Al-Tijari التجاري

TRANSLATION

Date: 8/3/2017
REF: CCG/22/2017

TO: Mr. Khaled Abdulrazaq Al-Khaled
Vice Chairman and CEO
Boursa Kuwait Securities Company

Greetings,

According to Chapter four (Disclosure of Material Information) of Rulebook ten (Disclosure and Transparency) of CMA Executive By-laws, kindly find attached the Annex No. (9) Disclosure of Credit Rating Form covering the updated credit rating report issued by Moody's on 6/3/2017.

Please note that there is no change from the previous credit rating opinion as issued in September 2016. Please also be advised that according to the issued report <u>the Bank's rating was confirmed at A3 with a stable outlook</u>.

Best Regards,

Yaqoub Habib Al-Ebrahim
Official Spokesman of CBK
GM, Compliance & CG

<u>Copy to:</u>
CMA / Manager, Disclosure Department

NOTE: This is a translation of the original for and binding Arabic text. In case of any difference between the Arabic and the English text, the Arabic text will be prevailing.

البنك التجاري الكويتي
Commercial Bank of Kuwait

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Annex (9)

Disclosure of Credit Rating Form

Date	8/3/2017
Name of Listed Company	Commercial Bank of Kuwait (K.P.S.C)
Entity who issues the rating	Moody's Agency
Rating category	– Bank Deposits: A3/P-2 – Baseline Credit Assessment: ba1 – Adjusted Baseline Credit Assessment: ba1 – Counterparty Risk Assessment: A2(cr)/P-1(cr)
Rating implications	"Moody" applies special methodology when evaluating banks, the same can be found on the Agency website. The A3 long-term deposit rating assigned to Commercial Bank of Kuwait (CBK) incorporates four notches of uplift from the bank's ba1 standalone baseline credit assessment (BCA), reflecting our view of a very high probability of support from the Kuwaiti government (Aa2 negative) in the event of need. The bank's short-term deposit rating is Prime-2. Furthermore, we have assigned a Counterparty Risk Assessment (CR Assessment) of A2(cr)/Prime-1(cr) to CBK. CBK's ba1 BCA reflects (1) low levels of well-provisioned problems loans but also elevated credit risks, as indicated by high credit concentrations and significant provisioning charges in recent years; and (2) strong core profitability and efficiency but modest bottom-line earnings. The BCA also reflects its comfortable liquidity supported by a deposit-based funding structure and solid capitalisation (with tangible common equity to risk-weighted assets of 16.7% as of end-2016). Even though asset quality has been stable in Kuwait we expect modestly higher problem loan formation going forward, while political stress or a further sustained reduction in oil prices will negatively affect business confidence and asset prices in Kuwait and may drive down asset quality faster than our current base-case expectations.
Rating effect on the status of the company	The report reflects, as shown below, the strengths of the bank and the negative aspects of the financial situation, also addresses the changes in oil prices as the main engine of the local economy and that could put pressure on the bank's domestic asset quality.
Outlook	All ratings carry a stable outlook.
Translation of the press release or executive summary	**Detailed Rating Considerations** STRONG CORE PROFITABILITY BUT BOTTOM-LINE EARNINGS AFFECTED BY HIGH PROVISIONS CBK exhibits strong operating efficiency with a cost-to-income ratio of 28% in 2016 (2015:27%), the best among its domestic rated peers, while pre-provision income at 2.5% of average total assets is above the system average (of around 2%). However, bottom-line profitability remains

modest, constrained by high provisions. These led to a net income to tangible assets of 1.2% in 2016, in line with the Kuwaiti banking system average. We expect that CBK's bottom-line profitability will improve in 2017, supported by improving margins as benchmark interest rates increase, though still pressured by high provisioning charges.

PROBLEM LOAN LEVELS REMAIN LOW; BUT HIGH PROVISIONING REQUIREMENTS AND CREDIT CONCENTRATIONS POINT TO ELEVATED CREDIT RISKS

CBK has drastically cut its non-performing loans-to-gross loans ratio to just 0.5% by end-2016 from 15.3% at end-2010. Furthermore, the bank has built-up substantial provisions against potential losses equivalent to 5.9% of gross loans. Nevertheless, high loan loss provisioning charges consumed around two thirds of the bank's pre-provision income in 2016 (on the back of significant write-offs, specific provisioning and booking further general provisions) indicating some latent risks on the bank's portfolio. Over the next 12 months, we expect provisioning requirements to remain high, mainly on the back of further provisioning requirements in light of market volatility and the low oil price environment.

SOLID CAPITALISATION BUFFERS TO ABSORB UNEXPECTED CREDIT LOSSES

CBK reported a Basel III Tier 1 capital adequacy ratio (made up almost exclusively by common equity Tier 1 capital) as of December 2016 of 16.7%, well above the median of similarly rated global peers and the current regulatory requirement. The central bank of Kuwait has fully implemented Basel III capital requirements, and CBK has to maintain common equity Tier 1, Tier 1 and total capital ratios of 10%, 11.5% and 13.5% respectively. These include a 2.5% capital conservation buffer, but also a domestic systemically important bank (D-SIB) surcharge of 0.5% specific to CBK. We note further that together with the introduction of Basel III, the CBK also issued regulations in December 2014 where the previous treatment of real estate collateral as a risk mitigant in the calculation of risk-weighted assets (RWAs) is to be phased out. In the past, banks could use 50% of the value of real estate collateral as a discount against relevant RWAs. The elimination of this discount, by 10% yearly over five years, leads to a gradual technical increase in RWAs.

The bank's equity-to-assets ratio was also strong at 14.6% as of December 2016.

We expect that CBK's capitalisation ratios will remain close to current levels, reflecting our expectation of contained growth in risk weighted assets and a gradual recovery in profitability. Based on our scenario analysis the bank's Tier 1 ratio will remain above 14% under our stress scenario assumptions.