BANQUE DU LIBAN

Basic Circular No 62

To Banks, Financial Institutions and External Auditors

Attached is a copy of Basic Decision No 7274 of April 15, 1999, on Dealing with Non-Resident Sectors[1].

Beirut, April 15, 1999

The Governor of Banque du Liban

Riad Toufic Salamé

Old numbering system: No 1719

[1] The title of this Decision was amended by Article 1 of Intermediate Decision No 8784 of July 14, 2004 (Intermediate Circular No 61).

BANQUE DU LIBAN

Basic Decision No 7274

Dealing with Non-Resident Sectors[1]

The Governor of Banque du Liban,

Pursuant to the Code of Money and Credit, notably the provisions of Articles 70, 76, 77, 79, 81 (Par. 6), and 174 thereof;

Pursuant to the Decision of the Central Council of Banque du Liban, taken in its meeting of April 14, 1999,

Decides the following:

Article 1:[2]

I- Banks and financial institutions domiciliated in Lebanon are prohibited, as far as each is concerned, from:

1- Receiving, from the non-resident financial sector (banks, financial institutions, exchange institutions, financial intermediation institutions, and insurance companies, whether foreign or Lebanese operating abroad), deposits in Lebanese pound, including fiduciary deposits, and from granting credits and opening credit and debit accounts in Lebanese pound for the said sector.

2- Accepting or financing any kind of debt originated outside Lebanon in any currency, except for:

a- Sovereign bonds issued by the G-10 countries.

b- Bonds rated "BBB" and above, issued by parties having an equivalent rating, provided their total value does not exceed 50% of the own funds of the concerned bank or financial institution, and provided this percentage is reduced by an amount equal to the sum of the nominal value of the operations performed on the structured financial instruments mentioned in Par. 3 and 4, and of foreign deposits of one year or more mentioned in Par. 5, Part I of this Article.

[1] The title of this Decision was amended by Article 1 of Intermediate Decision No 8784 of July 14, 2004 (Intermediate Circular No 61).
[2] The last amendment to this Article was made by Article 1 of Intermediate Decision No 10470 of July 9, 2010 (Intermediate Circular No 224).

In case these bonds are guaranteed, the guarantor must be rated “BBB” and above.

The concerned banks and financial institutions may obtain a prior approval from the BDL Central Council to exceed the above-mentioned 50% percentage. The Central Council’s approval is contingent upon the fulfillment of the following conditions:

- The concerned bank or financial institution must have a high solvency ratio.
- The concerned bank or financial institution must comply with Good Governance principles, with BDL regulatory Circulars, particularly the Circular on Corporate Governance and Basic Decision No 9286 of March 9, 2006 relating to the academic, technical and ethical qualifications required for performing certain functions in the banking and financial sectors, and also with the circulars issued by the Banking Control Commission.

c- Sovereign bonds issued by the host country in its local currency and in which Lebanese banks and financial institutions’ affiliates in this country (branches and affiliated banks and financial institutions abroad) invest, provided the total value of these investments does not exceed the value of deposits held by these affiliates in the local currency.

3- Executing for their own account, with non-resident sectors, operations on structured financial papers and instruments, denominated in any currency, except for those specified in Paragraph 4 of this Article or those:

a- Having an unconditional guarantee of the capital’s whole value.
b- Whose issuer or guarantor is rated “A” and above.
c- Whose total nominal value does not exceed the equivalent of 25% of the own funds of the concerned bank or financial institution.

4- Executing for their own account, with non-resident sectors, operations on credit linked notes (i.e. structured financial papers and instruments linked to foreign-currency denominated Lebanese Treasury bonds or foreign-currency denominated BDL certificates of deposit), except for those with conditions including:

a- An unconditional guarantee of the capital’s whole value, at least when there is no credit event, notably the non-repayment of these Treasury bonds and BDL certificates of deposit.
b- An “A” rating and above, for the issuer or the guarantor.
c- The obligation to reimburse in kind these Treasury bonds and BDL certificates of deposit, by transferring their ownership to the customer in case of a credit event, notably their non-repayment.
d- In the absence of an internationally recognized credit event, price variations of Credit Default Swaps on Lebanese Treasury bonds shall not be considered as a credit event category that compels the issuer to reimburse in kind these Treasury bonds by transferring their ownership to the customer.

The total nominal value of these instruments must not exceed the equivalent of 10% of the own funds of the concerned banks or financial institutions, unless there is a prior approval by the BDL Central Council.

