income, to determine whether any portion thereof has become actual profit.

Section Four: The Periodic Data

Banks shall provide the Central Bank with quarterly data (at end of March, June, September and December) on the classification of the investment and finance transactions and the provisions required therefore, using the enclosed forms (1,2,3,4 and 5), latest by tenth day of the month following the end of the subject period.

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**Guidelines Concerning Filling Up The Detailed Statement
on the Classification Of the Irregular Investment and
Finance Transactions for Each Customer
(Attached Statement No. 5)**

The following points shall be taken into consideration upon preparing the attached statement No.(5):

- This statement should not include data on the classification of consumer investment and finance transactions and other personal installment finance.
- Data related to investment and finance transactions below KD 10,000, including those which may not have secret numbers, shall be reported aggregately for each of the various categories of classification, noting that sufficient details about the number of customers of each category should be reported in the remarks column.
- All accounts of one customer should be listed under his secret number.
- The concept of “Customer’s Unity” in the manner provided for in the rules and regulations of classification, (Based on First/4 from the Section Two of these Instructions), so that all balances of the customer’s accounts (Regular & Irregular) shall be included in the event balances of the customer’s irregular accounts exceed 50% of the customer’s total investment and finance transactions, or in case the committee formed by the bank decides to make specific provisions for total debt of the customer and his other investment and finance transactions. Sufficient explanations shall be mentioned in the remarks column. [Code No.(001) should be entered in the remarks code column in case the balances of irregular accounts exceed 50% of total investment and finance transactions, and Code No.(002) in case the committee decides to form specific provisions for the total investment and finance transactions].
- The reported market value of the collaterals must be reduced by appropriate ratios to cover the market and exchange rates risks, or any other risks, depending on the type of each collateral.
- Sufficient clarifications should be mentioned in the remarks column in respect of the following cases:

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- * Whether the specific provision of the international sovereign transactions and international trade transactions has been computed according to amount of the difference between the market value and book-value. Code No. (003) must be entered in the remarks code column.
- * Whether the irregular investment and finance transactions are owed by institutions and companies fully owned by the government of Kuwait, and if there is a guarantee from the Government either for the transactions or for the losses such entities may incur, in which case code No. (004) must be entered in the remarks code column.
- * Whether specific provision for the regular sovereign risks transaction has been computed pursuant to the decision of the respective committee at the bank, to offset the country risks, in which case code No. (005) must be entered in the remarks code column.
- * Whether a current market value of the rescheduled debts exists in the international finance markets, in which case Code No. (006) must be entered in the remarks code column.

In the event other remarks evolve in the future, the Central Bank must be notified thereof in order to create code numbers for them in the remarks codes column.

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" Appendix "
Determination of The Size of
The International Sovereign Risk Finance Transactions as per
Bank of England Matrix

A- Determination of the risks:

The International Sovereign Risk Loans (which are meant to be those loans granted to, or guaranteed by, governments, public institutions and central banks), shall be determined through specific scores given to a number of elements classified into three main groups, in such a manner that such scores express the risks of non-repayment of such loans and their interest. Accordingly, the required provision's ratio shall increase with the rise of the number of such scores.

The aforesaid groups are as follows:

First Group: This group aims at identifying the countries with prospects of inability to repay their debts . This group consists of three elements, namely

- The country deferes the payment .
- The country has rescheduled the loan (after suspension of settlement) at any time during the previous five years, or is in the process of rescheduling the loan, or has suspended the settlement without arrangements with the creditors to this effect.
- Reschedulement for the second time or more (for rescheduled loans) during the previous 5 years.

Second Group: This group aims at identifying the nature of the difficulties and problems existing in the debtor countries. This group consists of four elements, namely :

- The country suspends the payment of the principal loan or the interest to international finance institutions (International Monetary Fund, World Bank, regional development banks)
- The country suspends the payment of the principal loan or rescheduled loans to other creditors (other than international finance institutions).

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- The country suspends the payment of the interest accrued on the principal loan or the rescheduled loans.
- Rescheduling of the existing loans into new loans, or capitalization of the interest or rescheduling in accordance with the regulations of Paris Club.

