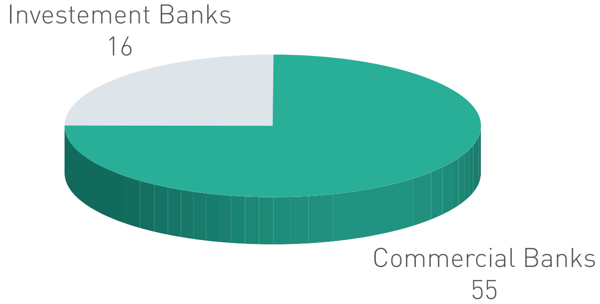
PART IV: THE LEBANESE BANKING SECTOR IN 2014

04

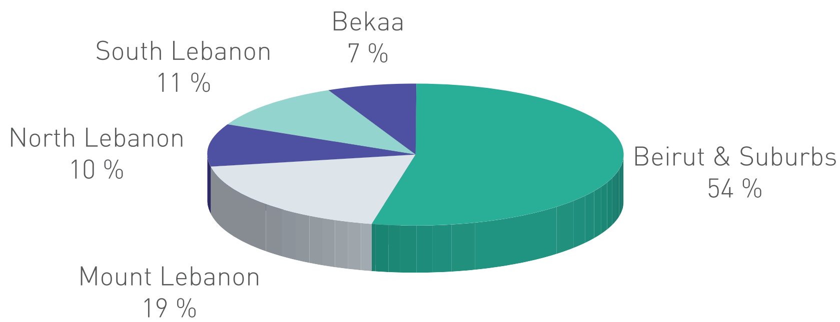
I- INTRODUCTION

1-1 At the end of 2014, the number of banks operating in Lebanon reached 71 distributed among 55 commercial banks and 16 investment banks. The number of branches of these banks attained 1,041 branches distributed over the Lebanese regions according to the relative geographic distribution of economic activities. Among the commercial banks were 5 Islamic banks and a small number of private banks with the rest classified as universal banks. Banks operating in Lebanon are distributed as follows: 8 branches for Arab commercial banks, 5 branches for foreign commercial banks, 47 Lebanese banks S.A.L. with majority Lebanese control, and 11 banks S.A.L. with majority Arab control (2 of them for investment) owning major shares in large and deep-rooted Lebanese banks with Lebanese management. It is possible to distribute Lebanese banks also among 41 groups: 32 groups for Lebanese banks with majority Lebanese control and 9 groups for Lebanese banks with majority Arab control. There exist as well 10 representative offices for foreign banks. Banks operating in Lebanon have correspondence relationships with 161 banks spread in 88 cities around the world facilitating financial transactions with other countries and vice -versa. In the framework of tight policies, Lebanese banks are subject to the rules and norms work of correspondent banks and are committed to what is issued by their authorities and countries. Banks communicate with their correspondents through recognized channels and visits of their top management directly to their counterparts in correspondent banks.

Lebanese Banking Sector Structure end 2014



Geographical Distribution of Commercial Banks Branches Operating in Lebanon end 2014

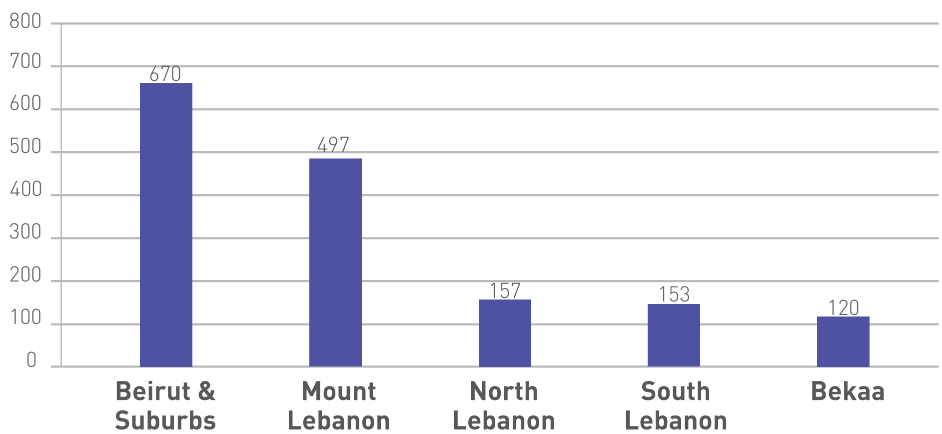


Source: BDL

1-2 Alongside that, there currently exist 17 Lebanese banks in 33 countries in the world: from the major markets in the Arab region (such as Egypt, Sudan, Algeria, Saudi Arabia, Emirates, Bahrain, Qatar, Oman, Syria, Jordan and Iraq), to regional markets with important economic weight (such as Turkey) all the way to Europe, America, Africa, Asia and Australia. This presence takes several legal forms distributed according to the latest data as such: 20 representative offices, 61 foreign branches, and 40 subsidiaries with more than 250 branches in their countries of location. The abroad branch network has become essential to Lebanese banks due to the narrow local market and its permanent exposure to various political and security pressures, as long as this expansion is carefully studied and subject to the follow-up of monetary and supervisory authorities in line with international standards. The banking foreign expansion represents an export of Lebanese services, contributes to restoring the balance of Lebanese external payments, and is associated with the strengthening of the human, capital and organizational resources of these banks.

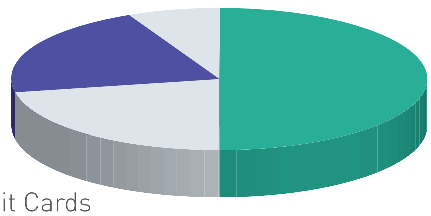
1-3 Along with the expansion of their branch network, banks in Lebanon continued in 2014 to develop their remote banking systems and means of payment or to conduct several banking services without communication with the bank branch employees. They have extended the use of ATMs and the functions that they can achieve from deposits, withdrawals, account statements and others, so that the number of ATMs machines placed at the service of customers amounted to 1,597 at the end of 2014. The total number of high security bank credit and debit cards in circulation reached around 2.4 million cards.

Geographical Distribution of ATMs in Lebanon end 2014



Source: BDL

Cards Distribution end 2014



Source: BDL

2014 also witnessed the issuance of more smart cards out of which many different credit cards representing the strong partnership among retail banking, the field of communication and commercial centers. Among the new cards is the launching of payments over the phone and hand watch which is the leading service in the Middle-East. Several banks also launched phone applications allowing bank customers to conduct highly-secured banking operations without bank recourse. This shows a transformation to a segment of universal banking and financial services and the strengthening of the competitive position.

