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THE LEBANESE POLITICAL AND ECONOMIC SYSTEMS

The Political System

The Constitutional System in Lebanon is best described as a Parliamentary Democracy committed to the following principles:

- Human Rights.
- Freedom of Speech and Belief.
- Private Ownership.
- Free Market Economy.

Lebanon's political system is based on the separation of legislative, executive and judiciary powers. The President of the Republic is elected by the National Assembly for a six-year term and appoints the Prime Minister in compulsory consultations with the Parliament. The President in accord with the Prime Minister also appoints the members of the Council of Ministers, which needs the vote of confidence from the National Assembly. The Council appoints senior executives in the public sector domain and proposes draft laws to the Parliament, which enacts laws and oversees government activities.

The Judicial branch consists of four courts of Cassation (three courts for Civil and Commercial cases and one court for Criminal Cases), Constitutional Council (rules on constitutionality of laws) and Supreme Council (hears charges against the President, Prime minister and ministers).

The main laws of economic nature are:

- The Lebanese Civil Law (mostly based on the Code of Obligations and Contracts) put into action in 1932.
- The Code of Real Estate Ownership.
- The Code of Commerce promulgated in 1942.
- The Code of Money and Credit promulgated in 1963.

LEBANON

Area:	10,452 km^2
Population:	4.2 million
Nominal GDP (2010):	USD 39.2 billion
GDP per Head:	USD 9,203
Adult literacy rate:	96%
Number of Banks:	68
(of which Foreign):	11
Number of Branches:	943

Lebanon has a long tradition of openness to the international community through its diplomatic and consular missions abroad, dynamic Lebanese business community overseas, and the large number of expatriates spread over the Arab countries, Europe, America, Australia and Africa. It hosts also a large number of missions, commissions and international organizations in its territory such as the United Nations Development Program (UNDP) and the United Nations Economic and Social Commission for Western Asia (ESCWA) headquartered in Beirut.

Lebanon is actively present in regional and international organizations and institutions. Lebanon is a founding member of the United Nations and the League of Arab States and has a membership status in all international organizations falling under the auspices of the United Nations. Lebanon is also a member of the International Bank for Reconstruction and Development (IBRD), the International Monetary Fund (IMF), and the International Finance Corporation (IFC). The World Bank has a permanent office in Beirut where it is housed also the IMF's Middle East Technical Assistance Centre (METAC). Lebanon is as well a dynamic member of the Francophone organization and an economic and social partner to the European Union in the context of Euro-Mediterranean partnership agreements. The country has an observer status in the World Trade Organization and the membership to the WTO is proceeding.

The Economic System

The Lebanese economy is a small open economy, based on the free market principles. Private assets ownership is guaranteed by the constitution. Lebanon has a long history of liberal or free trade and investment policies, with no restrictions on foreign exchange transactions and on the inward and outward movement of capital and financial assets. There is also no discrimination between locals and foreigners in this respect. Discrimination is even absent between foreigners of different countries themselves and that is in conformity with the GATS agreements on the liberalization of trade in financial services.

The economic policies of successive Lebanese governments since the Independence in 1943 have been encouraging private sector development through the 'free enterprise' ideology and government intervention in the functioning of the markets has been historically weak. Tax policies along other structural and legal undertaken reforms are also aiming at enticing foreign direct investment in Lebanon by providing a favorable environment for doing business in the country. Currently, the corporate tax rate is at 15 percent, personal income tax between 2 and 20 percent and the withholding tax rate set at 5 percent. Further, investments are facilitated and guaranteed or insured against a mixture of political and economic risks through a number of local authorities and international agencies and schemes.

The Investment Authority of Lebanon (IDAL) is authorized to oversee, create, facilitate and implement foreign investment projects in Lebanon. The National Investment Guarantee Corporation offers a ten-year insurance against non economic risks such as wars, riots, revolutions and nationalizations. In addition, Lebanon has joined the OPIC (Overseas Private Investment Corporation), the MIGA (Multilateral Investment Guarantee Agency) and the Arab Investments Guarantee Agency, and has been included in the export credit guarantee schemes of COFACE, ECGD and HERMES. Lebanon has always respected all its international debt commitments and did not default on any.

Recent Economic Developments

Lebanon had a robust economic growth in the last four years (2007-2010) in the face of multiform domestic, regional and global unrest and challenges. The average real GDP growth was around 8 percent over the mentioned period at a time where world economic performance as a whole much lagged behind, largely affected by the global recession and financial crisis. Average inflation rate did not exceed 6 percent over the same time interval influenced to a large extent by the rising commodity prices in 2008. The sustained improvement in economic output resulted from buoyant activities in the construction, tourism, trade and financial services sectors driven by two important factors. Firstly, the rising confidence of residents and the Lebanese Diaspora as well as foreign investors in the Lebanese economy and markets given the relatively stable political and security environment and improving macroeconomic management. Secondly, the profitable and reasonably secure business or investment opportunities opposed to challenging and uncertain regional and global environment.

The contained fiscal budget along with ample liquidity and declining interest rates contributed among other things recently to the low growth in Lebanon's public debt and resulted under the strong economic growth environment in the marked reduction of the public debt burden. The ratio of debt to GDP reached 134 percent in 2010 compared to 180 percent in 2006, thus reducing vulnerabilities though much remains to be done.

