

## **7- INSTRUCTIONS CONCERNING FINANCIAL INVESTMENT POLICY**

A) Instructions Concerning the organization of Islamic banks financial investment policy.

**Instructions No. (2/IBS/143/2003)**  
**Instructions Concerning The Organization of**  
**Islamic Banks Financial Investment Policy**

Islamic banks financial policy meant to be addressed by these instructions is the policy which regulates the business of financial investment in the securities portfolio, which includes financial instruments such as shares, finance sukuk and other investment instruments issued by other parties and acquired by the bank, either for trading purposes seeking to achieve profits from short term changes in prices, or for holding them for a period to achieve profits from their sale if the appropriate opportunity emerges, or for holding them up to the date of their maturities, in order to generate regular returns there- from and/or to take advantage of these instruments capital appreciation, as indicated in the statement of Islamic banks financial statement as designed by the Central bank.

In view of the increasing importance of this activity for banks, since it represents one of the main activities of banking and financial institutions, and given the dramatic developments in the financial markets and the broadening scope of dealing with a diversity of financial instruments, this type of activity must be managed within the framework of a clearly written investment policy approved by the bank's board of directors. This policy must include the appropriate strategy in this respect, and the assumptions on which such strategy is based, while taking into account the general financial conditions of the bank in terms of risk levels, management abilities, appropriateness of information systems, and local, regional and international economic and financial conditions. The policy must also set-up the bases and criteria that regulate such transactions, so as to be a protective fence that preserves shareholders as well as depositors funds.

Based on the rules of Article (98) of Law No. (32/1968) and its amendments, which authorizes the Central Bank Board of Directors to set-up for the Islamic banks the maximum limit for an Islamic bank's participation in the companies the bank establishes, or participates in establishing, or acquires shares therein, as well as to establish the rules and regulations that must be observed in this regard, together with the maximum limit for the bank's participation in anyone project, the Central bank Board of Directors has resolved, at its meeting of 19/10/2003, to issue the following regulations and controls concerning the organization of Islamic banks financial investment policy, which represent the minimum that Islamic banks must comply with in regard to financial investment business.

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### **First : General Objectives of the Financial Investment Policy:**

The board of Directors of each bank should adopt and follow a special policy of its own, which must be commensurate with the size of the financial investment activities of the bank, their diversity and complexity, and which aims at achieving the following objectives as a minimum:

1. Realize a proper return on such investments.
2. Provide appropriate liquidity level to meet contingent needs, without the bank being compelled to liquidate some of its assets to meet these needs, as this may expose it to losses, in particular if the market conditions are unfavourable.
3. Minimize the investment risks (market risks, financial risks...) which may arise from uncertainties in the financial investments markets or in the conditions of the institutions issuing the financial instruments invested in, primarily through diversifying the components of the securities portfolio for various kinds of investments and the underlying risks and setting up maximum limits.

### **Second : Minimum Criteria The Bank Should Abide by in its Financial Investment Policy:**

Banks must set up the appropriate investment policies which shall be as a regulator for decision-making process related to management of the bank's securities portfolio, and which should take the following criteria into account:

1. Dealing in high-quality securities<sup>(\*)</sup>, while observing the rule that financial investment must be restricted to the purposes of trading marketable financial instruments, and that the financial investments available for sale or held for investment must be in marketable financial instruments, to the extent possible. If such instruments are not marketable, then the same procedures provided for in Central Bank's instructions regarding the rationalization and organization of finance policy, must be implemented in relation to evaluating the conditions of the issuers of those instruments and / or the projects for which they were issued to finance.

(\*) For the purpose of defining the high quality of the securities invested in, their minimum definition would mean investment securities, classified as "BBB" by international rating agencies (such as standard & Poors and Moody's), or issued by governments of OECD countries, while observing the investment risks in each country separately, or by governments of GCC countries. If their rating is not possible, then the procedures provided for under the Central Bank instructions concerning rationalization and organization of the Islamic Banks finance policy, must be adopted in evaluating the financial conditions of the institutions issuing the securities and / or the projects for which finance such securities are issued.

