

Banking Control Commission



BANK FOR INTERNATIONAL SETTLEMENTS

Financial Stability Institute



F.S.V.C

MENA

Financial Regulators' Initiative

Macro Prudential Supervision *for Financial Stability*

A regional Experience (Lebanon)

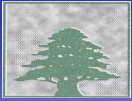
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Cairo, 7- 9 April, 2009



Macro prudential Supervision

I - Introduction

II- Definition of Macro prudential Supervision

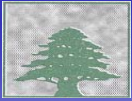
III - Importance of Macro prudential Supervision

IV- Macro Prudential Analysis and Tools

V - Macro Prudential Policy in Lebanon

VI - Macro Prudential Supervision in Lebanon:
Practices & Examples

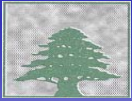
VII - Conclusion



I - Introduction

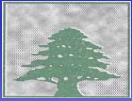
The State - of - the art theory of Banking Supervision consists in taking preventive measures in order to avoid any type of crisis in the financial sector by predicting, in advance, any major change in factors that may weaken the situation of this sector as a whole, or the situation of any specific unit that may contaminate the sector.

The earlier the changes are detected the more efficient is the treatment.



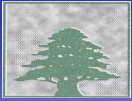
I – Introduction (Cont.)

The ability to monitor the financial system soundness, needs indicators that can be used as a basis for analyzing the current health and stability of the Financial System. These Financial Soundness Indicators (FSIs) comprise both aggregated Micro - Prudential Indicators of the health of individual financial institutions, Macroeconomic Variables associated with Financial System Soundness and Indicators of market perception.



I – Introduction (Cont.)

The micro – prudential indicators are commonly derived from the “**CAMELS**” approach. With regards to macroeconomic impulses, empirical analysis has shown that macroeconomic variables can signal imbalances that affect financial systems and have often pre - dated financial problems. For this reason, vulnerability assessments need to take into consideration the broad macroeconomic picture, particularly factors that affect the economy’s vulnerability to capital outflow and currency crises.

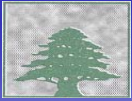


I – Introduction (Cont.)

The analysis of such quantitative variables needs to be completed by more qualitative judgments on the adequacy of institutional and regulatory arrangements vis - à - vis the risks being run by the financial system, including issues such as:

- * The Quality of Supervision and Regulation
- * The Legal Infrastructure
- * The Accounting and Disclosure Standards
- * The Incentive Framework

Macrosupervision is often assimilated to preventing systemic risk



II - Definition of Macro prudential Supervision

Macro-prudential analysis needs to identify:

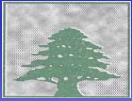
- The **Trends** in the Economy and in the Financial System which have implications for Financial Stability and as a result for Macroeconomic Stability.
- The **Interconnectedness** which can be a source of strength or weakness in a financial system. (*A connected system where all components are sound can be a source of resilience. Where segments are weak however, the feature can be a source of vulnerability and facilitate contagion*).
- The **Measures** which could be taken to address the resulting Risks.



III- Importance of Macro-Prudential Supervision

The lack of a system-wide macro-prudential approach of supervision and the failure to specify and use macro-prudential levers to offset systemic risks, were far more important to the *origins of the global crisis* than any specific failure in supervisory process relating to individual banks.

P.S.: *In the Declaration of the recent G 20 Summit in London, it was clearly stated: “**Reshape our regulatory systems so that our authorities are able to identify and take account of macro - prudential risks**”*



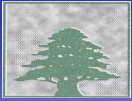
IV -Macro-Prudential Analysis & Tools

The major indicators should include trends in:

- The extension of credit to the economy, the credit pricing, the borrowers' leverage and the implications for the risks which both borrowers and lenders are running.
- The pattern of maturity transformation and resulting liquidity risks e.g. the extent to which banks are increasing or decreasing maturity mismatches and are relying on "Client Based Market Liquidity" or "Interbank Liquidity"

BCBS is working on a Global Liquidity Stress Model , which will be included in the next amendment to the Basel II Accord in the Spring of 2010.

- The Trend of Asset prices (Property, Equity and Securitized Papers) and their eventual relationship.
- The leverage in the financial system, whether at the institutional level (Bank capital to Asset ratios) or embedded in collateral margins.

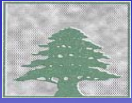


V- Macro Prudential Policy in Lebanon

The Banque du Liban (BDL) tends to focus on monetary policy analysis as required by different economic targets, and to stabilize the market during Times of Stress.

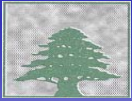
The Banking Control Commission (BCCL) focuses on the supervision of individual institutions, and on wider sectoral and system-wide risks.

The activity of macro-prudential analysis and the definition and use of macro-prudential tools, is conducted between the above two authorities.



VI- Macro prudential Supervision in Lebanon: *Practices & Examples*

- 1- BDL has established a joint working Group with the (BCCL) to:
 - Bring together insights from macro, sector-wide and Bank-specific analysis, and
 - The actions to be taken translate the said analysis of risks into Macro-Prudential Policy Measures.