Over the period 2007-2010, other key economic and financial indicators behaved as such:

• Accumulated balance of payments surpluses amounted to USD 16.7 billion despite the important accumulated trade deficits totaling USD 48.1 billion which were offset by larger net financial inflows.
• International foreign exchange reserves surged to very comfortable and unprecedented levels reinforcing the commitment to exchange rate stability.
• Interest rates on the domestic currency dropped substantially. The average debit rate on the Lebanese Pound fell from 10.37 percent end of December 2006 to 7.91 percent end of December 2010.

It should be highlighted finally that Lebanon remains committed to the joint and fruitful work efforts and cooperation between the Lebanese private sector and the Lebanese government (including the monetary and fiscal authorities) that would permit:

• The periodic revisiting of the legal and the legislative framework to help achieve the goals set in rebuilding and improving the social and economic structures in the country and in the development of the Lebanese money and capital markets.
• The upgrading of the country's infrastructure in the areas of electricity, telecommunication, transportation, education, health care, water and water treatment.
• The strengthening of the country's productive capacity and the competitiveness of the Lebanese firms after modernizing operations and processes and introducing the necessary economic and social reform measures .
• The cementing of public confidence and stability in the economic and political systems and the improvement of the country's standard of living.

THE LEBANESE BANKING SECTOR

The Lebanese Banking Sector comprises 54 small, medium and large size private commercial banks and 14 specialized medium and long term credit banks better known by investment banks. Banks operating in Lebanon are categorized also, in terms of ownership, as Lebanese, foreign and mixed, hence revealing the diversity and competitiveness of this sector and the low to moderate concentration of activities. The Lebanese banking industry employs currently close to 21,337 employees in 943 branches conveniently spread throughout the country. It manages around USD 140 billion in assets nation-wide (i.e, excluding assets of abroad subsidiaries and other entities) according to the latest available data (June 2011).

The size of the banking sector is considered large compared to that of the Lebanese economy, increasing with time to the extent that the ratio of total assets of banks to GDP reached around 340% in 2010. This points out to the substantial capacity of banks to attract savings from residents and non residents and their dominant position in the domestic capital market structure.

Resilience

The Lebanese banking sector has proved over many decades its ability to adapt successfully and weather very well financial and economic shocks of domestic or external origin. It therefore gained a large capacity to face and overcome challenges and uncertainties. In fact, it demonstrated its resilience to crises on many occasions of which recently the global financial crisis where it was able to isolate itself to large extent from its adverse repercussions thanks to its highly liquid and well capitalized position, conservative assets/liabilities structure, skillful and foresighted management, and prudent and stringent bank regulation and supervision. Earlier the sector confronted and survived many wars, aggressions, turmoils and unrest situations.

Following its leading role as a regional financial or banking center prior to the onset of war in 1975, the Lebanese banking sector was capable of sustaining a long destructive war between 1975 and 1990 and of overcoming successfully large scale domestic shocks in 2005 and 2006. Lebanon today is once again one of the major financial centers of the region.

Openness

The Lebanese banking sector is characterized by its large international openness supported by the absence of restrictions on capital flows and foreign exchange transactions and the indiscrimination between nationals and foreigners as already mentioned previously. The Lebanese banking industry interacts efficiently with a network of around 306 foreign correspondent banks spread in 102 major cities around the world, including major banks in the U.S and Europe, and serves the Lebanese communities abroad distributed among the 5 continents, trying to meet their needs. Foreign representation in Lebanon is important and considerable and it is either in the form of a foreign bank maintaining branches in Lebanon (11 banks) or equity stakes in several local banks (15). Foreign banks have also representative offices in Lebanon (10).

The Lebanese network overseas dates back to the 1960s, during which Lebanese banks opened branches in several Arab countries along with affiliates in France and Switzerland. This network then expanded from Middle East and Europe to reach Africa and the United States in the 1980s. Outward branching before mid 2000s experienced periods of expansion and retreat but it has been increasing rapidly however since 2006 with the support and encouragement of the regulatory and monetary authorities with the aim of diversifying income sources and risks and as banks' capacities on the financing and services levels exceeded the local demand or needs. Latest figures reveal that 18 Lebanese banks have 92 units (subsidiary, affiliate, branch, representative office,...) in 33 countries abroad of which 12 Arab nations. Subsidiaries and affiliated companies have about 222 branches in the countries referred to.

Performance

The Lebanese banking industry is financially sound and stable. It plays key roles in the Lebanese economy where banks continue to dominate the financial system of the country and are in fact the major destination of savings and chief providers of credit to individuals and businesses. The sector is also the main bridge for capital and financial inflows into Lebanon and for the financing of a major part of the deficit in the current account balance. The Lebanese banking sector was able to perform remarkably well in the last three years (2008-2010) in terms of assets growth, profitability, and control on operating expenses especially if compared to the performance of many other regional and international peers, always reconciling between risk taking and return and adhering to international best practices. Total assets grew annually on average by 16 percent and the average return on equity and assets was around 16.8 percent and 1.3 percent respectively. The average cost to income ratio retreated also to 47.2 percent.

