



بنك الكويت المركزي
Central Bank of Kuwait



THE FORTY-SECOND ANNUAL REPORT

FOR THE FISCAL YEAR 2013/2014



**H. H. Sheikh Sabah Al-Ahmad Al-Jaber Al-Sabah
The Amir Of The State Of Kuwait**



**H. H. Sheikh Nawwaf Al-Ahmad Al-Jaber Al-Sabah
The Crown Prince Of The State Of Kuwait**



**H. H. Sheikh Jaber Al-Mubarak Al-Hamad Al-Sabah
The Prime Minister Of The State Of Kuwait**

BOARD OF DIRECTORS OF THE CENTRAL BANK OF KUWAIT

FOR THE FISCAL YEAR 2013 / 2014



Dr. Mohammad Y. Al-Hashel

Governor
Chairman



Mr. Yousef J. Alobaid

Deputy Governor
Member



Mr. Khalifa M. Hamada

Undersecretary
Ministry of Finance
Member



Mr. Abdulaziz M. Al-Khadi

Undersecretary
Ministry of Commerce & Industry
Member



Mr. Mohammed Ali Al-Kadi

Member



Mr. Abdul Rasul Yousef Abu Al-Hasan

Member



Mr. Nasser Abdullah Alroudan

Member



Mr. Osamah Mohammad Al-Nisf

Member

In the Name of Allah, Most Gracious, Most Merciful

Introduction

I am pleased to introduce the 42nd Annual Report of the Central Bank of Kuwait (CBK) for the Fiscal Year (FY) 2013/2014 which contains the Auditors' Report on CBK's financial statements as at 31 March 2014. As in the previous years, the Report begins with a brief overview of the most significant monetary and banking developments in the Kuwaiti economy during FY2013/14. The Report also highlights the main procedures and operations performed by CBK's departments and offices in various areas relating to monetary and banking affairs during the mentioned fiscal year, including Bank's main supervisory efforts of domestic banking and financial system units.

Within the framework of CBK's continuous endeavors to keep pace with the developments in the business of international central banking, and in light of the advances in the technology of banknote issuance and central banks practices in this area, CBK, in accordance with Law No. 32 of 1968 concerning Currency, the Central Bank of Kuwait and the Organization of Banking Business, conducted a comprehensive technical study to evaluate the fifth issue of the Kuwaiti banknotes issued in 1994. Findings of the said study, revealed the need to make use of the developments in the technology of banknote printing industry achieved during the past twenty years which introduced advanced security features to guard banknotes against counterfeiting, as well as advances in the paper quality of banknotes. Based on the findings of the study, CBK recognized the need to launch a new issue of all banknote denominations to replace the 5th issue of banknotes introduced about twenty years ago, to take advantage of the said and other advances in the technology of banknote print quality. In this context and following the recommendation of CBK's Board of Directors, the Council of Ministers approved in its meeting held on 10 June 2013 the proposed new (sixth) issue including the specifications, image and design of banknote denominations. As per the Council of Ministers' resolution, CBK continued its extensive efforts during FY2013/14 to finalize the

preparations for launching the sixth issue of the Kuwaiti banknotes, to be released into circulation from 29/6/2014, God willing.

CBK has generally been focusing its continued efforts, during FY2013/14, on strengthening the foundations of monetary and financial stability in the State of Kuwait through formulation and implementation of monetary policy and developing supervision and oversight programs and methods over banking and financial system units, with the aim of boosting economic growth and creating an environment supporting the efficient performance of local banking and financial system.

As for monetary developments, Money Supply in its broad definition (M2) increased by 8.8% at the end of FY2013/14 compared with the end of the previous fiscal year. This increase reflects CBK's persistent efforts to provide an enabling environment for local banking and financial units to accommodate clients' funding needs in various domestic economic sectors. Within this context, the utilized cash portion of credit facilities extended by local banks to domestic economic sectors increased by 8% at the end of FY2013/14 compared with its level at the end of the previous fiscal year.

In the area of supervision during FY2013/14, CBK has continued its persistent efforts in supervising and overseeing registered local banking and financial system units, with the aim to strengthen their financial position in line with the international standards for effective banking supervision, enhance financial stability atmosphere and promote local banks abilities in risk management, and banks resilience against difficult and stressful situations. In this context, CBK has continued during FY2013/14 its efforts towards the implementation of the supervision standards introduced by the Basel Committee (Basel III Capital reform package) which contained a number of basic amendments to Basel II Capital Adequacy standard including the increase in the total ratio of the regulatory capital and redefining it within a set of standards that is meant to improve capital quality and introducing new standards of financial leverage and short/long-term liquidity.

During FY2013/14, CBK has published the first issue of the “Financial Stability Report” for 2012 containing an evaluation of the material risks facing the banking system particularly credit, market and liquidity risks. The Report also highlighted the trends in profitability and solvency of the banking system and its resilience against a variety of major endogenous and exogenous shocks, under different financial and economic stress tests scenarios. Issuance of the “Financial Stability Report” thus is deemed a significant addition to the publications of CBK which aim to promote transparency and provide reliable information and statistics related to the Kuwaiti banking and financial sector.

On another front, resident private sector deposits with local banks increased by 8.8% to KD 32298.5 million at the end of FY2013/14 compared to KD 29674 million at the end of the previous fiscal year. Consequently, the aggregate balance sheet of local banks increased to KD 54133.2 million at the end of the mentioned fiscal year against KD 48760.5 million at the end of FY2012/13, i.e. an increase of KD 5372.7 million or 11%.

During FY2013/14, and within the framework of CBK’s continued efforts to communicate and inform the economic and financial society, it has organized “CBK’s Forum” on 10 November 2013, hosting Her Excellency the IMF Managing Director, Madame Christine Lagarde, with the presence of officials, specialists and other parties interested in the economic affairs in general, and the banking and financial affairs, in particular.

CBK has also continued its efforts during FY2013/14 towards enhancing the capabilities of its human resources and enhancing the staff’s academic and professional qualifications and experiences through specialized local and international training programs with the intend to enhance staff performance, maintain current distinguished Kuwaiti staff and attract more similar Kuwaiti staff to join CBK so as to enhance the Bank’s ability to carry out its entrusted tasks. Within CBK’s efforts to promote employees performance, loyalty and incentives towards high-efficiency and outstanding performance, CBK has introduced the “Distinguished Employee” competition during FY2013/14. Competition

result has been announced and the distinguished employees of 2013 have been celebrated on 30 March 2014.

Moreover, CBK has continued its endeavors during FY2013/14 to develop and upgrade Bank's information technology (IT) infrastructure keeping pace with IT global breakthroughs. CBK has continued to develop, design and implement technical programs and systems in Bank's various departments and offices to ensure CBK's business continuity under different circumstances, and provide quality client service in line with the modern international standards applied. In early January 2014, CBK introduced its new pilot website designed to function as an advanced informative browser for researchers and other interested individuals, and as a channel of communication with CBK clients and site's visitors in promotion of the principals of transparency and disclosure through the expansion of the range of data and information published by CBK.

We pray to Allah the Almighty to grant success to our efforts and endeavors and to enable us to achieve the welfare of our beloved country, under the patronage of His Highness the Amir, Sheikh Sabah Al-Ahmad Al-Jaber Al-Sabah, His Highness the Crown Prince, Sheikh Nawwaf Al-Ahmad Al-Jaber Al-Sabah, and His Highness the Prime Minister, Sheikh Jaber Al-Mubarak Al-Hamad Al-Sabah, may Allah bless and guard them.

Dr. Mohammad Y. Al-Hashel
Governor of the Central Bank of Kuwait

Preface:

The Central Bank of Kuwait (CBK) has continued its efforts during FY2013/14 in pursuit of its objectives stipulated in Law No. 32 of 1968 concerning Currency, the Central Bank of Kuwait and the Organization of Banking Business and amendments thereof. These objectives include practicing the privilege of issuing the national currency on behalf of the State, maintaining relative stability of the KD exchange rate against foreign currencies and securing KD free convertibility, formulating and implementing monetary policy, controlling credit policies of domestic financial and banking sector units, developing supervision and oversight systems and programs of the sectors units with the intention to support the growth of the national economy on solid foundations and ensure financial and monetary stability in the country.

