04

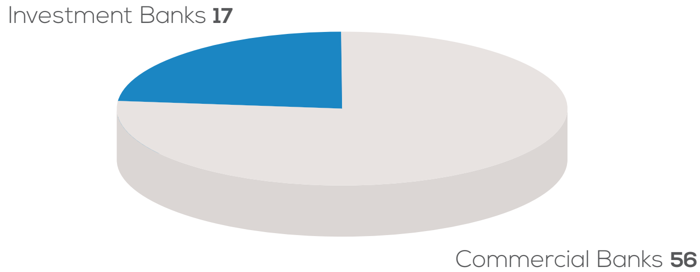
PART 4: ACTIVITY AND PERFORMANCE OF THE LEBANESE BANKING SECTOR IN 2013

I - Introduction

1-1 The banks operating in Lebanon continued in 2013 to play a vital role in reviving the national economy through the provision of a major part of the financial needs necessary for stimulating growth. Banks lent the private and public sectors with needed and sufficient amounts and provided the government with an important part of its revenue by paying their due taxes. They also created job opportunities for the Lebanese youth and continued to raise the standards of bank performance by improving the capabilities and skills of human resources. It is to mention that university graduates represent at this stage over 73% of the sector's labor force.

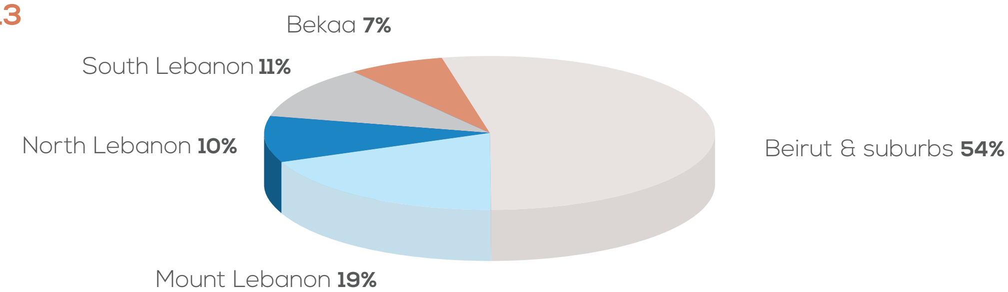
1-2 As far as banking structure is concerned, the number of banks operating in Lebanon reached 73 at the end of 2013, distributed among 56 commercial banks and 17 investment banks. The number of bank branches reached 1007 out of which 985 for commercial banks and 22 for investment banks, mid and long term- credit banks. The branches were distributed over the Lebanese territory according to the relative geographic distribution of economic activities. These figures show that Lebanon has a high bancarization rate, as there is one bank branch for every 5 thousand persons.

Lebanese Banking Sector Structure End 2013



Source: BDL

Geographical distribution of commercial banks branches operating in Lebanon End 2013



Source: BDL

1-3 With the expansion of their branch network, banks in Lebanon continued in 2013 to **develop their systems and means of payment.** They have extended the use of ATMs, so that the number of ATMs machines placed at the service of customers amounted to 1,516 at the end of 2013. The total number of bank credit and debit cards in circulation reached around 2,2 million cards, divided between 2,08 million cards held by residents and 101 thousand cards held by non-residents. Debit Cards accounted for about 54.6% of the total cards in circulation, in comparison to 22% for Credit Cards, and around 23,4% for term-payment cards (Charge Cards) and prepaid cards. 2013 also witnessed the issuance of more smart cards of which a variety of credit cards reflecting the close partnership between retail banking, telecommunication and trade centers.

1-4 In the framework of historical openness to the world, there are 14 branches for Arab and foreign commercial banks operating in Lebanon. It is to mention that some foreign banks operating in Lebanon are more influenced by the conditions prevailing in the country than Lebanese banks due to their relative lower share of the banking market (no more than 2%) and due to the high risk that parent banks accept to carry on their books. In addition, there exist 11 foreign banks operating in Lebanon owning major shares in large and deep-rooted Lebanese banks with Lebanese management, along with 10 representative offices of foreign banks. Banks operating in Lebanon also deal with more than 228 correspondent banks spread in 88 cities around the world to facilitate the international financial transactions.

1-5 The year 2013 was also characterized by the attempts of the administrations of banks to strengthen cooperation with banks in various countries and to expand abroad which has become equal to the growth of the internal activity. Such external expansion constitutes a major element in the growth of the banking sector as banks adopt this policy due to the limited internal market and to follow their customers' base. Foreign expansion also constitutes an export of Lebanese services and contributes to restoring the balance of Lebanon's external payments given that this expansion strengthens the human, capital, and organizational resources of these banks. It is to mention in this framework that the central Bank defines the relationship with the external units based on an independent circular (circular 110) in which it asks to be provided along with the banking control commission with regular financial and administrative reports on the activities of the external units of each bank. It also calls for the establishment of a special committee on the external units that meets regularly and, for example, provides the parent bank with a summary on the development of the activity of each of these units.

1-6 The Lebanese banks developed a very wide external expansion network relative to their activities and in the form of various legal entities from representative offices and wholly owned branches, to associate, subsidiary and sister banks. Thus, according to the latest available data, there are 17 Lebanese banks representing around 86% of the sector spread worldwide in 31 countries covering important Arab markets such as Syria, Jordan, Iraq, Egypt, Sudan, Algeria, Saudi Arabia, United Arab Emirates, Bahrain, Qatar, Oman and important regional economic markets such as Turkey. Additionally, Lebanese banks have expanded in the European continent starting with Switzerland, France, the United Kingdom, Germany, Luxembourg, Monaco, and passing through Romania, Belarus, Armenia, Belgium and Cyprus. The Lebanese banks have also expanded towards the American continent (Canada), and also Africa (Ivory Coast, Nigeria, Congo, Senegal) and finally Australia. The Lebanese banking network expanded in the aforementioned countries to several major cities with its 39 subsidiaries, associate banks and sister banks, owning several branches exceeding 270 branches as of May 2014 representing 25% of the branches in Lebanon. As far as the size of Lebanese banks operating abroad, this represents 17% of the total balance-sheets of these banks which means that various elements of risk are not concentrated but spread in an efficient manner in consistence with the shares of banks involved in the market.

1-7 The placements of banks abroad concentrate in countries that have, for the most, higher country risk than what is known as investment grade. There are of course countries like Syria, Sudan and Iraq that are not classified and with country risk higher than Lebanon. However, the share of these countries is marginal in relation to total external activity and also from the consolidated bank balance-sheets making their risk limited and controlled. It is worth indicating here, that with the beginning of the turbulences in the region, the Banking Control Commission started in cooperation with the concerned Lebanese banks to apply stress testing for banks present in Egypt, Syria, Jordan, Cyprus and lately Turkey. Stress Tests applied to credit and loan portfolios, the fluctuations in exchange rates, the decline in collateral values, in addition to asking banks to take collective provisions based on the results of the stress tests they have conducted. These markets are promising for the future and it is beneficial for the Lebanese banks to preserve their positions in them.

1-8 Banks continued coordination with the concerned monetary and governmental authorities in 2013 to develop systems and legislations capable of improving the banking profession and to present their views on proposals and laws related to financial and banking matters. Given that banks are involved in global matters, they are committed to the application of the international standards on combatting money laundering and terrorist financing.

