



مصرف لبنان
BANQUE DU LIBAN

A Reference for
Islamic Finance
Practice.

Enabling the environment for a Dynamic, Well-Integrated Islamic Financial Industry in Lebanon

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Outline

- Rationale
- BDL's Quest
- BDL's Organizational Arrangements
- Integration Strategy : Three pillars
 - Legal and Regulatory Platform
 - Knowledge and HR Platform
 - Innovation Platform
- Conclusion

Rationale

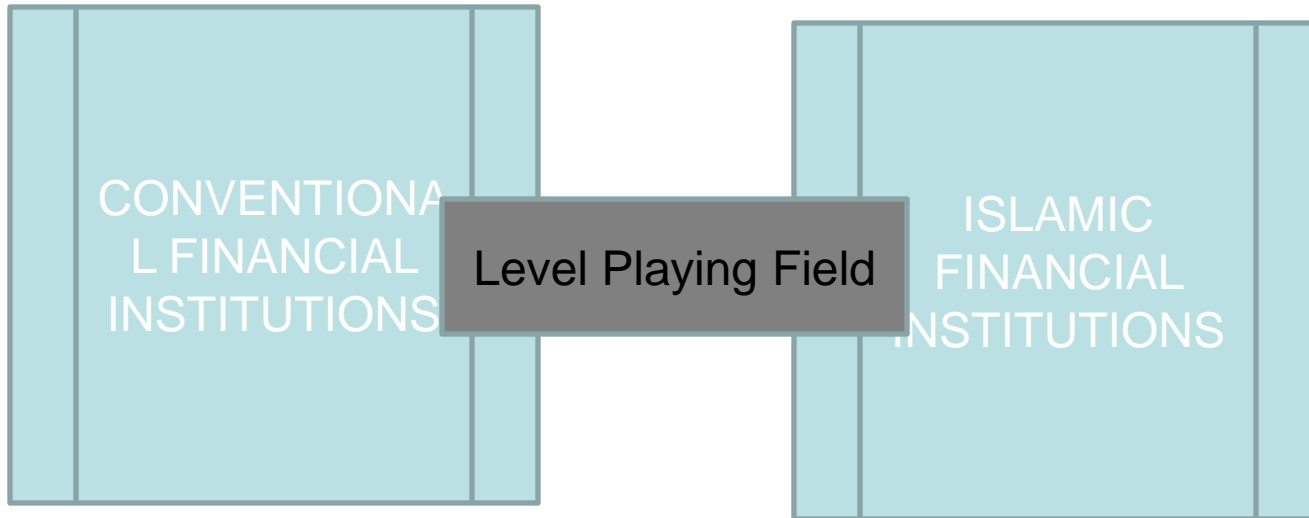
- Global Expansion of Islamic Finance
 - Oil boom; and
 - Growing number of the Muslim population around the globe
 - Increasing interest towards Socially Responsible Investments (SRI)
- Lebanon has a well-established expertise in banking
- Islamic Banks would be able to use Lebanon as a base for their local and regional operations in the same way that conventional banks do, as this would **reinforce Lebanon's position as a regional banking and financial center.**

Lebanese Banking System

Characteristics:

- ✓ Size: 3.5 times GDP (Total Assets of Banking Sector : \$110 Billions)
- ✓ Ownership: All banks are privately-owned (no Public Sector) - Most Banks include a foreign component
- ✓ Liquid: Short term Assets to Short Term Liabilities in Foreign Currencies = 30%
- ✓ Capital: Basel II Capital Adequacy Ratio about 12%
- ✓ Dollarization of deposits: 65%
- ✓ Supervision: Independent of political process
- ✓ Private Sector benchmarked returns (Similar to Singapore Model)
- ✓ Asset Concentration: Top 5 (53%), Top 10 (75%)