CBK's projects encompassed in the Medium Term Development Plan (2010/11-2013/14) assert its role stated above, and include the following:

- Enhancing CBK's efforts in drawing and implementing monetary policy for promoting monetary stability.
- Intensifying the supervisory and oversight efforts concerning the banking and financial system units aiming at upgrading their efficiency and competitiveness and strengthening the basis of financial stability.
- Enhancing the position of the local banking and financial system units.
- Upgrading retail banking services.
- Upgrading corporate banking services.
- Developing the services supporting the financial sector.
- The new Central Bank of Kuwait headquarters.

During FY2013/14, CBK has continued completion of the projects encompassed in the above-mentioned Medium Term Development Plan (MTDP). The MTDP projects are of going concern nature and relate to the core objectives sought by the CBK. This part of the

Report highlights CBK's efforts exerted during FY2013/14 serving the projects encompassed in the development plan, for the said fiscal year, as follows:-

First: Developments in Monetary Policy and Monetary Indices and aggregates:

- **Reinforcing CBK's efforts in drawing and implementing monetary policy for promoting monetary stability.**

This section of the Report highlights key developments in the State of Kuwait's major monetary indices and aggregates during FY2013/14 as reflected in the data on money supply, interest rate, KD exchange rate against major currencies, bank credit, domestic liquidity and issuance of public debt instruments. A significant part of these developments reflects the impact of CBK's efforts related to the formulation and implementation of monetary policy. Data related to Kuwait's major monetary indices and aggregates indicate the following positive developments during FY2013/14:

A-Money Supply:

Money Supply in its Broad Definition (M2) increased to around KD 33787.4 million at the end of FY2013/14 against KD 31066.4 million at the end of FY2012/13, i.e. an increase by KD 2721 million or 8.8% compared with an increase of KD 2478.1 million or 8.7% during the previous fiscal year. A major part of this increase in Money Supply reflects CBK's continuous efforts to control the levels of domestic liquidity contributing to the driving forces of the growth of various domestic economic sectors.

Money Supply Developments
(KD Million)

| End of Period | 2011/12 | 2012/13 | 2013/14 | Change in 2013/14 over 2012/13 | |
|--------------------------|----------------|----------------|----------------|-----------------------------------|-------------|
| | | | | Value | % |
| Money Supply (M2) | 28588.3 | 31066.4 | 33787.4 | 2721.0 | 8.8 |
| Money (M1) of which: | <u>6760.9</u> | <u>7906.8</u> | <u>9466.2</u> | <u>1559.4</u> | <u>19.7</u> |
| Sight Deposits | 5557.3 | 6514.4 | 7877.2 | 1462.8 | 22.5 |
| Quasi Money | <u>21827.4</u> | <u>23159.6</u> | <u>24321.3</u> | <u>1161.7</u> | <u>5.0</u> |
| KD Deposits | 19605.7 | 20137.7 | 21040.5 | 902.8 | 4.5 |
| FC Deposits | 2221.7 | 3021.9 | 3280.8 | 258.9 | 8.6 |

Source: Central Bank of Kuwait.

With respect to the factors affecting the changes in Money Supply (M2) within the monetary survey of CBK and local banks⁽¹⁾ at the end of FY2013/14 compared with the previous fiscal year, the mentioned rise in Money Supply in its Broad Definition (M2) of KD 2721 million or 8.8% came as a result of the increase in net foreign and domestic assets of those institutions. Net foreign assets increased by KD 1435.1 million or 9.7% at the end of FY2013/14 compared with the previous fiscal year. This rise in net foreign assets was caused by the increase in net foreign assets of CBK by KD 1162.7 million or 81% of the mentioned increase, and the increase in net foreign assets of local banks by KD 272.4 million or 19% of the increase in net foreign assets. Also, net domestic assets of those institutions increased by KD 1218.9 million or 7.6% at the end of FY2013/14 compared with the previous fiscal year.

(1) Includes as at the end of FY2013/14, Kuwaiti banks (5 traditional banks, 5 banks operating in accordance with the provisions of the Islamic Sharia, in addition to one specialized bank), and foreign bank branches (11, of which one operating in accordance with the provisions of the Islamic Sharia).

Net Domestic and Foreign Assets Developments
(KD Million)

| End of Period | 2012/13 | 2013/14 | Change | |
|---------------------------------|----------------|----------------|---------------|------------|
| | | | Value | % |
| Net Domestic Assets: | 31066.4 | 17236.3 | 1218.9 | 7.6 |
| -Claims on the Private Sector | 29501.3 | 31679.5 | 2178.2 | 7.4 |
| -Claims on the Government (Net) | -3941.4 | -4357.4 | -416.0 | 10.6 |
| -Other (Net) | -9542.5 | -10085.9 | -543.3 | 5.7 |
| Net Foreign Assets: | 14827.2 | 16262.3 | 1435.1 | 9.7 |
| -CBK | 8017.7 | 9180.4 | 1162.7 | 14.5 |
| -Local Banks | 6809.5 | 7081.9 | 272.4 | 4.0 |

Source: Central Bank of Kuwait.

B- Domestic Interest Rates:

CBK's discount rate plays a pivotal role resulting from its impact, within specified margins, on the maximum limits of interest rates on KD-lending transactions of local banking and financial system units. Accordingly, decreasing (or increasing) the discount rate will necessarily entail an equal decrease (or increase) in the maximum limits of interest rates on KD-lending transactions of local banking and financial system units.

In light of CBK's constant monitoring of local economic, monetary and banking developments on the one hand, and the changes in interest rates of major foreign currencies on the other, and in pursuit of CBK's efforts in order to strengthen the foundations of domestic economic growth while maintaining KD's attractiveness and competitiveness as a store for domestic savings and a tool to curb inflationary pressures, CBK has maintained its discount rate at its current (historically lowest) level of 2% during FY2013/14, after reducing it by 50 basis points in October 2012 (from 2.5% to 2%).

With regard to interest rates on both KD and US dollar customer time deposits with local banks, the average interest rate on KD customer time deposits witnessed a decline during

FY2013/14 compared with the previous fiscal year. Specifically, the average interest rate on KD customer time deposits of one-month and three-month maturity declined to 0.5611% and 0.7412% respectively against 0.6739% and 0.9081% for the two mentioned terms respectively during the previous fiscal year.

Moreover, average interest rate on US dollar time deposits with local banks of one-month and three-month maturity decreased during FY2013/14 reaching 0.1612% and 0.2836% respectively against 0.1937% and 0.3332% for the two mentioned terms respectively during the previous fiscal year. Consequently, the margin between the two averages of interest rates on KD and US dollar deposits of one-month and three-month maturity during FY2013/14 reached 0.40 percentage point and 0.458 percentage point respectively in favor of KD deposits, against 0.48 and 0.575 percentage point respectively in favor of KD deposits during FY2012/13.

On the other hand, average interest rates on local interbank KD deposits of one-month maturity increased during FY2013/14 reaching 0.554% against 0.526% for the mentioned term during FY2012/13. The average interest rates on public debt instruments limitedly declined during FY2013/14 reaching 1% for one-year treasury bonds compared to 1.1% during the previous fiscal year.

C- The KD Exchange Rate:

During FY2013/14, CBK continued its efforts targeting relative stability of the KD exchange rate against other major currencies, in light of the KD exchange rate policy adopted since 20 May 2007 pegging the Kuwaiti Dinar to a special weighted basket of currencies of the countries that are significantly engaged in trade and financial relations with the State of Kuwait.

