BANQUE DU LIBAN

Basic Circular No 121 to Banks

Attached is a copy of Basic Decision No 10185 of June 26, 2009, on credit risk mitigation techniques.

Beirut, June 26, 2009

The Governor of the Banque du Liban

Riad Toufic Salamé

BANQUE DU LIBAN

Basic Decision No 10185

Credit Risk Mitigation Techniques

The Governor of the Banque du Liban,

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

Pursuant to Basic Decision No 9302 of April 1, 2006 and its amendments, relating to the implementation of the international Basel II Accord on capital adequacy, and

Pursuant to the Decision of the Central Council of the Banque du Liban, taken in its meeting of June 24, 2009,

Decides the following:

Article 1:

Banks that apply the standardized approach in credit risk calculation, as part of Pillar 1 of the Basel II Accord, are allowed to use the following credit risk mitigation techniques:

1- Eligible financial guarantees
2- Clearance operations in the balance sheet between assets and liabilities
3- Eligible guarantees provided by counterparties, and credit derivatives to be specified in detail by the Banking Control Commission.

Article 2:

Banks must hedge against risks that may arise from using one or more of the above-mentioned techniques, and set appropriate procedures and internal controls for managing such risks.

Article 3:

In case the adopted procedures are inappropriate for managing risks arising from the use of credit risk mitigation techniques, the Central Council is entitled, upon recommendation by the Banking Control Commission to the Governor of the Banque du Liban (BDL), to require an increase in the bank's equity capital for dealing with these risks and/or require the adoption of any further prudential procedure, as part of the Supervisory Review Process, subject of Pillar 2 in the Basel II Accord.

Article 4:

Credit protection is not considered eligible as a credit risk mitigation technique in case there is a positive correlation between the borrowing client's risk exposure and risks associated with the submitted credit protection (guarantee, warranty or credit derivative … for instance, when the borrowing company submits to the bank shares from its stock as a financial guarantee against its indebtedness).

Article 5:

A bank that applies the standardized approach in computing credit risks in the banking book may choose between two approaches for dealing with financial guarantees that are eligible for credit risk mitigation:

1- The simple approach
2- The comprehensive approach

As for credit risks resulting from assets classified in the trading book, the comprehensive approach is the only authorized approach.

Article 6:

In case of difference between the currency of the debt and that of the credit protection, the value of the protection shall be reduced by a fixed haircut of 8%.

Article 7:

A difference between the debt's residual maturity and that of the eligible financial guarantees is allowed only when the bank adopts the comprehensive approach in dealing with these guarantees.

Article 8:

Guarantees provided by Kafalat S.A.L. – guarantees of loans to small and medium-size enterprises- against loans granted in Lebanese pound, are considered eligible for use as credit risk mitigation technique. The loan portion covered by this type of guarantee shall be weighted by a twenty percent ratio.

Article 9:

Banks are allowed to continue using real estate guarantees for mitigating credit risks. This applies only to debts classified in the non-performing loan portfolio, as specified by the BDL regulations and for an interim period ending on December, 31, 2018[1]. The portion covered by the real estate guarantee shall be weighted by a 50% ratio, after this portion is determined, based on 50% of the market value of the received real estate guarantee (land, commercial or residential buildings) or on the total value of the guarantee, whichever is less.

Article 10:

Net non-performing loans fully covered by guarantees that are inconsistent with the Basel II Accord shall be weighted by a 100% ratio, following deduction of provisions that should not be inferior to 15% of the granted loan's total value.

Article 11:

The Banking Control Commission shall issue the application rules of this Decision, and shall ascertain that its provisions are appropriately implemented.

Article 12:

This Decision shall become effective upon its issuance.

Article 13:

This Decision shall be published in the Official Gazette.

Beirut, June 26, 2009

The Governor of the Banque du Liban

Riad Toufic Salamé

[1]- Pursuant to Article 1 of Intermediate Decision No 12277 of June 7, 2016 (Intermediate Circular No 426), the interim period shall end on December 31, 2018, instead of December 31, 2015.