1-4 Social responsibility has become more included in the bulk of the duties of banks operating in Lebanon. The latest in 2014 was the joining of many banks to the declaration of the United Nations that adopts a group of values in the areas of human rights, work standards, the environment, and the fight against corruption. This means merging the social responsibility in bank behavior and its operations and relationships as banks introduced products related to the environment and friendly to the environment, the health of the citizen and its safety. Commercial banks operating in Lebanon kept playing a pivotal role in the national economic growth through providing an important part of financing needs necessary to stimulate the economy. Thus, they lent private sector institutions needed and sufficient amounts and provided the necessary liquidity to personal consumption and to the public sector which raised a major part of its revenues from tax payments made by banks. Banks also ensured job opportunities for Lebanese youth and continued to raise the level of bank performance by improving the capabilities and credentials of their human resources. It is to mention that university graduates currently represent more than 74% of the workforce of the Lebanese banking sector.

1-5 In 2014, in the context of full involvement in globalization, banks committed as usual to the application of the international standards on combatting money laundering and terrorist financing. They also committed to the modifications introduced by the Special Investigation Commission (SIC) in Lebanon. The box below contains a summary on the most important activities of the SIC in 2014.

In 2014, the Audit and Investigation Unit worked on 183 suspicious transactions reports and 133 requests of assistance. The SIC made to this effect several decisions from information exchange with other peer investigation units, keeping certain bank accounts traceable, freezing others, and lifting banking secrecy off 13 cases that were forwarded to the General Prosecutor.
During 2014, risk based onsite compliance examinations covered 30 banks, 23 financial institutions, 14 insurance companies, 58 money dealers, 7 brokerage firms as well as a number of other reporting entities. External auditors' annual reports on AML/CFT procedures at 69 banks, 53 financial institutions, and 48 type "A" Money dealers were also received and assessed as part of the Unit's offsite work. The SIC received 277 cases out of which were 201 from local sources (30 cases were sent to the General Prosecutor or the concerned parties and 48 cases are under investigation), 76 from foreign sources (42 cases were sent to the General Prosecutor or the concerned parties and 25 are under investigation). The cases received were distributed among embezzlement of private funds (25.3%), forgery (12%), terrorism or TF (8.7%), embezzlement of public funds (4.1%), trade & narcotics (2.1%), organized crimes (0.8%), and not specified cases (47%).

1-6 In the area of combatting money laundering and terrorism financing, and the commitment of Lebanon to international standards, we mention the intensified efforts conducted during the previous years by the BDL and banks on the strict application of sanctions imposed by the USA, the European Union and the United Nations on some countries, individuals and institutions. It is to mention the efforts conducted by the ABL through the parliamentary committees to pass the related laws. We mention here the presence of important draft laws in the parliament concerning the amendment of combatting money laundering Law 318/2001 to include new financial crimes, the joining of the United Nations treaty on fighting terrorism, the declaration of cross-border cash transfer, and the exchange of tax information. It is hoped that these projects will be passed in the near future which will strengthen the abilities of Lebanon in the area of fighting money laundering and terrorism financing.

We also mention that in the framework of cooperation with international organizations, the possibilities of cooperation among the INTERPOL, "the INTERPOL institution for a safer world", and the Lebanese banking sector were presented in a working meeting held at the ABL in January 2014 in order to enhance the fight against organized crimes, especially financial ones such as money laundering and terrorism financing.

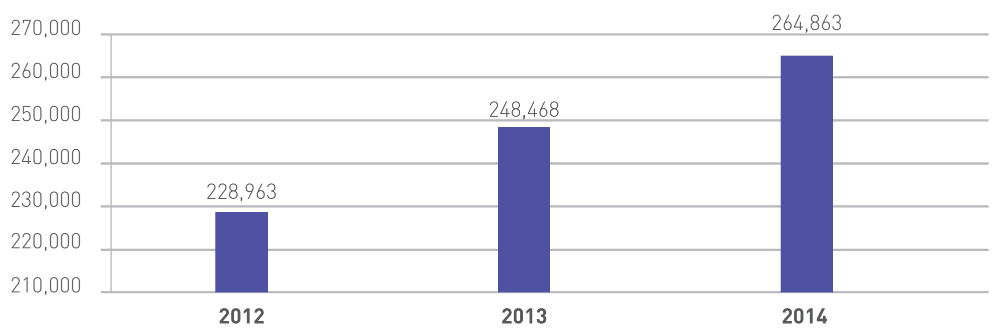
Finally, we mention that in 2014, Deloitte company prepared based at the request of the ABL the Sanctions and Embargos Program-Generic Policies and Procedures Manual after issuing in 2013 the Manual on "Policies and Measures" on the subjects of money laundering and terrorism financing and FATCA. Both manuals were prepared in close cooperation with the "Compliance and Anti Money Laundering" Committee at the ABL.

II- BANKING ACTIVITY

2-1 The Lebanese banking sector showed one more time in 2014 an acquired immunity in the face of the domestic and external challenges as well as a clear and certain ability to adapt to the most difficult and complex political, security and economic conditions. This sector remains one of the basic pillars of economic stability in the country knowing that it operates below its real potential and that it stores growth abilities exceeding by far the effective recorded growth rates. However, the results achieved by the sector in 2014 remain acceptable and good in light of the weak performance of the Lebanese economy and the events witnessed in the country from countrywide security disturbances, vacuum in the presidency, a large obstruction in the work of the executive and legislative authorities, in addition to the clouded regional environments negatively impacting various investment opportunities in Lebanon including financial ones.

2-2 At the end of 2014, the total assets of commercial banks operating in Lebanon reached around LBP 264,863 billion (the equivalent of USD 175.7 billion) compared to LBP 248,468 billion (USD 164.8 billion) end 2013. Hence, the total assets rose by 6.6 % in 2014 which is less than the increase of 8.5% in 2013.

Total Assets/Liabilities of Commercial Banks Operating in Lebanon
end of period- billion LBP



Source: BDL

The table below shows the evolution of liabilities items of commercial banks, in absolute value and relative importance of the total. The comparison between the end of 2013 and 2014 did not show a significant change except a slight increase in capital accounts from 8.6% of total balance-sheet at the end of 2013 to 9% at the end of 2014 and in non-resident financial sector deposits (from 3% to 3.3% respectively) against a decrease in the share of the resident private sector deposits (from 65.4% to 65%).