The US Dollar Exchange Rate against the KD and Some Major Currencies

| FY | 2012/13 | | | | 2013/14 | | | |
|----------------------|---------------|--------------|---------------|---------|---------------|--------------|---------------|---------|
| | Highest Price | Lowest Price | End of Period | Average | Highest Price | Lowest Price | End of Period | Average |
| Kuwaiti Dinar (fils) | 284.85 | 277.25 | 284.85 | 282.53 | 286.80 | 281.0 | 281.50 | 282.05 |
| Pound Sterling | 0.6717 | 0.6124 | 0.6599 | 0.6421 | 0.6724 | 0.5963 | 0.6031 | 0.6048 |
| Euro | 0.8286 | 0.7331 | 0.7788 | 0.7556 | 0.7824 | 0.7176 | 0.7255 | 0.7301 |
| Swiss Franc | 0.9953 | 0.9023 | 0.9494 | 0.9281 | 0.9770 | 0.8725 | 0.8855 | 0.8935 |
| Japanese Yen | 96.555 | 77.665 | 94.855 | 92.015 | 105.325 | 92.830 | 102.125 | 102.818 |

Source: Central Bank of Kuwait.

In this regard, the average exchange rate of the US dollar against the KD for FY2013/14 was 282.05 fils per US dollar against 282.53 fils during the previous fiscal year, i.e. a decrease by 0.48 fils or 0.2%. The difference between the highest (286.80 fils) and the lowest (281.0 fils) exchange rate of the US dollar against the KD during FY2013/14 was 2.1%. Conversely, the exchange rate of the US dollar witnessed evident fluctuations against other major currencies during FY2013/14. The difference between the highest and the lowest exchange rate of the US Dollar reached 9% against the Euro, 12% against the Swiss Franc, 12.8% against the Pound Sterling and 13.5% against the Japanese Yen.

D- Bank Credit:

The utilized cash portion of credit facilities extended by local banks to various economic sectors during FY2013/14 increased by KD 2197.7 million or 8% to reach KD 29519.2 million at the end of the mentioned fiscal year compared to KD 27321.5 million at the end of FY2012/13. This rise basically resulted from the rise in credit facilities extended to the Personal Facilities sector by KD 1280.4 million or 12.4%, Real Estate by KD 455.3 million or 6.3%, Trade by KD 368.3 million or 14.8%, Crude oil and gas by KD 103.1 million or 71.1% and Construction by KD 91.6 million or 5%. On the other side, cash credit facilities extended by local banks to Non-bank Financial Institutions declined by KD 335.4 million or 18.4% at the end of FY2013/14.

Developments of Balances of Utilized Cash Portion of Credit Facilities extended by Local Banks (to Residents)

(KD Million)

| End of Period | 2012/13 (1) | 2013/14 (2) | Change in (2) over (1) | |
|--|----------------|----------------|---------------------------|------------|
| | | | Value | (%) |
| Total utilized cash portion of credit facilities, of which: | 27321.5 | 29519.2 | 2197.7 | 8.0 |
| • Trade | 2493.6 | 2861.9 | 368.3 | 14.8 |
| • Manufacturing | 1798.2 | 1827.5 | 29.3 | 1.6 |
| • Construction | 1833.6 | 1925.2 | 91.6 | 5.0 |
| • Non-bank Financial Institutions | 1825.8 | 1490.4 | -335.4 | -18.4 |
| • Personal Facilities | 10328.7 | 11609.1 | 1280.4 | 12.4 |
| • Real-Estate | 7205.8 | 7661.1 | 455.3 | 6.3 |
| • Oil and Gas | 145.0 | 248.1 | 103.1 | 71.1 |

Source: Central Bank of Kuwait.

E- Domestic Liquidity:

CBK pursued to control the levels of domestic liquidity during FY2013/14 in coherence with the economic, monetary and banking developments in Kuwait. For this purpose, CBK uses numerous monetary instruments, notably the system of accepting time deposits from local banks, issuance of CBK bonds and managing issuance of public debt instruments including bills and bonds of the Kuwaiti Treasury on behalf of the Ministry of Finance. Furthermore, CBK directly interferes to control the levels of liquidity in the domestic banking sector units.

In this regard, time deposits of local banks with CBK, under the scheme of accepting time deposits from local banks, increased by KD 634.8 million or 23.6% to KD 3322.8 million at the end of FY2013/14 compared to KD 2688 million at the end of the previous FY2012/13. On the other side, CBK launched 42 issues of CBK bonds with a total nominal value of KD 6175 million during FY2013/14. Meanwhile, 41 previous issues of these bonds with a total nominal value of KD 6134 million matured during that fiscal

year. Accordingly, the outstanding balance of CBK bonds increased to KD 1950 million at the end of FY2013/14 against its level of KD 1909 million at the end of the previous fiscal year, i.e. a rise of KD 41 million or 2.1%.

F- Public Debt Instruments:

CBK manages the launching of public debt instruments including Kuwaiti Treasury bills and bonds on behalf of the Ministry of Finance. The availability of these instruments enables CBK to control the levels of domestic liquidity through the primary market of instruments, or through the use of open market operations in the secondary market of instruments. Within this context, CBK has launched 23 issues of Treasury Bonds during FY2013/14 with a total nominal value of KD 1122.3 million. Meanwhile, 19 previous issues of Treasury Bonds matured during that period with a total nominal value of KD 1185 million. Accordingly, the total outstanding balance of public debt instruments (Treasury Bills and Bonds) decreased by KD 62.7 million or 3.8% to KD 1577.3 million at the end of FY2013/14, against KD 1640 million at the end of the previous fiscal year. The outstanding balance of public debt instruments at the end of FY2013/14, was KD 1555.3 million (98.61%) held by local banks, and KD 22 million (1.39%) held by other local institutions.

Second: CBK's Supervisory Efforts:

CBK has continued its supervisory efforts during FY2013/14 aiming at enhancing the position of the local banking and financial system units and promoting financial stability. Those efforts are represented in CBK's Medium Term Development Plan projects which include the following:

- **Intensifying the supervisory and oversight efforts concerning the banking and financial system units aiming at upgrading their efficiency and competitiveness and strengthening the basis of financial stability.**

- **Enhancing the position of the local banking and financial system units supervised by CBK.**
- **Upgrading retail banking services.**
- **Upgrading corporate banking services.**
- **Developing the services supporting the financial sector.**

CBK has adopted several mechanisms and procedures in implementation of its supervisory projects including on-site/off-site monitoring and other follow-up methods, and communications and meetings with officials of banks and financial institutions supervised by CBK. Within this context, CBK has implemented a set of measures, regulations, circulars and controls in this respect, most prominent of which:

- In line with CBK's endeavors to keep pace with the international standards of banking supervision, and within the framework of the preparation of the new regulations of Basel III reforms package, the CBK's Board of Directors has approved the structure of the regulatory capital and the transitional phase for implementation. The Board has also approved the minimum capital adequacy ratio of 13% to be implemented in stages between 2014 and 2016. This ratio is set based on a quantitative-impact study carried out by the CBK in collaboration with a consultancy firm which is tasked to draft the Basel III regulations and the encouraging findings of the study which prove Kuwaiti banks' ability to meet the Basel III capital adequacy requirements. Moreover, CBK is currently implementing other standards included in the Basel III reform package represented in the standard of maximum limits of leverage and two liquidity standards in the form of short-term liquidity (Liquidity Coverage Ratio-LCR) and long-term liquidity (Net Stable Funding Ratio-NSR). Worth noting is that the new standard of capital adequacy aims at enhancing capital quality and increasing the ratio of regulatory capital to strengthen banks' resilience against losses and enable banks to build up additional capital buffers within a framework of macroprudential policies implemented by the regulatory authorities in order to limit systemic risk and enhance financial stability.

