

BANQUE DU LIBAN

Basic Circular No 81 addressed to Banks and to Financial Institutions¹

Attached is a copy of Basic Decision No 7776 of February 21, 2001 on operations relating to credit, investment, shareholding and participation.

Beirut, February 21, 2001

The Governor of the Banque du Liban

Riad Toufic Salamé

Old numbering system: 1892

¹ Addressed to financial institutions pursuant to Intermediate Decision No 8882 of November 8, 2004, (Intermediate Circular No 69).

Basic Decision No 7776

Operations relating to credit, investment, shareholding and participation

The Governor of the Banque du Liban,

Pursuant to the Code of Money and Credit, notably Article 174 thereof, and

Pursuant to the Decision of the Central Council of the Banque du Liban, taken in its meeting of February 21, 2001,

Decides the following:

Article 1¹:

- 1- All decisions taken by banks operating in Lebanon on granting credits, investing liquid assets, real estate investments, shareholding and participation, and on operations on their own account regarding structured or derived financial instruments, must be submitted to prior approval by one or more specialized committees whose task is to set efficient strategies for managing, monitoring and developing the activities of the bank, whether at the bank's level or that of the banking group, as applicable.
- 2- The Board of Directors of the Lebanese bank or the Management of the foreign bank's branch or affiliated banking group, must, as applicable, and according to the size of its activities:
 - a- Establish the needed specialized committees to be chaired by the Chairman of the Board or his/her deputy or a member delegated by the Chairman, or an expert in the field. Each committee must include as members two executives from the Bank's Management, selected according to their specialty, provided the number of members in each committee is no less than three, in accordance with a system set for this purpose.
 - b- Adopt working rules for each specialized committee.
 - c- Make sure that the tasks assigned to these committees constitute an adequate and comprehensive framework, ensuring that risk management policies cover all of the bank's activities.
 - d- Grant these committees the powers they need for their work, including proposing plans and supervising the tasks to be carried out according to their work rules.

¹ The last amendment to this Article was made pursuant to Article 1 of Intermediate Decision No 9419 of September 29, 2006 (Intermediate Circular No 116).

- 3- Each of the specialized committees must, as far as it is concerned:
- a- Describe, as accurately as possible, the above-mentioned operations (type, characteristics, terms, etc).
 - b- Set up a scheme to ensure that these operations or their consequences would not expose the bank to unbearable risks.
 - c- Assess the economic feasibility of the said operations in terms of future returns, and subject the bank to stress test scenarios to measure its ability to bear risk fluctuations (market data, prices of currencies, shares, bonds, or other financial instruments ...) and their impact on its financial situation.
 - d- Inform the Board of Directors of the Lebanese bank or the Management of the foreign bank's branch periodically, on a quarterly basis at least, of its recommendations about the above-mentioned operations whose value exceed 1% of the bank's net tier-one capital or the equivalent of one million US dollar, whichever is less, concerning each client or several clients forming a single economic group or an interconnected group, as defined in the BDL regulatory texts.
 - e- Comply with the regulations and laws in force, and with the directives issued by the Banque du Liban and the Banking Control Commission.
 - f- Study the bank's credit risk exposure, and set the ceilings and restrictions that ensure a balanced distribution and a diversification of credit risks, particularly at the level of economic sectors and geographical regions.
 - g- Study and compare the risks associated with the bank's financial sources and uses, notably their maturity dates (liquidity risks), and their vulnerability to interest rate fluctuations (market risks), etc.
 - h- Ensure that international accounting standards are applied, notably standards 32 and 39 about dealing with financial instruments, their rating, re-rating and evaluation, and the ensuing impact on the liquidity, profitability and solvency of the bank, and the transparency of its financial situation, in light of the stress-test scenario results.
 - i- Hold regular, periodic meetings, and as needed.
 - j- Provide the Board of Directors with the requested reports or with those specified in the banking regulations in force, on a periodic basis and as needed.

4¹-Lebanese banks and financial institutions are prohibited from:

- a- acquiring stocks or shares that entail unlimited responsibilities towards them.

¹ This paragraph was added pursuant to Intermediate Decision No 9891 of April 18, 2008 (Intermediate Circular No 159), then amended pursuant to Article 1 of Intermediate Decision No 10390 of March 8, 2010 (Intermediate Circular No 217) .