2-3 Total deposits remain the primary source for the activity of commercial banks operating in Lebanon representing 84% of total liabilities at the end of 2014 (84.5% at the end of 2013), which makes banks classified as part of what are internationally known as Deposit-rich Banks, or banks that rely largely and primarily on deposits to finance placements. In addition to deposits, banks include their own resources represented in capital accounts. Banks also try to increase their medium-term 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 %)

	2012		2013		2014	
	Value	%	Value	%	Value	%
Resident private sector deposits	152,124	66.4	162,396	65.4	172,041	65.0
Public sector deposits	4,008	1.8	4,463	1.8	4,842	1.8
Non-resident private sector deposits	36,311	15.9	42,934	17.3	45,680	17.2
Non-resident financial sector deposits	8,897	3.9	7,555	3.0	8,795	3.3
Capital accounts	19,058	8.3	21,410	8.6	23,719	9.0
Other liabilities	8,565	3.7	9,710	3.9	9,786	3.7
Total	**228,963**	**100.0**	**248,468**	**100.0**	**228,963**	**100.0**

Source: BDL

Deposits

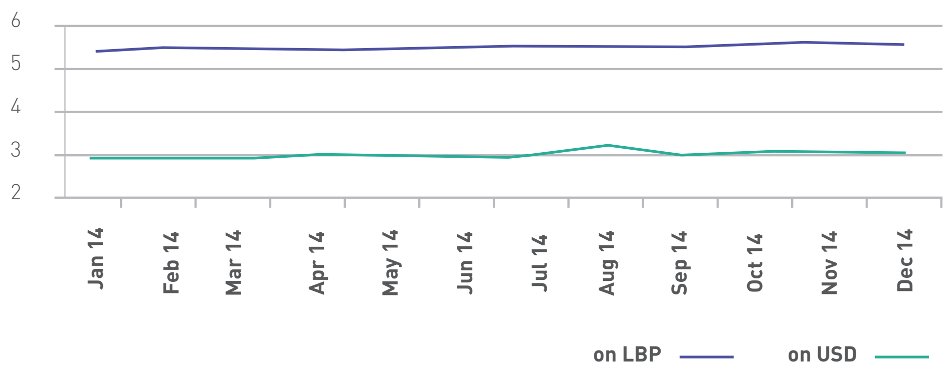
2-4 At the end of 2014, the total value of deposits, which includes deposits of resident and non-resident private sector and deposits of public sector, reached LBP 222,563 billion (the equivalent of USD 147.6 billion), compared to LBP 209,793 billion at the end of 2013, thus increasing by 6.1% in 2014 following a higher increase of 9% in 2013. The weak economic growth and the increase in the external account deficit caused a slowdown in deposit growth which remains, however, sufficient to cover the financial needs of the private and public sectors.

2-5 At the end of 2014, the share of the resident private sector reached 77.3% of total deposits, while the share of the non-resident private sector represented 20.5% and that of the public sector 2.2%. It is worth indicating that total deposits also include the portfolio of certificates of deposits issued by banks, which amounted to USD 529 million at the end of 2014. The majority of bank deposits are saving accounts (more than 80%) and short-term (less than 90 days). In another context, the share of deposits in LBP was 35.7% of total deposits while deposits in foreign currencies represented 64.3% at the end of 2014 (35.3% and 64.7% respectively at the end of 2013).

2-6 Bank deposits are concentrated in Beirut and its suburbs which attracted 69.3% of total deposits at the end of 2014, allocated to 48.5% of the total number of depositors, whereas 30.7% of the deposits belong to other regions and allocated to 51.5% of depositors, thus revealing a difference in the average deposit value between Beirut and its suburbs, and the other regions.

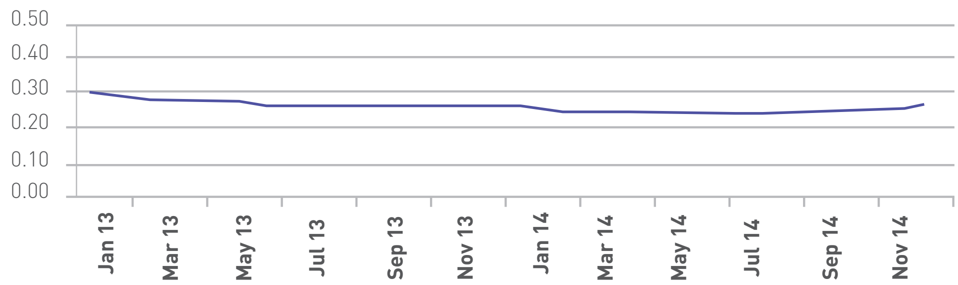
2-7 In parallel to the stability of interest rates on Treasury bills in 2014 as in the previous year, the average interest rates on new or renewed deposits in LBP and in USD slightly increased from 5.44% and 2.92% in 2013 to 5.52% and 3.03% in 2014 respectively, with slight monthly changes. It is to mention that international average interest rates remained at low levels as the US Federal Reserve kept a rate close to zero whereas the European Central Bank reduced its rates again in early June and also in September 2014. Interest rates on overnight deposits at the European Central Bank became negative and the main refinancing rate reached record low level. It is expected that the US average interest rates will increase effective the second half of 2015 or the beginning of 2016.

Deposit Interest Rates in Beirut Market (%)



Source: BDL

Libor 3 Month on USD (%)

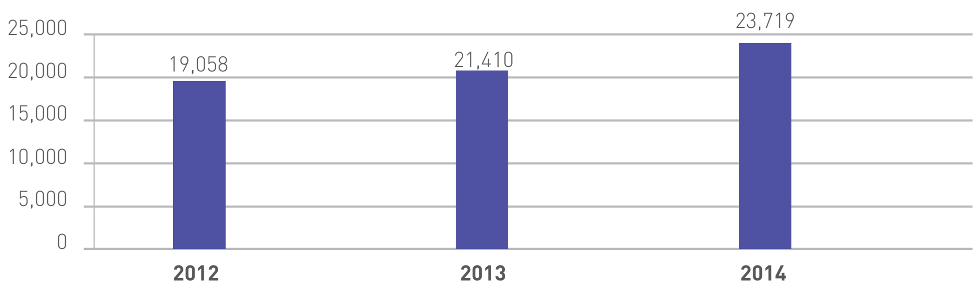


Source: BDL

Capital Accounts

2-8 At the end of 2014, capital accounts of commercial banks operating in Lebanon increased to LBP 23,719 billion (the equivalent of USD 15.7 billion) from LBP 21,410 billion at the end of 2013 i.e an 10.8% increase in 2014 compared to an 12.3% increase in 2013. At the end of 2014, capital accounts represented 9% of the consolidated balance sheets not weighted for risk (8.6% at the end of 2013) and 30.9% of total claims on private sector (30% at the end of 2013). These ratios are considered relatively good compared to counterpart banking sectors in numerous European advanced countries.

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



Source: BDL

2-9 Bank Capital is crucial to protect a bank from various risks and to increase confidence in its sustainability as well as the protection of bank customers, employees, shareholders, and the economy in general. Capital provides additional elements of strength and flexibility in implementing the internal and external expansion at the level of the diaspora and business. Enlarging the size of capital is a must for banks whose capital was 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 core capital and through opening bank capital accounts to new and existing shareholders. The second is from the retention of banks of most of their profits in their capital in order to enlarge it. This is supervised by the BDL and the Banking Control Commission (BCC).