BDL's Quest : The Islamic Banking Integration Strategy



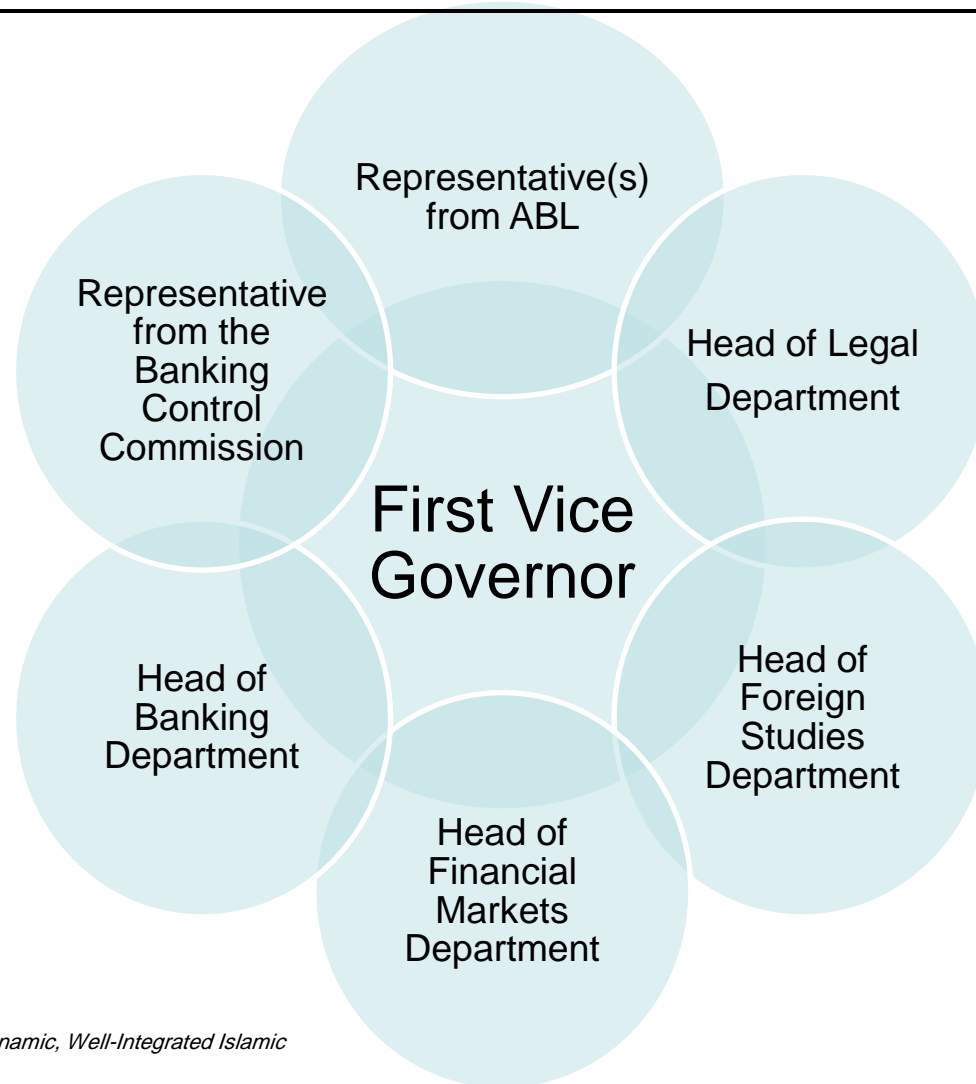
Banque du Liban's quest is to set the regulatory and supervisory framework that will provide the Islamic financial industry **with a level playing field .**

BDL's Organizational Arrangements

Subsequent to the Law No. 575 (February 2004), BDL set up an Islamic Banking Regulatory Committee, headed by the First Vice-Governor, in charge of:

- ✓ Setting up the rules and regulations for the establishment of Islamic Banks in Lebanon;
- ✓ Defining the financial activities and products that Islamic Banks are allowed to undertake; and
- ✓ Setting up standards and policies regarding risk management and capital adequacy.