They are also committed to the adjustments issued by the Special Investigation Commission which is in charge of the subject in Lebanon. This commission is in the process of issuing circulars or suggesting draft laws in line with the latest recommendations of the Financial Action Task Force on the Laundering of Money which is the international authority on the subject matter.

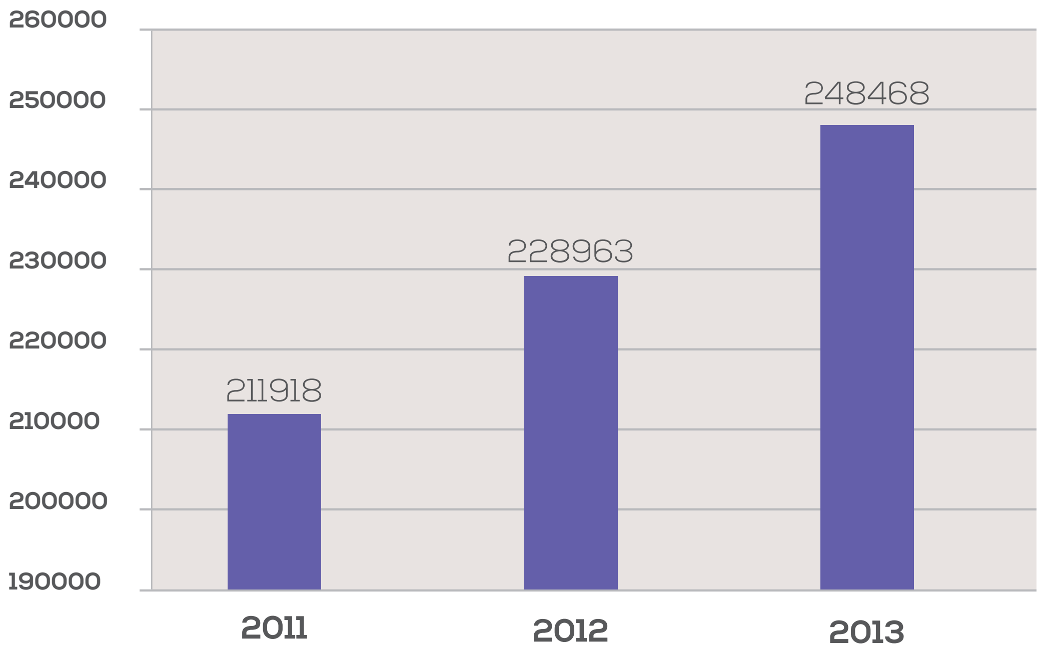
There is a special draft law concerning the exchange of tax information related to tax evasion and fraud, not included in law 318, which was approved by the council of ministers and is currently under study by the specialized parliamentary committees. Banks are very serious based on existing laws about emphasizing their commitment to international standards and safe-guarding the reputation of the banking sector.

Some of the latest recommendations are the use of the risk-based approach, the improvement and increase in transparency, and making the coordination among international bodies more effective. Concerning FATCA that applies to accounts of people holding the US nationality, it was decided that banks and financial institutions in Lebanon exchange information directly with the US tax administration. Banks have started studying the necessary measures for adoption based on the requirements of this law.

II - Banking Activity

2-1 At the end of 2013, the total assets of commercial banks operating in Lebanon reached around LBP 248468 billion (the equivalent of USD 164.8 billion) in comparison to LBP 228963 billion (USD 151.9 billion) in 2012. Hence, the total assets rose by a significant amount of 8.5 % in 2013 compared to an increase of 8% in 2012.

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



Source: BDL

2-2 The Table below shows the evolution of liabilities items of commercial banks operating in Lebanon, considering their absolute value and their relative importance regarding the total between the end of 2011 and the end of 2013. The share of the resident private sector deposits decreased from 67.2% at the end of 2011 to 65.4% at the end of 2013, against the increase of the share of non-resident private sector deposits from 15.1% to 17.3%, and the increase in the share of capital accounts from 7.6% to 8.6%. This shows that Lebanese banks still enjoy a strong fixed deposit base that represents the main source of funds to commercial banks operating in Lebanon. Total deposits represented 84.5% of the total assets by the end of 2013 making the banks part of what is known as Deposit-Rich-Banks or banks that rely to a great extent on deposits to finance placements and not on other sources not usually available in Lebanon. In addition to deposits, banks make use of their own resources represented in capital accounts. Banks also tried to increase their mid- 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 are still modest requiring the development of capital markets.

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

	2011		2012		2013	
	Value	%	Value	%	Value	%
Resident private sector deposits	142385	67,2	152124	66,4	162396	65,4
Public sector deposits	2999	1,4	4008	1,8	4463	1,8
Non-resident private sector deposits	32054	15,1	36311	15,9	42934	17,3
Non-resident financial sector deposits	8764	4,1	8897	3,9	7555	3,0
Capital accounts	16162	7,6	19058	8,3	21410	8,6
Other liabilities	9554	4,5	8565	3,7	9710	3,9
Total	**211918**	**100,0**	**228963**	**100,0**	**248468**	**100,0**

Source: BDL

Deposits

2-3 At the end of 2013, the total value of deposits, which includes the deposits of the resident and non-resident private sectors and deposits of the public sector, reached more than LBP 209793 billion (the equivalent of USD 139.2 billion), in comparison to LBP 192443 billion in 2012. This reflects an increase of 9% in 2013 slightly exceeding its rate of increase of 8.5% in 2012. The growth in the resident private sector deposits constituted 59.2% of the total increase in 2013, compared to 38.2% for the non-resident private sector. Deposits from non-residents represent a sign of confidence in the banking sector and its financial position, management and ability for development and growth. Deposits in LBP had a 35.3% share while deposits in foreign currencies represented 64.7% of the total in 2013.

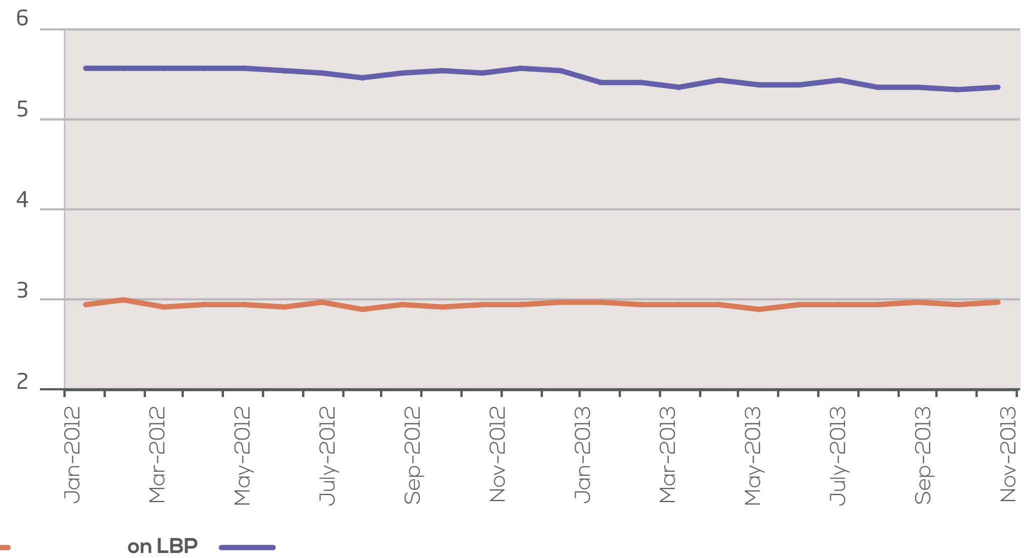
2-4 The share of the resident private sector reached 77.4% of the total value of deposits, while the share of the non-resident private sector represented 20.5% and that of the public sector 2.1% in 2013. It is worth indicating that total deposits also include the portfolio of certificates of deposits issued by banks, which amounted to USD 548 million at the end of 2013. The majority of bank deposits are saving accounts (over 80%) and short-term (less than 90 days) ones.

