04

PART IV
THE LEBANESE BANKING SECTOR IN 2015

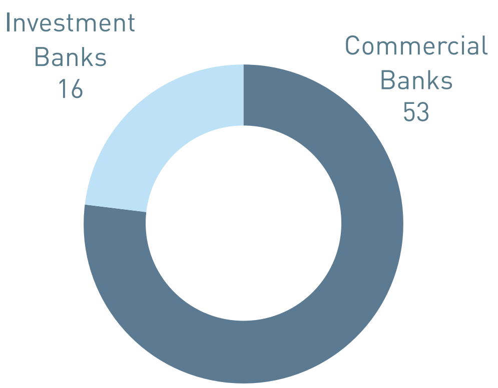
I- THE STRUCTURE OF THE LEBANESE BANKING SECTOR, SOCIAL RESPONSIBILITY AND INVOLVEMENT IN FINANCIAL GLOBALIZATION

1-1 At the end of 2015, the number of banks operating in Lebanon reached 69 distributed among 53 commercial banks and 16 investment banks. During the mentioned year, the list of banks was amended by removing each of "Al-Ahli International Bank S.A.L." after merging it with "Fransabank S.A.L.", and the "National Bank of Abu Dhabi S.A.A." that started its activity as a representative office, and "Warka Bank for Investment and Finance J.S.C.". The name of "Standard Chartered Bank S.A.L." was also changed to become "Cedrus Bank S.A.L." after an acquisition operation. It is possible to distribute banks operating in Lebanon among 49 groups: 31 groups for Lebanese banks with majority Lebanese control, and 18 groups for Arab/Foreign Banks and Lebanese banks with majority Arab/Foreign control. There are also 12 foreign banks representative offices in Lebanon. Banks operating in Lebanon have correspondence relationships with 183 banks in 82 cities around the world facilitating financial transactions with other countries and vice-versa.

1-2 Commercial banks operating in Lebanon at the end of 2015 were distributed as follows: 32 Lebanese banks S.A.L. with majority Lebanese control, 9 banks S.A.L. with Arab control owning large shares in Lebanese banks with Lebanese administrations, 8 branches for Arab commercial banks and 4 branches for foreign commercial banks. Among commercial banks, five Islamic banks and a few number of private banks to classify the others as universal banks, whose strategy is based on diversified sources of income starting with banking for corporate large companies, to retail banking and the expansion in serving small and medium companies, in addition to investment and treasury services, financial intermediation, and private services all the way to small loan services.

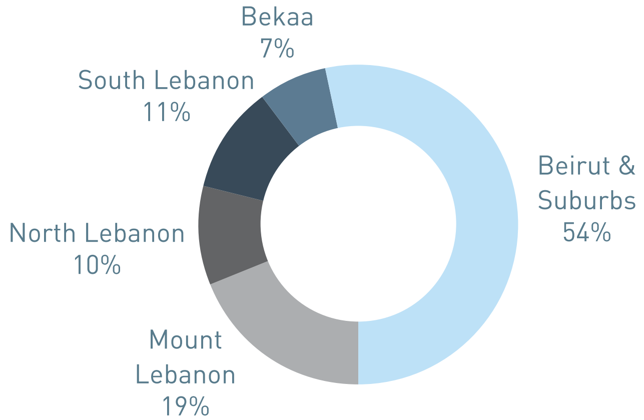
The total number of branches of operating banks reached 1,060 branches at the end of 2015, which are distributed among Lebanese regions consistently with the relative geographic distribution of economic activities.

Lebanese Banking Sector Structure - end 2015



Source: BDL

Geographical distribution of commercial banks branches operating in Lebanon end 2015



1-3 1-3 Based on the latest available information, there currently exist 18 Lebanese banks in 32 countries in the world: starting in the Arab region with major markets (such as Egypt, Sudan, Algeria, Saudi Arabia, United Arab Emirates, Bahrain, Qatar, Oman, Syria, Jordan, Iraq), to regional markets with important economic weight (such as Turkey) all the way to Europe, America, Africa, Asia and Australia. This presence takes several legal forms distributed over 19 representative offices, 64 direct branches, and 40 subsidiaries with more than 300 branches in their countries of location (refer to table no. 20 in the statistical appendix/ fifth section).

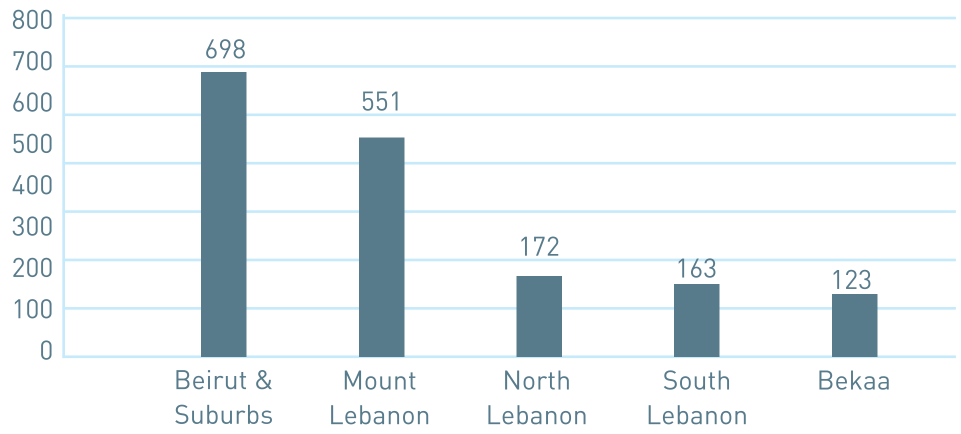
1-4 The Lebanese banking sector has shown resistance facing the deterioration in the political and security situations in some of the countries of its presence. Thus, the influence of the latest regional developments on it has been relatively limited in the Arab markets in general, as subsidiary banks were able to preserve their income revenues and asset quality, and to maintain their positions in these markets. Some of the reasons of this resistance are the small size of most banks outside their mother countries in relation to the size of their operations in the local market. Lebanese banks resorted to several stress tests conducted from the beginning of the regional disturbances, using severe scenarios to evaluate possible losses on lending portfolios and measure the impacts of these losses on the levels of liquidity and profitability. They also took all the private and collective provisions capable of covering relevant risks in the face of the current regional developments.

1-5 Along with the expansion of their branch network, banks in Lebanon continued in 2015 to develop their remote banking systems and means of payment. They have extended the use of ATMs and the functions they can perform from cash and checking deposits, withdrawals, account statements and others. Security systems were launched in electronic trading and conducting banking operations over the mobile telephone by introducing innovative solutions aiming at establishing the most secure method of electronic payment.[1] The ATMs machines number placed at the service of customers amounted to 1,707 at the end of 2015. The total number of high security bank credit and debit cards in circulation reached around 2.8 million cards. We mention in this framework that the BDL issued on April 22, 2016 intermediate circular no. 418 in which it prohibited using prepaid cards except the ones tied to a bank account and issued in the name of a specific person as part of combatting money laundering and terrorist financing.

In another context, electronic crimes/cybercrimes have become part of tangible crimes that can threaten the banking sector and financial transactions for individuals and companies, and require a clear approach to face them. Therefore, the Association of Banks in Lebanon participates, through three committees, in developing "Guidelines for combatting electronic crime in Lebanon" even though it believes that the best international banking industry practices today is to avoid conducting payment and transfer operations based on information incoming by the electronic mail because of their operational risk and the ability of cyber criminals to extract the information of the electronic mail even in the presence of preventive measures. The Association sees that the transfer of information and conducting electronic operations through online banking applications or the mobile phone is better because this information is renewed regularly as a result of the increase in the threats of electronic piracy. Controlling it from beginning to end is performed by the information technology experts in banks.

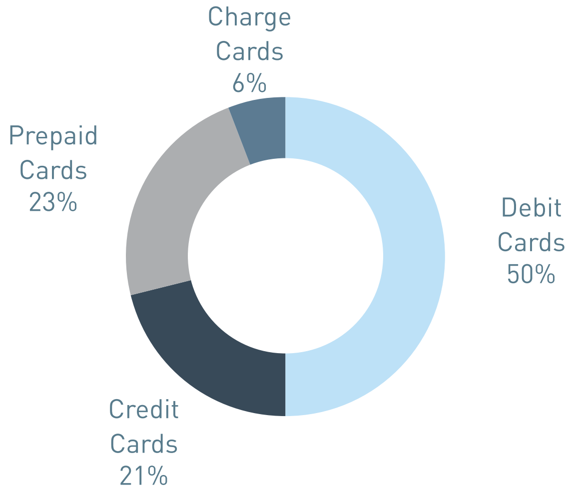
1 In the context of initiatives taken to establish the systems of electronic payments at the directorates and institutions in Lebanon, it is possible for all subscribers at the Water Authority of Beirut and Mount Lebanon to pay for water services over the electronic site of the concerned institution through bank cards issued by Lebanese or international banks.