BDL's Islamic Banking (IB) Regulatory Committee



BDL's Islamic Banking self-directed Teams

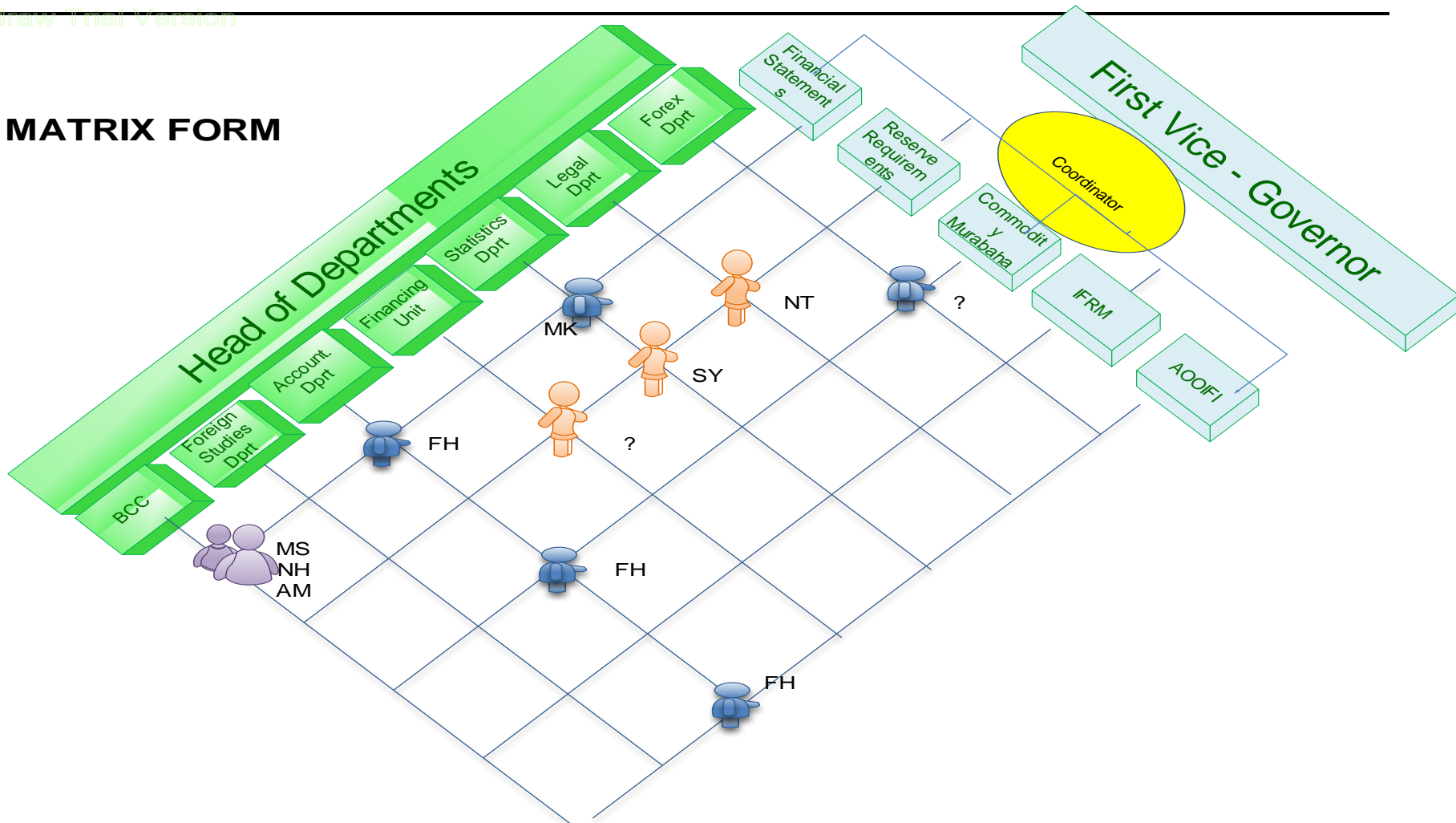
SDT Structure : Matrix Form

Both **divisional** and **functional** structures are implemented **simultaneously** since the organization needs both the expertise within legal, accounting, financial, supervisory functions and horizontal coordination across functions.