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2. Financial investments maturity dates must be observed in such a manner that ensures diversity of maturities in order to balance between achieving the highest return and the availability of liquidity, if so needed, while taking into account the maturities of the bank's resources, particularly the deposits and the degree of their concentration, as they represent the core of the bank's resources.
3. Creating a balance between the bank's investment policy and finance policy, without prejudice to the bank's role in extending finance to various economic sectors.
4. Adopting a balanced investment policy which would minimize the risks, on the one hand, and maximize the income, on the other.

**Third: The Maximum Limits for the Bank's Participation in Companies and in Anyone Project:**

1. The total ratio of the securities portfolio carried in the bank's books (excluding finance sukuk) should not exceed 50% of the bank's capital in its comprehensive concept, as defined under the Central Bank's instructions in respect of the capital adequacy ratio for Islamic banks.
2. The ratio of investment in all kind of securities of anyone issuer and its related parties should not exceed 10% of the bank's capital in its comprehensive concept. The following rules are to be observed in this regard:
  - a- For the purpose of computing the 10% ratio, the book-value of the securities carried in the banks books is to be used.
  - b- The definition of anyone entity and its related parties shall be applied here as defined in the instructions concerning the Maximum Limits of Liabilities For Anyone single Customer to an Islamic bank.
  - c- The total finance liabilities for anyone single customer (inclusive of financial investments in all types of securities issued by the customer), shall not exceed the Maximum Liabilities Limits For Anyone single Customer, as provided for in the relevant instructions.

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3. The face value of securities held by the bank in the form of shares or equity stakes in companies and projects should not exceed 10% of the issuer's or the project's capital.

If the bank desires to exceed the ratios stipulated under items No. 3 and 4 above, it will be required to obtain the Central Bank's prior approval by submitting for Central Bank's review and consideration a request supported by justifications and reasons for requesting the excess.<sup>(1)</sup>

4. The following will be exempted from the ratios stipulated in the above three items:
  - a- The bank's subsidiaries, provided that the Central Bank's prior approval is obtained for each case apart, based on a study submitted by the bank explaining the feasibility of this investment and its contribution to achieving the bank's objectives.
  - b- Bank's own purchased shares (Treasury Shares) in accordance with applicable resolutions and instructions.

The Islamic financial sukuk issued by the GCC and OECD governments are exempted from the 10% ratio provided for under Item (2) above, while taking into account investment risks in each country apart.

#### **Fourth: Financial Investments Accounting Policies and Procedures :**

Taking into account the nature of the Islamic banks activities in terms of practicing business in accordance with the Islamic Shareea'a principles, it is understood that it is a must to comply with International Accounting Standards when preparing and presenting banks closing financial statements and data in accordance with the rules of Ministerial Resolution No. 18/1990. Whereas the International Accounting Standards have provided a certain degree of flexibility in determining the accounting policies and procedures to be applied to financial investments, and whereas the accounting methods and techniques differ depending on the nature of those investments and their classification by objective of acquisition, it is a must in this respect to classify securities by the objective of ownership. The following rules have to be complied with in this regard :

(1) Circular No. (2/IBS/187/2006) issued on 22/3/2006 and falling within section [6] of this guide, includes the set of guidelines taken into account while considering banks applications for exemption from the maximum limits established for direct investment and financial investments

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1. Each security must be classified upon acquisition .
2. Securities may not be reclassified and transferred from one portfolio to another, except based on a comprehensive study that explains the justifications and technical bases which substantiate the reclassification. Such a study shall be submitted to Central Bank of Kuwait, upon request.
3. The accounts of each category of securities must be segregated from those of other categories into which securities are classified .
4. Consistency must be maintained in applying a specific accounting policy for each category of securities. Such a policy may not be changed except in case of need, and provided that the change is based on a study that explains the justifications and reasons as well as the results arising from such a change.