Geographical distribution of ATMs in Lebanon end 2015



Source: BDL

Cards distribution end 2015 - %



Source: BDL

1-6 Banks in Lebanon continued in 2015 to apply the international standards concerning social responsibility, especially the "Global Reporting Initiative GRI G4 ISO 26000" and also the ten "UN Global Compact Principles" in the fields of human rights, work standards, the environment and combatting fraud. It is expected for banks to play an important role in developing the society due to their large capabilities and the possible social implications that can result on the Lebanese society. Some banks invest in their human resources accompanied by an experienced and specialized team of some international groups and organizations to market a number of programs, advice customers and study the environmental impact of their investments. Proceeding from social responsibility, a number of banks have developed a leading and comprehensive vision in the projects related to the environment and energy consumption with the emphasis on offering studied facilities and necessary financing for these types of projects through the programs launched by the BDL, in addition to the banks' financing programs at reduced costs and subject also to BDL support. It has become important for banks to start taking environmental risks into consideration besides the other credit, market, and operational risks. Being the most important financing source, banks attempt to encourage environment friendly loans granted to households and individuals and are studying the possibility of issuing "Green Bonds" for environment friendly institutions and projects. Some banks include in managing their head offices and branches work tracks that conserve the environment such as reducing the consumption of energy, water, paper, and rationalize the use of transportation means for their employees, and other measures. The BDL had launched the national initiative for renewable energy in 2010. The number of companies interested in the environment increased from 34 to 270 and more than 325 projects benefited from environmental loans whose value reached USD 280 million. Some international financial institutions such as the IFC, the EIB, and the AFD contribute to granting loans to environment friendly projects. Green residential buildings and environment friendly projects will no doubt have their share in the new stimulating program launched by the BDL.

1-7 Circular no. 134 issued by the BDL in February 2015 related to basic decision no. 11947 on "Principles of carrying out Banking and Financial Operations with Clients" is included as part of the social responsibility of banks and financial institutions which gives the Financial Markets Authority and the Banking Control Commission a decisive role in customer protection concerning educating clients, raising their awareness, and clarifying their rights, giving direct benefits to both parties. Units established in banks to protect customers contributed to spreading the culture of transparency and acquainted the customers more with their rights and duties. And as with compliance units, it is necessary that every bank includes a department in charge of customer protection to emphasize the commitment of the bank towards its customers by providing them with the financial solutions of the highest caliber and the specialized services that satisfy their needs.

1-8 Lebanese banks renew regularly the emphasis on their commitment to all international financial laws, especially ones concerning combatting money laundering and terrorist financing and the ones caring for the operations of correspondent banks. They commit to the amendments introduced by the Special Investigation Commission in charge of this subject in Lebanon. The BDL issued several circulars so banks can avoid the risks of non-compliance and thus to assure correspondent banks. Out of the circulars related to money laundering is circular no. 411 issued in February 2016 prohibiting stocks issued in bearer form. Institutions holding these stocks have to settle their situation within a two-year period.

1-9 The laws passed by the parliament in November 2015 are to protect Lebanon from any international financial isolation and keep the deposits of customers away from any sanctions, despite the problems surrounding the country. The four laws related to the compliance with the international financial system which aim at averting Lebanon any sanctions and prevent its inclusion on the international black lists are: first, the accession of Lebanon to the United Nations Convention on combatting terrorism (Law no. 53), and second, on declaring the cross-border transportation of money carried by any individual (Law no. 42) even though this does not prevent the entry of cash but the declaration on sums exceeding USD 15 thousands, and third, on exchange of tax information to prevent tax evasion as requested by OECD (Law no. 43), and the fourth concerns major amendments to Law no. 318 on combatting money laundering to include new financial crimes (Law no. 44). The BDL issued in December 2015 basic circular no. 136 addressed to banks and financial institutions and various institutions subject to its licensing and supervision to apply the Security Council resolutions no. 1267 (1999), and no. 1988 (2011), and no. 1989 (2011) and successor decisions as banks are required to regularly consult the web page of the mentioned Council.

1-10 As a result of passing these laws and issuing the circulars related to these subjects by the BDL, the FATF-GAFI considered that Lebanon met all required conditions from the legal frameworks and from the practice in combatting money laundering and terrorist financing and the weapons of mass destruction and, thus, there is no need to include it on the surveillance follow-up lists. This announcement was issued by a general assembly including 199 countries which relieves Lebanon in its financial and banking dealings. Lebanese banks are strict in the issues of compliance and risk management and other required measures of combatting money laundering and terrorist financing and Know your Customer (KYC). These banks work on increasing the financial and the capable and needed material and human resources required for compliance departments and adopting the international specialized information technology programs. Additionally, what is being applied in the home country bank in Lebanon is applied on the branches of any Lebanese bank abroad along with the compliance with local existing laws.

Special Investigation Commission (SIC) report in 2015

In 2015, the work done by the Compliance Unit, the supervisory arm of the SIC can be classified under three main streams: making examination more robust, suggesting AML/CFT regulations that beef up controls to mitigate certain risks, and working with local authorities to develop mechanisms to comply with FATF recommendation no 6. Specialized circulars were issued by the BDL (136-393) and SIC (19).

In 2015, the Audit and Investigation Unit in the Commission handled 458 spontaneous disclosures on top of the 289 filed suspicious transactions (STR) and the 215 requests of assistance (ROA) received from foreign and local authorities. The SIC took in this regard several decisions out of which sharing information with other peer investigation units (FIUs), disseminating information to law enforcement authorities, keeping certain accounts traceable, in addition to freezing accounts and lifting bank secrecy off 28 cases that were forwarded to the General Prosecutor.

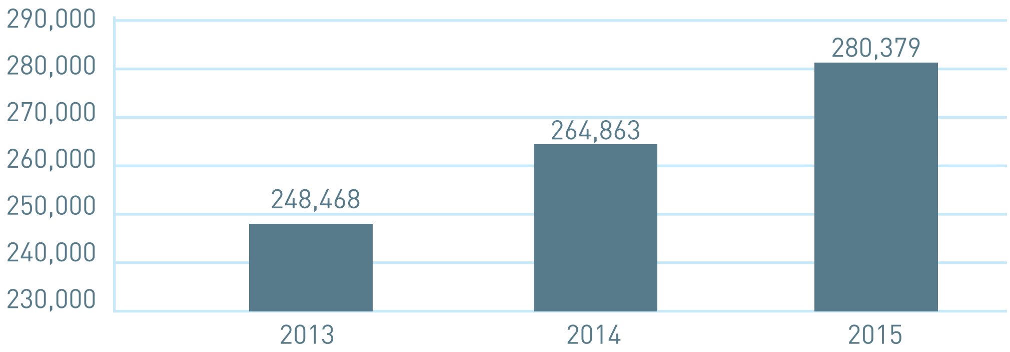
During 2015, risk-based onsite compliance examinations conducted by the audit unit using measures built on the risk-based approach for banks and other reporting entities, included 22 banks, 17 financial institutions, 28 insurance companies, 130 money dealers, 7 money remittance companies and 3 brokerage firms. The unit received the annual reports prepared by the external auditors on fighting money laundering and terrorist financing at 67 banks, 52 financial institutions, and 48 money dealers from category A. The Commission received several cases: 432 out of which were 331 from local sources (85 cases were forwarded to the General Prosecutor or the concerned parties and 76 are under investigation), 101 from foreign sources (72 cases were forwarded to the General Prosecutor or the concerned parties and 21 are under investigation). The cases received were distributed among embezzlement of private funds (28.5%), forgery (9.2%), terrorism or terrorist financing (7.3%), embezzlement of public funds and corruption (5.7%), trade of narcotics (3.3%), organized crimes (1.0%), and not specified cases (45%).

II- BANKING ACTIVITY

2-1 The Lebanese banking sector activity showed in 2015 as in the previous year a slowdown attributed to the operational circumstances in the framework of its work. The immunity of this sector, however, is still reflected in several indicators positioning it in a comfortable environment to meet the needs of customers while keeping a good margin of bank liquidity. The sector banking relied on factors of strengths still allowing it to support the Lebanese economy during the years in which it passed through more difficult circumstances then the ones it is currently witnessing while still carrying its duties especially as far as financing the public and private sectors. The points of strength of this sector lie in relying on the confidence of investors and resident and non-resident depositors in its quality and robustness, on one hand, and the comparative advantages that it enjoys through its conservative policy and the deep experience facing the challenges, on the other. During the period of political, security and economic crises, the banking sector maintained the solid trust of the agents earning the appraisal of the international financial and banking institutions. The results achieved by the sector in 2015 remained acceptable and good in light of the weak performance of the Lebanese economy in the context of the events and developments witnessed in the country.

2-2 At the end of 2015, total assets of commercial banks operating in Lebanon reached around LBP 280,379 billion (the equivalent of USD 186 billion) in comparison to LBP 264,863 billion at the end of 2014 (USD 175.7 billion). Hence, total assets rose by 5.9% in 2015 which is slightly less than the increase in 2014 (6.6%) and 2013 of 8.5%.

Total Assets/Liabilities of commercial banks operating in Lebanon
End of period- Billion LBP



Source: BDL

The table below shows the evolution of the most important liabilities' items of commercial banks, in absolute value and relative importance of the total. The comparison between the end of 2014 and 2015 did not show a significant change except a slight increase in "other liabilities" (from 3.7% to 4.2% respectively) with banks relying during some periods on interbank operations between the bank branches in Lebanon and branches abroad as an additional source of financing besides deposits and capital accounts.

Commercial Banks Liabilities at the end of the period (Billion LBP and %)

	2013		2014		2015	
	Value	%	Value	%	Value	%
Resident private sector deposits	162,396	65.4	172,041	65.0	180,489	64.4
Public sector deposits	4,463	1.8	4,842	1.8	5,074	1.8
Non-resident private sector deposits	42,934	17.3	45,680	17.2	48,026	17.1
Non-resident financial sector deposits	7,555	3.0	8,795	3.3	9,864	3.5
Capital accounts	21,410	8.6	23,719	9.0	25,131	9.0
Other liabilities	9,710	3.9	9,786	3.7	11,795	4.2
Total	**248,468**	**100.0**	**264,863**	**100.0**	**280,379**	**100.0**

Source: BDL

2-3 Total deposits remain the primary source for the activity of commercial banks operating in Lebanon representing 83.3% of total liabilities at the end of 2015 (84% at the end of 2014), and maintaining the predominant share on the liability side. In addition to deposits, banks include their own resources represented in capital accounts and other resources from market when needed. The expansion of the total assets of commercial banks operating in Lebanon relies to a great extent on the growth in deposits of the resident and non-resident private sector which are replenished by the flow of funds from abroad and the lending activity to the economy in its public and private sectors. Banks also try to increase their medium and long-term resources through the issuance of certificates of deposits, preferred shares and subordinated debt obligations in addition to ensuring credit lines from Arab and international institutions, organizations and funds. However, total resources outside deposits and capital accounts are still modest requiring the development of capital markets.

