

BANQUE DU LIBAN

Basic Circular No 108 to Banks

Attached is a copy of Basic Decision No 9641 of June 29, 2007 on regulating the relationship between banks and credit rating agencies.

Beirut, June 29, 2007

The Governor of the Banque du Liban

Riad Toufic Salamé

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BANQUE DU LIBAN

Basic Decision No. 9641

Regulating the Relationship between Banks and Credit Rating Agencies

The Governor of the Banque du Liban,

**Pursuant to the Code of Money and Credit, particularly Articles 70 and 174 thereof,
Pursuant to the Basle II International Agreement on Capital Adequacy,
Pursuant to Basic Decision No 9302 of April 1, 2006, on the implementation of the Basle II
International Agreement on Capital Adequacy, and
Pursuant to the Decision of the Central Council of the Banque du Liban taken in its meeting of
June 20, 2007,**

Decides the following:

Article 1:

For the purpose of implementing the provisions of this Decision, the following expressions shall mean:

Criteria: The criteria to be met by credit rating agencies, as specified in Annex 1 to this Decision, prepared on the basis of the Basle II Agreement.

Agency: The credit rating agency established in Lebanon or abroad.

Client: The big-size company or institution, referred to in the Basle II Credit Risk Standardized Approach (Claims on Corporates), which requests to be rated, or to obtain a rating for the guarantees and sureties it provides or for any financial instrument or product it issues.

Article 2:

Banks operating in Lebanon are prohibited from adopting the rating of an agency that does not comply with the attached criteria for measuring the client's credit risk weights.

Article 3:

Banks operating in Lebanon are prohibited from granting the agency with which they deal, or its senior managers, any kind of banking facility, whether directly or indirectly, or in a disguised manner through a third natural or moral person.

Article 4:

The client's relationship with the agency may be solicited or unsolicited (i.e. through the client's bank). In the latter case, the following documents must be obtained:

- A written approval from the client authorizing the agency to use the data and information held by the bank about the client's financial situation.
- A written commitment by the agency in which it undertakes not to misuse the information provided by the bank or the client.

Article 5:

The bank may ask more than one agency to rate a single client. In case of several ratings of a client on a specific date, the lowest shall be retained.

Article 6:

The rating of any client affiliated to a single economic group does not necessarily apply to the group as a whole, nor to any of its subsidiary companies or institutions, or to any of the guarantees or sureties it submits, or to any financial instrument or product it issues.

Article 7:

Through its control of banks, the Banking Control Commission shall monitor the agency's compliance with the criteria, and is entitled to accept or refuse the ratings of any agency.

Article 8:

The Banking Control Commission shall undertake the mapping of the rating categories adopted by the agency, in comparison with the Standard and Poor's rating category scale, adopted by the Basle International Committee, referred to in Annex 2, in order to ascertain their objectivity and the fact that their risk weightings reflect the client's real risks.

Article 9:

This Decision shall enter into force upon its issuance.

Article 10:

This Decision shall be published in the Official Gazette.

Beirut, June 29, 2007

The Governor of the Banque du Liban

Riad Toufic Salamé

ANNEX 1

Criteria to be met by credit rating agencies

The agency must satisfy the following criteria:

1- Objectivity

The credit rating approach must be sound, rigorous and verifiable.

In order to meet the objectivity criteria, the agency must fulfill, at least, the following conditions:

- Taking into account, in its rating process, of all the characteristics of the client's credit file.
- Giving a clear definition of the rating categories, and setting specific criteria to be adopted in rating clients within these categories.
- Adopting, in the rating of clients, the same criteria and procedures, based on comprehensive information collected through disclosures from clients, and/or market sources, and/or interviews with the client, and/or any other reliable source.
- Making sure that the adopted rating reflects all types of risks to which the client is exposed.
- Giving a definition of default that is in line with international standards and the local market, and subjecting its rating methods to quantitative back testing and modifying its rating accordingly.
- Adopting the same rating approach for each of the market sectors (banking sector, financial institutions sector, big-size firms sector, middle-size firms sector...), including back testing operations for one year at least.
- Making sure that all rating decisions are taken, within the agency, by a special committee called the Rating Committee.
- Constantly reviewing its criteria and procedures, and adjusting them to any external changes.
- Closely monitoring the client's situation after the publication of ratings, and modifying these ratings as needed.
- Adopting proper internal regulations that help in the credit rating process.