- b- Concentrating their shareholding and participation, whether directly or indirectly, so that none of them exceeds 10% of its own funds, in order to distribute them among various companies and sectors.

The provisions of this paragraph shall not govern shareholding and participation in Lebanon and abroad in banks, financial institutions, leasing companies, financial intermediation institutions, collective investment schemes and insurance companies, where shareholding and participation remains governed by the relevant legal and regulatory texts.

Banks and financial institutions whose situation is inconsistent with the provisions of this paragraph are granted a time-limit ending on December 31, 2010 to comply with it.

- 5- ¹ Lending and borrowing between a specialized bank and a commercial bank belonging to a single economic group is forbidden.

Banks whose situation is inconsistent with the provisions of this paragraph are granted a time-limit ending on December 31, 2010 to comply with it.

Article 1 bis²:

Banks and financial institutions are prohibited, as far as each is concerned, from undertaking on their own account:

- 1- Investments in collective investment schemes established or domiciled in Lebanon, without a prior approval by the Banque du Liban.
Such investments by banks are governed by the provisions of Article 153 of the Code of Money and Credit.
- 2- Operations on structured financial papers and instruments issued in any currency in Lebanon, except those specified in Paragraph 3 of this Article, or those:
 - a- having an unconditional guarantee of the capital's whole value;
 - b- having a total nominal value not exceeding the equivalent of 25% of the Tier 1 capital of the concerned bank or financial institution.
- 3- Operations on structured financial papers and instruments issued in Lebanon, and linked to foreign-currency denominated Lebanese Treasury bonds or certificates of deposit issued by Banque du Liban (credit linked notes), except for those with conditions including:

¹ This paragraph was added pursuant to Article 2 of Intermediate Decision No 10390 of March 8, 2010 (Intermediate Circular No 217)

² This Article was added pursuant to Article 1 of Intermediate Decision No 9928 of June 23, 2008 (Intermediate Circular No 169) then amended pursuant to Intermediate Decision No 10482 of July 22, 2010 (Intermediate Decision No 225).

- a- an unconditional guarantee of the capital's whole value, at least when there is no credit event, notably the non-repayment of the said Treasury bonds and credit linked notes;
- b- the obligation to reimburse in kind the said Treasury bonds by transferring their ownership to the client in case of a credit event, notably the non-repayment of the said Treasury bonds and credit linked notes.
- c- In the absence of an internationally recognized credit event, prices variations of Credit Default Swaps on Lebanese Treasury bonds shall not be considered as a credit event category that compels the issuer to reimburse in kind the said Treasury bonds by transferring their ownership to the client

Article 2:

- 1- No Lebanese bank may grant any of the credits stipulated in Article 152, Par. 4, of the Code of Money and Credit, if it does not comply with the solvency and liquidity ratios specified in the regulations issued by the Banque du Liban, or if it has not built the required reserve.
- 2- Subject to the provisions of Article 152 of the Code of Money and Credit and the provisions of Paragraph 1 of this Article, the value of any of the credits stipulated in the above-mentioned Article 152, Par. 4, must not exceed the following two ratios, whichever is less:
 - 50% of the borrower's share in the value of the operation (s) to be financed.
 - 40% of the net financial assets of the borrower and his/her guarantors.

When granting these credits, the bank must apply all administrative and financial conditions applicable to similar credits extended to its clients.

- 3¹ - Total credits granted by a bank under Article 152, Par. 4, of the Code of Money and Credit must not exceed, at any time, 5% of its shareholders' equity.

Each bank must reduce any excess over the stipulated ratio, so that it does not exceed:

- 10% by December 31, 2004.
- 5% by December 31, 2005, of which 2% may be granted without meeting the conditions stipulated in Article 152, Par. 4 of the Code of Money and Credit².

¹ This paragraph was originally added to Article 2 pursuant to Intermediate Decision No 8004 of December 14, 2001, and its last amendment was made pursuant to Article 1 of Intermediate Decision No 8554 of November 13, 2003 (Intermediate Decision No 40).

² This paragraph was amended pursuant to Article 2 of Intermediate Decision No 9040 Of June 1, 2005 (Intermediate Decision No 85).