2-5 In terms of resident and non-resident private sector deposits distribution by currency, the results show that the deposits issued in foreign currencies increased to more than USD 90.1 billion at the end of December 2013 (i.e. a growth of 11.2% in comparison to 2012). Deposits issued in Lebanese Pounds increased to LBP 69535 billion (i.e. a growth of 4.9%), leading to an increase in the dollarization rate from 64.8% at the end of 2012 to 66.1% at the end of 2013 in the presence of security and political instability.

2-6 Bank deposits are concentrated in Beirut and its suburbs. In fact, this region attracted 69.7% at the end of 2013, allocated to 47.6% of the total number of depositors, whereas 30.3% of the deposits are concentrated in other regions and allocated to 52.4% of depositors, thus revealing a difference in the average deposit value between Beirut and its suburbs and the other regions.

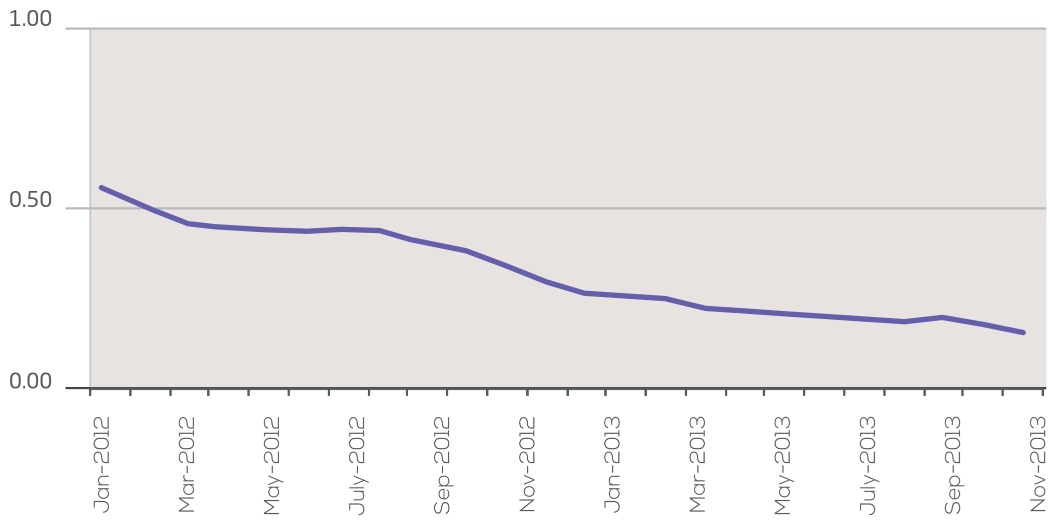
2-7 In 2013, in parallel to the stable interest rates on Treasury bills, the interest rates on deposits in LBP fluctuated up and down within a narrow range. The monthly average rate on new or renewable deposits reached 5.44% in December 2013, compared to 5.41% in December 2012. Furthermore, the average interest rate on deposits in USD witnessed slight changes, reaching 2.95% in December 2013, compared to 2.86% in December 2012 given that world average interest rates remained without change at low levels.

Evolution of deposit rates on Beirut's market (%)



Source: BDL

USD Libor for three months (%)



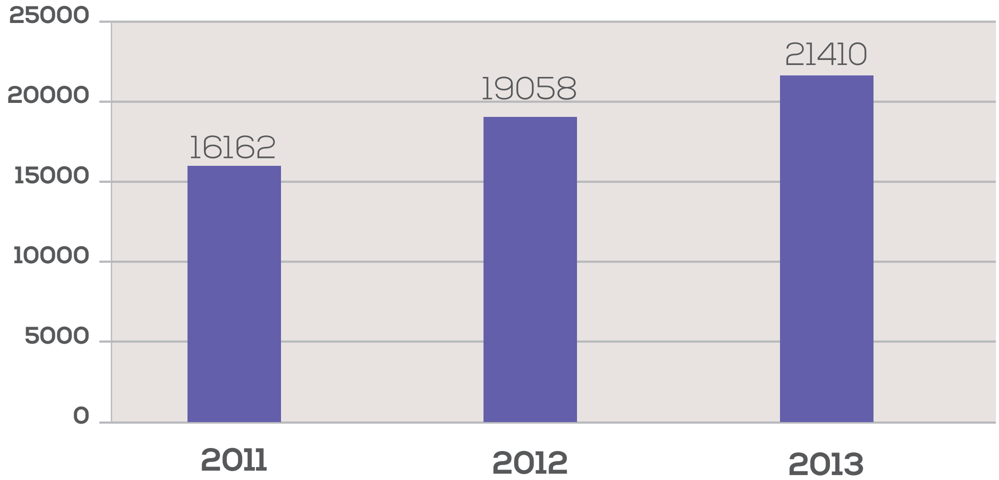
Source: BDL

Capital Accounts

2-8 At the end of 2013, capital accounts of commercial banks operating in Lebanon increased by 12.3% to LBP 21410 billion (the equivalent of USD 14.2 billion) in comparison to LBP 19058 at the end of December 2012. Capital accounts had registered an increase of around 18% in 2012. At the end of 2013, the share of capital accounts represented 8.6% of the consolidated balance sheet not adjusted for risk (8.3% at the end 2012) and 30% of the total loans to the private sector (29.1% at the end of 2012). These ratios are considered relatively good compared to counterpart banking sectors in numerous European advanced countries.

According to the latest available information, the ratio of capital accounts reached 6.3% of the total assets of the banking sector in Luxembourg, 5.2% in France, 4.8% in Belgium and 4.7% in Germany. It is to mention that bank core capital is distributed at the end of 2013 among USD 10 billion of common equity tier 1, USD 3 billion of additional tier one capital, and USD 1 billion of tier 2 capital.

Capital Accounts at Commercial Banks
end of period- billion LBP



Source: BDL

2-9 Bank Capital is crucial in protecting the economy and the savings of bank customers as it gives 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 duty for banks whose capital was composed of two sources: The first is from the new capital attracted from investors from Lebanon and abroad through the issuance of common and preferred shares classified as necessary capital and through opening bank capital accounts to new and previous shareholders. The second is from the retention of banks of most of their profits in their capital base in order to enlarge it. This is overseen by the Central bank and the Banking Control Commission.

2-10 The share of the supplementary capital, which includes the subordinated bonds and notes and some types of preferred shares, remains low compared to the core capital, as it represented 8.4% of capital accounts at the end of 2013 (6.1% at the end of 2012). It is clear that this is largely in line with the latest proposals of Basel 3 to strengthen the soundness of the banking sector, which include 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 treaty radically transformed the structure and the quality of capital accounts.