The Lebanese banking sector measures of capital adequacy and liquidity are strong and asset quality improved over the same mentioned period. Equity to total assets stood at 7.4 percent at the end of 2010 and the capital adequacy as per Basel II exceeded 13 percent. Liquidity as measured by the primary liquid assets to deposits reached 32.6 percent. The asset quality was much superior with the ratio of net doubtful and net substandard loans to net loans retreating from 2.44 percent in 2008 to 2.10 percent in 2010 supported by maintaining highly provisioned and collateralized loan portfolios. In this respect, the ratio of loan loss provisions on doubtful loans to doubtful loans reached around 88 percent in 2010 following the general trend of increasing provisions and reserves in order to confront the potential negative repercussions of the global financial crisis and economic recession, whereas net doubtful loans to net loans fell below the 1.5 percent.

Regulation and Supervision

Banks and other financial institutions in Lebanon fall under the jurisdiction of the Bank of Lebanon (BDL), the country's Central Bank, which is the bank regulatory authority. The Bank of Lebanon controls entry into the banking industry, defines the scope of banking activities and sets prudential regulations and codes of practice for banks.

The Banking Control Commission (BCC) is the bank supervisory authority. It is responsible for supervising banking activities and ensuring compliance with the various financial and banking rules and regulations.

Banking activities are also subject to both the Code of Commerce (1942) and the Code of Money and Credit (1963).

The progress made by the Lebanese banking sector over the last two decades or so in terms of restructuring, consolidation and modernization could not have been possible without the appropriate and strong bank regulation and supervision undertaken by the BDL and BCC and the close and fruitful cooperation of the banks and the Association of Banks (ABL) with the concerned authorities considering that their credibility on the local and international markets rests, among other things, on such cooperation and coordination.

The list of bank regulations and recent legislative financial / banking reforms is long and reflects the voluntary willingness of banks and the concerned authorities to restructure and modernize the banking sector and accompany the changes taking place in the international economic and financial environment. One of these banking reforms is the adoption in 2001 of a unified regulation for the acquisition of bank shares without any discrimination between Lebanese and non- Lebanese and between residents and non- residents. Other relatively new financial laws of concern include a law on assets securitization and another on collective investment schemes in securities and other financial instruments.

It should be mentioned that in many recent reports on the Lebanese financial system published by international and reputable financial organizations or institutions it has been highlighted that the Lebanese banking sector is stable and strong enjoying a serious and high quality supervision and regulation in conformity with the International standards.

In fact, Lebanese banks are well known for compliance with international norms and have been committed to standards and rules of the global banking industry for a long time. The regulatory and supervisory authorities as well as banks have resorted since the early 1990s and in collaboration with the Association of Banks to a series guidelines, procedures and systems which are set and disseminated by world standard setters such as the Bank for International Settlements (BIS), The international Monetary Fund (IMF), The Financial Action Task Force (FATF), and other international bodies.

Key Prudential Practices

In order to help preserve the stability and integrity of the banking system, the monetary and regulatory authority has imposed on banks a number of prudential banking measures adjusted periodically to take into account emerging trends and threats and to foster risk management at banks, the most important of which are as follows:

1. Lending to related parties (e.g. main shareholders, chairman, board members, top management and their families) cannot exceed 5% of shareholders' equity since end 2005.

2. Banks can only lend a single entity (be it a customer or a group owned by the same customer):
   - 20% of shareholders' equity if the facility is used in Lebanon or in countries with sovereign rating A+ and above.
   - 10% of shareholders' equity if the facility is used in countries with sovereign rating A and below.

Credits termed 'big risk' (credit exceeding 15% of shareholders' equity) should not exceed 8 times shareholders' equity.

3. Rules for Loan Classification and Provisioning are in conformity with those defined by the Basle Committee on Banking Supervision. Banks are required to classify their loans into five categories (standard, watch, substandard, doubtful, and bad debt). As by international accounting standards, all non-performing loans (NPLs) have their interest income reserved (unrealized) while provisioning is partial on doubtful debt and integral on bad debt (by decision of the Banking Control Commission -BCC- and depending on each individual file).

Provisioning is regulated by the monetary authority and the constitution and freeing of provisions is subject to BCC authorization. Provisions constituted under BCC authorization and supervision are tax deductible.

4. Banks have to hold at the BDL as required reserves on Lebanese pound accounts, the sum of 25% of their demand liabilities in LBP and 15% of their term liabilities in LBP. These reserves pay zero interest but certain deductions are allowed under a number of special lending schemes to some productive sectors and activities.

Banks are required as well to maintain at the BDL at least 10% of their foreign currency liabilities as net liquid assets, and at least 15% of these foreign currency liabilities as remunerated deposits. These latter are remunerated on the basis of maturity and prevailing market interest rates.

Banks must also keep at least 40% of their shareholders' equity denominated in the Lebanese currency as liquid assets.

5. Banks are required to meet a capital adequacy ratio of at least 12% of shareholders' equity to risk-weighted assets based on Basel I requirements. Since 2008, banks have been, however, in the process of implementing Basel II accord in a diligent and progressive manner and have started very recently preparing to meet over the medium term the challenging requirements of Basel III.