**Fifth : General Rules :**

1. A system for delegation of authorities in the area of financial investment must be set up and approved by the bank board of directors. The system is to include the establishment of different committees, a clear and accurate definition of the mechanism of their works and the powers delegated to them as well as to various administrative levels entrusted with financial investment transactions. In defining these powers, segregation should be made between local investment and foreign investment. Controls must be put in place to address exceptions to these delegated powers. The bank must also define the types of financial instruments eligible for investment, and maximum limits for investment in each type must be established for each executive level in the bank.
2. The bank must take the necessary actions ensuring compliance, by various respective managerial levels, with the approved investment policy, including the maximum limits, powers delegated and established responsibilities. The bank must also observe the following :
  - a) Periodically review the investment policy of the bank, and introduce necessary amendments thereto in the light of the general policy of the bank and market developments.
  - b) Provide the Central Bank with a copy of the financial investment policy, as well as with any future amendments thereto.

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3. The executive management of the bank should prepare and submit to the bank's board of directors a quarterly report on the securities portfolio, including an evaluation of this portfolio, the profits and losses resulting therefrom, and the future strategies of the bank's investments.

In addition to the above mentioned quarterly reports, the Chief Executive Officer must also be provided with monthly reports, or with shorter period reports, showing the evaluation of the portfolio and the profits and losses resulting therefrom.

4. The bank should give due attention to the selection of the officers in charge of financial investment transactions, both local and foreign. Such staff members must have the necessary experience and capabilities to carry out these transactions.

**Sixth :** Banks are required to provide the Central Bank with periodic quarterly data (at end of March, June, September, December) on the financial investments of the bank, using the attached forms. Such data must be submitted along with the other periodic data submitted to Central Bank of Kuwait for the said periods.

**Seventh :** These instructions shall be implemented with effect from the date of notification.

**Central Bank of Kuwait  
Supervision Sector  
Off-Site Supervision Department  
(Office Supervision Section)**

**Statement of the Total of Securities Portfolio\***

**As on**        /        /

Bank: Islamic Banks

Attachment No. (1)

| <b>Serial</b> | <b>Description</b>                                                              | <b>Amount in KD 000</b> |         |
|---------------|---------------------------------------------------------------------------------|-------------------------|---------|
|               | A-Shares:                                                                       |                         |         |
|               | Shares in subsidiaries                                                          | .....                   |         |
|               | Shares in affiliates                                                            | .....                   |         |
|               | Shares issued by other parties                                                  | .....                   |         |
|               | Total (A)                                                                       | .....                   |         |
|               | B- Finance sukuk                                                                |                         |         |
|               | issued by banks                                                                 | .....                   |         |
|               | issued by other financial institutions                                          | .....                   |         |
|               | issued by other issuers (including government sukuk)                            | .....                   |         |
|               | Total (B)                                                                       | .....                   |         |
|               | C- Other financial instruments                                                  | .....                   |         |
|               | Total (C)                                                                       | .....                   |         |
| 1             | Total book value for securities portfolio (A+B+C)**                             |                         | .....   |
|               | <u>Less:</u>                                                                    |                         |         |
|               | Finance sukuk                                                                   | (.....)                 |         |
|               | Subsidiaries shares                                                             | (.....)                 |         |
| 2             | Total investments exempted from the 50% ratio                                   |                         | (.....) |
| 3             | Net securities portfolio (1-2)                                                  |                         | .....   |
| 4             | Capital in its comprehensive concept                                            |                         | .....   |
| 5             | Ratio of net securities portfolio/capital in its comprehensive concept (3 /4)%. |                         | .....   |

**Signature :** .....

\* This statement is to be prepared quarterly

\*\* The total face value of those investments as carried in the bank's books. Such a total book value is to be checked against the corresponding items in Islamic Banks Financial Position Statement (1BS1)

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**Central Bank of Kuwait  
Supervision Sector  
Off-Site Supervision Department  
Office Supervision Sector**

attachment (2)

**Detailed Statement of All Types of Financial Investments  
Comprising 5% or More of the Bank's Capital in its Comprehensive Concept\*  
As on ----/----/----**

Bank's capital in its comprehensive concept : KD Thousand ....%.  
Investment ratio / capital in its comprehensive concept.....%  
Total ratio / capital in its comprehensive concept .....%