2-11 The regulatory authorities in Lebanon are following banks to enhance their capitalization by imposing minimum levels for capital ratios exceeding the ones imposed by Basel 3 by 1% to 1.5%. According to ABL, the solvency ratio of the Lebanese banking sector reached around 12.2% at the end of June 2013 in comparison to a minimum level of 10.5% suggested in Basel 3. The Leverage ratio (tier 1 to non-risk adjusted assets) reached 7% which is considered good compared to a suggested minimum of 3% in Basel 3. With the worsening of the situation in the region and its effects on Lebanon and on the size and variety of provisions that banks have to compile to face risk, the BDL announced at the beginning of 2014 the possibility of reconsidering the application of Basel 3 in a direction conducive for the commitment to the accord but without changing the capital ratios that Lebanese banks have started applying in detail.

On 6/3/2014, the BDL issued intermediate circular 358 in which it defined the organizational framework of the capital of banks operating in Lebanon. The circular addressed the credit weights consistent with the requirements of Basel 2/Basel 3 reducing some weights that can be improved especially the ones applied to bank deposits in foreign currency at the BDL, which are placed by the monetary authority at correspondent banks and thus not used domestically. Based on this circular, a weight of 50% was assigned which is an average between 20% and 100% that could be adopted. These adjustments are posed to relief banks and open venues for new investors to join the banking sector while keeping unchanged the time frame to comply with the new capital ratios. This means reaching 8% at the end of 2015 for common shares, 10.5 % for tier 1 capital, and 12% for total capital.

Placements of the Banking Sector

2-12 The structure of the uses of funds of commercial banks witnessed slight modifications in 2013 in comparison to 2012. The share of deposits at BDL slightly decreased to 33% from 34.6% of the total placements for the two years respectively. On the other hand, the share of foreign assets declined slightly to 16.2% while the share of loans to the resident private sector increased to 25.2% and the share of loans to the public sector increased back to 22.8% of all at the end of 2013.

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 2011 and 2013.

Commercial banks' assets at the end of period (Billion LBP and percentages)

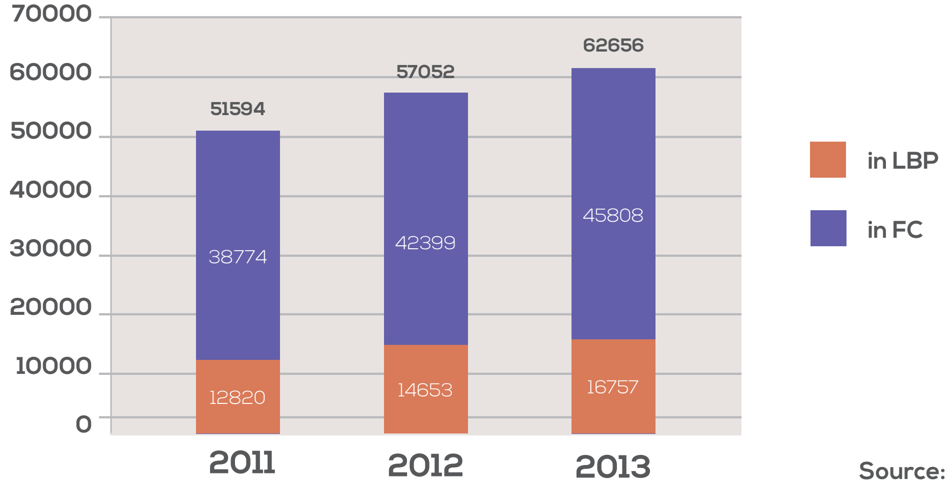
	2011		2012		2013	
	Value	%	Value	%	Value	%
Reserves*	71535	33,8	79604	34,8	82533	33,2
o/w : deposits with BDL	71143	33,6	79179	34,6	81957	33,0
Claims on the resident private sector	51594	24,3	57052	24,9	62565	25,2
Claims on the public sector	44055	20,8	46930	20,5	56786	22,8
Foreign assets	38436	18,1	39447	17,2	40137	16,2
o/w : claims on NR financial sector	22054	10,4	21702	9,5	21041	8,5
claims on NR private sector	7764	3,7	8452	3,7	8862	3,6
Fixed assets & Non-classified assets	6297	3,0	5930	2,6	6447	2,6
Total	**211918**	**100,0**	**228963**	**100,0**	**248468**	**100,0**

Source: BDL
*Vault cash & deposits with central bank.

Loans to the Private Sector

2-13 In 2013, bank **loans to the resident and non-resident private sectors** continued to increase, reaching an average of USD 47.4 billion at the end of the year, against USD 43.5 billion at the end of 2012. The increase that happened at a slower pace of 9% in 2013 in comparison to 10.4% in 2012 remains good and acceptable in due of the low rate of economic growth in the country. 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 12.4% of the total of loans granted to the private sector at the end of 2013.

Total loans to the resident private sector
end of period- billion LBP



Source: BDL

2-14 Banks continued in 2013 to finance the resident and non-resident private sector individuals and corporations at an acceptable rate of around 7% on average in LBP and foreign currencies and for periods relevant to the nature of the financed activity. Moreover, loans granted to the resident and non-resident private sectors represented the equivalent of 105% of the GDP (according to estimations) at the end of 2013, hence a considerably high ratio compared to many emerging countries. This relatively high ratio in Lebanon resulted, on the one hand, from the enormity of the private demand, a large part of which is financed by loans to individuals and corporations, for investments and particularly consumption. On the other hand, it resulted from the low capital of the corporate sector, its weak capacity for self-financing, and its excessive reliability on banks' financing, in the absence of stocks and bonds markets in Lebanon.

2-15 The ratio of loans in foreign currencies to deposits in foreign currencies decreased to 40.3% at the end of December 2013 against 41.6% at the end of 2012. Loans in LBP to deposits in LBP continued to increase moving from 22.1% at the end of 2012 to 24.1% at the end of December 2013. Lebanon's ratio of loans to deposits remains low, given the high liquidity levels of the Lebanese banking sector and the high size of savings in comparison to the absorptive capacity of the domestic economy.

2-16 The faster increase by 14.4% of loans in LBP in 2013 and by a similar amount in 2012 (14.3%) against 7.5% of loans in FC in 2013 and 9.3% in 2012 contributed to the additional decrease to 76.5% in the rate of loans dollarization at the end of December 2013, against 77.6% at the end of 2012. It is worth indicating that this rate reached 86.6% at the end of 2008. This decrease during the last few years was the result of incentives provided by the BDL for specific loans. These loans encompass particularly housing loans and ones granted to productive sectors for the financing of new projects or the expansion of existing projects. The loans also include loans granted to higher education, environmental friendly projects and agriculture (other than those subsidized).