6. The minimum capital for launching a new bank is LBP 10 billion for the head office of a commercial bank plus LBP 500 million for each additional branch; LBP 30 billion for setting up an investment/specialized bank; and LBP 150 billion for establishing an Islamic bank.

7. For foreign exchange exposure, banks are allowed to hold a daily maximum net trading position on all foreign currency accounts against the Lebanese Pound of 1% of the bank's shareholders' equity, while the global position cannot exceed 40% of shareholders' equity. The global position takes the sum of either all debit or credit positions of all foreign currency accounts, whichever bigger.

A structural position of 60% of shareholders' equity is authorized to hedge the capital denominated in LBP against fluctuations in the exchange rate.

8. Accounting practices are in conformity with international standards IAS. It is worth to clarify in this respect that in recent years banks in Lebanon have developed the accounting methods and systems so that transparency and good governance became more integrated into the banking culture and the rules of international accounting and auditing became more practical and executable. It should be mentioned also that

financial disclosure in Lebanon is considered good as certified by international organizations and is in harmony with the best international practices, thus reflecting the openness of banks to public and market control over their activities.

9. Banks are requested to establish internal audit and control units in accordance with the Principles for the Assessment of Internal Control System issued by the Basle Committee on Banking Supervision.

Banking institutions must create an audit committee the role of which to assist the board of directors in fulfilling its supervisory role, review internal control regulations, and supervise internal audit activities (unit and auditors).

Banks must institute a documented mechanism to evaluate capital solvency and set up corporate governance criteria according to Basel II.

10. Banks are required to withhold from their annual profits at least 0.2% and at most 0.3% of total risk weighted assets and contra accounts, as general banking risk reserves. These reserves are an integral part of shareholders' equity and are not tax deductible.

Banks must also transfer 10% of their annual profits to a legal reserve before the distribution of dividends.

Corporate Governance

Banks in Lebanon are strongly committed to the principles of good corporate governance on the believe that their proper implementation would, among other things, enhance their domestic and international reputation, competitive position, and access to relatively low cost funds, and would also increase the confidence of clients and investors in the bank. As a matter of fact, Lebanese banks conducted recently a profound internal corporate governance review and as a result many of these banks completed while still a few in the process of completing their corporate governance enhancement program or plan.

As such a large number of Lebanese banks have now their own code of corporate governance or their own corporate governance guidelines which document along with other charters, codes and terms of references the corporate governance framework or structure tailored to the evolving management needs of the bank and to the desire or expectations of depositors, investors, regulators, international banking community and others. Such guidelines, aiming at ensuring the best possible practice of corporate governance, taking into account the Lebanese market and bank specific peculiarities, comply with domestic laws and regulations and are largely inspired by and adhere to the Basel recommendations on corporate governance and OECD corporate governance principles.

Accordingly, Lebanese banks started a few years ago the gradual implementation of the governance code and guidelines particularly in relation to the board composition and the establishment and the use of board committees. Many institutions refreshed the Board's composition with new executive directors and non executive appointments with a deep banking and finance experience. Numerous Lebanese banking institutions have created as well their separate board committees namely: the Audit Committee, the Risk Management Committee, the Corporate Governance Committee, and Nomination and Remuneration Committee to enable the board exercise its duties and perform its role more effectively. Domestic banks have also enhanced the linkages between the board and its committees by establishing clear lines of responsibility and accountability and made larger space for deeper and broader discussions on key strategic issues of opportunities and risks.

Important to mention in this respect that the Association of Banks in Lebanon issued recently its Corporate Governance Guidelines for banks operating in Lebanon intended to assist banking institutions in developing and enhancing their corporate governance frameworks based on best international practices and adapted to the particular traditional characteristics of the Lebanese banking sector. The guidelines were also largely built on the finding and recommendations of a report entitled "Lebanese Banking Sector: Corporate Governance Survey" commissioned and edited by the Association of Banks in Lebanon and International Finance Corporation (IFC) and prepared by Ernst &Young in 2006 after a thorough review of the legal and regulatory framework pertaining to the corporate governance of banks in Lebanon. The ABL corporate governance guidelines involve chapters on: Core responsibilities of the board- Qualifications, independence and composition of the board- Board's own practices , structure, committees and conflicts of interest- Corporate governance in a group structure -Senior management- Risk management function- Risk management methodologies and activities- Risk management communication and reporting- Utilizing the work conducted by internal/external auditors and internal control functions- Compensation- Compensation alignment with risk taking- Know and understand your structure - Disclosure and transparency.

Risk Management

The Lebanese banking sector enjoys a strong risk governance structure and highly skilled and experienced risk personnel for the identification, management and control of risk. All banks have a clear board approved statement or expression of the level of risk they are ready to assume (better known by the risk appetite) as part of the strategic plans and policies and operate under carefully defined risk parameters. The Board not only defines the risk appetite but also approves policies and procedures related to all types of risks to which the bank is exposed to. A number of committees and departments/units are responsible for day to day risk management and for supporting the board risk management duties through devising the appropriate risk strategies, policies, procedures and limits. The proactive approach to risk management has always enabled the sector to face successfully internal and external shocks and crises and mitigate their impact on banks' performance, while risk policies and processes in place secure the optimal balance of risk and return. Large banks also conduct regular stress tests to ensure that the bank operates within the specified risk restrictions.

