



## ЗАРУБЕЖНЫЙ ОПЫТ

**MOHAMAD SAMI ZOULGHINA**

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### *DEVELOPMENT OF THE LEBANESE BANKING SECTOR*

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The main objective of this study is to shed light on banks as the most important industry in any economy, and the Lebanese economy in particular. Banks continue to dominate the financial system of Lebanon and are major providers of credit to individuals and businesses. The article examines different types of banks in Lebanon, their organization and structure. Specific features of Islamic banking are explained. Strengths and weaknesses of the Lebanese banking sector are analyzed in the context of the financial crisis of 2008 and current world financial conditions.

**Keywords:** financial institutions; Lebanese economy; Islamic banking; investment funds.

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The banking sector is a major factor of the economy involved in handling financial assets and transactions for clients, investing those financial assets as leverage to create more wealth as well as regulation of those activities by government agencies. A bank is a financial institution having a license to receive money, handle deposits and grant loans. Banks may additionally provide financial services, such as Forex transactions, wealth management and safe deposit boxes. There are several types of banks: commercial or retail banks, investment banks, Islamic banks, exchange banks, agricultural banks, industrial banks, cooperative banks, savings banks and central banks. In most countries, banks are regulated by the central bank, which is regularly controlled by the government. Central banks are mainly responsible for stability of the local currency, inflation control and monetary policy and managing liquidity. The central bank is often monopolized and mostly by national institution given the power of control over the production and distribution of money and credit. In modern economies, the central bank is usually responsible for establishing the monetary policy, providing financial services that include economic research and the regulation of commercial banks.

*Islamic Banking* means conducting banking operations in accordance with Islamic teachings. Banking practices involving receiving and paying interest are inconsistent with Islam's teachings. However, it is a simple fact of life that

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when modern banks appeared on the scene, Muslim societies were unable to keep away from interest-based transactions. The Islamic banking movement that has gained momentum in recent years is trying to change this situation. There are two dimensions of this movement. First, theoretical work on different aspects of interest-free banking is being undertaken. Second, practical experience in running interest-completely free banks and other financial institutions is gained. There is also a lot of interaction between Islamic banking practice and theory. The Islamic banking revolution is still in its infancy, but it has already had a major impact on the financial scene around the world [1].

Many people are actually interested in the Islamic banking phenomenon and the query of how it greatly differs from conventional financial services. However, despite the expansion over the past 30 years, Islamic banking remains poorly understood in many areas of the Muslim world and remains a mystery in much of the Western world [2].

The naming of Islamic banks may indicate that their work is limited to Muslims only. This is not accurate however, because it is not a condition that Muslims should not be either the employee, the owners of the property, or the client. There lies the importance of information about the realities of Islamic banking work by Islamic banks operating towards the people. The mechanism of the action of Islamic banks is built on the basis of sharing in profit and loss and, consequently, not ensuring the capital. Often this leads to citizens' reluctance to spend in these financial institutions, including Muslims, due not only to the loss of return but also capital because of the related concerns [3].

Islamic banks are mainly concentrated in the Gulf countries and East Asia and began operating in Lebanon following the adoption of Islamic banking law in 2004.

Lebanon currently has five Islamic banks: two are primarily operated by conventional Lebanese banks, three are owned by Islamic Arab banks. Yet in Lebanon, these banks are relatively new. Thus, it is impossible to compare their growth with traditional banks. Therefore, their total assets do not exceed half a percent of the total assets of banks operating in Lebanon during the best of their years. Nonetheless, it is important to mention that most Islamic banks are developing but, depending on the situation in Lebanon, at a different pace.

*Table 1. Development of Islamic Banks in Lebanon*

Name of Bank	Type &	Year
1. Blom Development	Lebanese Bank	2007
2. Bank Al Baraka	Bahraini Bank	2007
3. Arab Finance House	Qatari Bank	2004
4. Lebanese Islamic Bank	Lebanese Bank	2004
5. Al Bilad Islamic Bank	Saudi Bank	2005

*Source:* [3].

There are some important terms concerning Islamic banking practice:

*Ijara*. The selling of a usufruct of an asset is *Ijara or Leasing*. Leasing is a contract whereby the owner of something transfers his usufruct to another person for a specified period of time and on an agreed basis. The lease subject has a beneficial use to it. Things that have no usufruct can't be leased at all [4].

*Murabaha* is a special type of sale where the seller specifically refers to the price of the sold product that he has accrued and sells it to another person by adding some benefit or mark-up on it. *Murabaha's* income can be calculated by mutual consent, either in a lump sum or through a negotiated benefit ration to be paid over the costs. All costs incurred by the retailer in the purchase of the item such as freight, customs duty, etc. shall be included in the cost price, and the

mark-up may be added to the gross cost. However, recurring business expenses, such as staff salaries, premises rent, etc., will not be included in the expense of an individual transaction. In fact, those expenses are covered by the profit claimed over the cost.