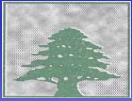


VI- Macro prudential Supervision in Lebanon: *Practices & Examples (Cont.)*

2- BCCL is conducting on a **Monthly basis** a deep analysis of a set of Macro Prudential Indicators that relates to:

- Distribution of Deposits & Banks' Government Exposure
- Aggregate Income Statement of the Banking System
- Major soundness indicators of the Lebanese Banking System

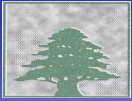
This followed the IMF FSAP mission in 1999 and the periodic Article IV Assessment missions



VI- Macro prudential Supervision in Lebanon: *Practices & Examples (Cont.)*

3- Since the assassination of former Prime Minister Hariri in Feb. 14th 2005, the BCC has been monitoring on a **Daily Basis**:

- Global liquidity position through: daily conversion between Lebanese Pound and Foreign Currency (in both sides) because Lebanon is a highly Dollarized Economy.
- Non Trade Related Transfers (In & Out of the Banking Sector)
Historically, we noticed a certain Volatility in Customers' Deposits
- Interbank Activity & Interbank Rates: (LL and FC's) in order to measure the reliance of the banking sector on the interbank financing.



VI - Macro prudential Supervision in Lebanon: *Practices & Examples (Cont.)*

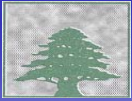
4- Close Monitoring of Large Exposure Borrowers in banks:

The BCC assesses on a periodic basis (Monthly), through a Specialized Department (Large Exposure Department) the :

- Financial Performance of large Debtor Customers:

Individuals, Companies and Groups (above \$14 million) in the banking sector, in order to early identify weaknesses and areas of risk, and give recommendations to banks to take appropriate measures to avoid Large Exposure problems.

- Non-Performing Loans, in order to find a rescheduling and / or refinancing scheme, to help the customers resuming their activities, which will have a positive impact on the economy as a whole and avoid the burden of new provisions in banks.



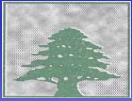
VI - Macro prudential Supervision in Lebanon: *Practices & Examples (Cont.)*

4- Close Monitoring of Large Exposure Borrowers (Cont.)

Focus on sector and industry studies & cross sector studies (sectors highly correlated with each other) especially those considered:

- **Highly volatile** (drastic change in commodity prices)
Currently: energy, steel, other raw materials used in R.E.
- **Highly leveraged** in the banking sector
- **Rapid expansion** (Real Estate , Telecom sectors etc...)
- **Concentration risk**

P.S. This helps the BCC estimating LGD when banks will shortly move from the Standardized Approach to the Foundation Internal Rating Based Approach (FIRB) in measuring Credit Risk.



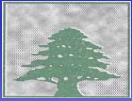
VI - Macro prudential Supervision in Lebanon: *Practices & Examples (Cont.)*

5- Since 2003: Banking sector CAR simulations are being performed to assess the impact of Basel 2 on Lebanese banks. (Risk Assessment Department - *previously Basel 2 Implementation Group* - is responsible to conduct this simulation studies)

- Currently: Monitoring a parallel run period on a Quarterly basis

- Basel 2 CAR calculations submitted by banks on a **Quarterly Basis:**

- Overall 4 QIS: (QIS 1: as of 30/6/2007, QIS 2: as of 31/12/2007, QIS 3: as of 31/3/2008 and 30/6/2008 and QIS 4: as of 30/9/2008, QIS 5 in process).

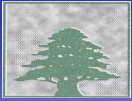


VI - Macro prudential Supervision in Lebanon: Practices & Examples (Cont.)

- Key Capital Ratios monitored by BCC:
 - **CAR**: Equity / Risk Weighted Assets
 - **Tier one Ratio**: Tier 1 Capital / Risk Weighted Assets
 - **Core Tier one Ratio**: (Tier 1 Capital – Preferred shares) / Risk Weighted Assets
 - **Leverage Ratio** : Equity / Assets

- Results of QIS will be used to prioritize Pillar 2 Missions.

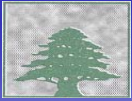
- Under Pillar 2: Assessment of a minimum Individual Capital Ratio (ICR) for each bank, in comparison to the Minimum Capital Adequacy Ratio (CAR:8%).



VI - Macro prudential Supervision in Lebanon: *Practices & Examples (Cont.)*

6- BDL Monitors on a Monthly basis:

- Average Cost of Funds (LL, USD, Euros, other currencies) for both Commercial & Investment Banks
- Distribution of Weighted Average Interest Rates for short & long term loans (LL, USD, Euros, other currencies)



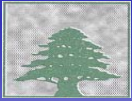
VI - Macro prudential Supervision in Lebanon: Recent Measures

7 - Banks, Financial institutions and brokerage firms operating in Lebanon are requested to disclose to the BCC, on a Monthly Basis:

- Investments in Bonds, Equities, Investment Funds and Structured Products.
- The assessment (Fair Value) of the gains or losses on these investments,

This allows the BCC to take corrective actions proactively.

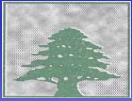
It also serve as an analysis tool for several departments within the BCC, that require timely and accurate information about the financial portfolios of Lebanese banks and institutions.



VII - Conclusion

Macro Prudential Supervision is helping the Regulators, (BDL & BCC) to:

- Focus, not just on the soundness of individual banks, but on broader financial stability objectives.
- Manage a Long Term Reform of the Banking Sector, through a number of actions:
 - * Encouraging Merger & Acquisition operations
 - * Dealing Successfully with weak banks
 - * Providing Liquidity in times of Stress:
 - 2005 (Assassination of Prime Minister Hariri)
 - 2006 (Israel War)
 - 2007 - Mid 2008 (Presidential election Crisis)



The End

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