Regarding credit risk management particularly, both credit risk appetite and strategies are usually laid down by the board and then communicated to senior management to devise the appropriate and in line credit policies and procedures, which are subject to periodic review. Credit risk is controlled by setting credit limits per individual counterparty, group of obligors, economic sector and country and by monitoring exposures in relation to such defined limits. Most banks have well established loan origination, assessment, documentation, monitoring, recovery and renegotiation processes.

Lebanese banking institutions use a conservative provisioning policy and all unfavourably classified accounts and loan loss provisions are reviewed and revaluated on a quarterly basis. The required amount and type of collateral is a function of the creditworthiness of the counterparty and the market value of the collateral is closely monitored so that banks may accordingly request additional collateral.

It is important to mention in this respect that banks in Lebanon have diversified portfolios where no individual economic activity or market accounts for more than 36 per cent of loans and advances to customers and have very low to no exposure at all to asset backed securities and to sovereigns and banks in the peripheral Europe. Retail and wholesale banking loans and advances are secured with historically proven sound types of collateral and guarantees. The quality of the loan portfolios has been constantly improving over the last few years as it has been highlighted earlier.

Banks in Lebanon also identify, measure, report and monitor all potential and actual market risks to which they are exposed (exchange rate risk, interest rate risk,...). Policies are set and limits monitored in order to ensure the avoidance of large, unexpected losses, and the consequent impact on the safety and soundness of the institution. Stress scenarios now include the various manifestations of the market related risks, such as increased volatilities and correlations and widening of spreads.

Concerning the exchange rate risk, it is worth reminding that the central bank of Lebanon allows a bank to maintain a currency exchange position, receivable or payable, that does not exceed at any time 1% of total net equity on condition that the global currency exchange position does not exceed 40 percent of this total net equity. In addition to regulatory limits, the bank's Board usually sets its own limits on positions by currency. These positions are monitored constantly to ensure they are maintained within established boundaries. Given the well established and strong peg, the bank in Lebanon is subject to currency risk on financial assets and liabilities that are listed in currencies other than the Lebanese pound.

Exposures to interest rate risk and positions are monitored on a daily basis by management and whenever possible, hedging strategies are used to ensure positions are maintained within established limits. The risks related to rising interest rates are under control with regards to banks' loans to the private sector, since they are, in a large part, current. Therefore, interest rates applied on these loans are periodically reviewed much in line with the period of revision of interest rates applied to deposits.

Finally regarding liquidity risk, the Lebanese banking sector enjoys historically high levels of liquidity, whether in the domestic or foreign currencies, allowing it to keep the liquidity risk under control. Maintaining a high minimum level of liquidity in LBP and particularly in foreign currencies is a strategy adopted by banks many years or even decades ago, in order to boost and safeguard confidence in the banking sector, on the 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 shocks and crises; most recently the global financial crisis, and in strengthening confidence in the sector and contributing to the monetary stability. At the end of 2010, the ratio of overall liquidity in LBP and foreign currencies reached around 60 percent of total deposits and other liabilities. Lebanon is also considered to be in an advanced and comfortable situation in meeting Basel III liquidity requirements.

Combating Money Laundering

Lebanon has long ago (more than sixteen years back) taken bold organizational, supervisory and legislative initiatives and concrete measures for fighting money laundering and combating the financing of terrorism. This stemmed from the rising awareness of the threats of money laundering and terrorism financing to the survival of the individual banking institution and the stability of the banking sector as a whole manifested by the potential financial loss and outflow and reputation damage that could result from using the banks as a channel for facilitating such illegal activities.

Even before the enactment of Law 318 by the Lebanese Parliament on April 20, 2001 - incriminating money laundering activities and permitting the efficient combating of such operations and the cooperation with the international community on this issue - Lebanese banks have worked hard to fight money laundering activities through their institutions by putting a lot of efforts in training their employees and introducing tight internal procedures as well as in coordinating with concerned governmental agencies. Banks in Lebanon elaborated and signed in 1997 a Due Diligence Convention: on the Commitment by Banks to Combat the Laundering of Illegal Drug-Trade Funds.

The law 318 was the fruit of the vigorous efforts undertaken by the Lebanese monetary and financial authorities, with the cooperation of the Association of Banks in Lebanon. It established the Special Investigation Committee (SIC), the Lebanese Financial Intelligence Unit (FIU). In addition to investigating suspicious cases of money laundering, the SIC's responsibilities includes also playing a transparent role among other financial Investigation units (FIU's) within the Egmont Group, strengthening cross border cooperation and information exchange. All banks operating in Lebanon are subject to a special audit by the SIC.