Murabaha is only applicable when it is possible to determine the exact cost of a material. The product will not be sold on a Murabaha basis if the exact cost will not be ascertained. In this scenario, the service must be sold on the basis of Muswamah (negotiation), i.e. without any relation to the cost or profit/mark-up ratio. In such cases the price of the product shall be determined by mutual consent in lump sum [4].

*Investment Funds.* An investment fund is a mutual pool in which the investors contribute their surplus money to gain Halal income in strict compliance with Islamic Shari'ah principles for the benefit of their investment. The Fund's subscribers can obtain a certificate certifying their subscription and entitling them to the pro-rata income the Fund actually earns [4].

*Salam* is a sale by which the seller undertakes to supply the buyer with certain specific goods at a future date in return for an agreed price that is paid in full on spot. Salam's contract imposes a moral obligation on seller Salam to supply the goods. When agreed, the deal with Salam cannot be revoked [4].

*Istisna'* is the second type of selling where a product is transacted before it becomes a reality. This means ordering a manufacturing company to produce a specific product for the buyer. If the manufacturer undergoes to produce the goods from the manufacturer with material for him, the transaction of *istisna'* would come into being. But for the legality of *istisna'* it is essential that the price be fixed with the agreement of all sides, and that the required material specification (meant to be manufactured) be totally settled between them [4].

*Modaraba* is a unique kind of partnership whereby one party gives funds to another in order to invest them in a business enterprise. The financial contribution comes from the first partner, called *rabb-al-mal*, and the other, called *modarib*, is solely responsible for the management and research. The *rabb-al-mal* may define a specific enterprise for the *modarib*, by which case he will only invest money in that particular business. This is named *modaraba al-moqayyadah* (Modaraba Restricted). But if he has made it possible for the *mudarib* to participate in whatever industry he wishes, the *modarib* will be allowed to invest the funds in whatever business he considers fit. This kind of *mudaraba* is called *al-modaraba al-motlaqah* (the *modaraba* without restriction). *Mudaraba* is commonly used in the form of start-up investment, venture capital or a mixture of both for equity financing [4].

*Mosharaka* is an Arabic word, which basically means 'sharing'. In business and trade terms, this means a joint venture in which all parties share the joint venture's profit or loss. It is a perfect alternative to interest-based funding, with far-reaching effects on both manufacturing and distribution. Interest is the only tool used indiscriminately in funding of every kind in the modern capitalist economy.

*Mosharaka* or *Shirkat-al-amwal* is a mutually agreed partnership between the parties. But there are some components that are unique to *Mosharaka's* contract, namely the position of each partner, the benefit allocation and distribution scheme and the *Mosharaka* tenor or time, whether it is *motanaqisa* or *motlaqa* [4].

Islamic Banks have similar functions to conventional banks such as mobilizing funds from savers, lending money to lenders and creating credit, facilitating transactions among others. The functions of Islamic Banks are extremely useful and socially desirable. The functions of conventional banks are tarnished by the

interest that limits their activities of money trade and they finance more in the view of short-term and personal loans. These focus areas mean that conventional banks do not solve the problem for venture capital needs and their contribution to the economic growth will have a less real potential.

Although Islamic banking is still a small part of the economy and financial sector, several studies have shown that Islamic banking is positively associated with economic growth. Islamic banking provides two improvements for the conventional banking system. First, Islamic Banks offer more lending to the production process, aiming to contribute to companies' capital. The financial resources allocation is more efficient than the pure lending activities. The expected impact on the economy will be more important. Secondly, Islamic Banks will guarantee people that interest rates will not be included in their contract.

Lebanese Banking Sector is financially stable and secure. It plays an important role in the Lebanese economy where financial institutions continue to control the financial system of the country and are main providers of credit to individuals and companies.

In Lebanon, the Bank of Lebanon (BDL), the country's central bank, that is the bank regulatory authority, is responsible for banks and financial institutions. The Central Bank of Lebanon monitors all bank entries, defines the scope of banking activities, and establishes banks' prudential laws and rules of practice.

The Banking Control Commission (BCC) was established in 1967 and is the bank supervisory authority. It is responsible for controlling banking operations and ensuring compliance with the various financial and banking rules and regulations. Without the necessary and effective banking regulation and supervision conducted by the BDL and BCC, progress made by the Lebanese banking sector over the past ten years or so could not have been possible.