2-17 Out of the BDL new policies of stimulating the private sector that were lately based on various pillars, comes firstly the stimulating package of liquidity at a low cost to banks. In this context, the BDL launched at the beginning of 2013 an incentive program for loans that included most of the economic sectors, particularly the housing sector, in an attempt to accelerate economic growth through banking loans in LBP at acceptable interest rates. With this initiative, the BDL placed USD 1.4 billion at the disposal of banks with 1% interest rate, so that they continue to grant loans to institutions and families through this new mechanism after the mechanism of benefitting from the 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 maximum interest rate ceiling of 5%. The banks and the market responded so well to the program that the amounts allocated for new projects and a large portion of the amounts allocated for housing loans were rapidly consumed. It is expected that the BDL will place at the beginning of the current year an additional sum through this mechanism for more economic stimulation and the activation of the housing and technical sectors in particular. The second incentive program is represented by the circular on the knowledge economy as this sector represents an engine for future growth. The BDL provides these projects with a guarantee of 75% which prevents banks from risking their own capital. This circular allows banks and financial institutions to contribute within the limits of 3% of their capital to finance start-up projects, business incubators and accelerators whose business is centered around the knowledge economy. 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 capital contributions are new functions allowing banks to support the mental capabilities and professional inventions that fit into the framework of the knowledge economy. The third pillar consists of extending from 7 to 10 years the maturity of subsidized loans, including new ones, to the productive sectors, especially tourism.

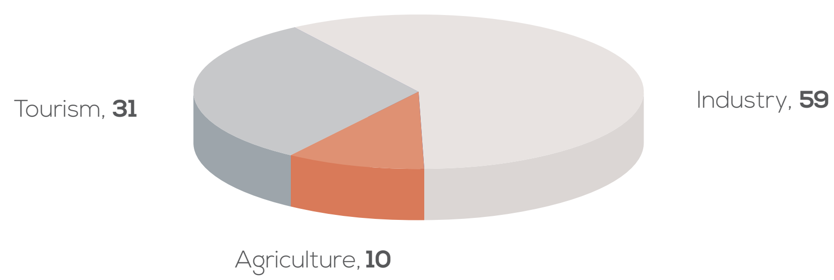
Subsidized loans and loans benefiting from deduction in reserve requirements (End of period – billion LBP)

	2010	2011	2012	2013
1-Subsidized -interest medium & long term loans	3545	4651	5469	6083
2-Subsidized-interest loans guaranteed by Kafalat	1164	1405	1607	1781
3-Subsidized-interest loans under the protocol signed with the EIB	199	204	204	204
4-Subsidized-interest loans granted by leasing companies	143	162	170	179
5- Subsidized-interest loans granted by IFC	75	79	79	80
6- Subsidized-interest loans granted to finance working capital	16	16	16	16
7- Subsidized-interest loans granted by AFD	7	7	7	7
TOTAL (1+2+3+4+5+6+7)	**5148**	**6524**	**7552**	**8350**
Utilized loans benefiting from deductions in banks liabilities	**2301**	**3035**	**3920**	**4166**
Utilized loans benefiting from deductions in reserve requirements	**5673**	**7338**	**9339**	**9899**

Source: BDL

2-18 Data reveal that loans in LBP benefiting from deductions in reserve requirements amounted to LBP 9899 billion at the end of 2013, registering an increase of 6% compared to 27.3% in 2012. This increase mainly resulted from the increase in the housing loans during the last few years. As for the loans benefiting from deductions in banks' liabilities, they reached LBP 4166 billion at the end of 2013, registering an increase of 6.3% compared to 29.2% in 2012. Data also show that the total loans at subsidized interest rates, granted between 1997 and 2013, reached LBP 8350 billion at the end of 2013 (USD 5.5 billion), rising by 10.6% in comparison to 15.8% in 2012. At the end of 2013, the loans granted within these special mechanisms represented 12% of the total loans granted to resident private sector distributed among industrial loans (59%), touristic loans (31%), and agricultural loans (10%). Four elements characterize these subsidized loans: the period of the loan for 7 or 10 years, the grace period, the relatively low average interest rates, and facilities and waivers based on the usage or reduction of required reserves.

Distribution of subsidized interest loans on economic sectors end of 2013- %



Source: BDL

2-19 It is noteworthy to mention in this context that banks play a significant role in the specialized financing schemes to the private sector, corporate and individuals. On the one hand, they are the partners of the Lebanese State as well as the international financial institutions, of which the Overseas Private Investment Corporation (OPIC), European Investment Bank (EIB), l'Agence Française de Développement (AFD), International Financing Corporation (IFC), Arab Fund for Economic and Social Development, the Arab Monetary Fund etc., and on the other, they are the lenders baring solely the credit risk of these loans and granting new kinds of loans of a wider diversity.

2-20 The latest data available until the end of 2013, related to the nature of loans granted by the financial sector, reveals that the major part of these loans representing 71.5% consists of limited-term loans, while the remaining part (28.5%) is in the form of overdrafts. It is to note that the overdrafts are usually granted to major clients or to clients with high creditworthiness, 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 2013, the share of advances reached 32.4% against real estate, 18.2% against personal guarantees, and 13% against cash collateral or bank guarantees.

2-21 The distribution of loans among the economic sectors corresponds roughly to the shares of these sectors in GDP, except the agriculture sector that requires specialized financing schemes, as is the case in most of the developed and emerging countries. The statistics indicate a good increase of loans to all economic sectors between the years 2011 and 2013. Loans remain concentrated in the trade and services sector, despite the continuous decrease of their share as percent of total loans that reached 34.5 % at the end of 2013. On the other hand, the share of personal loans increased to 27.8% at the end of that same year, knowing that the share of housing loans (included in this category) increased to 16.1%. Furthermore, the share of construction sector rose slightly to 17.4% as percent of total loans while the shares of industry and agriculture remained stable. Moreover, the share of financial intermediation registered a decrease to 5.4% and the share of other sectors to 2.6%.

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

	December 2011		December 2012		December 2013	
	Value (billion LBP)	Share (%)	Value (billion LBP)	Share (%)	Value (billion LBP)	Share (%)
Trade & Services	23257	35,11	25414	34,57	27501	34,47
Construction & building	10751	16,23	12267	16,69	13840	17,35
Industry	7445	11,24	8439	11,48	9007	11,29
Personal loans	16868	25,46	19368	26,35	22207	27,84
o/w: housing loans	9018	13,60	10957	14,91	12866	16,13
Financial intermediation	5226	7,89	5127	6,97	4316	5,41
Agriculture	644	0,97	683	0,93	824	1,03
Other sectors	2055	3,10	2209	3,01	2082	2,61
Total	**66246**	**100,00**	**73507**	**100,00**	**79777**	**100,00**

Source: BDL

2-22 Regarding the distribution of loans among the regions and beneficiaries, loans remain largely concentrated in the region of Beirut and its suburbs and in favor of its inhabitants, with a slight gradual decrease in the share of the region to 78% of total loans and 53.3% of the total number of beneficiaries, as by the end of 2013. This concentration is in line with the concentration of economic activity, population, and income in Beirut and its suburbs.

2-23 Concerning the distribution of loans by value and brackets, statistics show that loans whose values exceed LBP 1 billion, are distributed among 1.6% only of the beneficiaries, the number of which amounts to over 7370 persons and institutions, out of the total number of beneficiaries of around 466,000. This low percent is in line with the situation of any economy in the world. Therefore, 85% of the beneficiaries hold 11% of the value of loans, while 15% of the beneficiaries hold around 89% of the loans.

