Overview on Macroprudential Policies in Lebanon

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Given that traditional regulation permitted financial vulnerabilities to go unchecked, contributing to the 2008 financial crisis, authorities in many countries have been studying a more systemic approach to financial regulation. It was only after the global financial crisis that policymakers fully came to realize the costs of a systemic disruption in modern financial markets and the need to keep systemic risk in check. As a result, the macroprudential approach has been implemented.

Macroprudential policy's main goal is not to replace traditional regulation of financial institutions, such as commercial banks. On the contrary, it complements microprudential policies. However, it adapts the use of these tools to counter growing risks in the financial system.

Macroprudential policies are designated to identify and mitigate systemic risks, hence reducing the cost to the economy from a disturbance in the financial services that support the workings of financial markets. Since one tool cannot possibly tackle the various causes of systemic risk, the macroprudential authority must be able to adapt specific instruments to the particular exposures.

Several practices have been developed and have recently been used to tackle the accumulation of aggregate risks over time, of which the dynamic, or countercyclical, capital buffer. Financial institutions have always been required by regulators to maintain a certain amount of capital to enable them to absorb losses on loans or securities. As proposed by the Basel requirements, "the dynamic buffer would lead macroprudential authorities to require financial institutions to add to their capital when there are signs of unusually strong credit growth or a credit-driven asset price boom."

Macroprudential authorities also relied on many other tools to target specific vulnerabilities. Many of them have already been already used to prevent boom-bust credit cycles and include tools to address the interplay between market risks and credit risks. Of these macroprudential tools:

• "***Loan-to-value ratios (LTV)****:* Maximum LTV ratios are increasingly being applied to reduce systemic risk from booming periods in real estate markets. By limiting the loan amount to well below the value of the property, loan-to-value ratios help limit household leverage. They are often complemented by debt-to-income ratios that seek to limit the fraction of household income spent on servicing debt.

• ***Liquidity requirements****:* When funding is easy to obtain, an increase in required buffers of liquid assets provides cash reserves that can be drawn on when funding dries up.

• ***Dynamic provisions:*** These force banks to set aside money to cover loan losses in good times when credit losses are relatively low so that bank balance sheets are better prepared to absorb losses that build during downturns.

• ***Measures targeted at foreign currency lending****:* If borrowers take out loans in a foreign currency, their ability to repay can be significantly affected if the value of the foreign currency rises and they have not protected themselves against such a swing. The threat of a rise in foreign currency value heightens credit risk for lenders because repayment becomes more expensive for borrowers. Macroprudential measures to reduce these risks include portfolio limits on foreign currency lending and other targeted restrictions, such as requiring more capital and tighter loan-to-value and debt-to-income ratios for foreign currency loans."[1]

Usage of macroprudential policies varies from country to the other. Emerging countries use the tools the most, which is consistent with their higher exposure to external shocks, including volatile capital flows. Developing countries come in second and advanced countries follow. Loan-to-value ratios are relatively more used by advanced countries, due to higher concerns of the housing sector. Reserve requirements and fixed currency limits are more used in emerging countries, mainly due to their concerns with large and volatile capital flows.

In Lebanon, the authorities have been pre-emptive in adopting macroprudential measures to limit risks. Following the turmoil in Syria and the slowdown in the real estate sector, BdL tightened the maximum debt service-to-income ratio and loan to-value requirements for retail and housing loans, and increased collective provisioning on performing loans. These measures have served to strengthen the financial system's overall resilience in the context of weak economic growth.

Moreover, Lebanon has several supervisory bodies. The BCC has analyses banks' susceptibility to interest rate risks and risks related to their foreign operations. Aspects of macro financial risk and possible policy responses are discussed in BdL committees covering related issues, while the BCC considers macroeconomic risks for supervisory purposes.

[1] Reference: IMF

Although in most developed economies the use of macroprudential policies proliferated after the 2008 crisis, Banque du Liban successfully implemented them long before and tamed systemic risk in the banking sector during periods of financial stress. Macroprudential policies in Lebanon have historically attenuated potential financial stress that emanates from unstable credit growth in the banking sector. For example, by mandating relatively high reserve requirement ratios – 15 to 25 percent on LBP and 15 percent on foreign currency liabilities – BDL hinders the risky creation of money through fractional reserve banking. This policy, in turn, achieves a healthy environment for the financial sector characterized by diminished upward inflationary pressures, a liquid banking sector, and stable credit growth.