Third Group: This group aims at determining the rate of the risk which may result from the country's inability to repay its debt . This group consists of nine elements, namely:

- Ratio of payable interest to total exports (based on the data available for the twelve months period preceding the date of computing the provision).
- The level of country's reserves coverage of the average monthly imports.
- Ratio of the debts to gross domestic product.
- Ratio of the foreign debts to total commodities and services exports .
- The country's non-satisfaction of or response to the International Monetary Fund's requirements in the sense of the country's non-adherence to the agreements concluded therewith.
- The country is unable to bridge the financing gap representing the difference between the potential cash inflows and outflows, for a period exceeding 12 months.
- Ratio of market value of the country's foreign debt, to the debt's face value.
- Reliance basically on only one source of income, in the sense of relying on the income generated from the export of a specific commodity or service.
- Any other elements deemed necessary by the banks and finance institutions and approved by the Central Bank, whether economic or political, and which affect the ability of the respective country to repay its foreign debts at present or in the future.

The attached tables (A and B) show the detailed elements of each group and the number of scores required for each element.

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B- The Required Provisions:

The provisions required for the Sovereign risk financing transactions are determined in the light of the total scores recorded for each country in the three groups referred to above. The required provision for each set of scores shall be as follows :

<u>Total number of scores</u>	<u>The required provision %</u>
Less than 10 points	-
10-24	5-13
25-39	14-23
40-54	24-37
55-69	38-58
70-84	59-75
85-99	76-89
100-119	90-96
120-145	97-100

In order to apply this system effectively, banks are required to obtain detailed data on the conditions of the borrowing countries, and shall keep such data updated in due course.

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Table (A)

**Manner of Evaluating International Sovereign Risk Finance Transactions
As Per Bank of England Matrix**

Description	First Group						Second Group													
	(1)			(2)			(3)			(4)		(5)		(6)		(7)				
Name of the element	The country defers repayment			The country rescheduled the Loan (after suspension of repayment) at any time during the previous five years, or is in the reschedulement process, or has suspended repayment without arrangements with the creditors .			Reschedulement for the second time or more (for rescheduled Loans) during the previous five years.			The country suspends repayment of principal Loan or the interest to the Int'l financial institutions: - IMF - World Bank -Regional development Banks		The country suspends repayment of the principal Loan or rescheduled Loans to other creditors (other than international finance institutions)		The country suspends repayment of the interest accrued on the principal Loan or the rscheduled Loans		Reschedulement of the existing Loans into new Loans, or capitalization of the Interest, or reschedulement in accordance with the Paris club.				
Points	Months			Years			Years			Years		Months			Months			Years		
	From	to	Points	From	to	Points	From	to	Points	Period	Points	From	to	Points	From	to	Points	From	to	Points
	-	3	2	3	5	6	2	5	6	<2	10	-	3	4	-	3	4	3	5	4
	>3	12	4	<2	3	8	<1	1	8	>2	15	>	3	8	>	3	8	<2	3	8
	>12	36	8	<	2	12	<	12months	12			>	12	10	>	12	10	<	2	10
	>36	-	12																	
Minimum & Maximum weights	2-12			6-12			6-12			10-15		4-10		4-10		4-10				

Table (B)

Manner of Evaluating The International Sovereign Risk Finance Transactions as per Bank of England Matrix

Description	Third Group													
	(8)		(9)		(10)		(11)		(12)	(13)	(14)		(15)	(16)
Name of the element	Ratio of The payable interest to total exports		Ratio of the country's reserves coverage of the average monthly imports		Ratio of the foreign Loans to Gross Domestic Product		Ratio of the foreign Loans to total exports of commodities & Services		The country is unable to meet or to be responsive to I.M.F.'s requirements	The financing Gap is not covered for a period exceeding 12 months	Ratio of the market price of the country's foreign debt to the debt's face value		Basic reliance upon one source of income	Any other economic or political elements deemed necessary by the Banks or financial institutions, and which are approved by Central Bank of Kuwait and affect the concerned country's present or future ability to settle its foreign Loans .
Points	Ratio	Points	Ratio	Points	Ratio	Points	Ratio	Points	Points	Points	Ratio	Points	Points	Points
	>15%	3	<4	3	>50%	3	>200%	3	3	2	<70%	2	2	from 0 to 5
	>25%	5	<2	5	>75%	5	>300%	5			<50%	4		
	>35%	7	<1	7	>100%	7	>400%	7			<30%	8		
	>45%	10	<0.5	10	>150%	10	>600%	10			<10%	12		
Minimum & Maximum Weights	3-10		3-10		3-10		3-10		3	2	2-12		2	0-5