- CBK has continued its efforts in strengthening banks risk-management in line with the advanced supervisory methods. In this context, CBK has continued to instruct banks to perform semi-annual stress tests, according to a set of forms and detailed appendices which illustrate the methods adopted by each bank and the results of those tests. The stress tests performed at the end of December 2013 for a one-year perspective, revealed banks' ability to face various shocks under different stress test scenarios, and to cope with stressful situations. This shall be in parallel with receiving continuous data on internal capital adequacy assessment process (ICAAP) prepared by banks, assessing the findings and taking necessary measures regarding capital adequacy.
- CBK continued to direct banks to build precautionary provisions requested from each bank, in addition to the required provisions according to CBK's classification policy regulations, where the ratios of the requested provisions of non-performing loans are gradually being built according to the level, duration and value of collateral. This sober and gradual method reflects CBK's keenness to strengthen local banks position and maintain banks strong financial position which is reflected in local banks evaluations by international rating agencies, thus contributing to the enhancement of investors' confidence in local banks financial position. As a result of the gradual implementation of this prudential policy, the ratio of irregular cash debt to the total cash credit facilities portfolio reached 3.2% at the end of 2013 against 4.9% at the end of 2012, dropping below pre-crisis levels. The coverage ratio of specified and general provisions to the total irregular cash debt also increased to 141.3% at the end of 2013 against 94.8% at the end of 2012. All such indices indicate a strong and solid financial position of local banks.
- Out of CBK's keenness to enhance supervision practices of banking and financial system units, and in light of what has been revealed by the global financial and economic crisis on the importance of promoting sound application of corporate governance, CBK has issued on 3/9/2013 regulations regarding governance rules and regulations of finance companies supervised by CBK, in accordance with Article 217

of Law No. 97 of 2013 amending certain articles of the Amiri Decree Law No. 25 of 2012 regarding the issuance of the Companies Law. These regulations came in parallel with the governance regulations directed to Kuwaiti banks in June 2012. In this context, and relative to CBK's pursuit to urge banks to apply best practices of corporate governance, a survey was conducted on local banks in order to verify their ability to implement CBK's regulations concerning the application of the rules and regulations of governance, which became effective as of 1/7/2013, in addition to subsequent field inspections to ensure banks' compliance with these regulations.

- In the context of the supervisory practices adopted by CBK to enhance the financial position of the supervised units, CBK has issued on 8/9/2013 new controls to Islamic investment companies containing a modified way of calculating the general provisions on cash/non-cash investment and finance transactions of no specified provisions, included in the regulations issued on 27/7/1999 concerning the rules and principles of the classification of investment and finance transactions extended to clients according to Islamic finance formulas, and calculation of transactions provisions and generated income.
- In the field of macroprudential policies adopted by CBK to curb systemic risks and promote financial stability, CBK has issued a circulation on 12/11/2013 to local banks, investment companies and finance companies regarding the controls of the financing extended to individual clients for the purpose of purchasing and/or developing real estates located in private and model housing areas. These controls take into account the risks involved in this type of financing, which may confront individual clients and local banking sector units equally, entailing negative economic and social impacts. Thus the controls are introduced in the framework of a macroprudential policy which aims at eliminating systematic risks, particularly in light of the changes in the real estate market and CBK's realization of the acceleration of banks and clients' demand for this type of funding which may trigger intense competition among banks leading to an uncontrolled expansion of funding that could entail systemic risks.

- In pursuit of enhancing local banks' activities, performance and competitiveness within the banking sector, and upon the issuance of the legislative amendment permitting foreign banks operating in the State of Kuwait to open more branches and representative offices, CBK has issued a circular on 25/3/2014 to foreign banks operating in the State of Kuwait containing the rules, regulations and principles to be complied with, regarding permitting licensed foreign bank branches operating in the State of Kuwait to open more branches. Moreover, CBK's Board of Directors has approved a set of controls concerning the establishment of foreign bank representative offices. These regulations address several regulatory and supervisory aspects including identifying the foreign banks that are allowed to exist in the State of Kuwait through branches or representative offices. Those are the banks enjoying good credit rating & good business reputation, supervised by the authorities in their headquarters' countries and having formal written approvals to establish branches or representative offices in the State of Kuwait.
- Out of CBK's keenness to insure local banks and investment (finance) companies adherence to the rules governing consumer and installment loans/finance, CBK has issued a circular on 7/8/2013 to banks and finance companies instructing them to assign an audit office, other than their external auditors, to examine banks' consumer and installment loans/finance portfolios, during the period from 1/1/2008 to 31/8/2012. This procedure shall include outstanding consumer and installment loans on 30/6/2013, extended by banks as of 1/8/2008 for the cases that are not covered by the sample test carried out in accordance with the mentioned circular dated 16/7/2012, until 30/6/2013, after which a quarterly similar examination shall be initiated continuously.
- In light of CBK's significant role in the area of Anti-Money Laundering, reflected in CBK's coordination with the International Monetary Fund in terms of using the expertise of specialized experts in the field of the prescribed international standards relating to Anti-Money Laundering and Financing Terrorism, CBK's contribution in drafting Law No. 106 of the year 2013 and the executive regulations thereof, and

drafting the resolution concerning the establishment of the Financial Intelligence Unit (FIU), CBK has issued circulars on 23/7/2013 to all local banks, exchange companies and finance companies regarding Anti-Money Laundering and Financing Terrorism.

- In line with CBK's inspection methodology using risk on supervision, CBK has pursued the inspection responsibilities using advanced procedures and methodologies based on the quantitative and qualitative evaluation of the elements of banks' activities involving banking risks, taking into account the type of services and products offered to different denominations of bank clients. In addition, CBK continued to examine the operation systems and the availability of internal supervision controls, including the efficiency of banks auditing system.
- In the framework of implementing the requirements of Law No. 104 of 2013 concerning the establishment of the Family Support Fund, CBK has taken a number of measures including the issuance of circulations to conventional banks and investment companies regarding measures to be taken in implementation of the law. These measures include computing consumer and installment loans under the provisions of the said law, maintaining organized loan files for examination and taking necessary correction measures according to law requirements. In execution of the law CBK has held a number of meetings with the concerned bodies, and has been interconnecting with creditors, manager banks and auditors to clarify the tasks targeted and respond to relevant queries.
- In light of CBK's pursuance of banks leading positions, and the attention given to the training of national manpower and their priority in filling such positions, CBK has issued a circular to Kuwaiti banks on 29/8/2013 concerning banks career development plans and policies instructing them to appoint Kuwaiti staff in senior technical and administrative positions. A relevant circular was issued on 17/4/2014 emphasizing the Banks' insight and instructing banks to assign non-Kuwaitis in leading positions to train national staff within a convenient fixed period, to enable

them fill these jobs in the context of banks' career development and replacement plans.

Banking and Financial Aggregate Development:

A- The Aggregate Balance Sheet of Local Banks

Data on the aggregate balance sheet of local banks indicate an increase to KD 54133.2 million at the end of FY2013/14 against KD 48760.5 million at the end of FY2012/13, i.e. a rise by KD 5372.7 million or 11%. This rise was caused by various developments in the components of both sides (Assets and Liabilities) of the balance sheet, the most notable of which are highlighted as follows:

On the Assets Side:

- Local banks' claims on the private sector increased by around KD 2178.2 million or 7.4% to around KD 31679.5 million at the end of FY2013/14 against around KD 29501.3 million at the end of FY2012/13. This increase resulted from the increase in the balances of utilized cash portion of credit facilities extended by local banks to various domestic economic sectors by around KD 2197.7 million or 8% to around KD 29519.2 million at the end of FY2013/14 against around KD 27321.5 million at the end of the previous fiscal year on the one hand, and the decrease in the balances of other local investments by KD 19.4 million or 0.9% to around KD 2160.4 million at the end of FY2013/14 against KD 2179.8 million at the end of the previous fiscal year, on the other.
- Local banks' claims on CBK increased by KD 1322 million or 27.1% to KD 6208.7 million at the end of FY2013/14 against KD 4886.7 million at the end of the previous fiscal year. This rise resulted from the increase in the balances of sight deposits with CBK by KD 646.2 million or 223.1% (from KD 289.7 million to KD 935.9 million), time deposits with CBK by KD 634.7 million or 23.6% (from KD 2688 million to

KD 3322.8 million), and local banks' holdings of CBK Bonds by KD 41 million or 2.1% (from KD 1909 million to KD 1950 million) between the end of FY2012/13 and FY2013/14 respectively.