The serious and rapid implementation of this law on money laundering by the Lebanese Central Bank and banks, observed by a delegation of the Financial Action Task Force (FATF) during their visit to Lebanon in June 2002, permitted deleting the name of Lebanon from the list of non cooperating countries or territories (NCCTs) in the field of combating money laundering. In 2003, Lebanon was also removed from the FATF watch list after a team surveyed on the ground, how well the authorities and the banks were organized in term of management, supervision, reporting, policies and procedures and after making sure that banks abide by the FATF recommendations. An additional testimonial for the proper and legal operation of Lebanon's banking system is the non listing of Lebanon in the current FATF list of the 31 jurisdictions with deficiencies in anti money laundering and counter financing of terrorism (AML/CFT).

Recently, the Lebanese bank regulatory authority proposed amendments to anti money laundering Law 318 by adding the offense of terrorism financing to that of money laundering. Proposed amendments include also expanding the list of crimes that result in ill-gotten funds; considering the crime of money laundering as a separate offense that does not require conviction of suspect of the original offense, as well as the fact that a conviction of the original crime does not preclude pursuing the accused for money laundering crimes. Also the amendments would clarify in details the authority of the SIC as well as the procedures and measures it takes.

Earlier, the BDL has issued over a number of years circulars and set regulations and measures to fight money laundering and combat terrorism financing in accordance with current legislations and regulations that comply with the FATF 40+9 recommendations and the 25 criteria as well as with the Wolfsberg AML principles (trade finance principles).

As for operating banks, they have been constantly year after year strengthening the tools, including systems and procedures, for fighting money laundering operations, backed by adequate internal organization and training of employees. This is reflected in creating at each bank a special department for this task known as AML compliance unit and in abiding by both the circulars issued by the Central bank and the Special Investigation Commission in this regard, and by the Standards of "Know Your Customer (KYC)" to prevent the Lebanese banking sector from being used for illegal or criminal operations. The KYC procedures have been improved over the years and now all customers' names are screened against databases provided by worldwide reputable specialized firms and against local watch-lists provided by the Special Investigation Commission. Customers are required to identify the "source of their funds". Transactions that are inconsistent with the normal line of their businesses and suspected for hiding illegal activities are disclosed and reported to the SIC. In addition, the staff of the banking sector is constantly undergoing intensive and continuous training sessions, seminars, workshops and forums covering fighting money laundering and terrorism financing. These training seminars are held by the Central Bank, the Association of banks in Lebanon, and the banks themselves.

It is noteworthy that BDL circulars define clearly the role of the Compliance/AML committee at banks, and the job descriptions and functions of the compliance department created within banks. The compliance department is the central reference point gathering information on suspicious clients and coordinating with the SIC, correspondent banks and legal authorities for that purpose. The Central Bank defined also the role of "Branches Compliance officers" as being the first barrier against Money launderers and terrorists.

Lately, the Central Bank of Lebanon issued a set of circulars about the operations of money dealers and foreign exchange bureaus in Lebanon in order to deter their usage for money laundering and terrorism financing, and to preserve the reputation of the Lebanese financial sector.

Last but not least, one should argue from an international perspective that despite the coercible tools at hand and strong legislation there could be loopholes and some very sophisticated ways for using one bank or another in the money laundering process. What is important is to not generalize unfairly isolated cases and accusations to other banks or to the system as a whole and to have a quick and firm reaction from the concerned authorities responsible for vigilantly tackling the issue and prosecuting criminals. Combating money laundering and the financing of terrorism requires international cooperation as no single country or entity can do this alone and no individual country or bank can pretend that it is perfectly immune.

Services and Products

Banks in Lebanon offer innovative diversified and modernized products and services to meet and satisfy the changing needs and preferences of their customers. Many domestic banks are in fact universal banks and provide an array of traditional and modern financial services to individuals and corporations, which fall under:

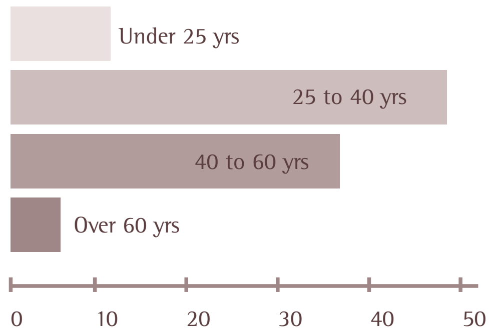
• Retail banking: including consumer credit such as mortgages, car loans, personal loans...and retail payment services (automated banking and cards services) plus electronic banking (telephone and internet).
• Corporate banking: involving corporate credit, corporate payment services and trade finance of different types and schemes.
• Investment services: underwriting, pension and mutual funds.
• Private banking, asset management, and consulting services.
• Insurance services and Islamic banking.

Human Resources

Banks in Lebanon employ close to 1.2% of the country's labor force. They attract highly qualified, skilled and experienced personnel. The employees of the Lebanese banking sector are best characterized as being young, with 59% of them less than 40 years old, and competent, with 88% of the total having formal training or a university degree. Women are well represented in the industry's work force whether in key or other positions with their share of the total amounting to 45%.

Lebanese banks have long ago focused on human resources development, particularly in the last two decades, by training and exposing employees to recent trends and developments in the global banking industry. The exposure and education is through (i) specialized seminars, workshops, and training courses abroad and domestically and within and outside the bank premises including those organized by the Association of Banks in Lebanon, and (ii) regular taught courses provided at the Center of Banking Studies for higher education in banking and financial markets.

