The Central Bank of Lebanon: New Regulations for Granting Retail Loans

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Lending activity is a double-edged sword. The world has witnessed the bad side when a mishandling or misperception of risk paved the way for reckless mortgage lending across America which in turn unleashed a full-fledged economic crisis. However, lending also constitutes an important channel through which aggregate demand can be revived and through which individuals can have access to home ownership, education, credit cards…etc.

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In Lebanon, where credits distributed by banks[1] (including financial intermediation and public sector administrations) represented 125% of GDP by June 2014, stakeholders in the financial system are keen on holding a tight grip on risk. One indicator portraying the risk-averse nature of Lebanon's lenders is the World Bank's "Credit Depth of Information Index". According to the World Bank, this gauge "measures rules affecting the scope, accessibility, and quality of credit information available through public or private credit registries. The index ranges from 0 to 6, with higher values indicating the availability of more credit information, from either a public registry or a private bureau, to facilitate lending decisions". Lebanon got an elevated score of 5.0 in 2011, which shows that the lending ecosystem minimizes risk-taking via high transparency high quality and availability of credit information.

It's in the same light that the Central Bank of Lebanon (BDL) issued new regulations concerning retail loans. Intermediate circular #369, concerns all retail loans i.e. consumer loans (cars, student, education), revolving credits and housing loans.

It is worth noting that this circular comes in a context where loan maturities have lengthened and where the granting of retail loans has recorded a substantial surge. While the average maturity of the banks' loan portfolio was below 30 months prior to 2009 it now exceeds 50 months. The same goes for retail loans which now have a maturity that exceeds 70 months.

Individuals receive a sizable chunk of the loans that are granted in the financial sector. According to BDL's figures, retail loans have surged over the past couple of years: while they represented 17% of total loans distributed in the financial sector in 2008, this share rose to 28% by June 2014. Retail loans grew by 7% year-to-date to reach $16B by June 2014. Out of total retail loans, the most attractive are housing loans with a share of 58%, followed by those for consumption with a stake of 28% and those for cars with a share of 10%. On a year-to-date basis, housing and consumption loans grew by 7.5% and 6.6% to reach $9.18B and $4.44B in June, respectively. However, the value of car loans slightly slid by 1.7% y-t-d to $1.51B in June.

All retail loans granted after 01/10/2014 must abide by new regulations. First, a car or housing loan intended for the purchase of a car or the first home must not exceed 75% of the good's price leaving a 25% down-payment for the debtor. This new regulation can't help but bring us back to the economy's "new orthodoxy" elaborated by Martin Wolf in his latest book: "The Shifts and The Shocks: What We've Learned- and Have Still to Learn – from the Financial Crisis" in which he dubs the "deleveraging of economies" as the "single most important lesson of the crisis" and where he states that "beyond some point, the growth in debt adds to the fragility of the economy more than it adds to either personal welfare or aggregate demand". Luckily, the BDL is adopting a preemptive policy that would not allow debt to go beyond the point where it becomes destabilizing for the economy.

The circular also adjusts the cap placed on cumulative monthly payments related to retail loans. The cumulative monthly payments for all retail loans must not exceed 45% of the household's monthly income, defined as the husband and the wife's monthly revenues. For housing loans, the cumulative monthly payments must not exceed 35% of the household's income.

[1] Credits that we are considering in this document are credits that contain all kinds of loans including financial intermediation and public sector administration but excluding government debt owned by banks

When the performance of a loan starts to deteriorate or the loan is becoming doubtful, commercial banks ought to calculate their special provisions based on the retail loan's net balance. The net balance for housing loans is obtained after the deduction of cash collateral and 60% of the property's estimated value or insurable value, whichever is less. For the remaining types of retail loans, the net balance is obtained after the deduction of the cash collateral.

Special Provisions on Retail Loans according to BDL Circular # 369

Period of Delay in Payments	Housing Loans	Car Loans	Credit Card Loans	Other Retail Loans
31-60 days	-	15%	25%	15%
61-90 days		20%	35%	25%
91-120 days	Stop Charging Interests	30%	40%	35%
121-180 days		40%	50%	50%
180-360 days	25%	50%	100%	100%
1-2 years	50%	100%	-	-
2-5 years	100%	-	-	-
More than 5 years	100% of the loan's balance, regardless of the value of collaterals	-	-	-

Source: Banque du Liban

General provisions must also be formed to hedge against payment default in retail loans. Housing, student and education loans are excluded from the portfolio of retails loans when the bank calculates the provisions. The latter must represent 2% of the portfolio by end 2014 and should increase by 0.5% annually for 6 years starting 2015. These reserves shall be part of the bank's Tier One Capital and cannot be reduced without pre-approval from the central bank. If reduced, these reserves must be built-up again during a period defined by the central bank.

Finally, it is important to see the big picture in which BDL's circular is inscribed: Macro prudential policy. Crisis after crisis, decision makers around the globe discovered that macro prudential policy is crucial for the soundness of any economy as it reduces the systemic risk in the financial sphere. The BDL has embarked on the macro-prudential train in more ways than one and will continue to do so in order to improve the way we perceive risk and how we manage it.

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