Deposits

2-4 At the end of 2015, the total value of deposits, which includes deposits of resident and non-resident private sector and deposits of some institutions of the public sector, reached LBP 233,589 billion (the equivalent of USD 154.95 billion), in comparison to LBP 222,563 billion (USD 147.64 billion) at the end of 2014. Thus, these deposits increased by around 5.0% in 2015 in comparison to a higher increase of 6.1% in 2014 and 9% in 2013. In fact, the weak economic growth and the increase in the external payments deficit caused a slowdown in deposit growth, which remains, however, sufficient to cover the financial needs of the private and public sectors, and to comply with the prudential standards and support the foreign currency reserves of the BDL. We point out here that the contribution of the external factor or capital inflows was weak because of the influence of the political and security challenges witnessed by the country and the resulting unstable situation, and the continuation of the Syrian crisis and its negative repercussions. The contribution of the internal factor, especially the public sector was in its turn weak due to the absence of the public budget and the weak capital expenditures, and to restricting fiscal policy.

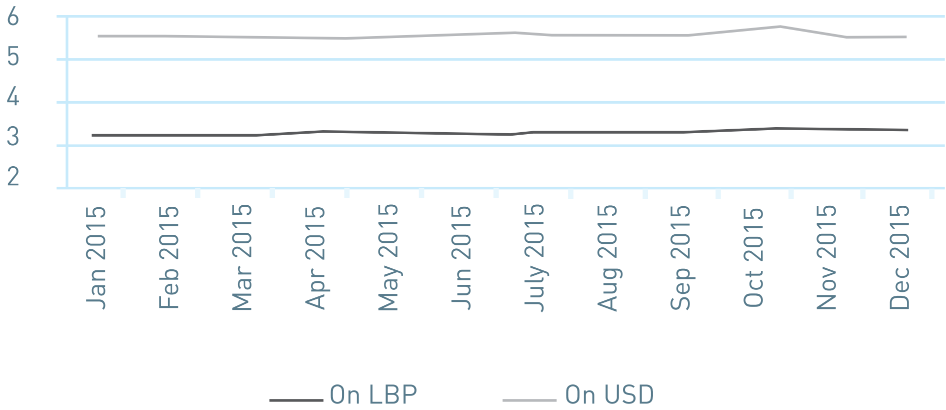
2-5 It is known that the banking sector attracts deposits from abroad in a sign on the important role of the Lebanese diaspora as the inflow of capital and investments of expatriates working outside represents a fundamental pillar for the banking sector and the economy as a whole, in addition to the social dimension of the financial support to the Lebanese households. However, despite the continuous inflow of capital of the non-resident Lebanese which contributes to the growth of bank deposits, estimated by the World Bank at USD 7.2 billion annually, and representing close to 14% of GDP, Lebanon suffers from a decline in investments. We mention that the Gulf and African countries are considered the principal sources of remittances and are the countries where the decline in oil prices negatively impacted their revenues.

2-6 At the end of 2015, the share of resident private sector reached 77.3% of total deposits, while the share of non-resident private sector represented 20.5% and that of the public sector 2.2%. It is worth indicating that deposits also include the portfolio of certificates of deposits issued by banks, which amounted to USD 500 million at the end of 2015 (USD 529 million at the end of 2014). The majority of bank deposits are saving accounts (more than 80%) and short-term (less than 90 days). One more time, the growth in deposits resulted especially from resident deposits representing more than three-fourth of the total growth in deposits in 2015. In another context, the share of deposits in LBP was 36.5% and 63.5% in foreign currencies at the end of 2015 (35.7% and 64.3% respectively at the end of 2014). The dollarization rate of the private sector deposits stood at 64.9% at the end of June 2015 the same recorded at the end of 2015 after declining during the period of September-November 2015 to 64.6%.

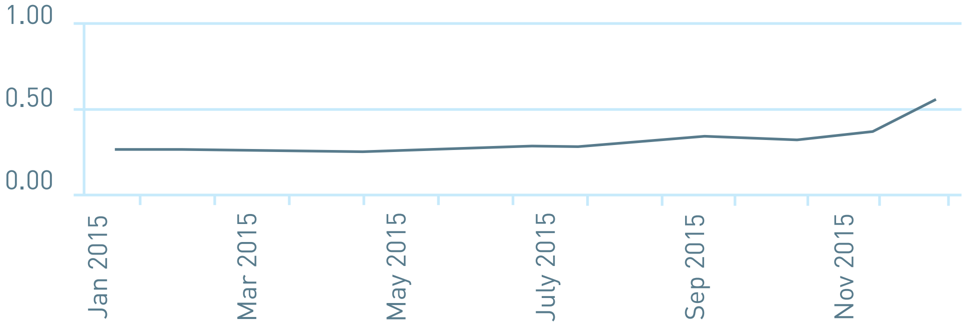
2-7 Otherwise, bank deposits are concentrated in Beirut and its suburbs which attracted 69% of total deposits at the end of 2015, allocated to 48.3% of the total number of depositors, whereas 31% of the deposits belong to other regions and allocated to 51.7% of depositors, thus revealing a difference in the average deposit value between Beirut & its suburbs and the other regions.

2-8 In parallel to the stability of interest rates on Treasury-bills in 2015 as in the previous year, the average interest rate on new or renewed deposits in LBP and USD slightly increased from 5.52% and 3.03% respectively in 2014 to 5.58% and 3.16% respectively in 2015 with slight monthly changes[2].

Deposit interest rates in Beirut Market (%)



Libor 3 Month on USD (%)



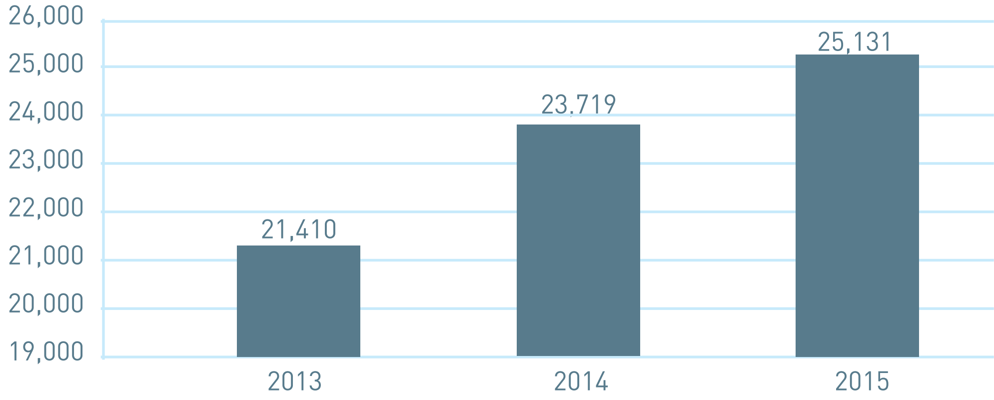
Source: BDL

2 It is to mention that world average interest rates remain, as this report is being prepared, at low levels as the US Federal Reserve raised at the beginning of December 2015 interest rates by 0.25% (between 0.25% and 0.50%) for the first time in several years believing that the US economy has overcome the repercussions of the international financial crisis and that the labor market has improved and the inflation rate has increased towards the targeted goal (knowing that it is far from it) of 2% in the medium term with the absence of the temporary implications of the decline in energy prices and imports. As for interest rates on deposits at the European Central Bank, they remain negative and the main refinancing rate at record low level.

2-9 Capital Accounts

At the end of 2015, capital accounts of commercial banks operating in Lebanon increased to LBP 25,131 billion (the equivalent of USD 16.7 billion) from LBP 23,719 billion at the end of 2014 registering an increase of 6% in 2015 in comparison to a higher increase of 10.8% in 2014 and 12.3% in 2013. At the end of 2015, capital accounts represented around 9% of the consolidated balance sheet (like at the end of 2014) and 30.7% of the total claims on private sector (30.9% at the end of 2014). These ratios are considered good compared to counterpart banking sectors in numerous European advanced countries. In addition to attracting deposits that exceed the financing needs of the public and private sectors, the financial sector has also the ability of attracting more financial resources due to the confidence of investors in Lebanon and the region in this sector, despite the inappropriate current economic situation and the difficult regional scene throwing its weight on Lebanon.

Capital Accounts in the Commercial Banks
end of period- billion LBP



Source: BDL

2-10 Banks' Capital is crucial to protect a bank from various risks and to increase confidence in its sustainability as well as to protect bank customers, employees, shareholders, and the economy in general. Capital provides additional elements of strength and flexibility in implementing the internal and external expansion at the level of the diaspora and business. Enlarging the size of capital is a must for banks whose capital was formed from the new capital attracted from investors in Lebanon and abroad through the issuance of common and preferred shares classified as core capital, and from retaining most bank profits into their capital to enlarge it. However, the increase in the country risk always necessitates the increase in the size of capital even at the expense of redistributing profits, which enhances capital adequacy, the liquidity of traded shares, transparency, and the solid financial position of the bank and the whole sector. This is supervised by the BDL and the Banking Control Commission.