2-10 The supplementary capital, which includes subordinated bonds and notes and some types of preferred shares, remains low compared to the core capital, as it represented 7.4% of capital accounts at the end of 2014 (8.4% at the end of 2013). 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 accord radically transformed the structure and the quality of capital accounts. The solvency ratio of the Lebanese banking sector exceeds 10% based on Basel 3 with an expectation that it will reach 12% at the end of 2015. The liquidity ratio exceeds 30% and the leverage ratio 10%. For the sake of comparison, the supervisory authorities in the USA adopt five categories to describe the level of capitalization of the US banking institutions. Well-capitalized includes institutions with capital to risk-weighted assets of no less than 10%, and core capital to risk weighted assets of no less than 6% and a leverage ratio or tier one capital to average total assets of no less than 5%.

Placements of the Banking Sector

2-11 Unlike the structure of liabilities, the structure of the uses of funds of commercial banks witnessed slight modifications at the end of 2014 in comparison to the end of 2013. The share of deposits at BDL continued to increase to 36.1% from 33.0% the total placements for the two dates respectively, and the share of loans to the resident private sector kept increasing to 25.8%. On the other hand, the share of loans to the public sector decreased to 21.3% at the end of 2014 after having increased in the previous year, and the share of foreign assets continued to decline to 13.8% on the same date.

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 2012 and 2014.

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

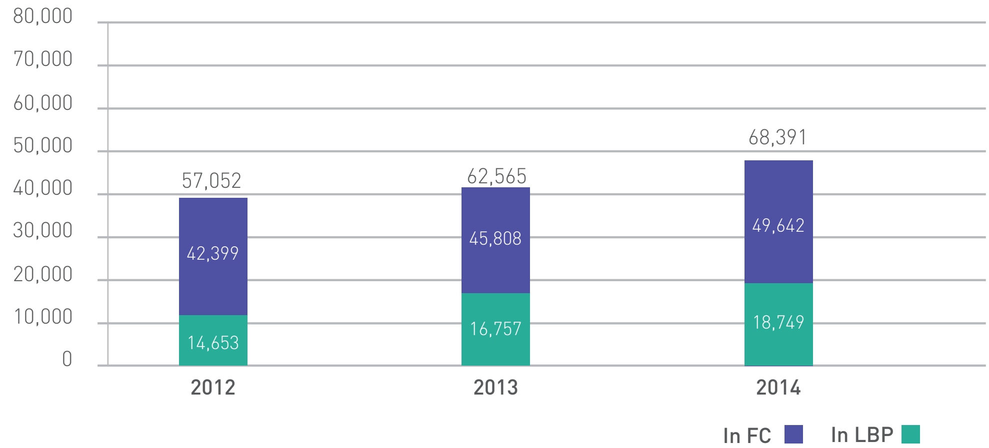
	2012		2013		2014	
	Value	%	Value	%	Value	%
Reserves	**79,604**	**34.8**	**82,533**	**33.2**	**96,314**	**36.4**
o/w : deposits with BDL	*79,179*	*34.6*	*81,957*	*33.0*	*95,707*	*36.1*
Claims on the resident private sector	57,052	24.9	62,565	25.2	68,391	25.8
Claims on the public sector	**46,930**	**20.5**	**56,786**	**22.8**	**56,308**	**21.3**
Foreign assets	**39,447**	**17.2**	**40,137**	**16.2**	**36,470**	**13.8**
o/w : claims on NR financial sector	*21,702*	*9.5*	*21,041*	*8.5*	*18,342*	*6.9*
claims on NR private sector	*8,452*	*3.7*	*8,862*	*3.6*	*8,339*	*3.1*
Fixed assets & Non-classified assets	5,930	2.6	6,447	2.6	7,380	2.8
Total	**228,963**	**100.0**	**248,468**	**100.0**	**264,863**	**100.0**

Source: BDL

Loans to the Private Sector

2-12 In 2014, bank loans to the resident and non-resident private sector continued to increase, reaching around USD 50.9 billion at the end of the mentioned year, against USD 47.4 billion at the end of 2013. However, its growth has slowed in the last 4 years reaching 7.4% in 2014 in comparison to 9.0% in 2013 while remaining good and acceptable in light of the weak economic growth in the country and the instability in the region. Furthermore, loans granted to the non-resident private sector, of which a large part is related to the financing of projects for Lebanese businesses abroad, particularly in Arab and African countries, represented 10.9% of the total loans granted to the private sector at the end of 2014 in comparison to 12.4% at the end of 2013.

Total Claims on Resident Private Sector
end of period- billion LBP



Source: BDL

2-13 Banks continued in 2014 to finance the resident and non-resident private sector, individuals and corporations, at an acceptable interest rate not exceeding 7% on average in LBP and foreign currencies and for periods relevant to the nature of the financed activities. Moreover, loans granted to the resident and non-resident private sectors represented the equivalent of 103% of the GDP at the end of 2014, hence a considerably high ratio compared to many emerging countries. This relatively high ratio in Lebanon could be explained, on one hand, by the enormous private demand, a large part of which is financed by bank loans to individuals and corporations for investment and particularly consumption. On the other hand, it resulted from the low capitalization of the corporate sector, its weak capacity for self-financing, and its excessive reliability on banks' financing, as financing through stocks and bonds markets is almost absent in Lebanon.

2-14 The ratio of loans in foreign currencies to deposits in foreign currencies slightly increased to reach 40.5% at the end of December 2014 from 40.3% at the end of December 2013. Loans in LBP to deposits in LBP continued to increase reaching 25.1% at the end of December 2014 in comparison to 24.1% at the end of December 2013. The ratio of loans to deposits remains low, given the high liquidity levels of the Lebanese banking sector and the large size of savings in comparison to the absorptive capacity of the domestic economy.

2-15 With the increase of loans in LBP by 11.9% in 2014 and 14.4% in 2013 at a faster rate than the increase of loans in USD, which reached 6.1% and 7.5% in the two respective years, the loan dollarization rate decreased to 75.6% at the end of December 2014, against 76.5% at the end of 2013. The decrease in loan dollarization rate during the last few years was the result of incentives provided by the BDL for specific loans in particular housing loans and ones granted to productive sectors for the financing of new projects or the expansion of existing projects. The loans also include loans granted to higher education, environmental friendly projects and agriculture.