2- Independence

The agency must not seek any personal benefit from the client, whether directly or indirectly. It must also be independent and subjected to no political and/or economic pressures that might affect the rating.

In order to satisfy the independence criterion, the agency must fulfill the following conditions:

- Ownership: The agency's shareholders must not exert any pressure on the rating decision taken by the agency, and may not own any kind of stock or share subjected to the agency's rating.

- Good Governance: The agency must establish and implement high-quality standards for good governance, in order to preserve the independence and credibility of its ratings.
- Financing sources: The client must exert no pressure on any contract concluded with the agency or any fees paid to it.
- Additional services: The agency is forbidden to provide the client with other services of any kind, such as risk management or consulting.
- Agency's executives and staff: The agency's officers must comply with the following:
 - Have no direct kinship with the client (ascendants or descendants, including those of second degree).
 - Have with the client no investment relationship that is relatively important (stocks, bonds, shares, participation).
 - An employee, in case of previous work with the client, must have quit the job since one year at least.
 - Refuse all kinds of direct or indirect benefits, whether in kind or in cash, and all donations or gifts offered by the client.

3- Transparency and access to information:

In order to ascertain the agency's compliance with the transparency criteria and the accessibility of information to any third party:

- The agency's ratings must be accessible to any of their actual and potential users in the local and international markets.
- The general rating approaches regarding each of the sectors that the agency intends to deal with must be accessible to all actual and potential users of the ratings in the local and international markets.

4- Disclosure

The agency must provide the required information to all the parties with which it deals, in order to enable them to take a proper decision on the credit rating appropriateness. Therefore, the agency must disclose, at least, the following information:

- The type of contractual relationship between the client and the agency (direct or indirect).
- A definition of default and a determination of default effective rates for each of the rating categories.
- A determination of acceptable time limits for adopting the rating.
- A definition of rating categories.

- The rating methodologies and any significant modification thereto, with explanation of the reasons.
- The changes made in the agency's rating of the client.
- The date of the last follow-up and the date of the rating modification.
- The date on which the agency ceased to monitor the client's rating, with explanation of the reasons (such as the client's wish, the agency's wish, or any other reason).

5- Required Resources

The agency must have adequate resources for undertaking a sound and rigorous credit rating. These include:

- Human resources: the agency's officers must have a good reputation, a wide experience and a high-level competency.
- Technical resources: the agency must adopt specialized programs and systems that allow the input and analysis of information in a sound and reliable manner.

6- Credibility

The agency's credibility is assessed on the basis of the following:

- Scope of its compliance with the five aforementioned criteria.
- Scope of adoption of the agency's ratings by independent parties (investors, insurance companies, owners of commercial companies ...).
- Existence of internal procedures that prevent the misuse of confidential information

ANNEX 2

Standard and Poor's rating categories adopted by the Basle Committee for credit risk weighting, according to the Basle II standardized credit approach

Rating Category	Agency Interpretation
AAA	<p>§ Highest rating.</p> <p>§ Extremely strong capacity to meet financial commitments.</p>
AA + AA AA-	<p>§ Very strong capacity to meet financial commitments.</p>
A+ A A-	<p>§ Capacity to meet financial commitments still strong, while being more susceptible to adverse effects of changes in economic conditions and circumstances.</p>
BBB+ BBB BBB-	<p>§ Adequate protection parameters but adverse conditions are more likely to lead to a weakened capacity of the obligor to meet its financial commitment.</p>
BB+ BB BB-	<p>§ Faces major ongoing uncertainties.</p> <p>§ Exposure to adverse conditions could lead to the obligor's inadequate capacity to meet its financial commitment.</p>
B+ B B-	<p>§ More vulnerable than BB- rated but obligor still currently has the capacity to meet its financial commitment on the obligation.</p>
CCC+ CCC CCC-	<p>§ Vulnerable to non-payment and is dependent upon favorable business, financial and economic conditions for the obligor to meet its financial commitment on the obligation.</p>
CC	<p>§ Highly vulnerable to non-payment.</p>
C	<p>§ May be used to cover situations where a bankruptcy petition has been filed (or similar action taken) but payments on this obligation continue.</p>
D	<p>§ A non-prospective rating, unlike all the others</p> <p>§ It is only used where a default has already occurred</p>