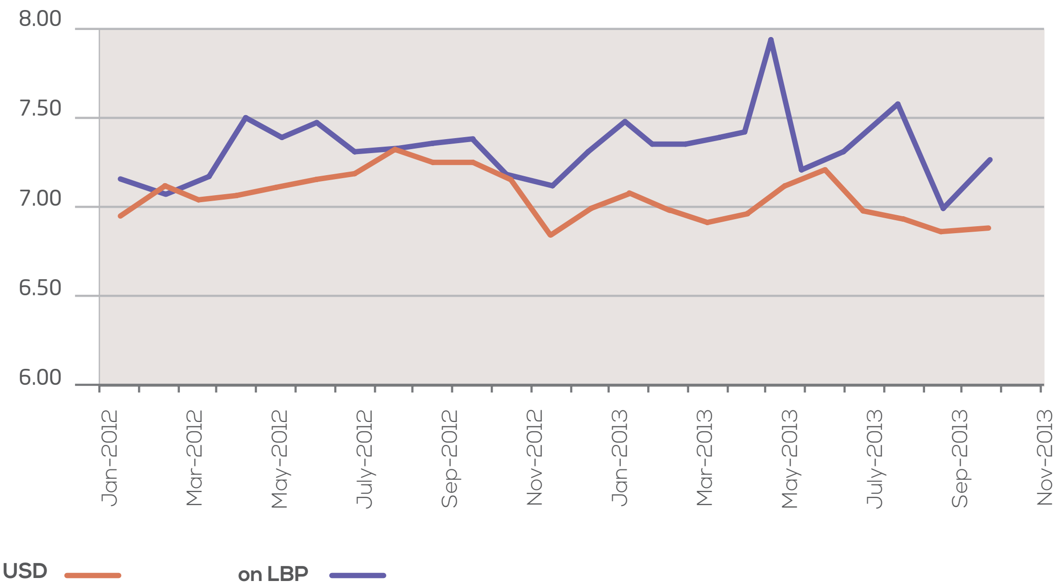
Distribution of loans according to the value and the beneficiaries (In percentage – End of 2013)

	by value	by beneficiaries
Below 5 million LBP	0,09	7,45
5 – 25 million LBP	4,28	54,05
25 – 100 million LBP	6,41	23,57
100 – 500 million LBP	14,03	12,12
500 – 1,000 million LBP	4,89	1,22
1,000 – 5,000 million LBP	14,01	1,12
5,000 – 10,000 million LBP	9,08	0,22
10,000 million LBP and above	47,21	0,24
Total	**79777**	**465535**

Source: BDL

2-24 In 2013 as well as 2012, the interest rates on new and renewed loans in LBP and in USD witnessed upward and downward fluctuations but within small margins. The average lending interest rate on LBP reached 7.29% in December 2013, against 7.07% in December 2012. On the other hand, the average interest rate on new and renewed loans in dollars reached 6.88% in December 2013 against 6.87% in December 2012.

Evolution of lending rates on Beirut's market (%)



Source: BDL

2-25 The ABL continued to issue circulars concerning the reference interest rate on Beirut's Market for the USD and for the LBP (Beirut Reference Rate-BRR) to go in pair with the movement of interest rates in the country. This rate takes into consideration for LBP-BRR and USD-BRR, the average interest on time deposits and operating costs on Beirut's market, in addition to the cost of reserve requirements only for the LBP-BRR, and the cost of liquidity for the USD-BRR at the Lebanese central bank and correspondent banks. This recommended rate on the LBP was 8.44% at the end of 2012, 8.48% at the end of 2013, and 8.58% in June 2014. Meanwhile, the recommended average rate on the USD for the same respective dates was 5.76%, 5,89% and 5,94%.

Claims on the Public Sector

2-26 At the end of 2013, **the claims of commercial banks on the public sector** increased to LBP 56786 billion in comparison to LBP 46930 billion at the end of 2012 registering an increase of 21% in comparison to a much lower figure of 6.5% in 2012.

2-27 This fact resulted from the increase in the commercial banks' portfolio of Treasury bills in LBP to 30114 billion at the end of 2013 in comparison to LBP 27107 billion at the end of 2012 and against LBP 24849 billion at the end of 2011. The banks' subscription increased in 2013 due to the excessive banks liquidity in LBP and the issuance of the Ministry of Finance of long term Treasury bills (7, 8, 10, and 12 years categories) with relatively high return.

2-28 Furthermore, the banks' portfolio of Eurobonds increased from USD 13081 million in 2012 to USD 17608 million at the end of 2013. This increase is due to the fact that banks purchased a large amount of Eurobonds from the BDL on one hand and largely subscribed in the Eurobonds issued by the Ministry of Finance during the considered period on the other.

2-29 The share of the claims on the public sector in LBP out of total loans to the public sector decreased to 53.3% in 2013 in comparison to 58% at the end of 2012, while the share of claims in foreign currencies increased to 46.7% from 42.0% for the two consecutive years.

Foreign Assets

2-30 Deposits of resident banks at correspondent banks reached around USD 14 billion at the end of 2013, against USD 14.4 billion at the end of 2012, thus declining by 3.0% in 2013, compared to 1.6% in 2012. The percent of these deposits out of total customers' deposits in foreign currency at banks declined from 17.8% at the end of 2012 to 15.5 % at the end of 2013.

2-31 These deposits remain a focal point in banks' financing of foreign activities and most of all in the management of risks, since they constitute a main source of liquidity in foreign currencies. Therefore, despite their weak return of 1% on average, banks always try, within the management of their resources, to ensure certain levels of liquidity in foreign currencies at correspondent banks as a main defense tool in case of any negative developments.

2-32 Deposits of banks at correspondent banks, net of deposits of non-resident banks, increased to around USD 8.9 billion at the end of 2013 against USD 8.5 billion at the end of 2012. In other terms, in 2013, deposits at correspondent banks covered more than two times and a half (2.8) the external commitments towards the non-resident banks (2.4 at the end of 2012).

2-33 Other foreign assets at banks increased by 10.1% in 2013 in comparison to 7.8% in 2012 reaching USD 6789 million at the end of 2013 in comparison to USD 6164 million in 2012. These assets mainly consist of direct investments in sister or affiliated banks and of investments in foreign portfolios whose credit rating is at least BBB or subject to the control of countries classified as BBB sovereign rating and above, in case they are issued by companies. These assets have a high return compared to the deposits at non-resident banks. They represent an acceptable diversity of foreign investments and a better distribution of risks.

Deposits at BDL

2-34 In 2013, the assets of commercial banks at the BDL continued to increase but at a slower pace than in the previous years, registering LBP 81957 billion at the end of 2013, in comparison to LBP 79179 billion at the end of 2012. Thus, they would have increased by 3.5% in 2013 in comparison to 11.3% in 2012.

2-35 The increase in bank customers' deposits in 2013 contributed to the increase in the required reserves in LBP and the required deposits in foreign currency at the BDL. Banks subscription in CDs issued by the BDL in large amounts in 2013 also contributed to an increase in bank deposits at the BDL. However, using some of their deposits at the BDL to subscribe in long-term Treasury-Bills (especially in September 2013) caused a decline in the growth of bank deposits at the BDL given that the portfolio of USD CDs issued by the BDL remained quasi- stable in 2013.