Currently in Lebanon there are two major types of banks – commercial and investment banks. There are more than 50 commercial banks in Lebanon with minimum 5 branches for small banks and maximum 75 branches for big banks. The high number of banks compared to the size of Lebanon indicates that this sector is a major influencer on the economy and attractive to foreign banks to operate in Lebanon, noting that almost half of the banks are foreign banks doing business in Lebanon. On the other hand, there are 15 investment banks operating in Lebanon that are responsible for mergers and acquisitions, they issue new stock and play as financial advisors, in addition to assets management for huge investments and personal wealth management for high-net-worth individuals.

The following statistics characterize the condition of Lebanese commercial and investment banks:

- 65 banks with 1,079 branches;
- 26,000 bank employees;
- USD 175 billion of total deposits, of which 120 billion are in U.S. currency;
- USD 53 billion of total loans to the private sector;
- USD 31 billion of total loans to the government;
- Annual profits of USD 1.8 billion [5].

*Table 2. Commercial Banks Figures, in Billions of LBP*

PERIOD	TANGIBLE ASSETS	INTANGIBLE ASSETS	OTHER ASSETS	OTHER FOREIGN ASSETS	RESIDENT CUSTOMERS' DEPOSITS	NR CUSTOMERS' DEPOSITS	TOTAL BALANCE SHEET
1	2	3	4	5	7	8	9
Nov-19	5662.6	2300.7	1773.7	6034.9	193007.2	50003.8	391486.8
Oct-19	5623.9	2298	1792.8	6066.3	198001.9	53565.8	396176.8
Sep-19	5618.9	2313.2	1855.4	6036.2	199302.4	55211.5	395259.9

*End of tabl. 2*

1	2	3	4	5	7	8	9
Aug-19	5683.2	2320.4	1709.5	6081.5	202067.8	55810.8	394806.8
Jul-19	5664.7	2319.8	1615.1	6097.2	202153.2	55584.5	390719.9
Jun-19	5620.9	2319	1504	6128	201707.2	55658	385890.7
May-19	5561.8	2316.2	1383.3	6105.1	200949.8	54750.2	382346.9
Apr-19	5543.1	2310.3	1403.3	6113.1	202336.8	56099.4	382373.6
Mar-19	5515.5	2308.1	1321.9	6094.5	202518.3	55658.9	381023
Feb-19	5373.5	2292.6	1377.1	6109.6	202098.6	55279.3	377237.2
Jan-19	5392.3	2285.7	1297	6100.8	201662.7	55801.5	375188.2
Dec-18	5352	2284.3	1213.9	6097.4	204196.5	56870	376097.2
Nov-18	5236.6	2252.2	1332	6107.8	203056.2	56352.4	371613.6
Oct-18	5213.6	2194	1055.4	6137	202938.9	56515.9	365739.6
Sep-18	5194.1	2162.4	1018.7	6168.5	204633	55820	363483.4
Aug-18	5119.9	2156.4	719.4	6175.6	204100.6	55285.8	359472.9
Jul-18	5118	2152.8	641.7	6176.7	203856.3	55203.3	356244.2
Jun-18	5099.6	2146.5	671.3	5922.5	204062.9	55395.4	353665.3
May-18	5090.1	2135.8	613.2	5954.8	202992.7	55124.5	350171.7
Apr-18	5085.4	2119	621.5	5990.4	202364.5	54289.1	341148.3
Mar-18	5046.8	2120.5	602.7	5979.1	202026.9	54345	338538.9
Feb-18	4944.5	2120.8	557.7	5979.9	201776	53483	336271.5
Jan-18	5142.3	1995.3	783.6	6492.8	201182	53321.2	335547.7
Dec-17	5136.4	1994.6	713.2	6409.4	200856.3	52997.7	331432.8
Nov-17	5057.4	1559.1	833.9	6255.2	199179.5	51808	325934
Oct-17	5043.1	1555.3	829.4	6280.9	201358.3	53513.7	325303.2
Sep-17	5012.4	1559.8	789.3	6295.6	201814.2	52620.9	321737.3
Aug-17	5004.7	1613.6	817.8	6309.7	201775.1	52759.9	315652.4
Jul-17	4986.3	1587.4	829.2	6378.4	200964.8	52393.1	314281.7
Jun-17	4956.1	1589.7	776.1	6380.6	199909.2	52414.2	313805
May-17	4896.3	1492.9	975	6415.2	198175.7	51764.7	311883
Apr-17	4877.7	1492.4	791.6	6300.3	196865.4	52090.2	310738.6
Mar-17	4843.8	1483.2	793.5	6308	195704.3	51571.9	310175.7
Feb-17	4834.2	1464.2	808.4	6324.7	195054.1	51490.9	308938
Jan-17	4823.2	1630	770.7	6356.8	193646	51216.1	308104.4

*Source:* [5].