2-11 The supplementary capital, which includes subordinated bonds and some types of preferred shares, remains low compared to the core capital, as it represented 7.3% of capital accounts at the end of 2015 (7.4% at the end of 2014). It is clear that this is largely in line with the Basel III accord to strengthen the soundness of the banking sector, which includes improving the quality of the capital base through focusing on the concept of shareholders equity within tier one, i.e. the core capital, and the marginalization of tier two, i.e. supplementary capital. This new accord radically transformed the structure and quality of capital accounts which ensures for banks the adequate factors of resistance in case their capital are exposed to any emerging pressure. This is an indication of a sound position especially that the liquidity ratio exceeded the required one (30%) which is of utmost importance as bank liquidity became after the global financial crisis a concept as important as capital adequacy. The mentioned indicators of financial performance which reflect the risk coverage in general stand witness to the maintenance of the sector of its international financial stance.

Finally, we mention the positive role played by banking supervision over the last years in the flourishing of the banking industry in Lebanon, especially concerning preserving high levels of capital adequacy and liquidity which are and remain a source of appraisal from customers and international financial institutions, despite the sovereign risks that are often hilighted by rating agencies and other international financial institutions.

Placements of the Banking Sector

2-12 Unlike the structure of liabilities, the structure of commercial banks uses of funds witnessed slight changes in 2015 in comparison to the previous year. The share of deposits at BDL continued its ascending trend to reach 37.9% out of total placements in 2015 from 36.1% at the end of 2014. In return, the share of loans to the public sector continued its decline to reach 20.3% at the end of 2015 compared to 21.3% at the end of 2014. The share of foreign assets continued to decline to reach 12.8% compared to 13.8% in the two periods respectively, whereas the share of loans to the resident private sector stabilized at 25.8% after having slightly increased in the previous years.

The table below presents the evolution of the main assets items of commercial banks, in terms of absolute value and relative importance to the total between the end of 2013 and 2015.

Commercial Banks' Assets at the end of period
(Billion LBP and %)

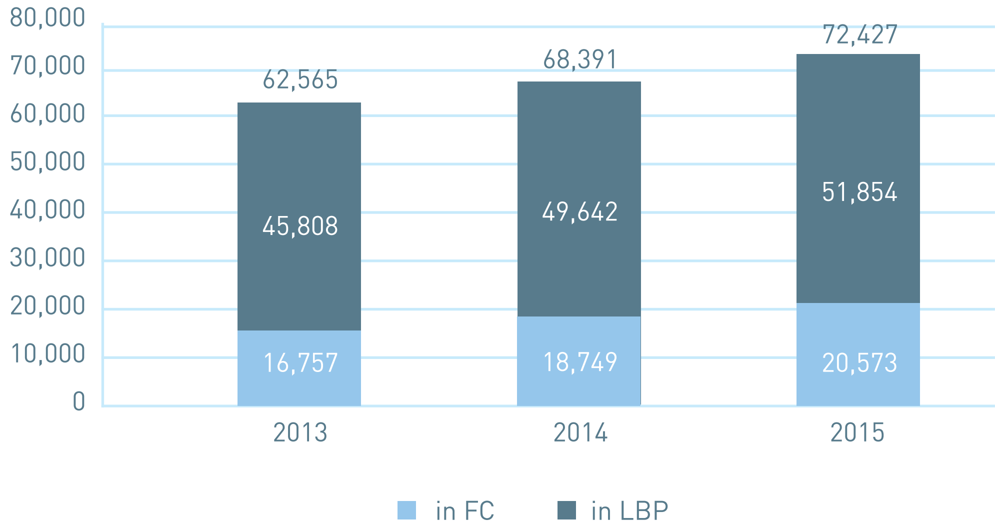
	2013		2014		2015	
	Value	%	Value	%	Value	%
Reserves	82,533	33.2	96,314	36.4	107,021	38.2
o/w : deposits with BDL	*81,957*	*33.0*	*95,707*	*36.1*	*106,329*	*37.9*
Claims on the resident private sector	62,565	25.2	68,391	25.8	72,427	25.8
Claims on the public sector	56,786	22.8	56,308	21.3	56,984	20.3
Foreign assets	40,137	16.2	36,470	13.8	35,870	12.8
o/w : claims on NR financial sector	*21,041*	*8.5*	*18,342*	*6.9*	*17,422*	*6.2*
claims on NR private sector	*8,862*	*3.6*	*8,339*	*3.1*	*9,316*	*3.3*
Fixed assets & Non-classified assets	6,447	2.6	7,380	2.8	8,077	2.9
Total	**248,468**	**100.0**	**264,863**	**100.0**	**280,379**	**100.0**

Source: BDL

Claims on Private Sector

2-13 In 2015, bank loans to the resident and non-resident private sectors continued to increase, closely reaching USD 54.2 billion at the end of the mentioned year, against USD 50.9 billion at the end of 2014. However, its growth has slowed down in the last 5 years reaching 6.5% in 2015 in comparison to a higher increase in 2014 (7.4%) and in 2013 (9%), while remaining good and acceptable in light of the weak economic growth in the country and the instability in the region. Furthermore, loans granted to the non-resident private sector, of which a large part is related to the financing of projects for Lebanese businesses abroad, particularly in Arab and African countries, represented 11.4% of the total loans granted to the private sector at the end of 2015 in comparison to 10.9% at the end of 2014 and 12.4% at the end of 2013.

Total claims on resident private sector
end of period- billion LBP



2-14 Banks continued to finance the resident and non-resident private sectors, individuals and corporations, at an acceptable interest rate not exceeding 7% on average in LBP and foreign currencies and for terms relevant to the nature of the financed activities. Moreover, loans granted to the resident and non-resident private sectors represented the equivalent of 107% of GDP at the end of 2015, hence a considerably high ratio compared to many emerging countries. This relatively high level in Lebanon could be explained, on one hand, by the enormous private demand, a large part of which is financed by bank loans to individuals and institutions for investment and particularly consumption. On the other hand, it resulted from the low capitalization of the corporate sector, its weak capacity for self-financing, and its excessive reliability on banks' financing, as financing through stocks and corporate bonds markets is almost absent in Lebanon.

2-15 On the other hand, the ratio of loans in foreign currencies to deposits in foreign currencies slightly increased to 41.2% at the end of December 2015 from 40.5% at the end of 2014. Loans in LBP to deposits in LBP continued to increase reaching 25.6% at the end of December 2015 in comparison to 25.1% at the end of 2014. Despite that, Lebanon's ratio of loans to deposits remains low, given the high liquidity levels of the Lebanese banking sector and the large size of savings in comparison to the absorptive capacity of the domestic economy.

2-16 With the increase of loans in LBP by 9.7% in 2015 and 11.9% in 2014, or at a faster rate than the increase of loans in USD, which stood at 5.5% and 6.1% in the two respective years, the loan dollarization rate decreased to 74.8% at the end of 2015, against 75.6% at the end of 2014 (76.5% at the end of 2013). The decrease in loan dollarization rate during the last few years, precisely since 2009, was the result of incentives provided by the BDL for specific loans in particular housing loans and ones granted to productive sectors for the financing of new projects or the expansion of existing projects. They also include loans granted to higher education, environmental friendly projects and agriculture (other than those with interest rate subsidies).

2-17 The BDL's policy of stimulating the private sector relied in the last years on several different pillars. We first mention the stimulus package of liquidity at a low cost to banks launched by the BDL at the beginning of 2013 based on intermediate circular 313/2013 that included most of the economic sectors, particularly the housing sector. With the continuing weak foreign demand due to the prevailing situation, the BDL started providing a new stimulus to economic growth through incentives to domestic demand via bank loans, especially in LBP and at acceptable interest rates. With this initiative, the BDL placed USD 1.4 billion at the disposal of banks at 1% interest rate, so that they continue to grant loans to institutions and households through this new mechanism after the mechanism of required reserves was consumed, knowing that banks bare alone the credit risk. The BDL also specified the benefit structure of this mechanism to economic activities, in addition to a lending rate ceiling of 5%. Banks responded so well to the program that the BDL placed in early 2014 an additional amount of USD 800 million to be lent through this mechanism for further economic incentives and repeated the initiative one more time allocating a sum of USD 1.0 billion in 2015 and is planning on providing a sum of more than USD 1.0 billion in 2016. These initiatives target the sectors of housing, education, environment, alternative energy, entrepreneurship, Research and Development, and the new productive and investment projects. The second incentive program is represented by intermediate circular 331/2013 concerning the knowledge economy as this sector represents an engine for future growth. This circular allows banks and financial institutions to contribute within the limits of 3% of bank's capital to finance start-up projects, business incubators and accelerators whose business is centered in the knowledge economy. The BDL provides these projects with a guarantee of 75% which prevents banks from risking their own capital. The purpose of this circular is to activate the procedures of establishing new promising companies that in the future could turn into companies capable of enriching the national wealth and creating new jobs. Capitalizing through partnerships and participations to capital is a new mission allowing banks to support the intellectual competencies and professional inventions that fit into the framework of the knowledge economy. In 2016, basic circular 23 was amended through intermediate circular no. 419 so that it is not possible for the total contributions of any bank in "companies" to exceed 4% of its capital, and for its contribution in any of the companies whose purpose is confined to the contribution in capital (Venture capital) "start-up companies" not to exceed 20% of this percentage and 10% in any other "companies". However, it is up to the Central Council of the BDL in justified cases to agree on exceeding any of these percentages. Banks have invested so far around USD 243 million in start-up companies and funds. The third pillar consists of extending the maturity of subsidized loans to the productive sectors, including tourism, from 7 to 10 years, based on circular 335/2013.