The Lebanese economy in the 21st century has been characterized by numerous adverse economic shocks and periods of financial stress. For example, the financial sector experienced augmenting financial pressures initiating in mid-2000 and stretching out to the end of 2002. This was attributed to a widening fiscal deficit, increased sovereign default risk, pressures on the domestic currency and decreased bank deposit growth. However, macroprudential policies, which focused on amplifying bank capital, loan structure, and asset liquidity, rendered the banking sector robust to financial stress and banking activity unharmed. This was reflected by the prevalent growth in bank assets by 5.84 percent from end-2000 to end-2001 and 10.27 percent from end-2001 to end-2002.

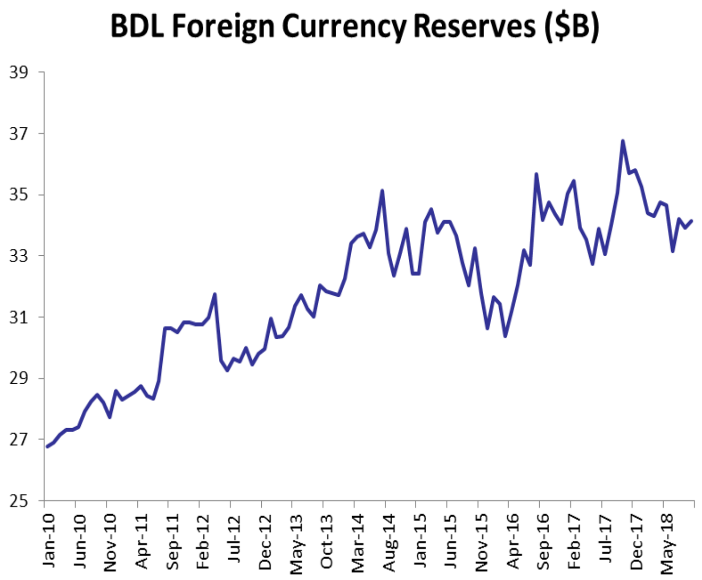
The year 2005 was a time of extreme political stress, yet the financial system remained resilient. The death of former Prime Minister Rafiq Hariri on 14 February, 2005 was followed by numerous distortions in macroeconomic variables which rendered the financial situation unstable. Investors' first reaction was massive capital outflows which led to a substantial decline (- 2.9 percent in March) in total deposits. Moreover, the period witnessed a striking rise by 10 percent in the dollarization rate of private deposits from January 2005 to March 2005. In turn, the impact led to a decline by around $2 billion in the central bank's foreign reserves. However, given well-established macroprudential policies which entailed a low risk, liquid banking sector, the financial system was shielded against a serious crisis.

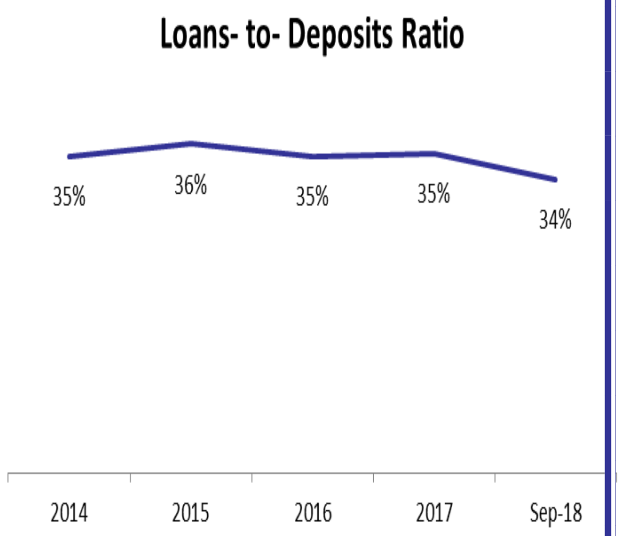
The year 2006 also witnessed a war, a three month embargo on Lebanon. The July 2006 war with Israel damaged the economy and was followed by frequent distortions in macroeconomic variables which translated into an unstable financial situation. Nevertheless, financial pressures in the banking system were efficiently controlled owing to its healthy liquidity position with the net liquid assets to customer deposits ratio reaching 85.1 percent by the end of 2006. The stability in the banking sector was also augmented by a low LT, significant Liquidity Coverage Ratio (LCR), and ample capital.