As can be seen from Table 2, the Lebanese banking sector has had a relatively high level of achievement in recent years and has attracted global attention. International business media outlets have commended Lebanon as one of the few nations that have been reporting on development since the economic crash of 2008. Perhaps due to its successful cooperation with international organizations and anti- money laundering initiatives being introduced there is an elevated worldwide awareness of Lebanon's economic activity.

Lebanon's banking sector was largely immune to the economic collapse of 2008, which led to the collapse of many financial institutions around the globe. This is because Lebanese banks have had years of experience working in an unstable and dangerous political environment. As a result, Lebanese banks have long adopted conservative banking policies. For example, banks need to have at least 30 % of their assets in money.

In the country's economic heartbeat, the big number of Lebanese expatriates residing overseas play a very significant role. These expats inject nearly \$7 billion back into the economy of Lebanon every year. Enormous Lebanese community overseas provides a possible explanation why Lebanese banks saw a 23 % rise

in deposits in 2008 when other banks faced a decline. When the West had problems, many of their liquid assets were moved back to their home nation by Lebanese expatriates.

The powerful global openness of the Lebanese banking sector also contributed to its achievement. This is a number of examples:

- the absence of foreign exchange or capital controls;
- the existence of twelve international banks operating in Lebanon;
- fifteen local banks with significant stakes in banks outside Lebanon.

What are the problems?

Compared to the size of its economy, Lebanon has one of the world's largest government debt, generated largely by servicing current debt and high government spending. This contributes to about 150 % of GDP. The World Bank reported that financial transfers to the state-owned supplier of energy alone averaged 3.8 percent of GDP from 2008 to 2017. In 2017, a pay increase in the public sector and higher interest rates contributed to the strains of the budget deficit [6].

In its current account, Lebanon also has a deficit because it imports much more than it exports. Financing these two deficits was based on the critical economic transfers made by Lebanese diaspora.

Lebanon is vulnerable to major refinancing hazards. To draw sufficient capital and deposits in particular, to fund significantly larger budgets and current account deficits is difficult considering the slower growth of deposits. Economists find lower oil prices as a major cause of the downturn, with many Lebanese employed in oil-producing nations of the Gulf. Political instability and reduced development in Lebanon were also listed as variables.

Because of the central bank's wise policies, the Lebanese banking sector is the main pillar of the Lebanese economy. The Lebanese banking sector has experienced excellent years, highlighted by strong activity growth, despite the political problem and war in Syria and a satisfactory profitability. Lebanese banking continues witnessing advantageous franchises, although their return on equity remains below their total capital costs in the light of competitive operating conditions on the domestic market. On the quantitative point, Lebanese banks again secured a strict risk profile last year while retaining their profit metrics. Assessment of their various exposures indicates significant liquidity, adequate capitalization, continuous asset value, and improved leadership performance. Lebanese banks continue to assume their fiduciary obligations at the qualitative level by enjoying adequate corporate governance standards, well-developed corporate social responsibility initiatives, and excellent transparency and reporting practices [7].

The evaluation of strengths and weaknesses of the Lebanese banking sector shows the following. On the strengths side, there is stability of working conditions while remaining demanding, sound system liquidity mitigating the risk of deposit flight, reasonable capitalization adequately meeting the higher capital requirements and rising the income of BDL-assisted banks.

In terms of weaknesses, banks remain exposed to the sovereign, the subdued perspective of national loan development in the midst of limited lending possibilities, and the adverse impact on banks' profitability outlook of subdued fresh business generation and higher taxes. While the above challenges are true challenges, we think possibilities outpace threats on the horizon, driving our general sector-friendly perspective. It is in this context that, in addition to sound performance metrics and a strict risk profile, the qualitative strengths of Lebanese banks look forward to external opportunities in their overall presence in their overseas markets.

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## МОХАМАД САМИ ЗОУЛГИНА

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### РАЗВИТИЕ БАНКОВСКОГО СЕКТОРА ЛИВАНА

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**Резюме.** Основная цель этого исследования — осветить деятельность банков, являющихся наиболее важной отраслью в любой экономике, особенно ливанской. Они доминируют в финансовой системе страны и являются основными поставщиками кредитов для физических и юридических лиц. Рассмотрены различные типы банков в Ливане, показано, как они организованы и структурированы, объясняются особенности исламского банкинга. Оценка сильных и слабых сторон банковского сектора Ливана была проанализирована в контексте экономического кризиса 2008 года и современных мировых финансовых условий.

**Ключевые слова:** финансовые институты; ливанская экономика; исламское банковское дело; инвестиционные фонды.

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