5- Investing above 10% of their own funds in the form of foreign deposits of one year or more.

6-[1] Making abroad treasury placements other than operating accounts, except at[2]:

- Correspondents rated BBB and above.
- Non-rated correspondents affiliated to banking groups rated BBB and above, provided these correspondents are based in countries rated BBB and above.

Placements at Lebanese banks' affiliates abroad are excluded from the paragraph above, without prejudice, where applicable, to the provisions of Article 1 of Basic Decision No 7156 of November 10, 1998 on Lebanese banks' deposits, placements and loans at sister or related banks and institutions abroad.

In all cases, total net credit exposure at each correspondent abroad, computed on the basis of the branches in Lebanon and abroad, must not exceed 25% of the bank or financial institution's own funds computed on the basis of the branches in Lebanon and abroad.

"Net credit exposure" at each correspondent shall mean:

- All kinds of treasury placements at the correspondent, including current and operating accounts.
- Cash collateral accounts.
- Investments in all the financial instruments issued by the correspondent.
- Any other direct or indirect operations due to which the bank or financial institution shall bear the correspondent's risks.

Accounts that may undergo a netting process pursuant to contracts signed between the bank and the correspondent shall not be considered as a credit exposure.

The BDL Central Council may, according to each case separately and on justified grounds, exempt a correspondent from the provisions of this Paragraph.

II- In order to implement the rules stipulated in Part I of this Article, the following percentages and rules shall be adopted:

1- The total value of operations specified in Part I, Paragraph 2 (Subparagraph b) and Paragraph 3, and carried out with a single issuer, must not exceed 10% of the own funds of the concerned bank or financial institution.

2- The rating given by Standard & Poor's, or any equivalent rating given by other reputable, international rating agencies, provided the lowest credit rating is adopted.

3- Ratings shall be adopted as at the operation execution date. In case the rating is downgraded, the concerned bank or financial institution must liquidate the relevant positions or inform the Banking Control Commission. The latter may impose the

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[1] This Paragraph was added by Article 8 of Intermediate Decision No 10987 of April 30, 2012 (Intermediate Circular No 299), then amended by Article 1 of Intermediate Decision No 11110 of July 21, 2012 (Intermediate Circular No 302).

[2] The beginning of this Paragraph was amended by Intermediate Decision No 11619 of November 29, 2013 (Intermediate Circular No 347).

liquidation of such positions within a specified time limit, or assess the advantage of keeping them with the possibility of requesting the building of a special provision, as the case may be.

4- In order to compute the percentages mentioned in Part I, Paragraph 2 (Subparagraph b), Paragraph 3 (Subparagraph c), and Paragraphs 4 and 5 of this Article, the placements made by banks and financial institutions' affiliates abroad in the portfolio of bonds, structured financial papers and instruments, credit linked notes, and funds deposited abroad for a period of one year or more, shall be computed in the numerator, while the consolidated net Tier I Capital shall be computed in the denominator.

5- When placing bids, banks and financial institutions are prohibited from exceeding the 50% percentage mentioned in Part I, Paragraph 2 (subparagraph b) above and the 10% percentage mentioned in Part II, Paragraph (1).

6- The total value of operations mentioned in Part I, Paragraph 2 (Subparagraph b) and Paragraphs 3, 4, and 5 must not exceed 50% of the own funds of the concerned banks or financial institutions.

III- [1]Banks and financial institutions domiciliated in Lebanon are prohibited from allowing the correspondent or custodian abroad to lend or dispose of Lebanese Treasury bonds or BDL certificates of deposit or credit linked notes that are deposited with the correspondent or custodian or are given as collateral against financing operations, including Repo Agreements. This prohibition must be explicitly stipulated in the contracts signed with the correspondent or custodian abroad.

IV-[2] 1- Banks and financial institutions domiciliated in Lebanon are prohibited from borrowing or obtaining a funding from the non-resident financial sector, against a guarantee formed of foreign-currency denominated Lebanese Treasury bonds or foreign-currency denominated BDL certificates of deposit or foreign sovereign Treasury bonds or any other foreign corporate bonds, unless the following conditions are fulfilled:

a- The value of the loan does not exceed 60% of the value of the guarantee formed of the above-mentioned portfolio of sovereign bonds or certificates of deposit, and 50% of the value of the guarantee formed of the portfolio of other foreign corporate bonds.
b- The aggregate value of borrowed funds does not exceed 50% of the own funds of the concerned bank or financial institution.
c- The value of foreign-currency BDL certificates of deposit is not computed as part of the foreign-currency net liquid assets, whenever given as collateral against these operations.