Subsidized loans and loans benefiting from deduction in reserve requirements (End of period – billion LBP)

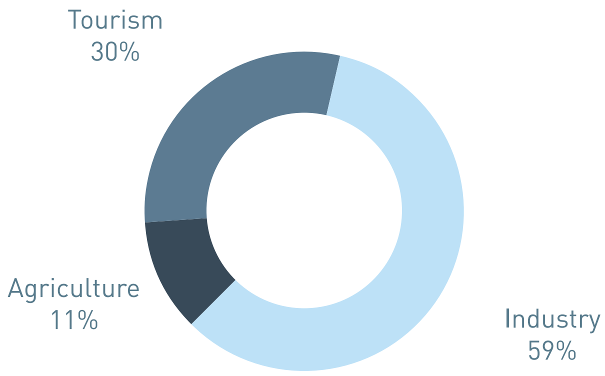
	2013	2014	2015
1- Subsidized -interest medium & long term loans	5,896	6,732	7,334
2- Subsidized-interest loans guaranteed by Kafalat	1,723	1,890	2,022
3- Subsidized-interest loans under the protocol signed with the EIB	204	204	204
4- Subsidized-interest loans granted by leasing companies	179	192	214
5- Subsidized-interest loans granted by IFC	80	80	80
6- Subsidized-interest loans to finance working capital	16	16	16
7- Subsidized-interest loans granted by AFD	7	7	7
TOTAL Subsidized-interest loans (1+2+3+4+5+6+7)	**8,105**	**9,121**	**9,877**
Utilized loans benefiting from deductions in banks liabilities subject to reserve requirements	**4,166**	**3,939**	**3,764**
Utilized loans benefiting from deductions in reserve requirements	**9,899**	**9,930**	**9,915**

Source: BDL

Data reveal that loans in LBP benefiting from deductions in reserve requirements decreased by 0.2% to reach LBP 9,915 billion at the end of 2015, given that they registered an increase of around 0.3% only in 2014 and of 6% in 2013. Its increase in the last few years mainly resulted from the increase in housing loans. Loans benefiting from deductions in bank liabilities subject to required reserves decreased by 4.4% in 2015 reaching LBP 3,764 billion at the end of the mentioned year after decreasing by 5.5% in 2014 and increasing by 6.3% in 2013.The slight increase or decrease in these loans in the last few years is attributed to the fact that banks relied specifically in their lending on the stimulus packages subject of intermediate circular no. 313/2013 previously addressed.

Data also show that the total subsidized interest loans, granted between 1997 and 2015, increased by 8.3% in 2015 reaching LBP 9,877 billion (or the equivalent of USD 6.6 billion). These loans increased by 12.5% in 2014 and 10.8% in 2013. The share of the industrial sector out of these loans represented 59% at the end of 2015, against 29.7% for the tourism sector and 11.3% for the agricultural sector. Four elements characterize these subsidized loans: the periods of the loan for 7 or 10 years, the grace periods, the relatively low average interest rates, and facilities and exemptions based on the usage or reduction in required reserves.

Distribution of subsidized interest loans on economic sectors end of 2015



Source: BDL

2-18 It is noteworthy to mention in this context that banks play a significant role in the specialized financing schemes to the private sector, institutions and individuals. On one hand, banks are the partners of the Lebanese State as well as the international and regional financial institutions, of which the Overseas Private Investment Corporation (OPIC), the European Investment Bank (EIB), l'Agence Française de Développement (AFD), the International Finance Corporation (IFC), the Arab Development Funds, the Arab Monetary Fund etc., and on the other, banks are the lenders baring solely the credit risk of these loans and offering new and varied loans.

2-19 The data related to the nature of loans granted by the financial sector reveal that, as of the end of 2015, a large part of these loans -representing 71.8%- consist of limited-term loans, while the remaining part or 28.2% is in the form of overdrafts. It is to note that overdrafts are usually granted to clients with high creditworthiness or to big clients where total loans are concentrated. Therefore, the share of these facilities from the total is in line with the distribution of loans by value and according to the beneficiaries. At the end of 2015, the share of advances against real estate guarantees reached 35.1%, in comparison to 18.3% for the advances against personal guarantees, 12.4% for the advances against cash collateral or bank guarantees, 4.1% for the advances against other real guarantees, and 2.0% for the advances against financial values.

2-20 The distribution of loans among the economic sectors corresponds roughly to the shares of these sectors in GDP, except for the agriculture sector that requires specialized financing schemes, as is the case in most of the developed and emerging countries.

Sectorial Distribution of Utilized Credits in the Financial Sector (End of period)

	December 2013		December 2014		December 2015	
	Value (billion LBP)	Share %	Value (billion LBP)	Share %	Value (billion LBP)	Share %
Trade & Services	27,501	34.5	29,373	34.0	30,991	33.4
Construction & building	13,840	17.3	14,471	16.7	16,335	17.6
Industry	9,007	11.3	9,320	10.8	9,398	10.1
Personal loans	22,207	27.8	24,911	28.8	27,060	29.2
o/w: housing loans	*12,866*	*16.1*	*14,893*	*17.2*	*16,457*	*17.7*
Financial intermediation	4,315	5.4	5,171	6.0	5,458	5.9
Agriculture	824	1.0	994	1.1	1,064	1.1
Other sectors	2,083	2.6	2,214	2.5	2,468	2.7
Total	**79,777**	**100.0**	**86,454**	**100.0**	**92,773**	**100.0**

Source: BDL

Loans remain concentrated in the trade and services sector, despite the continuous decrease of its share as percent of total loans that declined from 34% at the end of 2014 to 33.4% at the end of 2015 along with the share of the industrial sector that declined from 10.8% to 10.1% at the end of the two mentioned periods respectively. In return, the share of construction loans increased from 16.7% at the end of 2014 to 17.6% at the end of 2015, and the share of personal loans continued its increase to 29.2% at the end of 2015 with the increase in the share of housing loans included in this figure to 17.7% at the end of the mentioned year, whereas the share of other sectors witnessed minor upward or downward variations.

2-21 The distribution of loans among the regions and beneficiaries show their obvious concentration in the region of Beirut and its suburbs and in favor of its inhabitants, with a slight gradual decrease in the share of this region to 76.5% of total loans and 54.7% of the total number of beneficiaries at the end of 2015. This concentration is in line with the concentration of economic activity, population, and income levels in the capital and its suburbs.

2-22 Concerning the distribution of loans by credit range, statistics show that loans whose value exceeds LBP one billion, are distributed among 1.4% only of the beneficiaries (or 8,148 persons and institutions), out of the total number of beneficiaries of around 570,140. This low percent is in line with the situation of most countries in the world.

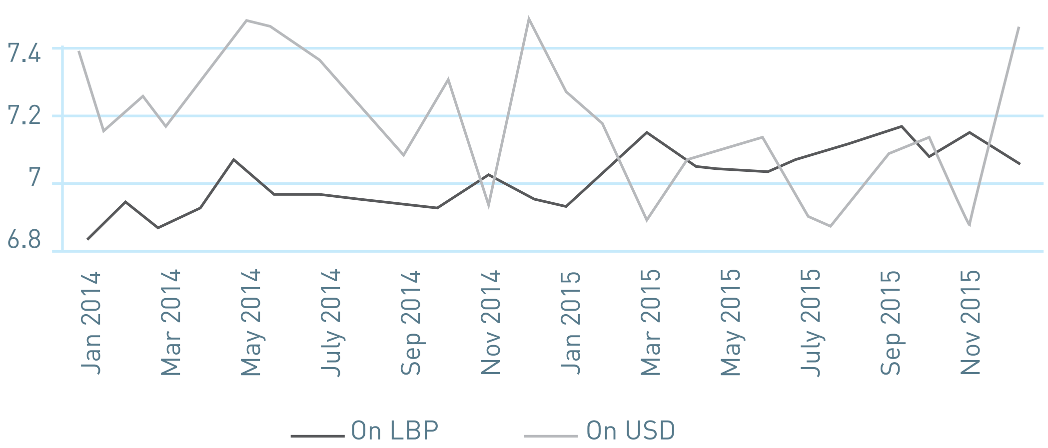
Distribution of loans according to the value and the beneficiaries (In percentage – End of 2015)

	by value (%)	by beneficiaries (%)
Below 5 million LBP	0.15	11.09
5 – 25 million LBP	4.14	53.15
25 – 100 million LBP	5.89	20.42
100 – 500 million LBP	15.54	12.70
500 – 1,000 million LBP	5.10	1.21
1,000 – 5,000 million LBP	13.16	1.00
5,000 – 10,000 million LBP	9.15	0.21
10,000 million LBP and above	46.88	0.22
Total (Billion LBP and Number)	**92,773**	**570,140**

Source: BDL

2-23 Concerning the interest rates on new and renewed loans, the average lending rate on the USD increased from 6.95% in 2014 to 7.08% in 2015 in parallel with a similar increase of the deposit interest rate on the USD, whereas the average lending rate on the LBP slightly declined from 7.27% to 7.09% during the two mentioned years respectively, probably influenced by the incentive packages for loans (especially in LBP) which is the subject of intermediate circular no. 313/2013 launched by the BDL. The lending interest rates in LBP or USD registered some limited upward and downward monthly fluctuations.

Evolution of Lending Interest Rates on Beirut's Market



Source: BDL

Claims on Public Sector

2-24 The claims of commercial banks on the public sector increased at the end of 2015 to reach LBP 56,984 billion in comparison to LBP 56,308 billion at the end of 2014, thus registering a slight increase of 1.2% after a slight decrease of 0.8% in 2014 in comparison to a large increase of 21% in 2013. This resulted from an increase in claims in foreign currency by 8.2% or more than USD 1.3 billion, compared to a decline in claims in LBP by 4.2% or LBP 1,337 billion. The Ministry of Finance issued in February and November 2015 Eurobonds in the amounts of USD 2.2 billion and USD 1.6 billion respectively. Banks subscribed in large amounts to these issuances in addition to buying Eurobonds in the secondary market. The decline of banks' portfolio in Treasury bills in LBP in 2015 indicates that their new subscriptions came less than maturing bills, knowing that banks concentrated their subscriptions on long-term categories (7 and 10 years) with good return issued in the mentioned year.