2-16 The BDL's policy of stimulating the private sector relied in the last period on several different pillars. We first mention the stimulating package of liquidity at a low cost to banks as the BDL launched at the beginning of 2013 based on intermediate circular 313/2013 an incentive program for loans that included most of the economic sectors, particularly the housing sector. With the continuing weak foreign demand due to the prevailing situation, the BDL started providing a new stimulus to economic growth through incentives to domestic demand via bank loans, especially in LBP, and at acceptable interest rates. With this initiative, the BDL placed USD 1.4 billion at the disposal of banks with 1% interest rate, so that banks continue to grant loans to institutions and families through this new mechanism after the mechanism of required reserves was consumed, knowing that banks bear alone the credit risk. The BDL also specified the benefit structure of this mechanism to economic activities, in addition to a debit interest rate ceiling of 5%. Banks responded so well to the program that the BDL placed in early 2014 an additional amount of USD 800 million to be lent through this mechanism for further economic incentives and repeated the initiative allocating a sum of USD 1.0 billion for the year 2015. These initiatives target the sectors of housing, education, environment, alternative energy, entrepreneurship, Research and Development, and the new productive and investment projects. The second incentive program is represented by intermediate circular 331/2013 concerning the knowledge economy as this sector represents an engine for future growth. This circular allows banks and financial institutions to contribute within the limits of 3% of bank's capital to finance start-up projects, business incubators and accelerators whose business is centered on the knowledge economy. The BDL provides these projects with a guarantee of 75% which prevents banks from risking their own capital. The purpose of this circular is to activate the procedures of establishing new promising companies that in the future could turn into companies capable of enriching the national wealth and creating new jobs. Capitalizing through partnerships and participations are new functions allowing banks to support the intellectual competencies and professional inventions that fit into the framework of the knowledge economy. Banks have invested so far around USD 200 million in start-up companies and funds. The third pillar consists of extending from 7 to 10 years the maturity of subsidized loans to the productive sectors, including tourism based on circular 335/2013.

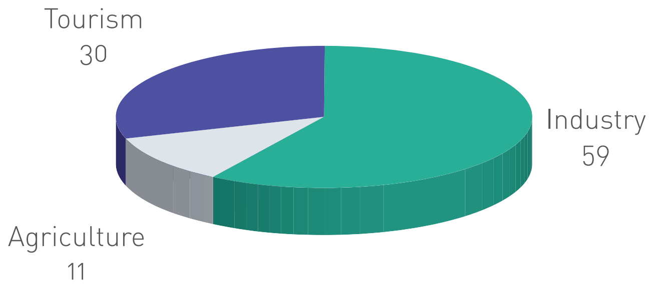
Subsidized Loans and Loans Benefiting from Deduction in Reserve Requirements (end of period – billion LBP)

	2012	2013	2014
1-Subsidized -interest medium & long term loans	5,334	5,946	6,786
2-Subsidized-interest loans guaranteed by Kafalat	1,575	1,748	1,916
3-Subsidized-interest loans under the protocol signed with the EIB	204	204	204
4-Subsidized-interest loans granted by leasing companies	170	179	192
5- Subsidized-interest loans granted by IFC	79	80	80
6- Subsidized-interest loans to finance working capital	16	16	16
7- Subsidized-interest loans granted by AFD	7	7	7
TOTAL Subsidized-interest loans (1+2+3+4+5+6+7)	**7,386**	**8,180**	**9,201**
Utilized loans benefiting from deductions in banks liabilities subject to reserve requirements	3,920	4,166	3,939
Utilized loans benefiting from deductions in reserve requirements	9,339	9,899	9,925

Source: BDL

2-17 Data reveal that loans in LBP benefiting from deductions in reserve requirements increased only by 0.3% to reach LBP 9,925 billion at the end of 2014, in comparison to an increase of 6% in 2013. This increase in the last few years mainly resulted from the increase in housing loans. Loans benefiting from deductions in banks' liabilities subject to required reserves decreased by 5.5% in 2014 reaching LBP 3,939 billion at the end of the mentioned year after increasing by 6.3% in 2013. Data also show that the total subsidized interest loans, granted between 1997 and 2014, reached LBP 9,201 billion (or the equivalent of USD 6.1 billion).These loans increased by 12.5% in 2014 after increasing by 10.8% in 2013. The share of the industrial sector out of these loans represented 58.7% at the end of December 2014, against 30.4% for the tourism sector and 10.9% for the agricultural sector. Four elements characterize these subsidized loans: the periods of the loan for 7 or 10 years, the grace period, the relatively low average interest rates, and facilities and exemptions based on the usage or reduction in required reserves.

Distribution of Subsidized Interest Loans on Economic Sectors end of 2014 - %



Source: BDL

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

2-19 The latest available data related to the nature of loans granted by the financial sector reveal that, as of end December 2014, a large part of these loans representing 72.3% consist of limited-term loans, while the remaining part or 27.7% is in the form of overdrafts. It is to note that overdrafts are usually granted to clients with high creditworthiness or to big clients where total loans are concentrated. Therefore, the share of these facilities from the total is in line with the distribution of loans by value and according to the beneficiaries. At the end of 2014, the share of advances against real estate guarantees reached 34.3%, in comparison to 18.3% for the advances against personal guarantees, 12.6% for the advances against cash collateral or bank guarantees, 4.8% for the advances against other material guarantees, and 2.3% for the advances against financial values.

2-20 The distribution of loans among the economic sectors corresponds roughly to the shares of these sectors in GDP, except for the agricultural sector that requires specialized financing schemes, as is the case in most of the developed and emerging countries. It is to mention that loans to the agricultural sector increased by more than 20% in 2013 and 2014 which is higher than the increase in total loans to all economic sectors that reached 8.5% in 2013 and 8.4% in 2014.

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

	December 2012		December 2013		December 2014	
	Value (billion LBP)	Share (%)	Value (billion LBP)	Share (%)	Value (billion LBP)	Share (%)
Trade & Services	25,414	34.6	27,501	34.5	29,373	34.0
Construction & building	12,267	16.7	13,840	17.4	14,471	16.7
Industry	8,439	11.5	9,007	11.3	9,320	10.8
Personal loans	19,368	26.3	22,207	27.8	24,911	28.8
o/w: housing loans	*10,957*	*14.9*	*12,866*	*16.1*	*14,893*	*17.2*
Financial intermediation	5,127	7.0	4,315	5.4	5,171	6.0
Agriculture	683	0.9	824	1.0	994	1.1
Other sectors	2,209	3.0	2,083	2.6	2,214	2.6
Total	**73,507**	**100.0**	**79,777**	**100.0**	**86,454**	**100.0**

Source: BDL

The statistics indicate a good increase of loans to all economic sectors between the end of the years 2012 and 2014. Loans remain concentrated in the trade and services sector, despite the continuous decrease of their share as percent of total loans that reached 34.0% at the end of 2014. The share of construction and contracting loans decreased to 16.7% of the total and the share of the industrial sector declined to 10.8% in line with the economic developments witnessed in the country lately, while the share of personal loans increased to 28.8% with the increase in the share of housing loans (included in this figure) to 17.2%. The share of financial intermediation increased to 6% and of agriculture to 1.2% whereas the share of other sectors remained stable at around 2.5%.

2-21 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 this region to 76.9% of total loans and 54.8% of the total number of beneficiaries at the end of 2014 compared to 78.0% and 55.7% respectively at the end of 2013. This concentration is in line with the concentration of economic activity, population, and income levels in the capital and its suburbs.

