

BANQUE DU LIBAN

Basic Circular No 94 addressed to Banks

Attached is a copy of Basic Decision No 8828 of 26 August 2004, relating to the Functioning of Islamic Banks in Lebanon.

Beirut, 26 August 2004

The Governor of Banque du Liban

Riad Toufic Salamé

Basic Decision No 8828

The Functioning of Islamic Banks in Lebanon

The Governor of Banque du Liban,

Pursuant to the Code of Money and Credit;

Pursuant to Law No 575 of 11 February 2004 (Establishment of Islamic Banks in Lebanon), particularly Articles 3 and 4 thereof; and

Pursuant to the Decision of the Central Council of Banque du Liban, taken in its meeting of August 25, 2004,

Decides the following:

Article 1¹:

Pursuant to the provisions of Paragraph 2, Article 3 of Law No 575 of 11 February 2004 relating to the Establishment of Islamic Banks in Lebanon, the rules below shall be adopted to establish contracts and determine the returns on deposit accounts that may be received by Islamic banks and that are linked to the bank's annual results or operations results:

First: Types of Deposit:

- 1- Current accounts and deposits received under the provisions of Paragraphs (1) and (2) of Article 307 of the Code of Trade, and respectively governed by applicable provisions and laws.
- 2- Deposits received under a Mudaraba contract.
- 3- Deposits received under a proxy contract.

Second: Establishing the Deposit Contract:

- 1- The contract of the deposit received pursuant to the provisions of Paragraph First (2) and (3) above, shall explicitly include, at least, the following elements:
 - a- The amount deposited at the concerned bank, the conditions of its use and its maturity date.
 - b- The profit share of each party, provided it is an undivided percentage and not a lump sum fixed in the Mudaraba contracts.
 - c- All expenses incurred by the capital owner (Rab al-Mal).
 - d- The possibility or impossibility for the depositor to withdraw the deposit before maturity, in whole or in part, and the conditions of such withdrawal.

¹- This Article was amended pursuant to Article 1 of Intermediate Decision No 12497 of 10 April 2017 (Intermediate Circular No 455).

- 2- The contract of the deposit received under the provisions of Paragraph First (2) above shall include, in addition to the stipulations of Paragraph Second (1), an explicit clause indicating that the percentage withheld to build up the Investment Risk Reserve and the Profit Equalization Reserve is a donation.

Third: Returns on Deposit Accounts:

- 1- Returns linked to the Bank's Annual Results:

Returns on deposit shall be linked to the bank's annual results when the Islamic bank is fully entitled by the deposit contract to invest the depositor's funds (current accounts or deposits received under the provisions of Paragraphs (1) and (2) of Article 307 of the Code of Trade).

- 2- Returns linked to Operations Results:

Returns on deposits received under the provisions of the Mudaraba contract or the proxy contract shall be linked to the results of pertaining operations.

Deposits received under the Mudaraba contract shall be recorded in the bank's balance sheet if the Islamic Bank has a significant influence in the investment of these funds. Deposits received under the proxy contract or Mudaraba contract shall be recorded off the bank's balance sheet if the Islamic bank does not have a significant influence in the investment of these funds.

- 3- Applying the Results Percentages:

The percentage due to depositors shall be applied at the end of the agreed financial period, periodically or annually, based on the book value (the balance recorded in the bank's books).

Article 2:

The value of the fixed assets intended for the Islamic bank's use shall not exceed 30% of the bank's net Tier 1 capital. Nor shall the percentage of the Islamic bank's investments in fixed assets, of which the above-mentioned percentage, exceed 50% of the total value of its investment portfolio.

Article 3:

The net Tier 1 capital of any Islamic bank shall at no time be less than 5% of the total value of its off-balance sheet investment portfolio.

Article 4¹:

- 1- The Islamic Bank shall build up, in addition to the reserves imposed on non-Islamic banks by laws and regulations, an Investment Risk Reserve against losses resulting from investment operations financed through customers' investment accounts under

¹- This Article was amended pursuant to Article 2 of Intermediate Decision No 12497 of 10 April 2017 (Intermediate Circular No 455).