- Foreign assets of local banks increased by KD 901.9 million or 9% to KD 10959.1 million at the end of FY2013/14 against KD 10057.3 million at the end of the previous fiscal year. This rise resulted from the increase in the balances of local banks' deposits with foreign banks by KD 684.8 million or 12.7%, foreign investments of local banks by KD 158 million or 4.7%, other foreign assets by KD 36 million or 8.1%, and credit facilities extended to non-residents by KD 23.1 million or 2.6%.
- Local banks' claims on the government decreased by KD 23.2 million or 1.5% to KD 1555.3 million at the end of FY2013/14 against KD 1578.5 million at the end of the previous fiscal year. This decline is attributed to the decrease in the balance of local banks' holdings of Treasury Bonds by the same value and ratio at the end of the mentioned fiscal year.

On the Liabilities Side:

- Resident private sector's deposits with local banks increased by KD 2624.5 million or 8.8% to KD 32298.5 million at the end of FY2013/14 against KD 29674 million at the end of the previous fiscal year. The mentioned rise primarily resulted from the increase in the balances of KD deposits by KD 2365.8 million or 8.9% to KD 29017.8 million at the end of FY2013/14 against KD 26652 million at the end of the previous fiscal year. Likewise, foreign currency resident private sector deposits with local banks increased by KD 258.7 million or 8.6% reaching KD 3280.7 million at the end of FY2013/14 against KD 3022 million at the end of the previous fiscal year.
- Foreign liabilities on local banks increased by KD 629.4 million or 19.4% to KD 3877.2 million at the end of FY2013/14 against KD 3247.8 million at the end of FY2012/13. This rise was brought about by the increase in the balances of non-resident banks' deposits by KD 553.6 million or 26.5%, other non-residents'

deposits by KD 44 million or 4.3%, and other foreign liabilities by KD 31.8 million or 22.6% at the end of FY2013/14 against FY2012/13.

The Aggregate Balance Sheet of Local Banks
(KD Million)

| Items | Balances at the end of the year | | |
|-------------------------------------|---------------------------------|----------------|----------------|
| | 2011/12 | 2012/13 | 2013/14 |
| Assets: | | | |
| Cash | 163.4 | 221.8 | 288.9 |
| Claims on CBK | 4135.7 | 4886.7 | 6208.7 |
| Balances (demand deposits) with CBK | 282.8 | 289.7 | 935.9 |
| CBK Bonds | 1704.0 | 1909.0 | 1950.0 |
| Time Deposits with CBK | 2148.9 | 2688.0 | 3322.8 |
| Local Interbank Deposits | 1058.8 | 988.1 | 1731.0 |
| Claims on Government | 1905.7 | 1578.5 | 1555.3 |
| Treasury Bonds | 1780.7 | 1578.5 | 1555.3 |
| Treasury Bills | 125.0 | - | - |
| Claims on Private Sector | 28639.4 | 29501.3 | 31679.5 |
| Credit Facilities to Residents | 25994.2 | 27321.5 | 29519.2 |
| Other Domestic Investments | 2645.2 | 2179.8 | 2160.4 |
| Foreign Assets | 8501.6 | 10057.3 | 10959.1 |
| Deposits with Foreign Banks | 4694.5 | 5387.9 | 6072.7 |
| Credit Facilities to Non-Residents | 661.4 | 899.9 | 923.0 |
| Investments Abroad | 2744.5 | 3328.1 | 3486.1 |
| Other Foreign Assets | 401.3 | 441.3 | 477.3 |
| Other Assets | 914.2 | 1526.7 | 1710.8 |
| Total Assets = Liabilities | 45318.8 | 48760.5 | 54133.2 |
| Liabilities: | | | |
| Private Sector Deposits | 27384.1 | 29674.0 | 32298.5 |
| KD Deposits | 25162.4 | 26652.0 | 29017.8 |
| Foreign Currency Deposits | 2221.7 | 3022.0 | 3280.7 |
| Government Deposits | 4505.2 | 4815.3 | 5208.8 |
| Local Interbank Deposits | 925.7 | 949.0 | 1756.6 |
| Shareholders' Equity | 6317.9 | 6652.1 | 7222.4 |
| Foreign Liabilities | 3193.0 | 3247.8 | 3877.2 |
| Non-Resident Bank Deposits | 2081.1 | 2088.0 | 2641.6 |
| Other Non-Resident Deposits | 960.7 | 1018.8 | 1062.9 |
| Other Foreign Liabilities | 151.3 | 140.9 | 172.7 |
| Other Liabilities | 2992.9 | 3422.3 | 3769.5 |
| Contra Accounts: | 7706.1 | 8121.1 | 9143.2 |
| Bank Guarantees | 6311.1 | 6815.1 | 7778.0 |
| Documentary Credits | 958.7 | 1016.8 | 1022.5 |
| Bank Acceptances | 436.3 | 289.2 | 342.7 |

Source: Central Bank of Kuwait.

- Shareholders' equity with local banks increased by KD 570.3 million or 8.6% to KD 7222.4 million at the end of FY2013/14 against KD 6652.1 million at the end of FY2012/13.
- Government deposits with local banks increased by KD 393.5 million or 8.2% to total KD 5208.8 million at the end of FY2013/14 against KD 4815.3 million at the end of FY2012/13.

On the other hand, the balances of contra accounts with local banks reached KD 9143.2 million at the end of FY2013/14 against KD 8121.1 million at the end of FY2012/13, i.e. an increase of KD 1022.1 million or 12.6%. The ratio of these balances represents 16.9% of the aggregate balance sheet of local banks at the end of FY2013/14 against 16.7% at the end of FY2012/13.

B- The Aggregate Balance Sheet of Local Investment Companies:

In accordance with the Law No. 7 of 2010 concerning the establishment of the Capital Markets Authority (CMA) and regulation of securities, the supervisory responsibilities of the investment funds and companies, except their financing activity, were transferred from the CBK to the CMA as of 13/9/2011. Worth noting is that a memorandum of understanding was signed on 11/9/2011 defining the frameworks of coordination between CBK and CMA regarding the supervision responsibilities of the units supervised by CBK. The memorandum covers the aspects of coordination related to the supervision of investment companies, licensing of new companies, and the coordination aspects of supervisory tasks and procedures of units supervised by CBK. A permanent joint work team was formed and authorized by CBK and CMA to carry out coordination tasks as per the memorandum of understanding signed.

In the same context, the aggregate balance sheet of local investment companies (Traditional and Islamic) reached KD 10573.2 million at the end of FY2013/14 (for 91 companies registered with the CBK at the end of FY2013/14) against KD 11575.8

million at the end of FY2012/13 (for 93 companies registered with the CBK at the end of FY2012/13), i.e. a decline of KD 1002.6 million or 8.7%. This decline was caused by various developments on both sides (Assets and Liabilities) of the aggregate balance sheet of local investment companies, briefed as follows:

On the Assets Side:

- Total foreign assets decreased by KD 639 million or 11.3% to KD 5025.6 million at the end of FY2013/14 compared to KD 5664.5 million at the end of FY2012/13.
- Total domestic investments dropped by KD 432.3 million or 14.1% to KD 6234.7 million at the end of FY2013/14 compared to KD 3067 million at the end of FY2012/13.
- The value of customer financing declined by KD 220.7 million or 23.9% to KD 702 million at the end of FY2013/14 against KD 922.8 million at the end of FY2012/13.
- Cash and other balances with local banks increased by KD 71 million or 16.8% to KD 494 million at the end of FY2013/14 against KD 423.1 million at the end of FY2012/13.

On the Liabilities Side:

- Total foreign liabilities decreased by KD 803.3 million or 30.5% reaching KD 1827.4 million at the end of FY2013/14 compared to KD 2630.7 million at the end of FY2012/13.
- The balances of financing from residents declined by KD 403.1 million or 14.6% to KD 2356.4 million at the end of FY2013/14 compared to KD 2759.6 million at the end of FY2012/13.