2-22 Concerning the distribution of loans by credit range, statistics show that loans whose values exceed LBP 1 billion, are distributed among 1.6% only of the beneficiaries (or 7,823 persons and institutions), out of the total number of beneficiaries of around 499,000. This low percent is in line with the situation of any economy in the world. Therefore, around 84% of the beneficiaries hold 10% of the value of loans, while 16% of the beneficiaries hold around 90% of the loan values.

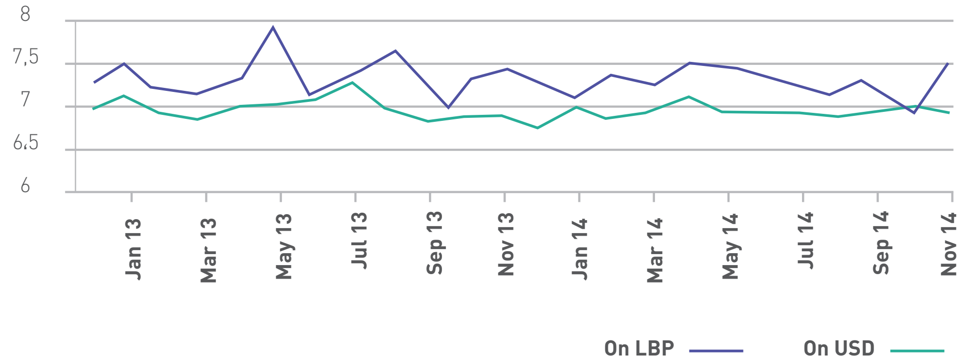
Distribution of Loans According to the Value and the Beneficiaries (in % – end of 2014)

	by value (%)	by beneficiaries (%)
Below 5 million LBP	0.11	9.31
5 – 25 million LBP	4.07	51.99
25 – 100 million LBP	6.16	22.85
100 – 500 million LBP	14.98	13.01
500 – 1,000 million LBP	5.05	1.28
1,000 – 5,000 million LBP	13.41	1.09
5,000 – 10,000 million LBP	9.36	0.23
10,000 million LBP and above	46.85	0.24
Total (Billion LBP and Number)	**86,454**	**499,445**

Source: BDL

2-23 Concerning the interest rates on new and renewed loans, the average lending rate on the USD remained stable in 2014 at 6.95% in comparison to 6.96% in 2013, whereas the average lending rate on the LBP slightly decreased to 7.27% in 2014 in comparison to 7.35% in 2013, with some limited upward and downward monthly fluctuations as appears in the figure below.

Evolution of Lending Interest Rates on Beirut's Market (%)



Source: BDL

Claims on the Public Sector

2-24 At the end of 2014, the claims of commercial banks on the public sector decreased to LBP 56,308 billion in comparison to LBP 56,786 billion at the end of 2013, registering a slight decrease of 0.8% in 2014 in comparison to a large increase of 21% in 2013. The slight decrease in 2014 comes as a result of the inability of the government to issue Eurobonds due to the non-parliamentary authorization to borrow and the relatively weak banks' appetite to subscribe to Treasury bills in LBP with maturity shorter than seven years due to the prevailing level of interest rates, so the banks focused on rolling-over maturing bills.

2-25 The commercial banks' portfolio of Treasury bills in LBP increased to 31,564 billion at the end of 2014 in comparison to LBP 30,114 billion at the end of 2013. The Ministry of Finance had issued in June and November 2014 long-term Treasury bills of 10 years category after having issued in 2013 Treasury Bills of 7, 8, 10, and 12 year categories. The banks' subscriptions concentrated on long-term bills due to their relatively high return and the availability of a good level of liquidity in LBP.

2-26 The banks' portfolio of Eurobonds, after their large increase in 2013, declined from USD 17,608 million at the end of the mentioned year to USD 16,311 million at the end of 2014. This decrease is largely due to the fact that maturing Eurobonds owned by banks have exceeded the new amount subscribed by banks in these bonds since the issuance of the Ministry of Finance of Eurobonds came relatively moderate in that year.

2-27 The share of the claims on the public sector in LBP out of total loans to the public sector increased to 56.3% at the end of 2014 in comparison to 53.3% at the end of 2013, while the share of claims in foreign currencies decreased to 43.7% from 46.7% for the two consecutive dates.

Foreign Assets

2-28 Deposits of commercial banks at correspondent banks continued to decline in 2014 to reach USD 12.2 billion at the end of the mentioned year against USD 14.0 billion at the end of 2013. Thus, these deposits declined significantly by 12.8% in 2014 after registering a lower decrease of 3% in 2013. These deposits declined as a percent of total deposits in foreign currency at banks from 15.5% at the end of 2013 to 12.8 % at the end of 2014. This is attributed especially to their very low return and the preference of banks to place them at the BDL, knowing that the BDL reinvests these deposits with foreign banks which mean that these deposits still carry the same levels of liquidity and risk while contributing to the support of the BDL's foreign currency reserves and, thus, monetary stability.

2-29 In addition to being a main source of liquidity in foreign currency, these deposits at correspondent banks remain a focal point in banks' financing of foreign activities and in the management of risks. Therefore, despite their weak return of less than 1% on average, banks always try, within the management of their resources, to ensure certain levels of liquidity in foreign currencies at correspondent banks which helps contain any negative developments.

2-30 Deposits of banks at correspondent banks, net of deposits of non-resident banks, decreased to around USD 6.3 billion at the end of 2014 against USD 8.9 billion at the end of 2013. In other terms, deposits at correspondent banks covered more than two times (2.1 times) the external liabilities towards the non-resident banks at the end of 2014 compared to 2.8 times at the end of 2013. It is to mention that non-resident banks that own creditor accounts in the banking sector are for the most subsidiaries of Lebanese banks.

2-31 Banks' other foreign assets decreased by 4.4% in 2014 in comparison to an increase of 10.1% in 2013, reaching USD 6,494 million at the end of 2014 in comparison to USD 6,789 million at the end of 2013. These assets mainly consist of direct investments in sister or affiliated banks and of investments in foreign bonds whose credit rating is at least BBB. These assets generate a high return compared to the deposits at non-resident banks and these foreign assets represent a desired diversification of foreign placements and thus a better distribution of risks.

Deposits at BDL

2-32 The deposits of commercial banks at the BDL continued to increase in 2014 at a fast pace registering LBP 95,707 billion at the end of the mentioned year in comparison to LBP 81,957 billion at the end of 2013. Thus, they would have increased by LBP 13,750 billion (USD 9.12 billion) or by 16.8% in 2014 in comparison to a lower increase of 3.5% in 2013. The large increase in these placements in 2014 was due to the excess sources of funds in banks that were not invested in the economy - with the slow-down of the private sector lending activities and the decline in credit to the public sector for the previously mentioned reasons-, and to the redistribution of portfolios especially deposits at correspondent banks, in addition to the required reserves in LBP and required deposits in foreign currencies. Bank deposits in foreign currency at the BDL increased substantially in 2014 contributing to the strengthening of monetary stability.