III - BANKS AND RISK MANAGEMENT

3-1 Banks' risk management depends mainly on strategies, policies, procedures and ceilings related to the types of risks and the adequate level of exposure determined and approved by the Boards of Directors. This management is subject to a daily follow up by the committees and the concerned departments that include efficient and highly experienced people capable of identifying, managing and controlling various banks' risks. 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 and international standard setters. These regulations stipulate the application of specific standards peculiar to the Lebanese situation, in addition to the international standards set, 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. It is worth indicating here, that with the increase in the regional risks, the Banking Control Commission started with the beginning of the turbulences in some of the countries in cooperation with the concerned banks to apply stress testing for banks present in Egypt, Syria, Jordan, Cyprus and lately Turkey. Stress Tests applied to credit and loan portfolios, the fluctuations in exchange rates, the decline in collateral values, in addition to asking banks to take collective provisions based on the results of the stress tests they have conducted.

Interest Rate Risk

3-2 Interest rate risk was almost absent in 2013, due to the quasi-stability of the interest rates. The risks related to rising interest rates are under control, with regards to banks' loans to the private sector, as they are in a large part, current. 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 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. Average life was around 1274 days for the Treasury bills in LBP at the end of 2013 and close to 5.9 years for the Eurobonds outside Paris 2 and 3. 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 return on long-term Treasury bills and CDs takes into account these risks, i.e. interest rates movements, in addition to the fact that Treasury bills and CDs are marketable and liquid, unlike the loans to the private sector. All these factors tend to limit these risks.

Exchange Rate Risk

3-3 In 2013, exchange rate risks remained low and under control as there were no new developments regarding the commitment of the government and BDL to the policy of fixing the exchange rate and the availability of official reserves that increased to record levels. These assets reached USD 31713 million at the end of 2013 which covers 18 months of imports and is equivalent to 70% of the monetary aggregates in LBP. Exchange rate risk remained also low in terms of the structural exchange positions. For the record, banks are strictly not authorized to take operational exchange positions (debit and credit), that exceed 1% of the net core capital. Moreover, they are only authorized to keep structural exchange positions to hedge the capital that constitute no more than 60% of the net core capital.

Credit Risk

3-4 In 2013, the quality of bank loans in some Arab countries, especially Syria, was negatively affected by the prevailing political and security developments. However, the credit risks for Lebanon remained in general and, to a large extent, under control despite the deceleration of the economic growth. Banks have continued to improve the quality of their loan portfolio and to take provisions. The ratio of doubtful debts/net total loans dropped to 3.4% at the end of 2013 against 3.5% in 2012 (4.5% for banks in the Arab region), and the provisions on doubtful debts moved to 75% against 74.7% during the two mentioned years respectively (89.7% for banks in the Arab countries).

On the other hand, bank sovereign risk exposure increased slightly in 2013, where the share of bank loans to the public sector and deposits at the BDL reached 55.8% of total assets at the end of 2013, against 55.1% at the end of 2012. It is worth indicating that a large part (around 51%) of this placement is in LBP practically negating default risk. As for the share pertaining to placements in foreign currencies, it is mainly at BDL, which re-invests such placements abroad in low-risk and high liquid instruments that may be similar to bank assets abroad. Moreover, the credit rating of Lebanon witnessed some decrease in 2013 as Standard & Poor's lowered the rating from B to B- in November 2013 with "negative" outlook before raising it to "stable" in April 2014. On the other hand, Moody's and Fitch Ibka kept the ratings of the Lebanese government securities the same in 2013 while lowering the outlook from "stable" to "negative". It is to note that the Lebanese government has never defaulted on payments, while the Eurobonds are to a large extent held by resident concerned groups which lowers default risk.

3-5 It is to mention that banks largely control credit risk that lies at the heart of banking activities. They possess significant increasing information about their clients and the sectors they work in, thus enabling them to examine files of clients thoroughly and seriously before granting any loans. They also strengthen the role of risk management units, take-up sufficient guarantees on their loans and periodically classify them according to the instructions of the monetary and supervisory authorities. Moreover, they constitute necessary provisions according to loans classification, where all bad loans are fully provisioned and registered off- balance sheet. Banks also abide by the prudential measures and ratios pertaining to loans to one borrower and those granted to related parties- individuals and companies. Furthermore, supervising authorities specified a maximum ceiling of possible loans granted to related parties. Bank management also insists that large institutions and senior borrowers provide audited budgets and adequate guarantees especially in terms of loans with no guarantees which represent almost 29% of the total loans to the resident and non-resident private sector.

Liquidity Risk

3-6 The Lebanese banking sector's high liquidity, whether in LBP or in foreign currencies, keep the liquidity risk under control. Maintaining a minimum level of liquidity in LBP and particularly in foreign currencies has been a strategy adopted by banks for many years, in order to boost and safeguard confidence in the banking sector, on one hand, and to deal with the adverse changes which may suddenly occur, on the other. This strategy has proven its efficiency in overcoming many crises, strengthening confidence in the sector and in contributing to monetary stability. At the end of 2013, 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 over 56% of total deposits and other liabilities, which is the highest in the region, against over 58% at the end of 2012. Moreover, the ratio of primary liquidity in foreign currencies (deposits at BDL and banks abroad) reached around 44% of total deposits and other liabilities in these currencies, knowing that such a level is necessary for good management of deposits in foreign currencies, in the absence of lender of last resort.

Solvency Risk

3-7 The 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' latest available statistics, the solvency ratio of Total Capital/Risk Weighted Assets was around 12.2% at the end of June 2013, well above the required minimum level of 10.5% based on Basel 3. Furthermore, the banking sector went in pair with international measures and procedures recently raised, making it stricter to boost the level of quality and transparency in the capital base and enhance the level of risk coverage and controlling the excess borrowing, or the ratio of debt to bank capital. 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.

3-8 According to the monetary authorities, the Lebanese banking sector would not face difficulties related to the implementation of Basel 3. The BDL issued intermediary circular no 282, where it requested banks to reach a ratio of 12% of total core capital/total assets at the end of 2015, knowing that the deadline set by Basel 3 to reach a ratio of 10.5% is the year 2019. The monetary authorities believe that these ratios will be reached through retaining part of the profits in capital and through the issuance of shares leading to the strengthening of core capital, as was the case during the last few years.

Reputation Risk

3-9 The BDL and banks operating in Lebanon continue the efforts they started years ago to fight money laundering and terrorism financing and to help align Lebanon with the international standards. During the last few years, these efforts increased, particularly with the strict application of sanctions imposed by the United States and the European Union on Syria and Iran.

3-9-1 The latest procedures included the issuance of the BDL of numerous circulars aiming at reorganizing many aspects of the money dealer profession in Lebanon, in addition to the important circular no 126/2012 on the relation of banks with the correspondents, in which the BDL requested from banks to be informed about laws, regulations, procedures, sanctions and restrictions established by the international organizations or the sovereign authorities in the countries of correspondent banks, and to deal with them accordingly. Furthermore, the BDL issued at the beginning of 2013, major circular no. 128/2013 related to the establishment of the Compliance department in each bank.

3-9-2 In order to protect the banking sector, banks operating in Lebanon were seriously and responsibly committed to the international sanctions imposed on Iran and Syria by other bodies than the United Nations to which Lebanon surely abides.

Bank management is seriously emphasizing the attendance of its employees on a permanent and intensive basis training seminars organized by the BDL, the Association of Banks in Lebanon and the banks themselves covering laws, systems, and also the standards and international developments concerning the subject of combatting money laundering and countering the financing of terrorism to reach higher levels of culture, technical know-how, and professionalism in the banking profession.