The Aggregate Balance Sheet of Local Investment Companies
(KD Million)

| Items | Balances at the end of the year | |
|------------------------------------|---------------------------------|----------------|
| | 2012/13 | 2013/14 |
| Assets: | | |
| Cash and Balances with Local Banks | 423.1 | 494.0 |
| Customer Financing | 922.8 | 702.0 |
| <u>Local Investments</u> | <u>3067.0</u> | <u>2634.7</u> |
| Financial Investments | 2594.9 | 2180.6 |
| Non-financial Investments | 472.1 | 454.0 |
| Foreign Assets | 5664.5 | 5025.6 |
| Other Assets | 1498.5 | 1716.9 |
| Assets=Liabilities | 11575.8 | 10573.2 |
| Liabilities: | | |
| Shareholder's Equity | 4236.7 | 4508.1 |
| Financing from Residents | 2759.6 | 2356.4 |
| Bonds, and Financing Sukuks | 244.6 | 85.2 |
| Foreign Liabilities | 2630.7 | 1827.4 |
| Other Liabilities | 1704.3 | 1796.0 |
| Number of Companies | 93 | 91 |

Source: Central Bank of Kuwait.

- Total Bonds and Financial Sukuks decreased by KD 159.4 million or 65.2% reaching KD 85.2 million at the end of FY2013/14 compared to KD 244.6 million at the end of FY2012/13.
- The value of shareholders' equity increased by KD 271.5 million or 6.4% to KD 4508.1 million at the end of FY2013/14 compared to KD 4236.7 million at the end of FY2012/13.

The balances of contra accounts data (off-balance-sheet items) indicate an important side of local investments companies activity (conventional and Islamic) in extending financial services to resident/non-resident clients. The balances of contra accounts of those companies (91 companies registered with the CBK at the end of FY2012/13) reached KD 20121.5 million at the end of FY2013/14 compared to KD 18166.9 million at the end of FY2012/13 (for 93 companies registered with the CBK at the end of FY2012/13), i.e. an increase of KD 1954.6 million or 10.8%.

Third: Major Banking Operations Performed by CBK:

Available data indicate that the value of currency in circulation reached KD 1488.9 million at the end of FY2013/14 against KD 1392.4 million during the previous fiscal year, i.e. an increase of KD 96.5 million or 6.9%. The highest balance of currency in circulation during FY2013/14 was KD 1515.7 million at the end of July 2013, while the lowest balance was KD 1379.0 million at the end of April 2013.

Moreover, CBK has continued its efforts during FY2013/14 towards ensuring the paper quality of banknotes in circulation by withdrawing and destroying the banknotes that are no longer fit for circulation in accordance with CBK's minimum quality requirements, and fighting counterfeit and forgery of banknotes in collaboration with other government bodies. These efforts are reflected in the value of withdrawn and destroyed banknotes reaching KD 265.1 million during FY2013/14.

In the course of CBK's constant pursuance of adopting best practices in international central banking, the Bank has conducted an evaluating study of the current issue of banknotes, which is the fifth issue introduced in 1994. In light of the findings of the study, CBK has decided to introduce a new issue of banknote denominations making use of the breakthroughs introducing new security features & specifications and advanced paper quality of banknotes. In this regard, and following the recommendation of CBK's Board of Directors, the Council of Ministers has approved in its session held on 10 June 2013 the proposed new (Sixth) issue including the specifications, images and design of the banknotes. In implementation of the Ministerial resolution, CBK has continued its persistent efforts during FY2013/14 to complete the preparations for the launching of the sixth issue of the Kuwaiti banknotes. The new Kuwaiti banknotes will enter circulation as of 29/6/2014, God willing.

Interbank settlements carried out through CBK using Kuwait Automated Settlement System for Inter-participant Payments (KASSIP) amounted to KD 218.15 billion during FY2013/14 against KD 158.38 billion during the previous fiscal year, i.e. a rise by

KD 59.78 billion or 37.7%. Total value of transactions made by CBK's clearing room during FY2013/14 increased to KD 13.48 billion for 2360 thousand transactions (cheques) (i.e. an average value of KD 5711.7/transaction) against KD 11.29 billion for 2249.7 thousand transactions (cheques) (i.e. an average value of KD 5017/transaction) during FY2012/13.

CBK has made 10185 banking transfers in favor of ministries and different government institutions totaling KD 1720.4 million during FY2013/14 against 9280 banking transfers totaling KD 1351.6 million during FY 2012/13. External banking transactions carried out by CBK in favor of ministries and other government bodies including documentary credits and payable bills and drafts during FY2013/14 are detailed as follows:

| Particulars | No. | Value (in KD) |
|---|------------|--------------------|
| First- Documentary Credits: | | |
| 1) <u>Opened</u> | <u>18</u> | <u>101,545,335</u> |
| - Local | - | - |
| - Foreign | 18 | <u>101,545,335</u> |
| 2) <u>Paid</u> | <u>150</u> | <u>84,440,842</u> |
| - Local | - | - |
| - Foreign | <u>150</u> | <u>84,440,842</u> |
| 3) <u>Amended</u> | <u>31</u> | |
| - Local | 1 | - |
| - Foreign | 30 | - |
| Second- Collection Transactions: | | |
| <u>Bills for Collection</u> | - | - |
| a-Inward | - | - |
| b-Paid-up | - | - |
| Third- Drafts for Collection | 75 | 96,047 |

Fourth: Labor Force at CBK:

In fulfillment of work requirements, CBK's total staff numbers has reached 981 employees at the end of FY2013/14, of which 864 (88% of the total) are Kuwaitis.

The Bank appointed new 36 staff during FY2013/14 of whom 32 (89% of total recruiting) are Kuwaitis.

CBK has also continued to participate in regional, Arab and international conferences and meetings addressing economic, financial, banking and IT topics. In this course, 173 staff were delegated to attend 78 conferences and meetings abroad during FY2013/14.

CBK has also introduced a new system for the enrollment of Bank's staff with reputable local and foreign universities for their master/doctorate degrees. During FY2013/14, 5 staff have qualified for scholarships.

In fulfillment of staff training needs and work requirements, CBK in coordination with specialized training bodies have organized different programs, invited competent lecturers from within CBK, and delegated a number of CBK's staff to attend programs, courses, seminars and specialized workshops in banking, finance, economics, administration and IT as follows:

A- Inside Kuwait:

During FY2013/14 a total of 377 staff attended 135 training courses in coordination with local bodies including The Institute of Banking Studies, The Arab Planning Institute, Kuwait Institute for Scientific Research, a number of local banks and financial institutions, specialized private local training bodies, audit bureaus, and Civil Service Commission.

B- Outside Kuwait:

During FY2013/14 a total of 169 staff attended 114 regional, Arab and international training courses in coordination with a number of training bodies and institutions specialized in banking, finance and economics including The Economic Policy Institute of the Arab Monetary Fund, Union of Arab Banks, Arab and foreign central banks,

International Monetary Fund, the World Bank, Bank of England, and U.S. Federal Reserve System.

Moreover, CBK has appointed a number of Kuwaiti fresh graduates holding university/diploma degrees. Fresh graduates are trained to qualify for the fulfillment of different jobs at CBK, each according to his/her field of study, by enrolling them in training programs including one general orientation program, one specialized program and one English language program organized in collaboration with the Institute of Banking Studies. For this purpose, CBK has developed a number of tests containing technical, behavioral, emotional intelligence and general information questions for CBK job applicants. These tests became applicable as of July 2008. During FY2013/14, 13 fresh university graduates and 6 fresh diploma holders were selected for internship programs at CBK. 11 interns - university graduates, and 9 interns - applied institutions graduates were employed by CBK after completion of training programs.

Furthermore, CBK in collaboration with other local banks has participated, for the third consecutive year, in organizing a program for the recruitment and training of Kuwaiti fresh graduates in the banking sector. The thirteen month program covering theoretical and practical training inside/outside Kuwait is basically organized by the Institute of Banking Studies under the supervision of CBK. During FY2013/14, 3 interns were trained at CBK in the third batch of this program.