III- BANKS AND RISK MANAGEMENT

3-1 The banking profession is accompanied by banks exposure to several types of risks that are effectively managed. 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 concerned committees and 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 in Lebanon and in all the countries where banks operate. These regulations stipulate the application of specific standards peculiar to the Lebanese situation, in addition to the international standards after their adaptation to the Lebanese banking structure and its characteristics, and with a margin of flexibility in the application and progressiveness in implementation, as needed.

The BDL established in 2014 the "Financial Stability Unit" with one of its main functions being to observe the financial and banking situation, to look-up the possible risks and crisis and to prevent crisis occurrence. It also adopted in the same year additional precautionary measures aimed at a better management of banking risks especially loans to related parties and real estate loans. The measures also placed higher ceilings on retail loans, asked banks to form provisions and general reserves on these loans, when and even in the absence of indicators of payment delays. Banks were also asked to form general provisions on the interest generating loans portfolio other than retail ones (all of these measures are detailed in part two of this report). It is to mention that with the increase in regional risks and the beginning of turbulences in some countries in the region, the Banking Control Commission (BCC) started implementing stress testing[1] on the concerned banks.

1 The stress tests included the portfolios of loans, the fluctuation in exchange rates, the decline in collaterals values. The banks were requested to take collective provisions as a result of these tests.

Interest Rate Risk

3-2 There was no negative developments concerning interest rate risk in 2014, due to the quasi-stability of the interest rates on the LBP and USD. The risks related to interest rate fluctuations are under control regarding banks' loans to the private sector, as they are in a large part, current by nature. Therefore, interest rates applied on these loans are being periodically reviewed in line, to a large extent, with the period of revision of interest rates applied on deposits. However, the situation is not the same for loans granted to the public sector and for banks' holdings of CDs at the Central Bank, since their maturities are relatively longer with fixed rather than variable interest rates. The weighted life, for example, was around 3.3 years for the Treasury bills in LBP at the end of 2014 and close to 5.6 years for the Eurobonds outside Paris 2 and 3 meetings. 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 rate fluctuations, in addition to the fact that Treasury bills and CDs are marketable and relatively liquid, unlike the loans to the private sector. All these factors tend to limit these risks. While the risks associated with rising interest rates on the USD may exist in the future with the possibility of an interest rate raise by the US Federal Reserve, its impact on the cost of banks' sources of funds will remain limited, as interest rate adjustments and increases will gradually take place over many years so that this policy does not negatively affect the already weak growth rates in the USA.

Exchange Rate Risk

3-3 In 2014, 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 of the USD/LBP and the availability of sufficent means for that. The BDL's foreign currency reserves reached record levels standing at USD 32,403 million at the end of 2014 which covers 19 months of imports and is equivalent to 67% of the monetary aggregates in LBP. Exchange rate risk remained also low in terms of the structure of exchange positions in banks' balance-sheets. For the record, banks are strictly not authorized to take operational exchange positions (debit or credit), that exceed 1% of the Tier One capital. Moreover, they are only authorized to keep structural exchange positions to hedge the capital that constitute no more than 60% of the Tier One capital.

Credit Risk

3-4 The credit risks inside the Lebanese economy remained in general and, to a large extent, under control despite the deceleration of the economic growth in the last few years. The ratio of doubtful debts/net total loans increased slightly to 3.6% at the end of 2014 against 3.4% at the end of 2013, and the provisions on doubtful debts decreased to 71% against 75% at the end of the two mentioned years respectively. It is to mention that the ratio of doubtful debts/ net total loans reached 4.8% on average for the MENA region in 2014.

On the other hand, bank sovereign risk exposure increased in 2014, where the share of bank loans to the public sector and deposits at the BDL reached 57.4% of total assets at the end of 2014, against 55.8% at the end of 2013. It is worth indicating that a large part (around 49.3%) 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 sovereign rating of Lebanon did not witness a major decline in 2014 as Standard & Poor's and Fitch kept the rating of the Lebanese government securities unchanged while Moody's lowered the rating from B1 to B2 in December 2014 with "negative" outlook. It is to note that the Lebanese government has never defaulted on payments, while the Eurobonds are to a large extent held by resident responsible parties which lowers default risk.

3-5 It is to mention that banks largely control credit risk and always aim to improve the quality of loan portfolio and to take preventive measures. They possess significant increasing and updated database 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 form 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 pertaining to loans to one borrower and those granted to related parties- individuals and companies. Bank management also insists that large institutions and large borrowers provide audited balance sheets and adequate guarantees especially for loans with no guarantees which represent almost 28% 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 largely 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 confidence in the banking sector in general, and to maintain confidence by dealing quickly with any negative development which may suddenly occur. This strategy has proven its efficiency in overcoming many crises, strengthening confidence in the sector and contributing to maintain monetary stability. At the end of 2014, 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 57% of total deposits and other liabilities, which is the highest in the region, against over 56% at the end of 2013. Moreover, the ratio of primary liquidity in foreign currencies (deposits at BDL and banks abroad) reached around 47% of total deposits and other liabilities in these currencies, knowing that such a high level is necessary for good management of deposits in foreign currencies in a dollarized economy, and 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, the solvency ratio (Total Capital/Risk Weighted Assets) was around 14% at the end of June 2014, according to the Basel 2 standard. Furthermore, the banking sector always goes in pair with international measures and procedures which became stricter with the increase in the level of quality and transparency in the capital base and the enhancement of the level of risk coverage and the control of the excess borrowing, or the ratio of debt to bank sources of funds. 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% (total capital/total risk-weighted 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 Tier One capital, as was the case during the last few years.

Reputation Risk Resulting from the Non-Application of Applying Compliance Measures

3-9 The BDL, with the support of banks, took important measures to fight money laundering and terrorist financing, among them the issuance of the circular no 126/2012 on the relation of banks with the correspondents, and circular no. 128/2013 related to the establishment of the Compliance department in each bank. The BDL also issued in September 2014 intermediate circular no. 371 in which it asks banks, among other things, to appoint an AML/CFT Branch officer, a person in charge of controlling the financial and banking operations to fight money laundering and terrorist financing in each branch of the bank. The Special Investigation Commission issued in its turn four new circulars to banks in 2014.

3-10 Banks also deal in a responsible manner with the subject of combatting money laundering and terrorist financing and abide by the international sanctions imposed on individuals and institutions in several countries even sanctions issued by international authorities other than the United Nations -to which Lebanon surely abides- in order to protect the banking sector.

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, the banks themselves and other groups. These seminars cover 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.