Mudaraba contracts, by withholding annually at least 10% of the investment net profits after deducting the bank's share as a Mudarib, until the cumulative amounts reach 20% of the investment accounts.

The prior approval of the Banking Control Commission is required to compute the Investment Risk Reserve or a portion thereof, as part of the provisions to be built against losses. In other cases, the Banking Control Commission may object, under its prerogatives, to any use and disposal of the Investment Risk Reserve.

In case of the consensual liquidation of the Islamic Bank, the Investment Risk Reserve shall not be automatically considered as an entitlement for the Islamic Bank shareholders. The remaining balance of the account shall be disposed of by decision of the liquidator, with the approval of the Bank's Sharia Board.

The Islamic Bank shall invest the Investment Risk Reserve solely at Banque du Liban, and the returns thereof shall be added to the balance of that Reserve, after withholding the Islamic Bank's share from returns, with such share capping at 10%.

- 2- Islamic banks can build a Profit Equalization Reserve in order to improve returns on customers' investment accounts, whenever such returns fall below returns on similar operations in the banking market.

This Reserve shall be built up from operations' profits before withholding the bank's share as a Mudarib, until the cumulative amounts reach 5% of investment accounts.

In case of the consensual liquidation of the Islamic Bank, the Profit Equalization Reserve related to the customers' investment accounts shall not be automatically considered as an entitlement for the Islamic Bank shareholders. The balance of this reserve shall be disposed of by decision of the liquidator, with the approval of the Bank's Sharia Board.

The Profit Equalization Reserve relating to customers' investment accounts shall be solely invested at Banque du Liban. The returns on investment of the Profit Equalization Reserve shall be added to the balance of that Reserve after withholding the Islamic Bank's share from returns, with such share capping at 10%.

Article 5¹:

- I- Islamic banks are prohibited from undertaking real estate brokerage of all kinds, or from financing Mudaraba operations in real estate or the purchase of built or unbuilt properties intended to be resold.
- II- In carrying out financing operations, the Islamic bank shall comply with the additional obligations below:
 - 1- In cases requiring guarantees from the bank's customers, the volume of financing shall not exceed 60% of the guarantees in kind, as assessed by the bank's experts on their own responsibility.

¹- The last amendment to this Article was made pursuant to Article 1 of Intermediate Decision No 9959 of 21 July 2008 (Intermediate Circular No 178).

If the value of the guarantee decreases for any reason, the bank shall immediately ask the customer to provide additional guarantees in order to abide by the above-mentioned percentage.

This percentage shall exclude: financing operations secured with cash deposits or bank guarantees given as pledge or collateral, financing operations concerning the purchase of equipment, and financing operations relating to a consumer loan or to a first personal house loan.

- 2- The financing by the bank of all its subsidiaries shall cap at 30% of its Tier 1 capital, and at 10% for a single subsidiary.

Both percentages shall cover the financing of collective investment schemes established and/or managed by the concerned bank under any system.

Article 6:¹

Islamic banks shall obtain the prior approval of Banque du Liban for any kind of operation, mechanism, structure or product intended to create Islamic investments other than those regulated or expressly specified in BDL regulations.

Article 7:²

Unless otherwise provided for, Islamic banks shall be governed, in addition to the provisions of this Decision, by all the provisions and regulations governing non-Islamic banks.

Article 8:³

This Decision shall be published in the Official Gazette and shall be effective upon its issuance.

Beirut, 26 August 2004

The Governor of Banque du Liban

Riad Toufic Salamé

¹- This Article was added pursuant to Article 3 of Intermediate Decision 9898 of 6 May 2008 (Intermediate Circular 163).

²- The numbering of this Article was amended to become “7” instead of “6”, pursuant to Article 2 of Intermediate Decision 9898 of 6 May 2008 (Intermediate Circular 163).

³- The numbering of this Article was amended to become “8” instead of “7”, pursuant to Article 2 of Intermediate Decision 9898 of 6 May 2008 (Intermediate Circular 163).