5- CLASSIFICATION POLICY FOR INVESTMENT & FINANCE TRANSACTIONS WITH CUSTOMERS

A) Rules and regulations for classifying investment transactions with and finance accorded to customers according to Islamic investment and finance formulas, the computation of their provisions and the manner of the accounting treatment of income generated therefrom.

(Attachment No.1)
(Islamic Banks Form)

**Overall Statement of Classification of Investment & Finance Transactions
(Regular & Irregular) & the Required Specific & General Provisions
As on / / , as per Relevant Rules & Regulations**

Bank Name: (Islamic Banks):

(Value in K.D 000's)

Description	Cash (1)	Non-Cash (2)	Total (1+2)
First: Total Investment & Finance Transactions			
A) Regular:*			
- Investment & Finance Transactions for Customers			
- Sovereign Risks Transactions			
- Consumer Finance & Other Personal Installment Finance Transactions			
Total of (A)			
B) Irregular:			
- Investment & Finance Transactions for Customers			
- Sovereign Risks Transactions			
- Consumer Finance & Other Personal Installment Finance Transactions			
Total of (B)			
Total Investment and Finance Transactions (A+B) **			
Second: Required Specific Provisions			
- Investment & Finance Transactions for Customers			
- Sovereign Risks Transactions			
- Consumer Finance & Other Personal Installment Finance Transactions			
Total Required Specific Provisions (Second)			
Third: General Provisions Required for Investment and Finance Transactions for Which no Specific Provisions Were Made *⁽¹⁾			
- 1% for cash Investment & Finance Transactions			
- 0.5% for Non-Cash Investment & Finance Transactions			
Fourth: Total Required General & Specific Provisions (Second+Third)***			
Fifth: Value of Yields and Profits in Suspense in the Bank's Records and Reported Within the Above Finance Balances⁽²⁾			
Sixth: Provisions Available in the Bank's Records***			

* Include the irregular investment and finance transactions & those listed under the "monitor" category for which no specific provisions are required according to the management's discretion, as well as those irregular finance transactions extended to the institutions & companies fully owned by the Kuwaiti Government & there is a guarantee from the Government for such debts or for the losses that may be encountered by such entities.

** To be matched with financial position data (IBS1) as follows:

A) Cash Facilities:

- Investment and finance transactions for customers (Item Q):
- Investment placements with financial institutions ((Item O/2/B and C)
- Investment placements with Banks (Irregular) (2)
- Yields and Profits calculated on finance transactions classified as "bad" and reported off the balance sheet (2)
- In addition to cash finance transactions at foreign branches.
- Total Cash finance transactions**

B) Non-Cash Finance Transactions (Item – M/1,2,3)

- In addition to non-cash transactions to foreign branches
- Total Non-Cash transactions

*** To be matched with the attached forms (2,3,4)

- 1) The percentage of the general provision was amended pursuant to circular No.(2/IBS/204/2007) issued on 12/3/2007.
- 2) Amendments introduced pursuant to circular No. (2/IBS/198/2007) issued on 29/1/2007.

5- CLASSIFICATION POLICY FOR INVESTMENT & FINANCE TRANSACTIONS WITH CUSTOMERS

- A) Rules and regulations for classifying investment transactions with and finance accorded to customers according to Islamic investment and finance formulas, the computation of their provisions and the manner of the accounting treatment of income generated therefrom.