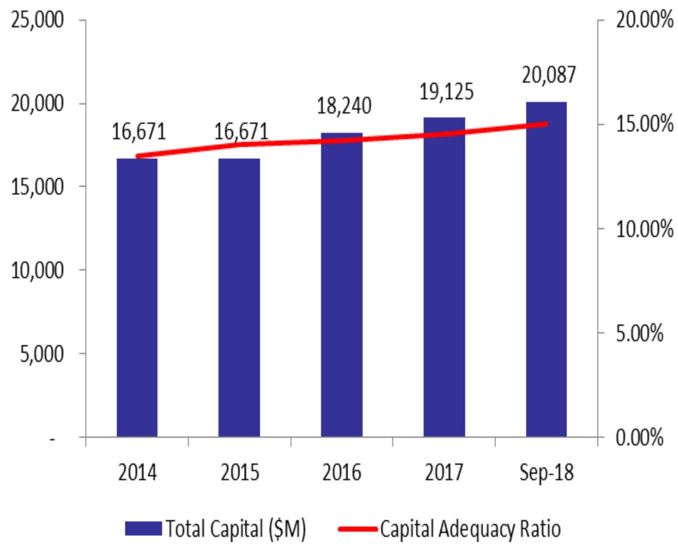
BDL has also intervened in 2001 to prohibit commercial banks in Lebanon from buying Mortgage Backed Securities (MBS) and Collateralized Debt Obligations (CDOs) which proved to be an optimal decision years later. When the global financial crisis ignited on October 2008, banks internationally struggled to bear the losses associated with MBS and CDOs. Accordingly, capital inflows to Lebanon thrived as the banking sector was globally perceived as a safe haven. This regulation saved the Lebanese economy from a financial crisis and put it on a path towards economic prosperity, as reflected by a real GDP growth of 9.25 percent in 2008 and 10.05 percent in 2009. It also contributed to reinforcing foreign currency reserves at BDL and strengthening the Lebanese Pound.

Finally, although the period from November 2017 until today has been characterized by low real economic activity, political pressure, and financial stress but the banking sector remains stable. BDL has ensured, through both macroprudential and monetary policies, that the systemic risk of the banking sector remains stable and sustainable. Moreover, according to BDL, consolidated bank capital has reached around USD 20 billion and bank reserves at BDL remain substantially high, ensuring a buffer against potential losses and ample bank liquidity.

Macroprudential Figures on Lebanon







Source: BDL

Lebanon's Macroprudential Policies

Minimum capital for new banks	• LBP 10 billion for the head office of a commercial bank and LBP 500 million for each additional branch. • LBP 30 billion for establishing an investment/specialized bank. • LBP 150 billion for establishing an Islamic bank.
Minimum capital adequacy ratio	In compliance with Basel II Accord. Currently, banks are preparing to meet Basel III requirements as follows: - Common Equity Tier 1 ratio: 9% at end 2017 to 10% at end 2018. - Tier one ratio: 12% at end 2017 to 13% at end 2018. - Total Capital ratio: 14.5% at end 2017 to 15% at end 2018. These ratios include the "Capital Conservation Buffer" that must reach 4.5% by the end of 2018.
Limits of facilities granted to a single entity	• 20% of the bank shareholders' equity (Tier one) if the facility is used in Lebanon or in countries with sovereign rating A+ and above. • 10% of the bank shareholders' equity if the facility is used outside Lebanon. • Total facilities must not exceed 50% of the bank shareholders' equity when used in countries with sovereign rating from BBB to A, and 25% in countries with sovereign rating less than BBB. • The total facilities that are used outside Lebanon (all foreign countries) cannot be larger than four times the bank shareholders' equity, and in countries with sovereign rating less than BBB only 100% of the bank shareholders' equity. • The total facilities that each exceeds 10% of the bank shareholders' equity (large exposure) cannot be larger than 4 times the bank's equity.
Lending to related parties	Starting November 2012, the total of these credits must not exceed 2% of shareholders' equity, and 1% for those granted without meeting the conditions stated in the above mentioned paragraph.

Liquidity ratios	• Banks have to hold at the BDL as required reserves on Lebanese pound accounts, the sum of 25% of their demand liabilities in LBP and 15% of their term liabilities in LBP. These reserves pay zero interest but many deductions are allowed under a number of special lending schemes to some productive sectors and activities. • Banks are required as well to maintain at the BDL at least 10% of their foreign currency liabilities as net liquid assets, and at least 15% of these foreign currency liabilities as remunerated foreign currency deposits. These latter are remunerated on the basis of maturity and prevailing market interest rates. • Banks must also keep at least 40% of their shareholders' equity denominated in the Lebanese currency as liquid assets.
Foreign exchange exposure	• The daily net trading position against the Lebanese Pound must not exceed 1% of shareholders' equity while the global position cannot exceed 40% of shareholders' equity. The global position takes the sum of either all debit or credit positions of all foreign currency accounts, whichever bigger. • A structural position of 60% of shareholders' equity is authorized to hedge the capital in LBP against fluctuations in the exchange rate.

Source: ABL

For your Queries:

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