مصرف لبنان
BANQUE DU LIBAN

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Basic Circular to Banks No 119

Attached is a copy of Basic Decision No 9957 of July 21, 2008, relating to the assessment of bank capital adequacy.

Beirut, July 21, 2008

The Governor of the Banque du Liban

Riad Toufic Salamé

BANQUE DU LIBAN

Decision No. 9957

Assessment of Bank Capital Adequacy

The Governor of the Banque du Liban,

Pursuant to the Code of Money and Credit, notably Articles 70 and 174 thereof;

Pursuant to Basic Decision No 9302 of April 1, 2006 and its amendments, on the implementation of Basle II capital adequacy accord; and

Pursuant to the Decision of the Central Council of the Banque du Liban, taken in its meeting of July 17, 2008,

Decides the following:

Article 1:

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

Capital: the own funds accepted for calculating the solvency ratio, in accordance with the regulatory texts issued by the Banque du Liban and the Banking Control Commission.

Pillar I: Pillar I, as specified in the Basle II Accord (Minimum Capital Requirements).

Pillar II: Pillar II, as specified in the Basle II Accord (Supervisory Review Process).

Article 2:

In addition to meeting Pillar I requirements, Executive Management of banks operating in Lebanon, as defined in the regulations issued by the Banque du Liban, must:

I- Establish a documented mechanism to assess capital adequacy, according to:

1- The nature and size of the bank, and the variety and sophistication of its banking operations and services.

2- The type and size of risks to which the bank is exposed.

3- The bank's future plans.

II- Carry out capital adequacy assessment according to the following:

1- Identifying, measuring, monitoring and controlling risks to which the bank is exposed, namely:

   a- Risks to be covered through Pillar I, i.e. credit risk, market risk and operational risk.

   b- Risks not totally covered through Pillar I:

      - Interest rate risk in the banking book.

      - Credit concentration risk, namely:

         - Concentration Risks concerning a single client or a single economic group.

         - Concentration risks concerning an economic sector or a specific geographical region.

         - Concentration risks on a specific type of guarantees or sureties.

   c- Liquidity risk.

   d- Other risks such as reputational risk, business risk, and strategic risk.

2- Identifying future capital requirements in the light of :

   a- The bank's future strategy (geographical expansion, service diversification, etc.)

   b- The results of the stress test that the bank is bound to carry out, in order to evaluate its current capital sensitivity and its capacity to face exceptional but likely events in the foreseeable future.

   These tests may include:

- A separate test for each of the factors affecting the risks to which the bank is exposed (sensitivity analysis), such as interest rate variations.

- A simultaneous test for more than one factor (scenario tests), such as a drop in interest rates associated with a huge liquidity shortage…).

- Any more comprehensive test that might be required from banks in the future.

3- Studying future risks and needs, as mentioned in paragraph II, subparagraphs 1 and 2, comparing them with the current level of the bank's capital, and setting up a working plan regarding necessary measures to be taken, when additional capital is needed.

4- Verifying periodically the bank's capital adequacy so as to keep the capital superior to the minimum required level, in anticipation of any possible risks or negative variations.

III- Require the Internal Audit Unit to verify compliance by the bank with the mechanism adopted for assessing capital adequacy, at least once a year, and submit relevant proposals to the Board of Directors.

Article 3:

The Board of Directors of each bank operating in Lebanon must:

1- Approve the capital adequacy assessment mechanism.

2- Review periodically the components of the assessment mechanism for ascertaining their efficiency and modify them as necessary, in light of changes in the bank's future plans, expansion projects and/or operational, legal or economic environment in which it works, since these changes may affect assumptions and methodologies involved in determining capital adequacy.

3- Include any new risk identified in the capital adequacy assessment process.

4- Ascertain the existence of efficient systems that help the bank avoiding losses in the future, such as a banking governance system, a risk management system, internal audit and control systems.

Article 4:

The Banking Control Commission shall periodically verify the bank's capital adequacy, by reviewing and evaluating the qualitative and quantitative components adopted by the bank in the capital adequacy assessment process, in accordance with the requirements specified in this Decision and with other regulations and implementation rules issued, or to be issued, by the

Banque du Liban and the Banking Control Commission. Following are some of the most important components:

1- Qualitative components: include reviewing and assessing the following systems:

   a- Banking governance system.

   b- Risk management system.

   c- Internal audit and control systems.

2- Quantitative elements: include the calculation of required capital level, in conformity with Pillar I and Pillar II requirements.

Article 5:

The Banking Control Commission may request the bank to increase its own funds, in case it finds weaknesses or deficiencies in the qualitative or quantitative components specified in Article 4 above. However, such an increase does not relieve the bank from the obligation to address these weaknesses.

Article 6:

This Decision shall be effective upon its issuance.

Article 7:

This Decision shall be published in the Official Gazette.

Beirut, July 21, 2008

The Governor of the Banque du Liban

Riad Toufic Salamé