Attachment (2)

***Distribution of Required General & Specific Provisions According Classification Categories
of the Investment and Finance Transactions with customers * as on / / ⁽¹⁾***

Bank Name: (Islamic Banks):

(K.D 000's)

S.N	Type of classification	Number of Customers	The utilized balance of the transactions			Amount of Yields and Profits in Suspense **	Deferred Income	Value of excluded collateral ***	Amount of the required provisions ****	The Provision Available in the Bank's Records
			Cash (A)	Non-Cash (B)	Total (A+B)					
1	Regular									
2	Monitor category; does not need specific provisions									
A	Total (1+2)									
3	Monitor category; needs specific provisions									
4	SubStandard									
5	Doubtfull									
6	Bad									
B	Total (3+4+5+6)									
	Total (A+B)*****									

* Include international commercial loans

** Include the amounts computed on debts classified as "bad" and reported off the balance sheet according to the circular issued in this respect.

*** Value of collaterals is computed on the basis of market value, after decreasing it by the ratios necessary for coverage of market & exchange rates risks & any other risks.

**** Include the required general provision for the transactions which do not require specific provisions (Items 1&2), and the specific provisions required for the irregular transactions (Items 3,4,5 &6).

***** Include loans granted to bank staff according to internal policy : KD ----- Thousand

(1) This statement was amended according to circular No. (2/IBS/199/2007) dated 29/1/2007

5- CLASSIFICATION POLICY FOR INVESTMENT & FINANCE TRANSACTIONS WITH CUSTOMERS

A) Rules and regulations for classifying investment transactions with and finance according to Islamic investment and finance formulas, the computation of their provisions and the manner of the accounting treatment of income generated therefrom.

Distribution of the Required General & Specific Provisions, According to Classification Categories of the Sovereign Risks Finance Transactions as on / /⁽¹⁾

Bank Name: (Islamic Banks):

(K.D 000's)

S.N	Type of Classification	Number of Customers	The Utilized Balance of Transactions			Amount of Yields and Profits in Suspense*	Deferred Income*	Value of excluded collateral*	Amount of the required Provisions **	The Provision Available in the Bank's Records	
			Cash (A)	Non-Cash (B)	Total (A+B)						
A	Regular Transactions: Do not require specific provisions according to management's discretion										
B	The transactions which require specific provisions 1- Regular 2- Irregular - Monitor Category - SubStandard - Doubtful - Bad										

Total for (B)											
Total (A+B)											

* This data is to be filled in, in case of applying the percentage of the provisions required for each category of the irregular transactions categories, according to the rule of Item First- paragraph B/3 of the second section of these instructions.

** Include the general provision required for the transactions which do not require specific provisions (Item-A), and the specific provisions required for other transactions (Item - B), computed as per the rules of item First / B of the Section Two of the instructions.

*** Include the amounts computed on debts classified as "bad" and reported off the balance sheet according to the circular issued in this respect.

(1) This statement was amended according to circular No. (2/IBS/199/2007) dated 29/1/2007

5- CLASSIFICATION POLICY FOR INVESTMENT & FINANCE TRANSACTIONS WITH CUSTOMERS

A) Rules and regulations for classifying investment transactions with and finance according to Islamic investment and finance formulas, the compilation of their provisions and the manner of the accounting treatment of income generated therefrom.

Distribution of The Required General & Specific Provisions, According to Classification Categories of The Consumer Murabaha Transactions & Other Personal Installment Finance Transactions as on / / ⁽¹⁾

Bank Name: (Islamic Banks):

(K.D 000's)

	Type of Classification	Number of Customers	Amount of Transactions	Amount of Yields and Profits in suspense *	Deferred Income	Amount of the required provision**	Amount of the provision available in the Bank's records
1	Regular						
2	Monitor category; does not require specific provisions						
A	Total (1+2)						
3	Monitor Category; requires Specific Provisions						
4	Sub-Standard						
5	Doubtful						
6	Bad						
B	Total (3+4+5+6)						
	Total (A+B)						

* Including those computed on debts classified as "bad" and reported off the balance sheet according to the instructions issued in this respect.

** Including the general provision for the transactions which do not require specific provisions (Items 1,2) & the specific provisions required for irregular transactions (Items 3,4,5,6) .