**Bank: Islamic Banks**

| S.N. | Company invested in & its related parties | Book Value of Financial Investments |           |                      |                   | Other Cash finance Obligations (2) ** | Total Cash finance Obligations (1+2) (3) *** | Customer's Total Liabilities (4) **** |
|------|-------------------------------------------|-------------------------------------|-----------|----------------------|-------------------|---------------------------------------|----------------------------------------------|---------------------------------------|
|      |                                           | Shares (A)                          | Sukuk (B) | Other Securities (C) | Total (A+B+C) (1) |                                       |                                              |                                       |
|      | First : Company Invested In (a)           |                                     |           |                      |                   |                                       |                                              |                                       |
|      | Second : Related Parties (b)              |                                     |           |                      |                   |                                       |                                              |                                       |
| 1    |                                           |                                     |           |                      |                   |                                       |                                              |                                       |
| 2    |                                           |                                     |           |                      |                   |                                       |                                              |                                       |
| 3    |                                           |                                     |           |                      |                   |                                       |                                              |                                       |
| 4    |                                           |                                     |           |                      |                   |                                       |                                              |                                       |
| 5    |                                           |                                     |           |                      |                   |                                       |                                              |                                       |
|      | Total (B)                                 |                                     |           |                      |                   |                                       |                                              |                                       |
|      | Grand Total (A+B)                         |                                     |           |                      |                   |                                       |                                              |                                       |

**Signature : .....**

- \* This statement is to be prepared quarterly.
- \*\* For identifying other cash obligations (other than financial investments), the bank has to observe the concepts mentioned under "Item Second" of instructions concerning the Maximum limit for anyone single customer's liabilities to an Islamic bank.
- \*\*\* Should match with column No.(1) of Form No. (A.M.18) concerning the statement of existing finance obligations amounting to 5% or more of the capital base, in accordance with the said instructions.
- \*\*\*\* Should match with column No. (6) of the above mentioned Form No. (AM18). Including total cash and non-cash finance liabilities-collaterals submitted-net customers' liabilities to subsidiaries.

**Central Bank of Kuwait  
 Supervision Sector  
 Off-Site Supervision Department  
 (Office Supervision Section)**

Table No. (3)

**Detailed Statement of Securities Investment in  
 Which Investment Represents  
 10% or More of the Issuer’s Capital**

In KD 000

| S.N | Name of Company invested in** | Face value of Shares owned by the Bank |                      |           | Total Face value of shares issued by the Company invested in |                      |           | Investment ratio in the issuer’s capital |
|-----|-------------------------------|----------------------------------------|----------------------|-----------|--------------------------------------------------------------|----------------------|-----------|------------------------------------------|
|     |                               | No. of Shares                          | Face value Per share | Total (1) | No. of shares                                                | Face value Per share | Total (2) | (1÷2) %                                  |
|     | Subsidiaries                  |                                        |                      |           |                                                              |                      |           |                                          |
|     |                               |                                        |                      |           |                                                              |                      |           |                                          |
|     |                               |                                        |                      |           |                                                              |                      |           |                                          |
|     |                               |                                        |                      |           |                                                              |                      |           |                                          |
|     | Affiliates                    |                                        |                      |           |                                                              |                      |           |                                          |
|     |                               |                                        |                      |           |                                                              |                      |           |                                          |
|     |                               |                                        |                      |           |                                                              |                      |           |                                          |
|     |                               |                                        |                      |           |                                                              |                      |           |                                          |
|     | Other                         |                                        |                      |           |                                                              |                      |           |                                          |
|     |                               |                                        |                      |           |                                                              |                      |           |                                          |
|     |                               |                                        |                      |           |                                                              |                      |           |                                          |
|     |                               |                                        |                      |           |                                                              |                      |           |                                          |
|     |                               |                                        |                      |           |                                                              |                      |           |                                          |

**Signature : .....**

\* This statement is to be prepared quarterly.  
 \*\* including subsidiaries and affiliates.