The Banking Sector Work Force: Age Composition (2010)



Payment Systems

Commercial banks in Lebanon provide small and large value transfer services to their clients and to the economy as a whole. They currently dominate the national payment system in terms of operation and management. A range of choices is provided to users of payment services characterized by product differentiation in a highly competitive market. This competitive environment has led banks to develop a variety of competing systems especially in debit, credit, charge and branded cards.

Technology upgrading in the area of small and large value transfer systems enabled banks to improve cost efficiency and increase customers' satisfaction.

Banks in Lebanon are increasingly using SWIFT services to communicate and transfer funds locally and across borders and the International Bank Account Number standard (IBAN) in international incoming and outgoing money transfers. Direct debit payments are also becoming a relatively important method of making payments (public utility bills, taxes...), and the use of Automated Teller Machines is now widely spread in the country. Salaries of employees in the private and public sectors are increasingly becoming domiciliated.

There is also a growing use of electronic banking services, especially that Lebanese banks are investing heavily in new, secured and sophisticated information and communication technology. This investment would also permit banks to treat rapidly and efficiently a larger flow of documentation and information and to facilitate product and delivery channels developments.

In recent years, access to banking services has been expanding significantly through not only the branching out policy adopted by banks in Lebanon but also through the enlarged ATM network and the World Wide Web. As of June 2011, there exist around 2 bank branches and 3 ATMs per 10,000 inhabitants.

Financial Intermediation and Capitalization

Banks in Lebanon continue to play actively their traditional financial intermediary role of accepting deposits and making loans to customers, both individuals and corporations, in addition to providing the above mentioned range of products and services. The total consolidated balance sheet of banks (total assets) multiplied by 1.8 times in 4 years (June 2007 – June 2011), thus growing at an average annual rate of 15 percent over the mentioned period.

Lending Activity

At the end of June 2011, total claims to non- banks resident and non resident private sector and to the public sector were around USD 64.9 billion, of which USD 37.3 billion (89 percent of GDP) went to the private sector, while the remaining (USD 27.6 billion or the equivalent of 75 percent of GDP) were allocated to the public sector through subscription in Lebanese government Treasury bills and bonds. Lending activities to the private sector were mainly in foreign currencies in line with the overall economic dollarization prevailing in the country, with the dollarization rate in private sector lending reaching 79.3% at the end of June 2011.

Lending to the private sector is allocated sectorially as follows as of March 2011: 35.4% to the trade and services sector, 17.2% to the construction and contracting sector, 23.1% to individuals as consumer loans (including housing), 11.5% to the manufacturing sector and 12.8% to others.

Over the last few years bank regulatory and supervisory authorities and local banks made huge efforts to offer for the private sector, particularly to small and medium enterprises, medium and long term financing directed to the industry, agriculture, tourism and housing sectors. This was made possible through special financing schemes and protocols of which subsidized interest loans and through credit lines from international financial institutions such as the IFC, EBI and AFD, given the international credibility of Lebanese banks.

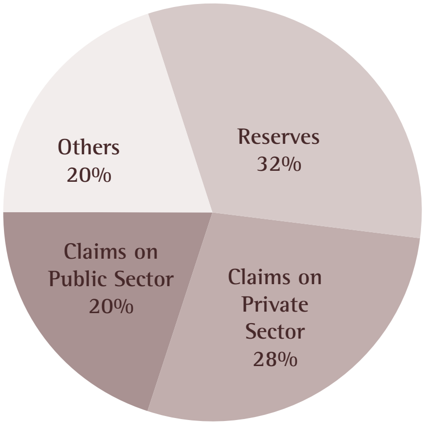
Funds Raising

Banks in Lebanon had a successful history of attracting a relatively large amount of deposits, when compared to the GDP, from both local and international sources. At the end of June 2011, deposit liabilities amounted to USD 113.1 billion (277 percent of GDP). At that date, dollarization in deposits of the private and public sectors stood at 65.8%.

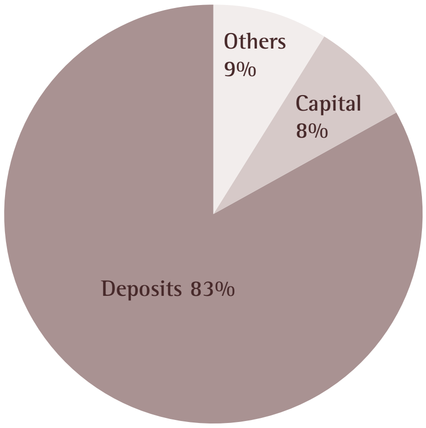
These deposits are actually listed as the fourth largest deposit base in the Arab world, following the UAE, Saudi Arabia, and Egypt. Knowing that the amount of deposits of the public sector in these three countries is large (between 12 and 24% of total deposits) when compared to Lebanon where it is marginal, not exceeding 1.5% of total deposits.