The slight decrease in 2014 comes as a result of the inability of the government to issue Eurobonds due to the absence of authorization to borrow on one hand, and the relatively weak banks' appetite to subscribe to Treasury bills in LBP with maturity shorter than seven years because of the prevailing level of interest rates on the other hand. So the banks focused on rolling-over maturing bills while being satisfied with a simple surplus.

2-25 Going back to 2015 and in detail, the commercial banks' portfolio of Treasury bills in LBP decreased to LBP 30,243 billion at the end of 2015 compared to LBP 31,564 billion at the end of 2014. The Ministry of Finance had issued in February, April, June, August, October and November 2015 long-term Treasury bills of 7 years category, and bills of 10 years category in January, March, May, July, September, October and December of the same year. The banks' subscriptions as we previously mentioned focused on long-term bills due to their relatively high returns and the availability of a good level of liquidity in LBP at banks.

2-26 The banks' portfolio of Eurobonds increased from USD 16,311 million at the end of 2014 to USD 17,645 million at the end of 2015. This is especially due to the subscriptions of banks in the new bills issued that year.

2-27 As a result, it became natural that the share of the claims on the public sector in LBP out of total loans to the public sector decreased to 53.3% at the end of 2015 against 56.3% in 2014, while the share of claims in foreign currencies increased to 46.7% against 43.7% for the two consecutive dates.

Foreign Assets

2-28 Deposits of commercial banks at correspondent banks continued to decline in 2015 to reach around USD 11.6 billion at the end of the mentioned year against USD 12.2 billion at the end of 2014 and USD 14.0 billion at the end of 2013. Thus, these deposits declined by a 5.0% in 2015 following a higher decline of 12.8% in 2014. The ratio of these deposits out of total customer's deposits in foreign currency at banks declined to 11.8% at the end of 2015 from 12.8% at the end of 2014. This is attributed especially to their very low return and the preference of banks to place them at the BDL, knowing that the BDL reinvests these deposits with foreign banks, which means that these deposits still carry the same levels of liquidity and risk for banks while contributing to the support of the BDL's foreign currency reserves and reinforcing monetary stability.

2-29 In addition to being a main source of liquidity in foreign currency, these deposits at correspondent banks play an important role in Lebanon's financing transactions with abroad and in risk management. Therefore, despite the low return of these foreign placements with less than 1.0% on average, banks always try, while managing their resources, to ensure a minimum level of liquidity in foreign currencies at correspondent banks which helps contain any negative incidental developments.

2-30 Deposits of banks at correspondent banks, net of deposits of non-resident banks, decreased to around USD 5 billion at the end of 2015 compared to USD 6.3 billion at the end of 2014. In other terms, deposits at correspondent banks covered 1.8 times the foreign liabilities towards the non-resident banks at the end of 2015 compared to 2.1 times at the end of 2014. It is to mention that non-resident banks that own creditor accounts in the banking sector are for the most subsidiaries of Lebanese banks.

2-31 On the other hand, banks' other foreign assets decreased by 6.7% in 2015 after a decline of 4.4% in 2014, reaching USD 6,058 million at the end of 2015 in comparison to USD 6,494 million at the end of 2014. These assets mainly consist of direct investments in sister or affiliated banks and of investments in foreign bonds whose credit rating is at least BBB and above and subject to the control of countries classified as BBB sovereign rating and above in case they are issued by corporations. These placements generate a high return compared to the deposits at non-resident banks and these foreign assets represent a desired diversification of foreign placements and thus a distribution of risks.

Deposits at BDL

2-32 The deposits of commercial banks at the BDL continued to increase in 2015 reaching LBP 106,329 billion at the end of the mentioned year in comparison to LBP 95,707 billion at the end of 2014. Thus, they would have increased by LBP 10,621 billion or by 11.1% in 2015 in comparison to a higher increase of LBP 13,750 billion or 16.8% in 2014. The share of these deposits out of total banks' assets increased to 37.9% at the end of 2015 from 36.1% in the previous year, knowing that this share registered its highest level historically during 2015 (38.2% at the end of September 2015).

The large increase in these placements in 2015 as in the previous year was due to the excess sources of funds in banks that were not invested in the economy- with the slowdown of the private sector lending activities and a decline or a slight increase in credits to the public sector-, and due to the redistribution of portfolios especially deposits at correspondent banks in addition to the constitution of the required reserves in LBP and required deposits in foreign currencies. It is to mention that the BDL started issuing from the beginning of 2015 CDs for banks in LBP and USD for 20 and 30 years, in addition to other categories that are regularly issued.

The increase in these deposits in 2015 came especially in the form of CDs in LBP and USD in addition to deposits in various maturities. It is to mention that banks' deposits in foreign currencies at the BDL increased substantially in 2015 after registering a substantial increase in the previous year contributing to a great extent to the strengthening of monetary stability.

III- BANKS AND RISK MANAGEMENT

3-1 The banking profession entails banks' exposure to several types of risks that are effectively managed. Lebanese banks adopt international regulatory and supervisory standards and practices of the banking industry through compliance with rules, regulations and guidelines issued by the local monetary and supervisory authorities in Lebanon and in all the countries where banks operate. These regulations stipulate the application of specific standards peculiar to the Lebanese situation, in addition to the international standards after their adaptation to the Lebanese banking structure and its characteristics, and with a margin of flexibility in the application and progressiveness in implementation, as needed.

3-2 The BDL took in the last two years additional precautionary measures aimed at better management of bank risks addressing specifically combating money laundering and terrorist financing which we will tackle in the next section. These measures have also focused on other issues in the banking profession such as the modification of the status of the Central Office of Credit Risk (Centrale des Risques) in a more strict direction, the classification of loans, distributing the principal credit portfolios, debt restructuring, lending to related parties, real estate loans, placing higher ceilings on retail loans, forming provisions and general reserves on retail loans, in the presence and even in the absence of indicators of payment delays, and forming collective provisions on interest generating loans portfolio other than retail ones. These measures will be detailed in the second part of the report.

Alternatively, the BDL established the "Compliance Unit" at the beginning of 2016 with the aim to ensure that all departments at the BDL and also in banks and regulated institutions comply with the applicable laws and regulations especially those in relation to combating money laundering and terrorist financing and suggesting measures to prevent and/or manage the ensuing risks. The BDL had established in 2014 the "Financial Stability Unit" with one of its main functions being to observe the financial and banking situation, to look-up the potential risks and crisis and to prevent crisis occurrence. It is to mention that with the increase in regional risks and the beginning of turbulences in some countries, the Banking Control Commission (BCC) started implementing stress testing[3] on the concerned banks.

Reputation Risk resulting from the non-application of compliance measures

3-3 Banks are seriously involved with the subject of combating money laundering and terrorist financing and with the international sanctions imposed on individuals and institutions in several countries, first by a conscious and responsible decision of banks administrations and second, in compliance with Law 318/2001 and its amendments (Law no. 44/2015) and with international standards of the banking industry and with circulars and lists issued by the monetary and supervisory authorities in order to safeguard the banking sector, the savings of the Lebanese, and to protect the Lebanese economy. Banks have developed in this domain throughout the last few years effective policies and systems, which made them gain credibility in the international financial markets. Bank management is seriously emphasizing the attendance of its employees on a permanent and intensive basis training seminars and workshops organized by the BDL, the Association of Banks in Lebanon, the

3 The stress tests included the portfolios of loans and advances, exchange rate fluctuations, the decrease in the value of assets used as collateral, with banks being asked to take collective provisions as a result of these tests.

banks themselves in addition to international parties. These seminars cover laws, systems, and also the standards and international developments concerning the subject of combating money laundering and terrorist financing, and the awareness on how to identify, freeze and report suspicious transactions, and the constant communication with the Special Investigation Commission, with the purpose of reaching higher levels of culture, technical know-how, and professionalism in the banking profession.

3-4 After the Parliament passed in November 2015 the four financial laws related to combating money laundering and terrorist financing (Law 44/2015), the declaration of amounts of carried cash at the border, the exchange of tax information, and on Lebanon's adherence to United Nation's 1999 International Convention for the Suppression of the Financing of Terrorism, the legal framework for fighting money laundering and terrorist financing would have been completed. This protects the work and practice of banks at this level in addition of course to the circulars and decisions of the BDL and the Special Investigation Commission. As a result, FATF considers Lebanon to have met all the international required conditions which keeps Lebanon's banks within the global financial system.

3-5 The BDL took intensive and important measures in the last years to fight money laundering and terrorist financing out of which we mention the issuance of circular no 126/2012 on the relation of banks with the correspondents, and circular no. 128/2013 related to the establishment of the compliance department, and also issuing in September 2014 intermediate circular no. 371 in which BDL asks banks, among other things, to appoint an AML/CFT Branch Officer, a person in charge of controlling the financial and banking operations to combat money laundering and terrorist financing in each branch of the bank. Through intermediate circular no. 393 issued in June 2015, banks were asked to establish an effective internal control system to combat money laundering and terrorist financing concerning the electronic banking and financial transactions. The BDL also issued in December 2015 basic circular no. 136 concerning the application of the UN Security Council resolutions no. 1267 (1999), 1988 (2011), 1989 (2011), and any related successor resolutions. Through intermediate circular no. 411/2016, the BDL prohibited banks from dealing with companies whose stocks are issued in bearer form. In April 2016, the BDL prohibited banks from issuing prepaid cards that are not linked to a bank account. The Central Bank also issued in May 2016 basic circular no. 137 on dealing with the US Act of December 18, 2015 and with its implementing regulations regarding the prevention of access by Hizballah to international financial and other institutions. The BDL also modified through intermediate circular no. 421 issued in May 2016 the "Regulations on the Control of Financial and Banking Operations for Fighting Money Laundering and Terrorist Financing" incorporated in the basic circular no. 83/2001, as it added from among many things, some types of institutions (such as specialized lending entities "comptoirs") and Non-Profit Organizations (NPOs) on the list of high risk entities, as well as asking for the establishment of an AML/CFT board committee.