3-11 In the same framework, and by a decision of the Committee for Compliance and Fighting Money Laundering in the Association of Banks, several "Compliance General Meetings" were held in 2013 and 2014 for the directors of compliance departments in the banks operating in Lebanon to discuss subjects of combatting money laundering, FATCA, the relationship with correspondent banks, and other topics.

The ABL and Lebanese banks continued their moves and international relations and communication in 2014 aimed especially at the USA and a number of European countries with major importance to the banking sector. Meetings were held with high level public officials and bankers to improve the reputation of the Lebanese banking sector and its image abroad and to preserve and strengthen the relationship with correspondent banks for the benefit of the customers, the banking sector and the Lebanese economy.

IV- BANKING SECTOR PERFORMANCE

4-1 In 2014, net profits of banks operating in Lebanon (Lebanon's branches) increased by 2.6% following a 4.9% increase in 2013, given the difficult internal work environment and conditions. Net profits reached LBP 2,536 billion (the equivalent of USD 1,682 million) in 2014 compared to LBP 2,471 billion (the equivalent of USD 1,639 million) in 2013.

4-2 Given that bank profits growth in 2014 was lower than the growth in bank total assets (6.6%) and core capital (12%), the return on average shareholders' equity (ROAE) decreased to 11.32% in 2014 from 12.23% in 2013, and the return on average assets (ROAA) also decreased to 0.97% from 1.01% respectively. The decline in each ROAA and the equity multiplier (total assets over total capital) between 2013 and 2014 from 12.11% to 11.73% caused the decline in ROAE.

4-3 The decline in ROAA, indicating a decrease in the effectiveness of transforming the sources of funds into net profits, was due to the decrease in the profit margin (net profit to total operating revenue) from 16.73% to 15.54% which reflects the reduction in the ability to control cost and possibly the inappropriate policies of pricing banking services and products. It is also possible to explain the decrease in ROAA from another perspective due to the decline in the net interest margin (interest revenues minus interest expenses) over total assets from 1.75% to 1.71% reflecting the decline in the effectiveness of managing interest cost.

The decline in the equity multiplier is the result of the greater reliance of banks on capital in increasing assets and less in liabilities other than shareholders such as debt instruments like deposits and others. This shows one more time the inverse relationship between solvency and profitability.

4-4 The ROAE and the ROAA for banks in Lebanon are comparable to the world averages but lower than the ones in Arab and emerging countries. For the sake of comparison, the ROAE stood at 12.7% and the ROAA at 1.6% for the first 150 Arab banks based on the latest available information.

4-5 The cost to income ratio significantly increased from 52.5% in 2013 to 57.9% in 2014. Despite the increase in net interest received by 11%, which was helped by the decline in net provisions on doubtful loans, the increase of the cost that includes total staff expenses, administrative and general expenses, and other general operating expenses, by 27.2% was higher. It is worth mentioning that net provisions against doubtful loans were revised and reduced in 2013 with some of these provisions being released in 2014 after banks constituted excess provisions in the past due to the economic and domestic situations and the risks that have affected the customers in neighboring countries.

Profit & Loss Accounts of the Banking Sector (LBP billion)

	2013	2014
1- Interest received	12,711	13,733
2- Interest paid	8,422	9,244
3- Interest margin (1)-(2)	**4,289**	**4,489**
4- Net provisions	166	-86
5- Net interest received (3)-(4)	**4,123**	**4,575**
6-Net commissions & other income	2,061	2,554
7-Net financial income (5)+(6)	**6,184**	**7,129**
8-Operating & General expenses	3,245	4,129
9-Profits before tax (7)-(8)	2,939	3,000
10- Extraordinary net income	-4	30
11- Tax on profits	464	494
12-Net profits (9)+(10) – (11)	**2,471**	**2,536**

Source: BDL

4-6 The table below details the evolution of revenues between the years 2013 and 2014. Total revenues increased from LBP 14,768 billion to LBP 16,317 billion respectively, registering an increase of LBP 1,549 billion and 10.5% (5.4% in 2013). This resulted from the increase of in interest received 8% (6.6% in 2013) and in other revenues and net commissions received by 25.6% (in comparison to its decline by 1.1% in 2013). The increase in interest received is tied to the loans to the private sector, and the investment in sovereign financial instruments- such as Treasury bills and CDs in domestic currency and the US dollar- and non-sovereign financial instruments, knowing that interest rates in Beirut market were stable in general and the international interest rates remained at very low levels. The increase in net commissions went in-line with off-balance sheet activities and other banking services generating commissions. Thus, the share of interest received out of total income decreased from 86.1% in 2013 to 84.2% in 2014, while the share of commissions and other revenues increased from 13.9% to 15.18% for the same two years.

The more important comparison could be the decrease in net interest received out of the net financial income, from 66.7% in 2013 to 64.2% in 2014, and subsequently the increase in net commissions and other net income from 33.3% to 35.8% 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 banking, retail operations, capital market services, consultancy services, trade finance 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)

	2013	2014	Change (%) 2014-2013
Interest received	12,711	13,733	+8.0
Net commissions received and other Income received	2,057	2,584	+25.6
Total income	14,768	16,317	+10.5

Source: BDL

4-7 The Table below details the evolution and the distribution of expenses during 2013 and 2014. Total expenses increased from LBP 12,297 billion to LBP 13,781 billion, thus increasing by LBP 1,484 billion and 12.1% (+5.6% in 2013).

Expenses Distribution (LBP billion)

	2013	2014	Change (%) 2014-2013
Interest paid	8,422	9,244	+9.8
Net provisions	166	-86	-
Administrative expenses	3,245	4,129	+27.2
o/w staff expenses	*1,750*	*1,910*	*+9.1*
Tax on Profit	464	494	+6.5
Total expenses	**12,297**	**13,781**	**+12.1**

Source: BDL

Expenses paid increased by 9.8% in 2014 in comparison to 6.9% in 2013 thus surpassing the growth in interest received. This is due to the increase in deposits by around 6% with a slight increase in the average deposit rates, in addition to low levels of paid interest on non-resident financial sector.
In 2014, banks released parts of net provisions on loans and facilities (LBP 86 billion) after reducing them in 2013, knowing that constituting provisions aim at hedging risk as previously mentioned.

Furthermore, other administrative and operating expenses increased by 27.2% in 2014 (a 6.5% increase in 2013). This increase partly resulted from the increase in staff expenses (9.1% in 2014 compared to 4.9% in 2013) related particularly to the increase in the number of employees in the sector (+714 persons in 2014), 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 that banks bear for development and improvement to keep pace with world banking standards increased substantially by 48.4% in 2014 in comparison with 8.4% in 2013. Tax on profit increased by 6.5% in 2014 (3.6% in 2013), reaching LBP 494 billion against LBP 464 billion in 2013 and representing 16.5% of net profit before tax.