IB SDT's Structure: Matrix Form

Esraw Trial Version

MATRIX FORM



BDL's Inter-disciplinary SDT

ISLAMIC BANKING SDT FINANCIAL STREAM (4)

Phase I

Phase II

WG1

Financial Concepts

Real Estate Investments;
IRR/PER; Fixed Assets; Investment Portfolio, Interbank placements, Hamish Al Jadiyah, Profit Recognition

WG2

Financial Statements

3010 / P&L / Mapping 2010 & 3010

WG3

Measure of Liquidity in L.L and in F.C

WG4

Capital Adequacy

BDL's Inter-disciplinary SDT

ISLAMIC BANKING SDT LEGAL STREAM (5)

Phase I

WG5

Review of Law
575

**(Real Estate Inv.
Banking
Secrecy,
Deposit
insurance)**

WG6

Taxation's
Exemptions

WG7

Reserve
Requiremen
ts and
Exemptions

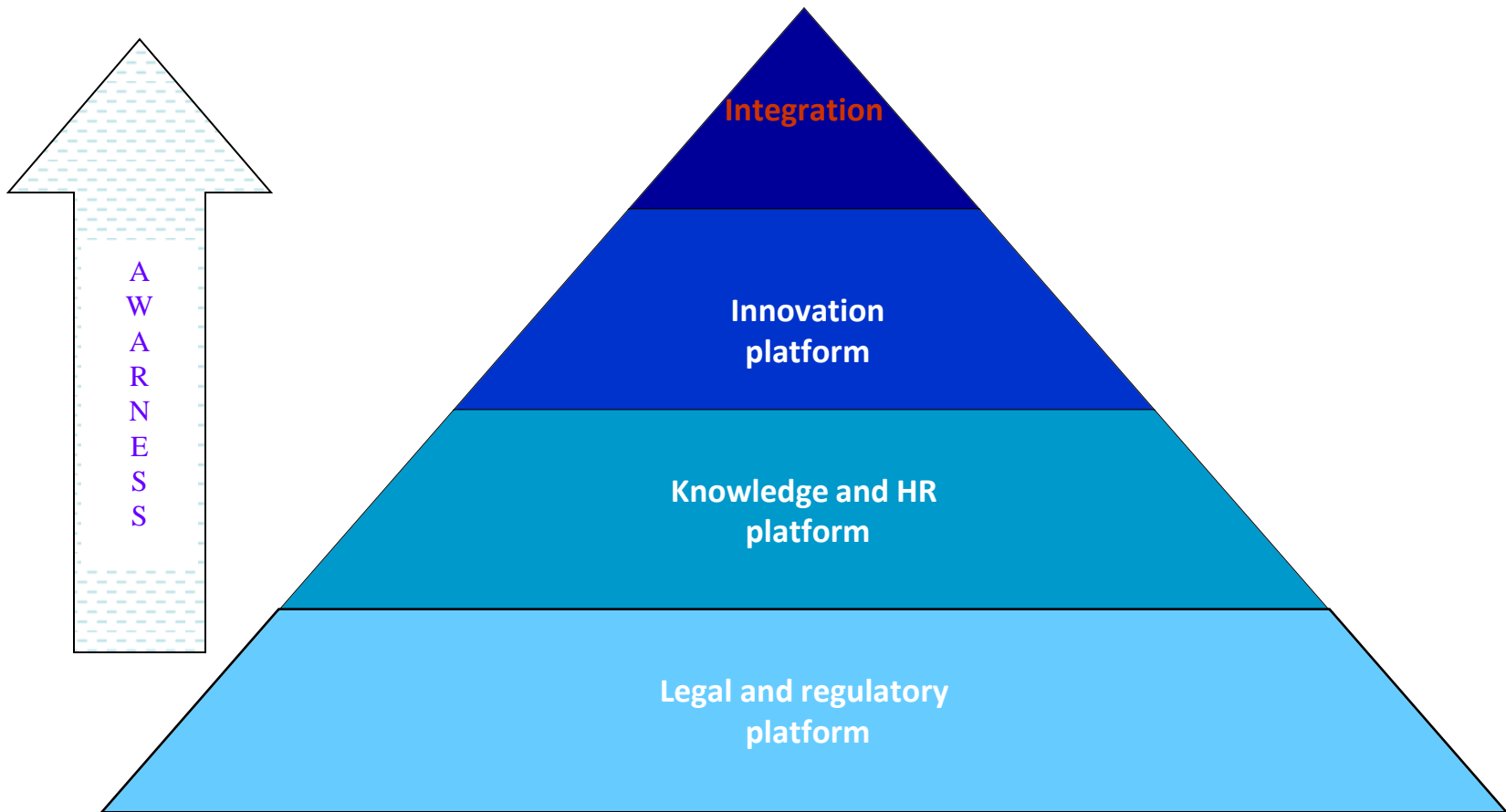
WG8

Corporate
Governance

WG9

Deposits Accounts
(Type of accounts
(maturities &
returns), Co-mingling
of funds)

BDL's Integration Strategy



I- Legal and Regulatory Platform

LAW

575	11/02/2004	The establishment of Islamic Banks in Lebanon
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BDL BASIC CIRCULARS

BCC CIRCULARS

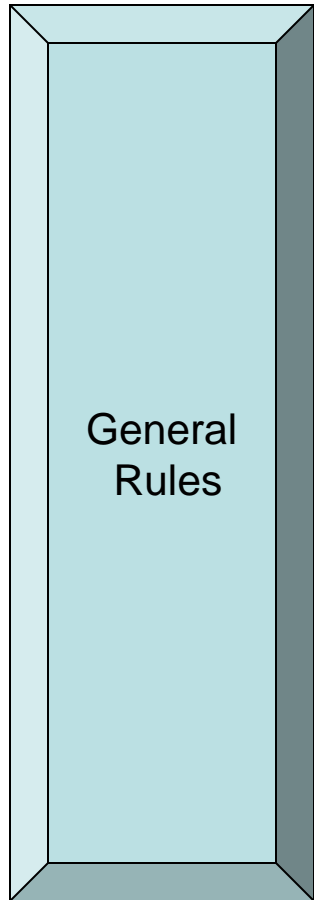
Reference No	Date of issuance	Subject	Reference No	Date of issuance
94	26/8/2004	Operations of Islamic Banks in Lebanon		
95	26/8/2004	Conditions for establishment of Islamic Banks in Lebanon		
96	20/10/2004	Murabaha instrument regulations		
97	19/1/2005	Musharaka instrument regulations	246	13/7/2005
98	1/6/2005	Islamic Collective Investment Schemes		
99	1/6/2005	Ijara and Ijara wa Tamalluk operations	247	31/10/2005