In the same framework, and by a decision of the Committee for Compliance and Fighting Money Laundering in the Association of Banks, two meetings were held in July 2013 and April 2014 for the responsible staff of the compliance departments in the banks operating in Lebanon to discuss subjects of combatting money laundering, FATCA, the relationship with correspondent banks, and other issues. Additionally, the Association of Banks organized several meetings for the directors and staff of the compliance departments one of which was with the US assistant secretary of treasury in November 2013 and another one by an invitation of City Bank in the same month.

In parallel, the company Deloitte prepared, based on a request of the Association, the two manuals of "policies and procedures" on the subjects of anti-money laundering and countering the financing of terrorism on one hand and FATCA on the other in close coordination with the Committee for Compliance and Fighting Money Laundering in the Association. Both manuals were distributed to all banks operating in Lebanon in November 2013.

On another level, we point-out to the activities made by the Association of Banks in Lebanon and banks in several countries of major importance to the banking sector (USA, France,...) through meetings with high level public officials and bankers and through the organization of the "Lebanese Banking Day" with the purpose of improving the reputation and image of the Lebanese banking sector abroad without forgetting the efforts made by banks through the parliamentary committees to pass relevant laws.

In the framework of cooperation with international organizations, we mention discussing in a business meeting held at the Association premises in January 2014 the possibilities of cooperation among the INTERPOL, the "INTERPOL organization for a safer world" and the Lebanese banking sector for the purpose of strengthening combatting organized crimes, especially financial crimes, such as money laundering and terrorism financing.

3-9-3 It is worth indicating that three major draft laws in this field are being reviewed by the Parliament. The first relates to the amendment of law no 318/2001 on fighting money laundering, the second on the statement of cross-border money transfers and the third on the exchange of tax information. The enactment of these laws will lead to the strengthening of Lebanon against money laundering and terrorism financing.

IV - BANKING SECTOR PERFORMANCE

4-1 In 2013, net profits of banks operating in Lebanon increased by 4.9% from 2012, given the difficult internal work environment and conditions, and developments in neighboring countries. These net profits reached LBP 2,471 billion (the equivalent of USD 1,639 million) in 2013 against LBP 2,356 billion (the equivalent of USD 1,563 million) in 2012, which represents approximately the same figure as 2011.

4-2 Given that bank profits increased in 2013 by a lower percent than the percent increase in bank total assets (8.5%) and the percent increase in basic capital (9.6%), **the return on average shareholders' equity** (ROAE) decreased from 13.15% in 2012 to 12.23% in 2013. As for **the return on average assets** (ROAA), it also decreased from 1.04% to 1.01% respectively during the same periods. Nevertheless, the profitability measures (ROAE and ROAA) are similar to world average but lower than measures in Arab and emerging countries. For instance, the ROAE of the top Arab 172 banks was 12.09% and the ROAA of these banks was 1.59% in 2013.

4-3 The cost to income ratio slightly increased from 52.1% in 2012 to 52.5% in 2013. Despite the increase in net banking product by 5.8%, which was helped by the decline in net provisions on doubtful loans, the cost that includes total staff expenses, administrative and general expenses, and other general investment expenses, increased by 6,5%. It is to mention that banks found it necessary to form additional provisions in 2012 due to the domestic economic situation and the risks that influenced their clients in neighboring countries. Net provisions against doubtful loans were also revised and reduced in 2013.

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

	2012	2013
1- Interest received	11926	12711
2- Interest paid	7881	8422
3- Interest margin (1)-(2)	**4045**	**4289**
4- Net provisions	274	166
5- Net interest received (3)-(4)	**3771**	**4123**
6-Net commissions & other income	2076	2061
7-Net financial income (5)+(6)	**5847**	**6184**
8-Operating & General expenses	3047	3245
9-Profits before tax (7)-(8)	2800	2939
10- Extraordinary net income	4	-4
11- Tax on profits	448	464
12-Net profits (9)+(10) – (11)	**2356**	**2471**

Source: BDL

4-4 The table below details the evolution of revenues between the years 2012 and 2013. Total revenues increased from LBP 14006 billion to LBP 14768 billion respectively, registering an increase of LBP 762 billion or by 5.4% (+8.9% in 2012). This resulted from the increase of 6.6% (8.9% in 2012) in interest received in comparison to the decline in other revenues and net commissions received by 1.1% (+21% in 2012). The increase of interest received was tied to the increase in loans to the private sector, and the investment in sovereign financial instruments- such as Treasury Bills and CDs in domestic currency and the US dollar- and non-sovereign financial instruments, knowing that interest rates in Beirut market were stable in general and the global interest rates remained at very low levels. The stability or slight decrease in net commissions went in-line with off-balance sheet activities and other banking services generating commissions, given that the special increase in net commissions in the previous year was in a way affected by the reconsideration of the list of banking conditions recommended by the Association of Banks in Lebanon. While the share of interest received out of total income slightly increased from 85.1% in 2012 to 86.1% in 2013, the most significant increase remains in the share of net interest received out of the net financial income, where these shares increased from 64.5% in 2012 to 66.7% in 2013, leading the share of net commissions and other net incomes to fall from 35.5% to 33.3% respectively during the two mentioned years. This goes in line with the concern of banks to diversify their services, including the strengthening of the private exchange such as 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.

Income Distribution (LBP billion)

	2012	2013	Change (%) 2013-2012
Interest received	11926	12711	+6,6
Net commissions received and other Income received	2080	2057	-1,1
Total income	**14006**	**14768**	**+5,4**

Source: BDL

4-5 The table below details the evolution and the distribution of expenses during the years 2012 and 2013. The total expenses increased from LBP 11650 billion to LBP 12297 billion, the equivalent of LBP 647 billion or by 5.6% (+13.1% in 2012).

Expenses Distribution (LBP billion)

	2012	2013	Change (%) 2013-2012
Interest paid	7881	8422	+6,9
Net provisions	274	166	-39,4
Administrative expenses	3047	3245	+6,5
o/w staff expenses	1668	1750	+4,9
Tax on Profit	448	464	+3,6
Total expenses	**11650**	**12297**	**+5,6**

Source: BDL

Interests paid increased by 6.9% in 2013 in comparison to 9.4% in 2012 thus surpassing the percent increase in interest received. This is due to the increase in deposits by around 9% with a relative stability in the average lending interest rates, in addition to low levels of paid interest on the deposits of non-resident financial sector.

Net provisions on loans declined from LBP 274 billion in 2012 to LBP 166 billion in 2013, implying that banks reduced the size of provisions to cover risk as previously mentioned. Furthermore, other administrative and operating expenses increased by 6.5% in 2013. This increase largely resulted from the increase in staff expenses (+4.9%) related particularly to the increase in the number of employees in the sector (+500 persons), and the annual increase and benefits that banks grant their employees based on the Collective Labor Agreement. It is to mention that the increase in other operating expenses by 8.4% that banks bear fall within the bracket of development and improvement required to keep pace with world banking standards. Finally, it is to mention that staff expenses had increased by 13.4% in 2012 due to the increase in the minimum wage and the cost of living since February 2012. Other investment expenditures increased by 23.5%. The tax on profit increased by 3.6% in 2013, reaching LBP 464 billion against LBP 448 billion in 2012 representing 16% of net profit before tax.