National Investment Reform Agenda Workshop - Lebanon

Grand - Sérail

Beirut - Lebanon

“The Ongoing Reforms to regulate the Financial Markets"

April 19 2007

By Jean Riachi

Table of Contents

Table of Contents (continuous)

1. 1990-2007: The missed opportunity

- Lebanon failure to establish efficient equity markets
  - Limited number of listed companies and concentration in banks
  - Insufficient volume of transactions
  - Meager general public participation in Markets
  - Poor foreign interest in Lebanese Markets

- An illusionary success in debt market
  - Oversized Eurobond sovereign debt
  - Poor secondary market activity
  - Concentration in banks' proprietary portfolios
  - Inexistent corporate debt market

- Lebanon's failure to gain a role as a financial center

  - Asset management activities: very few mutual funds and only for domestic investments

  - Wealth management, estate planning, offshore corporate service: provided by few local institutions or branches of foreign institutions and only for domestic investors

  - Lebanon has missed the trends and innovations in investments and Wealth management that were witnessed during the last 15 years such as: private equity funds, structured products, family offices, hedge funds, LBO's…

2. Why a strong non-banking financial sector is important for Lebanon?

- Financial services: A major opportunity for the Lebanese economy
  - Capitalize on Lebanon climate and geography
  - Capitalize on Lebanon skilled man power
  - High value added and innovative industry that could create thousands of qualified and well paid jobs
  - Volume not limited by size of domestic economy

- Financial markets: an efficient tool to finance domestic needs
  - Better risk distribution and assessment
  - Provide equity financing
  - Channel liquidity to private sector

- Banking sector in Lebanon: a success story or a burden?
  - Oversized sector with no room for healthy growth
  - Monopoly on resources from deposits leading to major unbalances
  - Incestuous relationship with the public sector.

    - Distorted risk premiums
    - Scarcity of liquidity available for private sector
    - Complacency with public deficit
    - hard landing scenarios more probable because markets do not play a corrective role

3. The needed reforms

- The need for an independent body that would regulate, support and promote the non-banking financial services industry and financial markets

    - Code of commerce and credit empowered BDL: successful story for the banking sector

    - The Constant adaptation of regulations is a must

- The need for a more comprehensive legislation
  - Modernization of related Laws (some date from the early 30s)
  - Adaptation to new products and trends

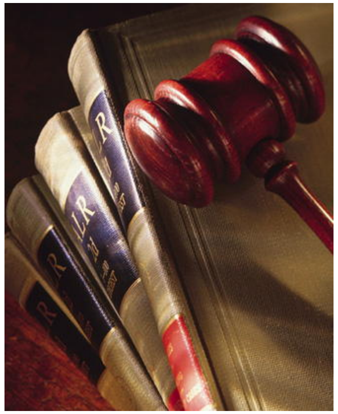
- The need for fiscal reforms
  - Lebanon is not a tax heaven but a tax nightmare
    - Withholding taxes hurting competitiveness in financial services
    - Fiscal stamp horror story
    - Tax rules not in line with IFRS

- The need for an independent supervision and a specialized judiciary system
  - Supervision of financial services needs a specific competence
  - Traditional court system: Lengthy, unqualified with regard to Financial Markets, (and corrupted?)

1. The creation of a Regulatory Framework and a Regulatory Body:

- Mission of the Regulatory Body (as per the law):

  - To organize and develop the financial markets
  - To minimize systemic risk
  - To protect investors
  - To implement rules and regulations
  - To supervise
  - To authorize and license



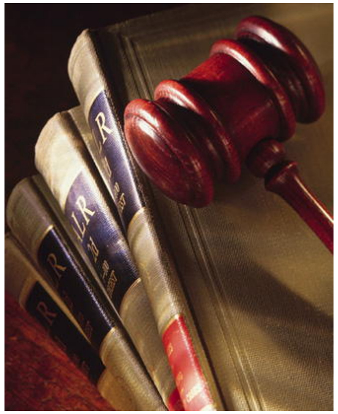
- Summary of primary functions:

  - Rule – Making

  - Authorization

  - Supervision

  - Enforcement



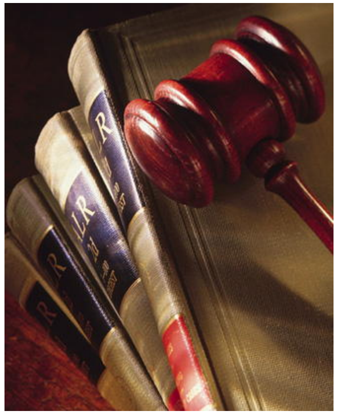
- The Regulatory Body's Board Of Directors (BOD):

  - The BOD is appointed by the Council of Ministers

  - All board members must be free of any other professional occupation

  - Independence of Board members is theoretically guaranteed (none of the members is expandable before the completion of his/her term)

  - Internal structure to be implemented by BOD (divisions, Human resources, Budget,…)



- Activities falling under the new body’s authority

  - Creation and management of exchanges

  - Authorization for individuals and firms operating in the financial markets

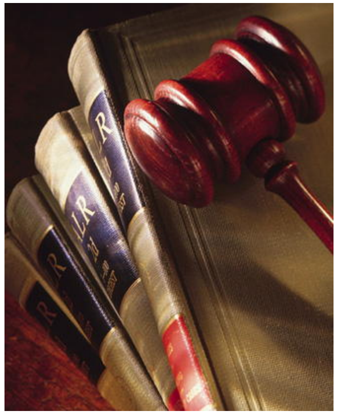
  - Mutual Funds

  - Securitization funds

  - Midclear

  - Initial Public Offerings (IPO) and listings

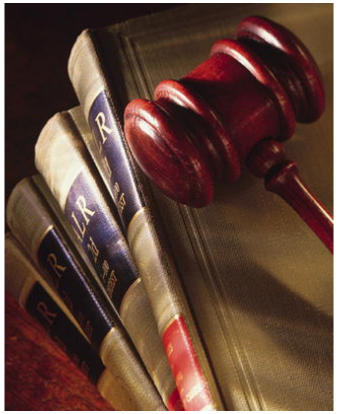
  - Exceptions: Sovereign bonds, Short term instruments and other instruments to be determined by BOD



- Litigations and breaches (Disciplinary Committee and Special Court)

  - Breaches as defined by the Law: insider trading, unfair or fraudulent disclosure of companies statements, misleading reporting on transactions and market manipulation.

  - The Disciplinary Committee:
    The Committee is empowered to sanction (suspension, fines,…) all breaches.



- The Special Court:

- Members of the Special Court are appointed by the Council of Ministers

- The Court is composed of one high-ranked judge and two experts

- The Court have jurisdiction over civil and commercial matters only

- The Court has an exclusive jurisdiction on matters related to financial markets

- Cases referred by the Regulatory board or the disciplinary committee regarding breaches

- Litigations submitted by individuals or firms

2- SWOT Analysis of the new framework:

a- Strengths

- Independence of the Regulatory Body

- Empowerment → will allow rule-making without the usual red-tape

b- Weaknesses

- Framework does not include all Financial and ancillary services (insurance, legal, compliance, accounting, market information services)

- Current framework and classification of financial institutions (commercial banks, investment banks, financial institutions, brokerage,…) still in place → not suitable c- Opportunities

- The creation of a new framework will help attract global and regional firms.

- Gain market shares from competing centers (DIFC)

d- Threats

- Will politics and sectarianism affect the appointment of skilled board members?

- Conflicts between BDL and Regulatory Body powers with regards to authorization of firms

Thank you