3-6 In the same framework, and by a decision of the Committee on Compliance and Anti- Money Laundering at ABL, several "Compliance General Meetings" were held on a regular basis since 2013 for the directors of compliance departments in banks operating in Lebanon. Several subjects were discussed and coordinated, in their last meetings, related to the scope of work of the compliance department out of which, for example, the four financial laws passed by the Parliament in November 2015, the relationship with correspondent banks, the compliance with the international laws and requirements, in addition to other subjects.

The ABL and Lebanese banks continued their regular external moves in 2015 aimed especially at the USA and a number of European countries with special importance to the banking sector. Meetings were held with high level public officials and bankers to reinforce the reputation of the Lebanese banking sector and its image abroad and to preserve, even strengthen, the relationship with correspondent banks to remain a part of the international financial system, for the benefit of the customers, the banking sector and the Lebanese economy.

Solvency Risk

3-7 Banks pay special attention to the subject of risks related to weak solvency or to the insufficient capital to cover all types of risk inherent in the daily commercial operations of the bank. Banks always seek to reinforce their solvency and capital base not only for the purpose of facing the many risks, covering possible losses, the compliance with related local and international standards, but also to preserve the high financial strength to support the requirements of growth and expansion in the existing and potential activities and in the financial markets, in addition to protecting the funds of depositors, other lenders and investors in the banks. The process of evaluating and following the sufficiency of capital is in line with the policies and procedures established by the banks' administrations and based on the rules and ratios and measures imposed by the local supervisory authorities, and as such based on the provisions of the circulars on capital adequacy especially BDL's basic circular no. 44 and its amendments. The size of capital required at all times and conditions is thus matched with the Risk Weighted Assets and Off-Balance sheet commitments especially credit risk, market risk, operational risk, as is practiced in the international banking industry and based on international standards.

3-8 Lebanese banks adopt in general the Standardized Approach in measuring credit risk weighted assets, and the Standardized Measurement Method in evaluating market risk weighted assets, and the Basic Indicator Approach in measuring operational risk. In order to meet the requirements of capital adequacy based on Basel 3, the BDL placed in 2011 a minimum level of capital to risk weighted assets to be gradually achieved by the end of 2015, for Common Equity Tier 1 Ratio to be no less than 8%, for Tier 1 capital ratio to be no less than 10%, and Total Capital Ratio to be no less than 12% knowing that the Basel 3 accord stipulates a period ending in 2019 to reach the ratio of 10.5%. These ratios include a capital conservation buffer that is to reach 2.5% of risk weighted assets by the end of 2015.

3-9 The Lebanese banking sector is characterized by a high solvency ratio, according to Basel standards and in conformity with the best practices and criteria adopted in the banking industry worldwide. According to the monetary and supervisory authorities, the solvency ratio (Total Capital/Risk Weighted Assets) was around 15.1% at the end of 2015, based on Basel 3 standard. The Lebanese banking sector did not face difficulties related to the implementation of Basel 3 as it attempted in the last previous years to strengthen its Tier 1 Capital by retaining part of the profits in capital and through the issuance of shares. Furthermore, the banking sector always goes in pair with new international regulations and measures which became stricter with the increase in the level of quality and transparency in the capital base and the enhancement of the level of risk coverage and the control of the excess borrowing, or the ratio of debt to bank sources of funds and other subjects. It is also to note that the Basel Committee leaves to the local monetary authorities an important margin to assess what is appropriate to the local market.

Credit Risk

3-10 In line with the international guidelines on Compliance and Corporate Governance, banks operating in Lebanon determine the level of their credit risk appetite and credit risk limits through their boards of directors that inform in their turn the specialized committees and directorates about this subject to set policies and take procedural measures commensurate with their decisions and stated goals. Banks try to control or limit credit risk by placing limits or maximum ceilings on the size of risks they are willing to accept be it in relation to counterparties or the industry and geographic concentration as well as monitoring and following up the degree of risk exposures and its suitability or conformity with the limits that have been set. In fact, there are ceilings placed for placements at banking or financial institutions and in financial instruments with high credit rating, and for exposure to sovereign risk, in addition to the restrictions applied on loans and advances to customers including restrictions concerning the country, the economic sector, the terms, the credit rating, the guarantors and others to avoid concentration risk.

3-11 Banks try to limit credit risks related to loans and advances granted to customers, through a series of adopted measures that address the initiation of the loan, the formation of the credit file, the provision of necessary documents, guarantees and collaterals, the follow-up, the periodic classification of loans based on the instructions of the monetary and supervisory authorities, and by forming the necessary provisions against loans according to their classification, so that bad loans are fully provisioned and recorded off-balance sheet. Banks are also committed to the precautionary standards pertaining to loans to one borrower and those granted to related parties- individuals and companies. Additionally, bank management insists that large institutions and large borrowers provide audited balance-sheets, on one hand, and adequate guarantees, on the other. Granting credit facilities is the beginning of joint work between bank branches and the concerned divisions, departments, and units in the head office where credit analysis is performed on the creditworthiness of the borrower and his ability to repay, and the feasibility study of projects. The credit risk management division reviews the file and conducts credit analysis independently and prepares a written opinion of the risks associated with the credit facilities that were studied and submits it to the concerned credit committees. Credit committees are responsible for approving the facilities up to the level specified for them. Banks have different levels of authorities or parties trusted with approving loan application, and this depends on the nature and size of requested facilities and designated ceilings. Thus, approving the loan may be confined to the approval of credit committees or may be subject to executive committees or to the boards of directors.

3-12 The credit risks inside the Lebanese economy remained in general and to a large extent under control despite the deceleration of economic growth in the last few years. The ratio of doubtful debts/ total loans increased slightly to 3.64% at the end of 2015 against 3.59% at the end of 2014, and the provisions on doubtful debts (provisions/doubtful debts) decreased slightly to 68.8% against 71% during the two mentioned years respectively. It is to mention that the ratio of doubtful debts/ total loans reached 3.8% on average for the MENA countries based on the latest available information.

On the other hand, bank sovereign risk exposure increased in 2015, where the share of banks' loans to the public sector and deposits at the BDL reached 58.2% of total placements at the end of the mentioned year, against 57.4% at the end of 2014. It is worth indicating that a relatively large part (around 49%) of placements with the public sector and the BDL is in LBP practically negating default risk. As for placements in foreign currencies, they are invested for a large part at the BDL, which re-invests such placements abroad in low-risk and highly liquid instruments that may be similar to bank assets abroad. Moreover, the sovereign rating of Lebanon did not witness a major decline in 2015 except that "Standard & Poor's" revised the outlook on the credit rating of Lebanon to "negative" from "stable" to follow the credit agencies of Moody's and Fitch that did this before, while the three mentioned agencies maintained their sovereign credit rating for Lebanon. It is worth noting that the Lebanese government has never defaulted on payments, while the Eurobonds are to a large extent held by resident responsible parties, which lowers default risk.

Interest Rate Risk

3-13 There were no negative developments concerning interest rate risk in 2015, due to the quasi-stability of the interest rates on the LBP and the USD. The risks related to interest rate fluctuations are considered under control regarding banks' loans to the private sector, as they are variable rate loans by nature in a large part. Therefore, interest rates applied on these loans are being periodically reviewed in line, to a large extent, with the period of revision of interest rates applied on deposits. However, the situation is not the same for loans granted to the public sector and for banks' holdings of CDs at the Central Bank, since their maturities are relatively longer with fixed rather than variable interest rates. The weighted life, for example, was around 3.3 years for the Treasury bills portfolio in LBP at the end of 2015 and around 6.3 years for the Eurobonds portfolio (without Paris 2 and 3 Eurobonds). It is noteworthy that interest paid on deposits in LBP is related to the return on Treasury bills in LBP, not the opposite. Moreover, the yield on long-term Treasury bills and CDs takes into account these risks, i.e. interest rates fluctuations, in addition to the fact that Treasury bills and CDs are marketable and relatively liquid, unlike the loans to the private sector. All these factors tend to limit these risks. While the risks associated with a further increase in interest rates on the USD may exist in the future with the possibility of an interest rate rise by the US Federal Reserve, its impacts on the cost of banks' sources of funds will remain limited as interest rate increases will gradually take place over many years so that this policy does not negatively affect the already weak growth rates in the USA. It is to note that the Federal Reserve Bank increased at the end of 2015 the interest rates on the USD by 25 basis points.

Exchange Rate Risk

3-14 Exchange rate risks remained low and acceptable in 2015 as there were no new developments regarding the commitment of the government and BDL to the policy of fixing the exchange rate of the USD/LBP and the availability of sufficient means for that. The BDL's foreign currency reserves remained at a high level standing at USD 30.6 billion at the end of 2015 which covers 20 months of imports and the equivalent of 59% of the monetary aggregate in LBP (M2) and 24.8% of the broad monetary aggregate (M3). Exchange rate risk remained also low in terms of the structure of exchange positions in banks' balance-sheets. For the record, banks are strictly not authorized to take net, short or long, trading position that exceed 1% of the net Tier One capital. At the same time, banks' global foreign exchange position should not exceed 40% of the net Tier One Capital.