100	16/7/2005	Mudaraba instrument operations	249	7/3/2006
101	10/12/2005	Salam instrument	253	11/4/2007

I- Legal and Regulatory Platform

BDL BASIC CIRCULARS			BCC CIRCULARS	
102	10/12/2005	Istisna instrument	254	18/8/2007
107	17/2/2007	Islamic Financial Statements		
112	27/9/2007	Corporate Governance for Islamic Banks		
113	9/11/2007	Monetary reserve requirement, minimum special reserve and required investments of Islamic banks		
116	13/5/2008	Special provisions on the shareholders' equity of Islamic banks		
BDL INTERMEDIARY CIRCULARS				
144	19/09/2007	The Status of the Central Office of Credit Risk		

I- Legal and Regulatory Platform

- Major differentiating Characteristics :



- Only local banks or foreign financial institutions (with a proven record of Islamic financial acumen) / No Islamic windows;
- Minimum capital of US \$100 Million (reduced to US \$20 Million if it is a subsidiary of a Lebanese mother bank);
- Minimum deposits term : six months;
- Current accounts deposited in IBs are covered by the National Deposit Guarantee Institution;
- The banking secrecy law is levied exceptionally (and solely) to the Banking Control Commission to make sure that current accounts and investment accounts are segregated and the related profit distribution calculated properly;
- Statutory Reserves are applicable to on and off-balance sheet current and investment accounts;
- No Central Council Shari'ah Board;
- Similar to conventional banks, Islamic Banks reports clients defaults to the Centrale des Risques.