Within this context, CBK has approved higher study applications for 11 staff during FY2013/14, in accordance with the conditions and regulations applicable by the Bank. CBK has also continued the temporal training of university and institution students at the Bank's departments and offices. During FY2013/14, 11 students from the College of Administrative Sciences-Kuwait University and 2 students from the Public Authority for Applied Education and Training Institute (College of Business Studies) completed training programs at CBK.

Within CBK's efforts to elevate job performance level, and promote employees loyalty and incentives towards higher efficiency and outstanding performance, CBK has organized the "Distinguished Employee of the year 2013" competition. For the purpose of this competition, CBK has adopted a set of performance and evaluation standards to assess employees in all Bank's sectors. Competition result has been announced and the distinguished employees of 2013 have been celebrated on 30 March 2014.

Fifth: Other Activities:

CBK has continued its efforts during FY2013/14 towards developing and updating the infrastructure of information technology in line with recent IT breakthroughs. CBK's main efforts included the initiation of CBK's Core Banking developing program and completion of the E-banking System modification. E-banking System-transferring to the production environment is in progress. With regard to the Automated Cheque Clearing System project, CBK has signed a contract with the supplier of the interbank electronic cheque clearing system to enable interbank automated cheque clearing in Kuwait. A different contract was signed with a consultancy firm to provide consultancy and administrative services for this project and initiate project execution. In addition, the layout of the internal local network of the infrastructure project of Bank's new headquarters was finalized and project is under construction.

On another front, CBK has completed during FY2013/14 developing and testing the "Cost Of Funds-COF" system purposing electronic receipt of the cost of funds to be included within the Traditional Banking System-TBS. As earlier mentioned, TBS-transferring to the production environment is in progress. Also, Kuwait InterBank Offered Rate-KIBOR system was completed and transferred to the production environment. This system is designed to calculate the average interest rate on local interbank deposits and to extract KIBOR electronically. Meanwhile, the testing of the New Islamic Banking System-New IBS is in progress. Likewise, the Liquidity System-LIQ, purposed to receive liquidity data electronically and include it within the Traditional

Banking System-TBS was also completed and system-testing is in progress to be later transferred to the production environment.

During FY2013/14, and in light of CBK's commitment to enhance Bank's interconnection with the components of the economic and financial society, CBK has organized CBK's Forum on 10 November 2013, hosting Her Excellency the IMF Managing Director, Madame Christine Lagarde, with the presence of officials, specialists and other individuals interested in the economic affairs in general, and the banking and financial affairs, in particular.

On a different front, CBK has continued during FY2013/14 to publish various Arabic/English analytical and statistical periodicals, distributed locally and internationally to authorities/individuals interested in the monetary, banking, financial and economic developments in the State of Kuwait. Within this context, CBK has published the Financial Stability Report for 2012 in October 2013, which is the first issue of a new periodic publication aiming at promoting transparency and providing reliable information and statistics related to the Kuwaiti banking and financial sector.

In pursuance of CBK's continued efforts to promote disclosure and transparency through expanding the circle of published data and information and increasing access facilitations, CBK has launched its new pilot website, in early January 2014, which is designed to function as an advanced informative browser for researchers/interested individuals, and as a channel of communication with Bank clients and site visitors.

- **CBK's New Headquarters**

CBK's persistent efforts continued during FY2013/14 in order to finalize the remaining phases of the Bank new headquarters. Completion percentage of the project at the end of FY2013/14 was 86.5% reflecting the effective procedures taken by the Bank. CBK shall continue such efforts to ensure full completion of the headquarters project, as the earliest possible time.

Sixth: The Central Bank of Kuwait
Balance Sheet and Profit & Loss Account
For the Fiscal Year Ended 31 March 2014

AUDITORS' REPORT

We have examined the financial statements of the Central Bank of Kuwait ("The Bank"). Our examination included such tests of the accounting records and such other auditing procedures as we considered necessary. We obtained all the information and explanations which we deemed necessary for the purpose of our examination.

In our opinion, the financial statements give a true and fair view of the real financial position of the Bank on 31 March 2014 and of the results of its operations for the year then ended, in compliance with Law No. 32 of 1968 and amendments thereof.

Furthermore, in our opinion, proper books of account have been maintained and the financial statements are in accordance therewith, and the preparation of an inventory was duly carried out.

Waleed Abdullah Al-Oseimi

Register of Accountants & Auditors

License No. 68 A

Al-Aiban, Al-Osaimi & Partners

Member of ERNST & YOUNG

Safi Abdulaziz Al-Mutawa

Accountant & Auditor

License No. 138 A

KPMG, Safi Al-Mutawa & Partners

Member of KPMG International

4 May 2014

State of Kuwait

BALANCE SHEET AS AT

(AMOUNTS IN KD)

| Assets | Notes | 31 March 2014 | 31 March 2013 |
|---|-------|------------------|------------------|
| Gold | 2 | 31,736,361 | 31,736,361 |
| Cash, Current and Call Accounts in Foreign Currency with Banks and other Financial Institutions | | 199,287,348 | 206,572,741 |
| Deposits and Investments in Foreign Currency | 3 | 8,957,896,050 | 7,793,775,790 |
| Other Assets | 4 | 24,788,780 | 29,730,724 |
| | | 9,213,708,539 | 8,061,815,616 |
| Accounts Managed by CBK on behalf of the Government of the State of Kuwait, and Contra Accounts | 11 | 2,579,581,765 | 2,684,566,263 |
| | | | |

The attached notes from 1 to 14 constitute an integral part of these financial statements.

31 MARCH 2014

| Equity and Liabilities | Notes | 31 March 2014 | 31 March 2013 |
|---|-------|------------------|------------------|
| Capital - Fully Paid Up | | 5,000,000 | 5,000,000 |
| General Reserve Fund | 5 | 295,000,000 | 295,000,000 |
| Special Account | 6 | 100,091,646 | 401,629,136 |
| Profit for the Year | | 19,399,944 | 15,887,745 |
| Currency in Circulation | 7 | 1,488,932,063 | 1,392,422,677 |
| CBK Bonds Issued | 8 | 1,950,000,000 | 1,909,000,000 |
| Government Accounts | | 703,833,086 | 704,549,662 |
| Accounts of Banking System Liquidity Support | 9 | - | 1,000,000 |
| Local Banks' Current Accounts and Deposits with CBK | 10 | 4,266,953,908 | 2,988,923,526 |
| International Institutions | | 4,960,364 | 6,205,151 |
| Collateral against Documentary Credits | 11 | 91,430,152 | 175,743,955 |
| Other Liabilities | 12 | 288,106,376 | 166,453,764 |
| | | 9,213,708,539 | 8,061,815,616 |
| Accounts Managed by CBK on Behalf of the Government of the State of Kuwait, and Contra Accounts | 11 | 2,579,581,765 | 2,684,566,263 |

The attached notes from 1 to 14 constitute an integral part of these financial statements.

CENTRAL BANK OF KUWAIT

**PROFIT & LOSS ACCOUNT FOR
FY ENDED 31 MARCH 2014
(KD)**

| | Notes | 31 March 2014 | 31 March 2013 |
|--|--------------|--------------------------------|-------------------------------|
| Interest & Revenues from Investments | | 81,320,623 | 82,250,565 |
| Expenses of Interest and Commissions | | <u>(101,293)</u> 81,219,330 | <u>(50,162)</u> 82,200,403 |
| Other Revenues | | <u>366,094</u> | <u>505,645</u> |
| Operating Revenues | | 81,585,424 | 82,706,048 |
| Operating Expenses | 13 | <u>(62,185,480)</u> | <u>(66,818,303)</u> |
| Net Profit for the year | | <u>19,399,944</u> | <u>15,887,745</u> |
| Disposed of according to Article 17 of Law No. 32 of 1968 and its amendments, as follows: to the Government's Account | 5 | <u>19,399,944</u> | <u>15,887,745</u> |

The attached notes from 1 to 14 constitute an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS
(31 MARCH 2014)

1- Activities:

The Central Bank of Kuwait (“The Bank”) is incorporated by Law No. 32 of 1968 and amendments thereof. The CBK is a public institution with an independent juristic personality, and is entrusted with issuing the local currency on behalf of the State of Kuwait, ensuring the stability of the Kuwaiti currency and its free convertibility into other foreign currencies, drawing the monetary and credit policies, and the supervision of the banking and financial system, in addition to serving as a banker and financial advisor to the Government.