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[1] This Paragraph was added by Article 1 of Intermediate Decision No 11514 of August 23, 2013 (Intermediate Circular No 333).
[2] This Paragraph was added by Article 1 of Intermediate Decision No 11898 of November 12, 2014 (Intermediate Circular No 378).

d- The operations-related contract includes, in compliance with BDL relevant regulations, an explicit text that confers to the borrowing bank or financial institution the absolute and unconditional right to take immediate measures to adjust the situation resulting from the downgrading of foreign sovereign and non-sovereign bonds to below BBB.

e- Whenever foreign sovereign and non-sovereign bonds given as guarantee are downgraded to below BBB, a special provision equivalent to the downgrading is built until the liquidation of these bonds.

2- The concerned banks and financial institutions shall disclose to the Banking Control Commission, on a monthly basis, the position of operations mentioned in Paragraph IV.

Article 2:

The prohibition stipulated in Article 1 of this Decision shall not govern:

1- The guarantees given by the non-resident financial sector against loans granted in Lebanese pound for ascertained investments or commercial activities in Lebanon.

2- The value of checks collected in Lebanese pound on behalf of the non-resident financial sector and converted into a foreign currency within 72 hours.

Article 3:

Resident banks may subscribe to Lebanese Treasury bonds on behalf of the non-resident financial sector, according to the following conditions:

1- The source of funds must be foreign-currency deposits converted into Lebanese pounds for this specific purpose.

2- Communicate to the BDL Department of Financial Operations the names of the non-resident financial sector institutions that intend to subscribe to Treasury bonds, and obtain the BDL prior approval for any such subscription and its size.

Article 4:

Banque du Liban may subscribe to Lebanese Treasury bonds on behalf of the non-resident financial sector, in case the condition stipulated in Article 3, Paragraph 1 of this Decision is met.

Article 5:

Whenever banks and financial institutions detect, due to the execution of specific operations, that they have accounts in Lebanese pound held by non-resident financial intermediation institutions and insurance companies, or fiduciary deposits in Lebanese pound received from the non-resident financial sector, they shall immediately communicate the detailed situation of these accounts to the Banking Control Commission and the BDL Department of Statistics and Economic Research.

Article 6[1]:

Banks and financial institutions shall immediately deposit at Banque du Liban, for each daily balance, a minimum special reserve in Lebanese pound equivalent to the total value of operations that contravene the provisions of Article 1 of this Decision. This reserve shall be deposited for a one-month period, in a zero-interest special account, to be named “Reserve for Deposits, Loans and Accounts in Lebanese Pound of the Non-Resident Financial Sector”.

Article 7[2]:

Banque du Liban shall collect from banks and financial institutions that do not comply with the provisions of Article 6 above a penalty interest computed according to the provisions of Article 77 of the Code of Money and Credit and to the relevant regulatory texts issued by Banque du Liban.

Article 8:

In addition to the stipulations of Articles 6 and 7 above, banks and financial institutions that do not comply with the provisions of this Decision shall incur the appropriate legal and administrative measures and procedures.

Article 9:

External auditors shall verify that the concerned banks and financial institutions are fulfilling the obligations stipulated in this Decision, and must report any violation to the Banking Control Commission and the BDL Department of Statistics and Economic Research.

Article 10:

The following regulatory texts issued by Banque du Liban are repealed[3]:

- Circular No 249 of November 7, 1979, addressed to banks
- Decision No 6140 of April 4, 1996, attached to Circular No 1421 of April 4, 1996, addressed to banks and financial institutions

[1] This Article was amended by Article 3 of Intermediate Decision No 10341 of December 22, 2009 (Intermediate Circular No 211).
[2] This Article was amended by Article 4 of Intermediate Decision No 10341 of December 22, 2009 (Intermediate Circular No 211).
[3] The numbers of the Circulars are given according to the old numbering system.

- Decision No 6569 of April 24, 1997, attached to Circular No 1517 of April 24, 1997, addressed to banks

- Decision No 7217 of February 4, 1999, attached to Circular No 1696 of February 4, 1999, addressed to banks, financial institutions and exchange institutions.

Article 11:

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

Beirut, April 15, 1999

The Governor of Banque du Liban

Riad Toufic Salamé