(1) This statement was amended according to circular No. (2/IBS/199/2007) dated 29/1/2007

5- CLASSIFICATION POLICY FOR INVESTMENT & FINANCE TRANSACTIONS WITH CUSTOMERS

A) Rules and regulations for classifying investment transactions with and finance accorded to customers according to Islamic investment and finance formulas, the computation of their provisions and the manner of the accounting treatment of income generated therefrom.

**Detailed Statement of The Classification of the Irregular Investment &
Finance Transactions for Each Customer***
as on / / ⁽¹⁾

Bank Name: (Islamic Banks)

(K.D 000's)

Secret No.	A/C #	The utilized balance of the transactions (3)			Value of Excluded collateral	Amount of Yields & Profits in Suspense **	Deferred Income	Balance of investment & Finance transactions Based on which the provision is computed (7)	Classification of the transactions (8)	Required Provision (9)		Remarks* (10)	
		Cash	Non-cash	Total (3a+3b)						%	Value (7x9a)		
(1)	(2)	(3a)	(3b)	(3c)	(4)	(5)	(6)	3c-(4+5+6)	Classification category	(9a)	(9b)	(10a)	(10b)
First: Facilities Granted to the Customers:													
Total of First													
Second: International Commercial Facilities :													
Total of Second													
Third: Sovereign Risks Facilities:													
Total of Third													
Fourth: Rescheduled Credit Facilities:													
Total of Fourth													
Total (First++ Fourth)													

* Attached "Guidelines" should be observed upon preparing this statement.

** Including those computed on debts classified as "bad" and reported off the balance sheet according to the instructions issued in this respect.

(1) This statement was amended according to circular No. (2/IBS/199/2007) dated 29/1/2007

5- CLASSIFICATION POLICY FOR INVESTMENT & FINANCE TRANSACTIONS WITH CUSTOMERS

A) Rules and regulations for classifying investment transactions with and finance accorded to customers according to Islamic investment and finance formulas, the computation of their provisions and the manner of the accounting treatment of income generated therefrom.

Executive Director

*Moharram 10, 1428 H
January 29, 2007*

THE GENERAL MANAGER,

**Circular No. (2/IBS/199/2007)
to All Islamic Banks**

It has been noticed that there are differences in local banks' interpretation of the concepts of preparing the tables for finance and investment transactions classification policy as attached to the Central Bank of Kuwait's instructions. In this regard, some explanatory amendments have been introduced to some of those tables, addressing the following points:

- 1- Investment placements with banks classified as "irregular", as well as the yields and profits in suspense for bad debts and which are reported off the balance sheet as per the subject instructions, must be reported in the margin of attachment No. (1) of the tables of the classification policy.
- 2- A note has been added to the margin of table No. (2) of the finance and investment transactions classification tables, indicating the size of finance granted to your bank staff according to your internal policy.
- 3- Item " Five ": Amount of Yields and Profits in Suspense in your records, has been added to table No. (1) of the classification tables.
- 4- A special column has been added for deferred income within tables No. (2,3,4 and 5), and another special column has been added for yields and profits in suspense in table No. (4) of the classification policy tables.

Your bank has to observe these amendments with effect from the data for the period ending on 31/3/2007.

Best Regards,

Ibrahim A. Al-Qadhi
Executive Director of the Supervision Sector

5- CLASSIFICATION POLICY FOR INVESTMENT & FINANCE TRANSACTIONS WITH CUSTOMERS

- B) Circular No. (2/IBS/199/2007) concerning the unification of concepts for preparing investment and finance transactions classification tables in accordance to the instructions issued on 3/11/2003 with regard to the rules and regulations for classifying finance and investment transactions and computing their provisions.