2- Significant Accounting Policies:

The financial data were prepared in accordance with Law No. 32 of 1968 and amendments thereof. The applied significant accounting policies are as follows:

a- Gold:

In accordance with the Amiri Decree of 4 July 1978, gold is valued at KD 12.500 per fine ounce.

b- Local Bonds and Public Debt Instruments:

Public Debt Instruments are recorded at purchase cost.

c- Cost of Money Market Operations:

The cost arising from intervention operations in the money market (CBK Bonds issued, local banks deposits and tawarruq operations) is charged to the Ministry of Finance Account/cost of supporting money market operations, according to the agreement between the Bank and the Ministry of Finance (Note 12).

d- Revenue Recognition:

Interest receivable is recognized on a time proportion basis, taking into account the principal outstanding and the interest rate applicable.

e- Capital Expenditure:

Capital expenditure is charged to operating expenses in the year of authorization.

f- Foreign Currencies:

In accordance with Article 48 of Law No. 32 of 1968 and amendments thereof and the Amiri Decree of 4 July 1978, all cash assets and liabilities in foreign currencies are revaluated at the exchange rates prevalent on the date of the preparation of the balance sheet, and the resulting gains or losses are taken to the special account in the balance sheet (Note 6).

3- Deposits and Investments in Foreign Currencies (KD):

| | <u>2013/14</u> | <u>2012/13</u> |
|---|----------------------|----------------------|
| Deposits with Foreign Banks and Institutions | 8,953,672,050 | 7,789,503,790 |
| Central Bank's Facilities to the International Bank for Reconstruction and Development | 4,224,000 | 4,272,000 |
| | <u>8,957,896,050</u> | <u>7,793,775,790</u> |

4- Other Assets (KD):

| | <u>2013/14</u> | <u>2012/13</u> |
|--|-------------------|-------------------|
| Interest Receivable on Deposits and Other Assets | 9,990,996 | 13,705,862 |
| Investments (KD) | 2,791,210 | 2,791,210 |
| Prepaid Expenses | 2,686,245 | 449,718 |
| Advance Payments | 2,652,846 | 6,199,247 |
| Other Debit Balances | 6,667,483 | 6,584,687 |
| | <u>24,788,780</u> | <u>29,730,724</u> |

5- General Reserve Fund:

In accordance with Article 17, paragraphs 3 (a) and (b) of Law No. 32 of 1968 and amendments thereof, the net profits of the CBK shall be paid into the General Reserve Fund until the balance of the fund amounts to twenty-five million Kuwaiti Dinars, unless the Board of Directors recommends and the Minister of Finance approves further increases in the balance of the Fund. In 1985, the Board's recommendation to increase the balance of the fund to KD 179 million was approved by the Minister of Finance and Economy. In accordance with the Board's decision dated 5 May 2003, and the approval of the Minister of Finance dated 7 May 2003, it was agreed to increase the balance of CBK General Reserve Fund by KD 116 million to KD 295 million, by transferring half of CBK net annual profits to the Fund balance.

Therefore, no amount has been allocated since 2007, where the balance of the reserve has reached to KD 295 million.

6- Special Account (KD):

| | <u>2013/14</u> | <u>2012/13</u> |
|---|--------------------|--------------------|
| Balance at the Beginning of the Year | 401,629,136 | 280,235,501 |
| Net difference in foreign currency, resulting from revaluation of cash assets and liabilities in foreign currencies | (301,537,490) | 121,393,635 |
| Balance at the end of the Year | <u>100,091,646</u> | <u>401,629,136</u> |

The special account represents the net difference accumulating from the revaluation of cash assets and liabilities in foreign currencies, and the profit resulting from the withdrawal of currency banknotes from circulation, based on Article 48 of Law No. 32 of the year 1968 and amendments thereof, and the Amiri Decree of 4 July 1978.

7- Currency in Circulation (KD):

| | 2013/14 | 2012/13 |
|------------------------------------|----------------------|----------------------|
| Net Issued Currency | 2,128,373,360 | 2,349,314,450 |
| Less: Currency in the CBK's Vaults | (639,441,297) | (956,891,773) |
| | <u>1,488,932,063</u> | <u>1,392,422,677</u> |

Net issued currency represents the total printed cash minus destroyed cash.

Currency in the CBK's vaults includes cash prepared for circulation (withdraw/deposit), invalid cash prepared to be destroyed, and the strategic cash reserve.

8- Issued Bonds:

CBK bonds are negotiable and only purchased by local banks and local investment companies subject to CBK's supervision. The CBK uses these bonds in domestic liquidity management.

9- Banking System Liquidity Support Account:

Represents the amount transferred to the Central Bank according to the instructions of the Ministry of Finance - pursuant to the requirements of paragraph (e) in Article 31 of Law No. 32 of 1968 and amendments thereof, concerning Currency, the Central Bank of Kuwait, and the Organization of Banking Business, to support the banking system liquidity.

10- Local Banks' Current Accounts and Deposits with CBK (KD):

| | 2013/14 | 2012/13 |
|-----------------------------------|----------------------|----------------------|
| Current Accounts | 944,192,014 | 300,891,534 |
| Deposits | 540,000,000 | 965,000,000 |
| Tawarruq Operations (withdrawals) | 2,782,761,894 | 1,723,031,992 |
| | <u>4,266,953,908</u> | <u>2,988,923,526</u> |

11- Accounts Managed by CBK on Behalf of the Government of the State of Kuwait, and Contra Accounts (KD):

| | <u>2013/14</u> | <u>2012/13</u> |
|--|-------------------|--------------------|
| a- Accounts Managed by the CBK on Behalf of the Government of Kuwait | 2,483,109,613 | 2,519,839,104 |
| b- Contra Accounts: | | |
| Documentary Credits | 93,513,857 | 161,720,582 |
| Memorial Banknotes and Coins | 2,958,295 | 3,006,577 |
| | <u>96,472,152</u> | <u>164,727,159</u> |
| Collections According to Law No. 41 of 1993 | 2,579,581,765 | 2,684,566,263 |

On 31 March 2014, deposits of KD 91,431,152 (KD 175,743,955: 2013) were held against the documentary credits referred to above.

12- Other Liabilities (KD):

| | <u>2013/14</u> | <u>2012/13</u> |
|---|--------------------|--------------------|
| Payable Expenses | 13,065,695 | 15,733,354 |
| Other Credit Balances | 269,897,060 | 148,504,996 |
| Ministry of Finance - Cost of Supporting Money Market Operations (Note 2) | 5,143,621 | 2,215,414 |
| | <u>288,106,376</u> | <u>166,453,764</u> |

Other credit balances include provisions for staff leave pay, termination benefits, and credit accounts of banking and non-banking institutions.

The Balance of Ministry of Finance - Cost of Supporting Money Market Operations represents the remaining funds transferred from the Ministry of Finance after charging the cost of supporting money market operations carried out by CBK according to the agreement between CBK and the Ministry of Finance.

13- Operating Expenses (KD):

| | <u>2013/14</u> | <u>2012/13</u> |
|---|-------------------|-------------------|
| Staff Costs | 33,203,170 | 33,665,256 |
| Administrative and Computer Operation Costs | 5,352,105 | 4,166,856 |
| Purchase of Furniture and Equipment | 34,986 | 752,765 |
| Production and Shipment of Currency | 5,843,953 | 3,648,149 |
| Miscellaneous | 2,314,021 | 1,989,718 |
| Construction Costs | 15,437,245 | 22,595,559 |
| | <u>62,185,480</u> | <u>66,818,303</u> |

14- Promissory Notes Held:

On 31 March 2014, promissory notes held by the CBK in safe custody on behalf of international institutions totaled KD 436,722,028 (KD 465,013,627: 2013).

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