- 4¹- The limits of credits authorized under Paragraph 3 of this Article shall be computed on the basis of credits granted by the bank's head office and branches in Lebanon and abroad, and the affiliated banks and financial institutions in Lebanon, and also on the basis of the consolidated tier-one capital of the bank's head office and branches in Lebanon and abroad, and the affiliated banks and financial institutions in Lebanon, after deduction of the shareholdings and participations in affiliated banks and financial institutions abroad.
- 5⁷- Any party whose status is governed by the provisions of Article 152, Par. 4 of the Code of Money and Credit, is prohibited from benefiting from all kinds of facilities, credits or loans granted by affiliated banks or financial institutions abroad.

Article 2 (bis)²:

- 1- Banks and financial institutions operating in Lebanon are prohibited from:
- a- Granting their clients, other than in the form of term loans, facilities to finance any fixed asset (real estate, machinery, equipment, and any other fixed asset). Any such facility may not be granted before considering the economic feasibility of the project to be financed and the client's financial situation, and setting the repayment schedule according to the client's cash flow.
 - b- Granting their clients current account facilities, except for financing current operations or operations linked to the working capital*, after taking cognizance of the facilities granted to the client by banks and financial institutions, notably the current account facilities specified in item "Z1" of Table "CTC01" (symbols allotted to loans types), attached to the Centrale des Risques regulations on banking risks, without prejudice to the provisions of legal and regulatory texts in force.
 - c- Granting to a single client current account facilities that exceed 70% of his/her working capital, provided their total does not exceed, in any case, five times the client's equity capital**, or the investor's account when the client is a natural person or an individual enterprise.

If these facilities exceed the above-mentioned limit, the excess shall be turned into a term loan, or into bonds to the order of the concerned bank or financial institution, and scheduled according to the clients' cash flow.

¹ This paragraph was added pursuant to Article 2 of Intermediate Decision No 9928 of June 23, 2008 (Intermediate Circular No 169) whose Article 3 reads as follows:

"Banks and financial institutions whose status is inconsistent with the provisions of this Decision must, within one month from its issuing date, inform the Banking Control Commission".

² This Article was added pursuant to Intermediate Decision No 8882 of November 8, 2004 (Intermediate Circular No 69), then amended pursuant to Article 2 of Intermediate decision No 9040 of June 1, 2005 (Intermediate Circular No 85).

*The working capital is formed of the following components: the stock+ advances paid to suppliers + clients + various receivables + charges computed in advance, less (advances collected from clients + suppliers + various payables + revenues computed in advance).

** The equity capital is formed of: the capital, the issue premiums, the reserves, the profits carried forward, and other, legally accepted components.

The following elements shall not be computed within the limit:

- i. Bank acceptances and operations linked to documentary credits.
- ii. Facilities covered by cash guarantees, bank guarantees, or guarantees issued by financial institutions included in the List of the Banque du Liban.

As an exception to the provisions of this paragraph, current account facilities may be granted to a single client for a period ending on December 31, 2007¹, provided these facilities do not exceed 100% of his/her working capital and do not exceed, in any case, a total equivalent to seven times the client's equity capital or the investor's account when the client is a natural person or an individual enterprise.

- d- Authorizing any excess over the limit of current account facilities granted to their clients, unless in an accidental or temporary manner, provided the agreed excess is not over 10% of the facilities granted to the client, and provided the total of all facilities and accidental excess does not exceed the limit specified in paragraph (c) above.
- e- ²Imposing any compensation or penalty, or any increase on the interest rate, commission or expenses concerning the excess approved by the bank or financial institution, except if the client does not honor his/her commitments or engagements resulting from the accidental excess within a 90-day period. In such a case, the bank or financial institution may impose, starting from the day on which the excess occurred, an additional penalty interest that does not exceed 2% of the excess alone. In all cases, the excess must be settled, with the client's consent, within one year from the date of its occurrence, and through one of the following measures:
 - Reimbursement by the client.
 - An increase in the facilities granted to the client, based on the client's financial situation, if the bank or the financial institution deems it appropriate.
 - A re-classification of the account within one of the categories (4) or (5), specified in Basic Decision No 7159 of November 10, 1998. Consequently, the facilities granted to the client shall be suspended.
- f- Increasing the interest rate on the facilities in use, when classified within one of the categories 4 and 5, specified in Basic Decision No 7159 of November 10, 1998.
- g- ³Granting their clients real estate credits that exceed:

¹ This paragraph was added pursuant to Article 6 of Intermediate Decision No 9457 of November 9, 2006 (Intermediate circular No 127).