I- Legal and Regulatory Platform

- Major differentiating Characteristics :



Specific Ratios

- Off-balance sheet investment portfolio must not exceed 20 times its net Tier-One capital to encourage the on-balance sheet operations;
- Investment in fixed assets, including fixed assets intended for its own use (up to 30% of net Tier-One capital), must not exceed 50% of the total value of its investment portfolio;
- Provisions for meeting risks related to “result-linked deposit accounts” shall be withheld at a minimum ratio of 12% of net investment profits of the various operations until Cumulative provisions reach twice paid-up capital;
- Investments and Placements in Lebanon must account at least for 50% of the assets and rights included in the BS;
- Collateral should be at least 60% of the value of financing except when there is Cash collateral, Letter of Guarantee, Consumer Loan or First Personal House Loan.

I- Legal and Regulatory Platform

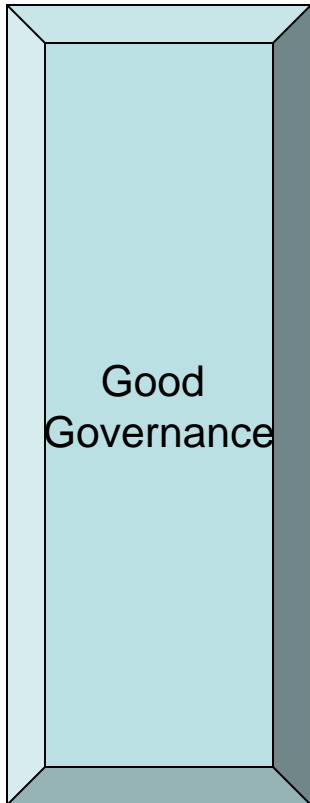
- Major differentiating Characteristics :



- Restriction to conduct commercial operations on real estate;
- Murabaha: Only binding Murabaha contracts are allowed;
- Murabaha: 15% cash of Hamish Jiddya (Margin of Guarantee);
- Musharaka: only allowed to enter a Musharaka with a limited liability scheme: Caps the exposure of IB to the value of the capital of the firm in case of bankruptcy of the company;
- Mudaraba: if IB is the Rabb el Mal, an account should be opened to the Mudarib with the bank to ensure control of cash flows: limits the moral hazard of IB entering into Mudaraba;
- For all Islamic financial instrument the law requires the Islamic Bank to liquidate all acquired assets in a period of 6 months: Maintains a high level of liquidity with IB's and prevents the eventual transformation of IB into an "inventory" driven institution.

I- Legal and Regulatory Platform

- Major differentiating Characteristics :



- Establishment of a “Corporate Governance Committee” at BDL.
- Establishment of a Sharia’a Auditor, independent of the auditing or the Sharia Board. The Sharia’ Auditor controls ex-ante and ex-post the strict compliance of the IB operations with the Sharia’ Board decisions.
- Details public disclosure requirement with emphasis on profit distribution calculations, funds intermingling proportions, PER distribution and investment baskets.
- Disclose Sharia Board annual report to the public at large, allowing a “community” scrutiny and assessment of the IB Sharia compliance quality and observance.

II- Knowledge and H.R. Platform

- BDL is collaborating with prominent educational institutions to enhance the quality of knowledge acquired by professionals in Islamic Finance.
- These initiatives are in line with Lebanon's already-established Regional Positioning as the "Center of Human Resources Excellence".
- These initiatives promotes the industry at-large through the enhancement of the cross-border penetration of Islamic financial knowledge into conventional financial markets.

II- Knowledge and H.R. Platform

- 1. Islamic Financial Qualification (IFQ):**
CISI – BDL – ESA (English and Arabic)
- 2. Islamic Financial Risk management (IFRM):**
BDL – GARP
- 2. Executive Master in Islamic Finance (XIFM):**
BDL – ESA – Erasmus Rotterdam

Islamic Financial Qualification (IFQ)

- ✓ Launched in 2006;
- ✓ Advisory Council headed by the BDL's First Vice-Governor;
- ✓ Six members for ACIF and 10 prominent contributors to the workbook;
- ✓ Constant review of the qualification content : The release of the third edition was in September 2009;
- ✓ Translation into Arabic is underway;
- ✓ Not yet mandatory in Lebanon.