Attachment No.(1)
(Islamic Banks Form)

Overall Statement of Classification of Investment & Finance Transactions (Regular & Irregular) & the Required Specific & General Provisions As on / / , as per Relevant Rules & Regulations

Bank Name: (Islamic Banks)

(K.D 000's)

Description	Cash (1)	Non-Cash (2)	Total (1+2)
First: Total Investment & Finance Transactions			
A) Regular:*			
- Investment & Finance Transactions for Customers			
- Sovereign Risks Transactions			
- Consumer Finance & Other Personal Installment Finance Transactions			
Total of (A)			
B) Irregular:			
- Investment & Finance Transactions for Customers			
- Sovereign Risks Transactions			
- Consumer Finance & Other Personal Installment Finance Transactions			
Total of (B)			
Total Investment and Finance Transactions (A+B) **			
Second: Required Specific Provisions			
- Investment & Finance Transactions for Customers			
- Sovereign Risks Transactions			
- Consumer Finance & Other Personal Installment Finance Transactions			
Total Required Specific Provisions (Second)			
Third: General Provisions Required for Investment and Finance Transactions for Which no Specific Provisions Were Made *⁽¹⁾			
- 1% for cash Investment & Finance Transactions			
- 0.5% for Non-Cash Investment & Finance Transactions			
Fourth: Total Required General & Specific Provisions (Second+Third)***			
Fifth: Value of Yields and Profits in Suspense in the Bank's Records and Reported Within the Above Finance Balances			
Sixth: Provisions Available in the Bank's Records***			

* Include the irregular investment and finance transactions & those listed under the "monitor" category for which no specific provisions are required according to the management's discretion, as well as those irregular finance transactions extended to the institutions & companies fully owned by the Kuwaiti Government & there is a guarantee from the Government for such debts or for the losses that may be encountered by such entities.

** To be matched with financial position data (IBS1) as follows:

A) Cash Facilities

- Investment and finance transactions for customers (Item Q):
- Investment placements with financial institutions ((Item O/2/B and C)
- Investment placements with Banks (Irregular)
- Yields and Profits calculated on finance transactions classified as "bad" and reported off the balance sheet
- In addition to cash finance transactions at foreign branches.

Total Cash finance transactions

B) Non-Cash Finance Transactions (Item – M/1,2,3)

In addition to non-cash transactions to foreign branches

Total Non-Cash transactions

*** To be matched with the attached forms (2,3,4)

1) The percentage of the general provision was amended pursuant to circular No. (2/IBS/204/2007) issued on 12/3/2007.

5- CLASSIFICATION POLICY FOR INVESTMENT & FINANCE TRANSACTIONS WITH CUSTOMERS

B) Circular No. (2/IBS/199/2007) concerning the unification of concepts for preparing investment and finance transactions classification tables in accordance to the instructions issued on 3/11/2003 with regard to the rules and regulations for classifying finance and investment transactions and computing their provisions.

***Distribution of Required General & Specific Provisions According Classification Categories
of the Investment and Finance Transactions with customers * as on / / ⁽¹⁾***

Bank Name: (Islamic Banks)

(K.D 000's)

S.N	Type of classification	Number Of Customers	The utilized balance of the transactions			Amount of Yields and Profits in Suspense **	Deferred Income	Value of excluded collateral ***	Amount of the required provisions ****	The Provision Available in the Bank's Records
			Cash (A)	Non-Cash (B)	Total (A+B)					
1	Regular									
2	Monitor category; does not need specific provisions									
A	Total (1+2)									
3	Monitor category; needs specific provisions									
4	SubStandard									
5	Doubtfull									
6	Bad									
B	Total (3+4+5+6)									
	Total (A+B)*****									

* Include international commercial loans

** Include the amounts computed on debts classified as "bad" and reported off the balance sheet according to the circular issued in this respect.

*** Value of collaterals is computed on the basis of market value, after decreasing it by the ratios necessary for coverage of market & exchange rates risks & any other risks.

**** Include the required general provision for the transactions which do not require specific provisions (Items 1&2), and the specific provisions required for the irregular transactions (Items 3,4,5 &6).