² The last amendment to this paragraph was made pursuant to Article 1 of Intermediate Decision No 9193 of November 16, 2005 (Intermediate Circular No 96).

³ This paragraph was added pursuant to Article 1 of Intermediate Decision No 9958 of July 21, 2008 (Intermediate Circular No 177).

- A maximum of 60% of the value of the real estate to be purchased or of the current value of the ongoing real estate project.
- 60% of the value of the guarantee offered.

The following items are excluded from the above-mentioned ratios:

- Housing loans for purchasing a first house.
- Loans granted by the Housing Bank.
- Loans granted to the Housing Authority or to the Military Volunteers Housing System.
- Loans extended in accordance with the memorandum signed with each of the Housing Authority or the Military Volunteers Housing System.
- Housing loan programs stipulated in Basic Decision No 6180 of May 31, 1996.

h- ¹ Undertaking any form of real estate brokerage operation, financing a real estate speculation, or purchasing built or non built real estate for resale purpose.

2- Banks and financial institutions whose status is inconsistent with the provisions of subparagraphs a, b, c, and d of Paragraph 1 of this Article must, by December 31, 2006, comply with them and regularize their situation accordingly.

3²- Banks and financial institutions must:

- a- Verify more strictly the purpose of the facilities granted to their clients and the implementation of the provisions of Article 161 of the Code of Money and Credit, and reconsider the value of these facilities once a year at least, and as needed, in order to ascertain that the facilities granted to each of their clients are properly used, in conformity with available data on the financial situation and the size of activities of each client.
- b- Verify on their own responsibility, when examining a real estate credit file, the purpose of the credit and the sources of funds to be used for repayment.
- c- Verify, in the case of financing a construction project, the soundness of the sale contracts concluded between the owner and the purchaser, in addition to monitoring the project's cash flows, and verifying that the purchaser is making payments according to the agreed schedule.

¹ This paragraph was added pursuant to Article 1 of Intermediate Decision No 9958 of July 21, 2008 (Intermediate circular No 177).

² This paragraph was amended pursuant to Article 2 of Intermediate Decision No 9958 of July 21, 2008 (Intermediate circular No 177).

- 4- Banks and financial institutions' officers in charge of granting and monitoring facilities must verify, through audited balance sheets, each item quality in the client's working and equity capitals, and request from the client, as needed, any additional information.
- 5¹- The Banking Control Commission shall refer to the BDL Central Council any violation by a bank or financial institution of subparagraphs "g" and "h" of Paragraph 1 of this Article. The Central Council is entitled to require the infringing bank or financial institution to deposit with the Banque du Liban, in a special, zero-interest account, a special minimum reserve determined according to the case and/or to take against the said bank or institution other measures deemed necessary.

Article 3:

Banks must deposit with the Banque du Liban, in a special, zero-interest account, a special minimum reserve equal to the amount exceeding any of the ratios specified in Article 2, Par. 2 of this Decision. The reserve must be set aside in the credit currency, and deposited for a one-month period for each day in which the ratio is exceeded.

Article 4:

The Banque du Liban shall collect from banks, which do not comply with the provisions of Article 3 above, a penalty interest to be computed according to the provisions of Article 77 of the Code of Money and Credit and to the relevant regulations of the Banque du Liban.

Article 5:

Any bank whose bylaws are inconsistent with the provisions of this Decision, particularly Article 1 thereof, must, by June 30, 2001, amend the said bylaws accordingly.

Article 6:

This Decision shall enter into force upon its issuance.

Article 7:

This Decision shall be published in the Official Gazette.

Beirut, February 21, 2001

The Governor of the Banque du Liban

Riad Toufic Salamé

¹ This paragraph was added pursuant to Article 3 of Intermediate Decision No 9958 of July 21, 2008 (Intermediate Circular No 177).