The before mentioned lines of credit from international financial institutions are stable long term sources of funds (7 to 12 years of maturity) and the Association of Banks in Lebanon has actively followed the formulation of these mechanisms of specialized financing. The commercial risk related to these lines of credit is borne by banks and their main objective is to provide banks in Lebanon with long term sources of funds given that the majority of bank debt liabilities is essentially placed in short term debt instruments. Such lines make international financial organizations extend credit and avoid the related management cost and the commercial risk of bank customers.

Composition of Banks' Uses of Funds
June 2011



Composition of Banks' Sources of Funds
June 2011



Capitalization

The capital accounts of banks reached USD 10.4 billion at the end of June 2011 and constituted 7.6 percent of total assets.

Banks in Lebanon aim, within the directions of the monetary and supervisory authorities, at enhancing their capital funds and their provisions, in parallel with the expansion of their assets by nature and volume particularly those weighted with high risk weights in line with Basel II Agreement, and for the purpose of increasing the confidence of depositors and investors in banks and the financing of the expansion abroad.

The capital base is expanded through the opening of banks' ownership to old and new shareholders by the means of issuing ordinary and preferred shares, as well as through retaining a considerable part of the profits.

Capital components other than the one included under shareholders' equity remain relatively minor and this in line with Basel III requirements on promoting the quality of the capital base through focusing on the concept of shareholders' equity within tier one and the marginalization of tier two.

Social Responsibility

Banks in Lebanon have a long tradition of corporate social responsibility and do recognize sincerely that they are both a part of and responsible to the society which they serve. Their social practices, initiatives and activities in the areas of education, culture, environment and others reflect this understanding and would result in generating new businesses and retaining old ones. Banks are very involved in their local community through financial sponsorship of cultural activities and social events. Most banks have a code of ethics that stresses customer satisfaction, confidentiality, fairness and integrity.

Commercial Banks in Lebanon

CONSOLIDATED BALANCE SHEET				
USD million, end of period	2008	2009	2010	Jun-11
ASSETS				
Reserves	25,946	35,539	40,567	43,491
Claims on R Private Sector	21,061	24,259	30,316	32,349
Claims on Public Sector	25,416	29,063	29,315	27,646
Foreign Assets (1)	19,127	23,680	25,727	28,356
Fixed Assets	2,451	2,509	2,778	3,326
Unclassified Assets	254	201	222	262
TOTAL ASSETS	94,255	115,250	128,925	135,430
LIABILITIES				
Deposits of R Private Sector	66,274	79,193	88,719	91,578
Deposits of Public Sector	883	1,055	1,398	1,647
Deposits of Non-Residents	11,506	16,573	18,485	19,904
Deposits of Non-Res. Banks	4,305	4,600	4,501	5,700
Bonds	62	95	273	424
Capital Base	7,101	7,945	9,221	10,354
Unclassified Liabilities	4,125	5,790	6,328	5,822
TOTAL LIABILITIES	94,255	115,250	128,925	135,430

Source: Banque Du Liban
(1) includes credits to non-residents

PERFORMANCE RATIOS

	2008	2009	2010	June 2011
Growth (%)				
Assets	14.6	22.3	11.9	5.0
Loans (res. and non res. private sector)	22.6	13.3	23.1	6.7
Deposits	15.6	23.1	12.2	4.2
Shareholders' Equity	14.5	11.0	15.7	14.1
Cost Efficiency				
Cost-To-Income (%)	53.1	51.6	47.2	n.a
Liquidity(1) (%)	32.2	29.6	32.6	33.4
Capital Adequacy (2) (%)	12.1	12.4	13.4	n.a
Capital / total assets	7.5	6.9	7.2	7.6
Profitability (%)				
Net Return on Average Equity	15.4	15.5	18.8	n.a.
Net Return on Average Asset	1.2	1.1	1.3	n.a.

Sources: Banque Du Liban - IMF
(1)Claims on private sector/deposits of private sector
(2) Based on Basel II risk weights.

KEY ECONOMIC INDICATORS

million USD	2008	2009	2010	Jan-June 2011
Overall Economy				
Nominal GDP	30,080	34,925	39,248	
Real GDP Growth	9.3%	8.5%	7.5%	
Inflation Rate	5.0%	1.2%	4.0%	
Dollarization (Deposits) (1)	68.8%	63.8%	62.4%	65.8%
BDL FX Reserves (1)	17,062	25,660	28,598	28,335
LBP/ US$ (1)	1507.5	1507.5	1507.5	1507.5
Public Finance				
Deficit/Expenditures	29.4%	26.0%	25.6%	15.4%
Gross Public Debt (1)	47,059	51,152	52,602	52,515
Net Public Debt (1)	41,536	44,173	45,028	45,584
Net Domestic Debt (1)	20,352	22,853	24,435	24,880
Foreign Debt (1)	21,184	21,320	20,593	20,704
External Sector				
Exports	3,478	3,484	4,253	2,117
Imports	16,137	16,242	17,964	9,228
Balance of Trade	-12,659	-12,763	-13,711	-7,111
Balance of Payments	3,462	7,899	3,325	-479

Sources; Ministry of Finance, Central Bank of Lebanon, Lebanese Customs Administration, Central Administration of Statistics, ABL Data Base.
(1) End of Period