***** Include loans granted to bank staff according to internal policy : KD ----- Thousand)

***Distribution of the Required General & Specific Provisions,
According to Classification Categories of the Sovereign Risks Finance Transactions as on / /***

Bank Name: (Islamic Banks)

(K.D 000's)

S.N	Type of Classification	Number of Customers	The Utilized Balance of Transactions			Amount of Yields and Profits in Suspense *	Deferred Income *	Value of excluded collateral *	Amount of the required Provisions **	The Provision Available in the Bank's Records
			Cash (A)	Non-Cash (B)	Total (A+B)					
A	Regular Transactions do not require specific provisions according to management's discretion									
B	The transactions which require specific provisions :									
	1- Regular									
	2- Irregular:									
	- Monitor Category									
	- SubStandard									
	- Doubtful									
	- Bad					***				
	Total for (B)									
	Total (A+B)									

- * This data is to be filled in, in case of applying the percentage of the provisions required for each category of the irregular transactions categories, according to the rule of Item First- paragraph B/3 of the section two of these instructions.
- ** Include the general provision required for the transactions which do not require specific provisions (Item-A), and the specific provisions required for other transactions (Item - B), computed as per the rules of item First / B of the Section two of the instructions.
- *** Include the amounts computed on debts classified as "bad" and reported off the balance sheet according to the circular issued in this respect.

***Distribution of The Required General & Specific Provisions, According to Classification Categories
of The Consumer Murabaha Transactions & Other Personal Installment Finance Transactions as on / /***

Bank Name: (Islamic Banks)

(K.D 000's)

S.N	Type of Classification	Number of Customers	Amount of Transactions	Amount of Yields and Profits in suspense *	Deferred Income	Amount of the required provision **	Amount of the provision available in the Bank's records
1	Regular						
2	Monitor category; does not require specific provisions						
A	Total (1+2)						
3	Monitor Category; requires Specific Provisions						
4	SubStandard						
5	Doubtful						
6	Bad						
B	Total (3+4+5+6)						
	Total (A+B)						

* Including those computed on debts classified as “bad” and reported off the balance sheet according to the instructions issued in this respect.

** Including the general provision for the transactions which do not require specific provisions (Items 1,2) & the specific provisions required for irregular transactions (Items 3,4,5,6) .

**Detailed Statement of The Classification of the Irregular Investment &
Finance Transactions for Each Customer * as on / /**

Bank Name: (Islamic Banks)

(K.D 000's)

Secret No.	A/C #	The utilized balance of the transactions (3)			Value of excluded collateral (4)	Amount of Yields & Profits in Suspense ** (5)	Deferred Income (6)	Balance of investment & Finance transactions based on which the provision is computed (7)	Classification of the transactions (8)	Required Provision (9)		Remarks * (10)	
		Cash (3a)	Non-cash (3b)	Total (3a+3b) (3c)						% (9a)	Value (7x9a) (9b)	(10a)	(10b)
(1)	(2)	(3a)	(3b)	(3c)	(4)	(5)	(6)	3c-(4+5+6)	Classification category	(9a)	(9b)	(10a)	(10b)
First: Facilities Granted to the Customers:													
Total of First													
Second: International Commercial Facilities:													
Total of Second													
Third : Sovereign Risks Facilities:													
Total of Third													
Fourth: Rescheduled Credit Facilities:													
Total of Fourth													
Total (First++ Fourth)													

* Attached "Guidelines" should be observed upon preparing this statement.

** Including those computed on debts classified as "bad" and reported off the balance sheet according to the instructions issued in this respect.

GOVERNOR

*Safar 22, 1428 H
March 12, 2007*

THE CHAIRMAN,

Circular No. (2/IBS/204/2007)

**To all local Shari'a – compliant banks concerning
the amendment of the ratio of general provision on investment &
finance transactions for which no specific provisions have been made**

We would like to advise you that the Central Bank Board of Directors, at its meeting of 11/3/2007, resolved to introduce the following amendment to Central Bank of Kuwait instructions of 3/11/2003 concerning the rules and regulations for classifying investment and finance transactions accorded to customers in accordance with Islamic investment and finance formulas, computing their provisions and treating the income generated therefrom. The amendment relates to the general provisions ratio, as follows:

“The ratio of the general provision for the investment and finance transactions for which no specific provisions have been made, has been reduced to become a minimum of 1% for cash investment and finance transactions and a minimum of 0.5% for non-cash investment and finance transactions. Banks may not dispose of the surplus general provisions existing in their records as on 31/12/2006, and resulting from reducing the general provisions ratio in the mentioned manner, except with the prior approval of the Central Bank of Kuwait”.