Operational Risk

3-15 Banks operating in Lebanon adopt a set of policies and procedures in managing operational risks related to a sudden interruption in working systems, or to human and administrative errors in achieving required duties, or to fraudulent operations, or to the exposure to external events such as natural disasters, strikes, demonstrations or others which could cause a damage to the reputation of the bank, or could have legal or organizational impacts, or could lead to a financial loss. There is an operational risk management framework subject to annual audit based on required supervision and in line with the practice of the international banking industry, and also an independent team to manage these operational risks whose main duty is to apply the contents of the mentioned framework, in coordination and cooperation with other units in the bank such as internal audit, or the corporate information security and business continuity. The framework for managing the operational risk includes principals tested in reality such as the Redundancy of Mission Critical Systems, Segregation of Duties, application of Strict Authorization Procedures, Daily Reconciliation, in addition to managing operational risks at the practical level, and other principals or directives. Insurance coverage is used as an External Mitigant to limit risks in accordance with the size and characteristic of the activity. Banks operating in Lebanon apply in general the Basic Indicator Approach for calculating the required capital in the face of operational risks, thus complying with the Standardized Approach of Basel 2 accord on capital adequacy.

Liquidity Risk

3-16 The Lebanese banking sector enjoys high liquidity levels, whether in LBP or in foreign currencies, which keeps the liquidity risk largely under control to a great extent. Banks have adopted for many years a strategy of maintaining a floor level of liquidity in LBP and particularly in foreign currencies in order to reinforce the confidence in the banking sector in general, and to preserve it by dealing quickly with any negative development which may suddenly occur. This strategy has proven its efficiency in overcoming many crises, strengthening confidence in the sector and contributing to maintaining monetary stability. The ratio of overall liquidity in LBP and foreign currencies, i.e. reserves and portfolio of Treasury bills in LBP and foreign currencies of less than one year maturity and foreign assets, excluding claims on the non-resident private sector reached 57.4% of total deposits and other liabilities at the end of 2015 (around 57% at the end of 2014). This ratio is the highest in the region in comparison to the average ratio of reserves and foreign assets over total assets of the Arab banking sector standing at 29.4% over the same period. Moreover, the ratio of primary liquidity in foreign currencies or deposits at BDL and at banks abroad reached around 47% of total deposits and other liabilities in foreign currencies, knowing that such a high level is considered necessary for good management of deposits in foreign currencies in a dollarized economy, in the absence of a lender of last resort.

IV- BANKING SECTOR PERFORMANCE

4-1 In 2015, net consolidated profits of banks operating in Lebanon (Lebanon's branches) reached LBP 2,839 billion (USD 1,883 million), thus increasing in a year by 9.6% compared to a lower increase of 5.3% in 2014. Given that bank profits growth rate in 2015 was higher than the growth rate in bank total assets (6.0%) and in core capital (6.1%), the return on average shareholders' equity (ROAE) slightly increased to 11.63% in 2015 from 11.56% in 2014 and the return on average assets (ROAA) rose to 1.02% from 0.99% respectively during the same two periods.

4-2 The slight increase in ROAA was due to a slight increase in each of the profit margin, or net profits over total operating revenues, (16.3% in 2015 compared to 16.2% in 2014) which shows the ability to control cost, and the net interest margin, or interest received minus interest paid over total assets (1.68% in 2015 compared to 1.66% in 2014) which reflects the continuation of effectiveness of managing interest expense.

4-3 The improvement in ROAE is the result of the increase in ROAA mentioned above between 2014 and 2015 compared to a stable equity multiplier, or total assets over total capital which implies the continuity of banks to rely on capital in increasing assets or placements more than debt or liabilities. This shows one more time the inverse relationship between solvency and profitability.

4-4 The ROAE and the ROAA for banks in Lebanon are comparable to the world averages but lower than the ones in Arab and emerging countries (especially ROAA). For the sake of comparison, the ROAE reached 11.65% and the ROAA 1.52% for banks in the Middle-East based on the latest available information. This reflects the fact that banks in Lebanon maintain a high level of liquidity to face risks and any fluctuations that may occur in light of the instability prevailing in Lebanon and the region as a whole.

4-5 The cost to income ratio slightly decreased to 52.4% in 2015 from 53.0% in 2014. There was an increase in the cost that includes total staff expenses, operating and general expenses, and depreciations by 7.0%. But the growth rate of net financial income was higher (8.2%) realized by the contribution of the increase in net interest received (despite the slight increase in net provisions on doubtful loans), net profits on financial transactions, foreign exchange operations and return from stocks, shares and participations, knowing that net commissions decreased between 2014 and 2015 with the decline in economic activity and foreign trade in general. It is to be mentioned that banks formed excess provisions due to the economic and domestic situations and risks that have affected clients in neighboring countries. Banks are also required pursuant to the intermediate circular no. 420 to constitute provisions against debit accounts that are closed in applying the measures, sanctions, and restrictions decided by the international organizations or by foreign sovereign authorities and to work on collecting these loans from the concerned clients without amending their credit classification.

Profit & Loss Accounts of the banking sector (LBP billion)

	2013	2014	2015
1 - Interest received	12,716	13,709	14,842
2 - Interest paid	8,422	9,213	10,019
3 - Interest margin (1)-(2)	**4,294**	**4,496**	**4,823**
4 - Net provisions	-186	-294	-318
5 - Net interest received (3)-(4)	**4,108**	**4,202**	**4,505**
6 - Net commissions & other income	2,054	2,294	2,523
7 - Net financial income (5)+(6)	**6,162**	**6,496**	**7,028**
8 - Operating & General expenses	3,054	3,230	3,446
9 - Depreciations & net provisions/profits on tangible and intangible assets	179	214	239
10 - Ordinary profits before tax (7)-(8)-(9)	2,929	3,052	3,343
11 - Extraordinary net income	-2	30	35
12 - Profits before tax (10)+(11)	2,927	3,082	3,378
13 - Tax on profits	467	493	539
14 - Net profits (12) – (13)	**2,460**	**2,589**	**2,839**

Source: BDL

4-6 The table below details the evolution of income between 2014 and 2015. Total revenues increased from LBP 16,034 billion to LBP 17,401 billion respectively, registering an increase of LBP 1,367 billion or 8.5% (+8.6% in 2014). This resulted from the increase in interest received (8.3%), net gains on financial instruments (+14.7%), net profits on foreign exchange (+71.3%), and gains on stocks, shares and participations (+53.1%), in comparison to a decline in net commissions received (-5.8%) and other operating income (-21.4%). The interest received is tied to the loans to the private sector, and the investment in sovereign financial instruments- such as Treasury bills and CDs in local currency and US dollar- and non -sovereign financial instruments, knowing that interest rates in Beirut market registered slight changes in general between 2014 and 2015 as such the global interest rates remained at very low levels. The decrease in net commissions is possibly due to the decrease in the off-balance sheet activities tied basically to the letters of credit and asset management accounts. Based on that, the share of interest received constituted 85.3% out of total income in 2015 (85.5% in 2014) compared to 14.7% for the share of commissions and other income (14.5%) for the same two periods respectively.

4-7 It is indicated that the share of net interest received out of net financial income slightly decreased to 64.1% in 2015 (64.7% in 2014), leading the share of net commissions and other net income to constitute 35.9% (35.3%) for the two mentioned years respectively. This goes in line with the concern of banks to diversify their services, including the strengthening of private banking, retail operations, capital market services, consultancy services and the financing of trade and other off-balance sheet operations, which will provide them with a parallel non-interest income in the form of fees and commissions. We point out that banks realized in 2015 from the operations on financial instruments more than they achieved from commissions contrary to the two previous years.

Income Composition (LBP billion)

	2013	2014	2015	Change (%) 2015-2014
Interest received	12,716	13,709	14,842	+ 8.3
Net commissions & other income	2,052	2,325	2,559	+ 10.1
Net commission received	928	996	938	- 5.8
Net gain/loss on financial instruments	663	855	981	+ 14.7
Net profits on foreign exchange	171	122	209	+ 71.3
Net gain/loss on financial investments	213	207	317	+ 53.1
Other operating income	79	115	79	- 31.3
Net extraordinary income	-2	30	35	+ 16.7
Total income	**14,768**	**16,034**	**17,401**	**+ 8.5**

Source: BDL

4-8 The table below details the evolution and the distribution of expenses during the years 2014 and 2015. Total expenses increased from LBP 13,445 billion to LBP 14,561 billion, or the equivalent of LBP 1,161 billion or 8.3%. Interest paid increased by 8.7% in 2015 in comparison to an increase of 9.4% in 2014 thus slightly exceeding the growth in interest received. This is due to the increase in deposits by around 5% with a slight increase in the average deposit rate (from 5.52% in 2014 to 5.58% in 2015 on LBP and from 3.03% to 3.16% on the USD respectively), while the interest rate on the non-resident financial sector remaining at low levels. In 2015, banks kept constituting provisions with the aim of hedging risks as previously mentioned.

Expenses Composition (LBP billion)

	2013	2014	2015	Change (%) 2015-2014
Interest paid	8,422	9,213	10,019	+8.7
Net provisions	186	294	318	+8.2
General & operating expenses	3,233	3,445	3,685	+7.0
o/w staff expenses	*1,744*	*1,913*	*2,027*	*+6.0*
Tax on Profit	467	493	539	+9.3
Total expenses	**12,308**	**13,445**	**14,561**	**+8.3**

Source: BDL

4-9 Furthermore, general and operating expenses increased by 7.0% in 2015 (6.5% in 2014). This increase largely resulted from the increase in staff expenses (+6% in 2015 compared to 9.7% in 2014) related particularly to the increase in the number of employees in the sector (+788 persons in 2015), and the annual increase and allowances that banks grant their employees based on the collective labor agreement knowing that transportation allowances in 2015 declined with the decrease in world oil prices. It is to mention that the increase in other operating expenses that banks bear for development and improvement required to keep pace with world banking standards increased substantially by 8.3% in 2015 in comparison to a lower increase of 2.8% in 2014. The tax on profit increased by 9.3% in 2015 (5.5% in 2014), reaching LBP 539 billion against LBP 493 billion in 2014, representing around 16.0% of net profit before tax.