Islamic Financial Risk management Certificate (IFRM)


- GARP is the leader in Risk Management certification worldwide.
- BDL possesses unsurpassed expertise in Islamic financial principles, strong relationships with the central banking community throughout the world, and a strong interest in seeing the formal development of standardized approaches to Islamic finance.
- MOU between BDL and GARP signed in August 2008.
- Development of certificate is overseen by an **Advisory Committee** gathering world's top academics, scholars and practitioners in Risk management, Sharia, and banking


IFRM Program : Basic approach



The approach presents the financial statements for Islamic Financial Institutions (IFIs) and compares them to the conventional ones, thus enhancing the analytical aspects that should enable the identification of the different classes of risks, their measurement, and finally their management.

IFRM Program : Major Topics

1. Conventional banking and classes of risks
 2. Islamic Financial institutions and classes of risk.
 3. Risk measurement of Islamic financial instruments
 4. Risk management of Islamic financial instruments
 5. Enterprise Risk Measurement and Management in Islamic Financial Institutions
- 
- Core

1. Regulatory Issues in Islamic Finance
 2. Derivatives and Hedging in Islamic Finance
 3. Islamic Capital Markets
- 
- Electives

Executive Master in Islamic Finance (XIFM)

- ✓ First Master Program in Islamic Finance in Lebanon and in the GCC
- ✓ 2009 First Intake
- ✓ XIFM students from BDL, Banking and Corporate Sector
- ✓ Signature of an agreement to deliver in Effat University – Jeddah, KSA.