With my best wishes,

SALEM ABDUL AZIZ AL-SABAH

5- CLASSIFICATION POLICY FOR INVESTMENT & FINANCE TRANSACTIONS WITH CUSTOMERS

- C) Circular No. (2/IBS/204/2007) concerning the amendment of the ratio of general provision for investment and finance transactions for which no specific provisions have been made.

GOVERNOR

*Jumada Al-Aula 28, 1429 H
June 2, 2008*

THE CHAIRMAN,

**Circular No.(2/BS,IBS,IS,IIS/221/2008)
To all local banks and investment companies
on preparation of consolidated financial statements**

We would like to advise you that it was noticed that some banks and investment companies failed to follow standard policies and treatments for all units of the group while preparing the consolidated financial statements. This is specifically the case with regard to failing to classify credit facilities/finance granted by subsidiaries, and making the provisions necessary therefore, as applicable with regard to credit facilities/finance granted by the mother bank/company.

In light of the above, your bank/company should comply with the following, while preparing the consolidated financial statements:

- 1) Standardized accounting policies and treatments should be followed at the level of all group units, including the formation of provisions necessary for balances of credit facilities/finance granted by the mother bank/company – as a minimum – in accordance with Central Bank of Kuwait’s instructions on the rules and regulations for classifying credit facilities/investment and finance transactions, as well as calculating their provisions, manner treatment of the income from these transactions, and the amendments thereto.
- 2) Classification should be started for credit facilities/finance existing as of 30/6/2008 with the consolidated subsidiaries of your bank/company, and provisions required for them should be determined in accordance with the classification policy issued by Central Bank of Kuwait. You should provide us, no later than end of August 2008, with statement of classification of the balances of these facilities/finance transactions on the forms used for this purpose. In the future, it should be observed that this data, which is submitted to Central Bank of Kuwait quarterly, should be at the level of both mother bank/company, and consolidated level.

It has been resolved to grant the concerned banks and investment companies a grace period to make the required provisions, which have not yet been made, for credit facilities/finance transactions with subsidiaries in accordance with the classification policy issued by Central Bank of Kuwait, gradually, starting from 30/9/2008, and up to end of 2009.

With my best wishes,

SALEM ABDUL AZIZ AL-SABAH

The Manager

*Rajab 14, 1429 H
July 17, 2008*

THE GENERAL MANAGER,

Circular to all Islamic banks

This is made further to the circular dated 3/11/2003 to all Islamic banks, regarding the rules and regulations for classification of investment and finance transactions accorded to customers in accordance with Islamic finance formulas, computation of the provisions thereof, and the manner of the accounting treatment of income generated therefrom.

We would like to advise you that the irregular customers, classified in Table 4: Consumer Finance and Other Installment Finance, should be listed in Table 5: Classification of Irregular Investment and Finance Transactions, by customers secret numbers. Irregular consumer and installment finance customers having secret numbers in the table should be listed. Irregular finance transactions of customers without secret numbers should be gathered under a new item entitled “Irregular Finance Transactions of Customers without Secret Numbers”, in the same Table 5.

Please consider conducting the necessary checking between the contents of Table 5, and the corresponding contents of Tables 2, 3 and 4 of the Finance and Investment Transactions Classification tables.

Your bank/company should comply with the above with effect from September 2008 statements.

Best regards,

**Manager, Off-Site Supervision Department
Dr. Mohammad Yousuf Al-Hashel**

5- CLASSIFICATION POLICY FOR INVESTMENT & FINANCE TRANSACTIONS WITH CUSTOMERS

- E) Circular concerning the manner of classifying customers' irregular credit facilities in table No.(5) by secret Number, complementing the Central Bank of Kuwait rules and regulations for classification of investment and finance transactions accorded to customers in accordance with Islamic finance formulas, computation of their provisions, and the manner of the accounting treatment of income generated therefrom.