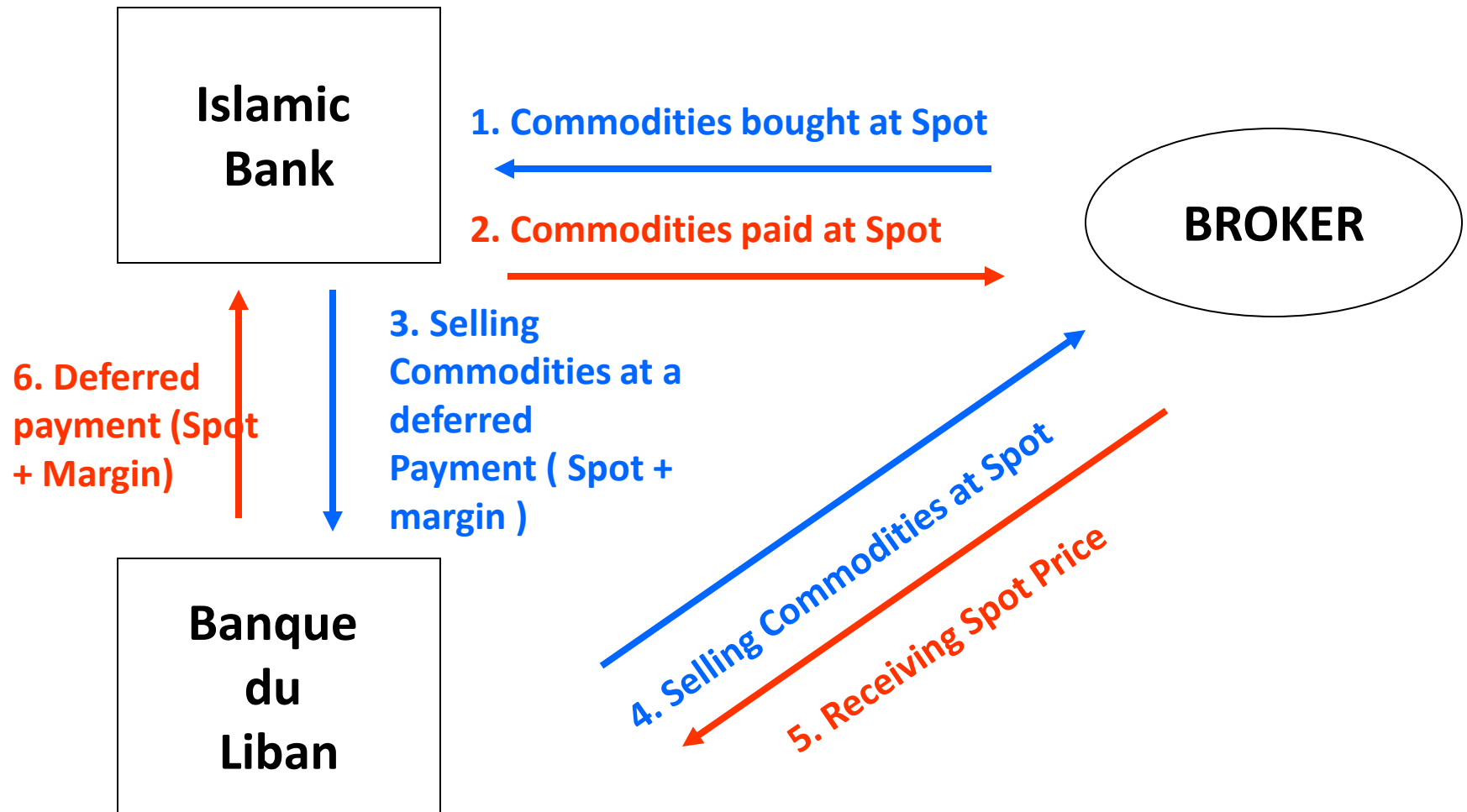
III- Innovation Platform

1. Liquidity Management of Islamic Banks: ILM scheme
2. Islamic Kafalat and loans guarantee
3. Interest (return payment) subsidy
4. “Centrale des Risques” Islamic instruments update
5. Upcoming projects

1. Liquidity management of Islamic Banks: ILM Scheme

- ✓ First Shari'ah compliant deposit scheme, the Islamic Liquidity Management (ILM), launched in Summer 2007;
- ✓ Addressed for the Lebanese Islamic Financial institutions in the context of the minimum required and excess investments. Also available for international institutional investors and regional Islamic banks willing to invest in Lebanon;
- ✓ Investment instrument using Platinum or Palladium as the underlying traded;
- ✓ Enhance the competitive edge sector by providing an investment instrument with returns comparable to those offered to conventional banks;
- ✓ Information related to the tenures and the rates of returns are available on BDL Page on Reuters (BDL 15).

BDL Commodity Murabaha



2- Islamic Kafalat and loans guarantee

- Kafalat, an independent private-public company, guarantees 75% of loans granted by conventional banks to agricultural, industrial, touristic, and technological projects.
- Kafalat charges 2.5% commission of the guaranteed value.
- Kafalat guarantee was extended to Islamic banks granting financing facilities to their clients under Murabaha, Ijara, Salam, and Istisna' facilities.

3- Interest (Return Payment) Subsidy

- ✓ Upon BDL's request to the Ministry of Finance, an amendment has been introduced to the Budget extending the interest payment subsidy to Islamic banks granting financing facilities to clients undergoing agricultural, industrial, touristic and technology projects, in the form of return payments subsidy.
- ✓ This subsidy will take effect upon the approval of the Budget by the Parliament.

4-Taxation Framework

Suppression of the double-taxation in the context of Islamic Financial operations:

- ✓ In view of creating a fair level playing field BDL supported the suppression of the double taxation in the context of the purchase and sale operations related to Islamic Financial operations.
- ✓ The exemptions includes the VAT as well as the registration taxes and will become operational upon the approval of the Budget by the Parliament.

5- Upcoming projects

A sample :

1. Islamic Banks / Lebanese Republic Sukuk
2. Consolidated Financial Statements and Sectoral Consolidation
3. Arbitration and integration with Lebanese laws
4. Islamic inter-banks fund

CONCLUSION

“NO OBSTACLES BUT NO SPECIAL FAVORS”

THANK YOU