



**DIAGNOSTIC REPORT ON THE  
LEGAL AND REGULATORY ENVIRONMENT FOR MICROFINANCE  
IN LEBANON**

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## I. Overview of the Lebanese Banking Sector and Microfinance Sector

### A. Banking

Lebanon enjoys a liberal economy based on market-led dynamics and private ownership.<sup>1</sup> The financial sector in Lebanon is well-developed with a sophisticated commercial banking sector and a well-managed and active Central Bank. Despite political instability, the Lebanese banking sector witnessed high growth during the 1990s and continued to enjoy some growth even in the midst of the country's recent conflicts. The banking and services sectors dominate the economy, representing 72 percent of the country's gross national product.

There are 54 commercial banks in Lebanon (including nine foreign banks and several French banks' subsidiary companies) and 10 specialized banks (including four Islamic banks). The commercial banks have an extensive branch network with a ratio of one branch per 4,555 people. Despite years of civil war and continued political turbulence, they have been able to garner one of the highest bank-deposits-to-gross domestic product ratios (300%) in the world.

### B. The Microfinance Sector<sup>2</sup>

Lebanon has approximately 20 microfinance providers (MFPs),<sup>3</sup> which in fact offer only microcredit services and (for a few) business development services. Most of the MFPs are NGOs that were formed by local or international NGOs to provide various social and economic development services, including microcredit. Credit is often provided at below market interest rates. Few MFPs are dedicated to working according to international best practices.

When compared to the exponential growth that the microfinance industry has witnessed in the Arab region over the past 10 years, Lebanon's microfinance sector has trailed behind. The sector is far from meeting the potential demand. After a decade of operation, the country's primary MFPs (listed in Table 1 below) currently serve in the range of 38,000-55,700 active clients in total.<sup>4</sup> (A rough estimate of the total number of

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<sup>1</sup> Lebanon has liberal codes for capital and money market transactions, with no restrictions on either inflows or outflows. The country has an open foreign exchange market, full currency convertibility, and unrestricted repatriation of capital.

<sup>2</sup> The term "microfinance" refers to the provision of financial services on a sustainable basis to the poor and to microenterprises, including not only loans but also savings, money transfer services and insurance as well as business development services. Thus far, the microfinance sector in Lebanon has focused almost exclusively on credit.

<sup>3</sup> Although banks are involved in microlending through partnership arrangements with MFPs, the term "MFP" is not used in this report to refer to banks.

<sup>4</sup> This wide range is due to the lack of data from Al Qard Al Hassan. A 2008 demand study of the IFC and Grameen-Jameel Pan-Arab Microfinance Limited entitled "Lebanon: A Diagnostic Study on the Demand for Financial Services

active clients of those MFPs not included in the Table is 1,000-2,000.) Of the MFPs listed in Table 1 (excluding Al Qard al Hassan), the portfolio size ranges from approximately US\$425,000 (Makhzoumi Foundation) to US\$10 million (Al Majmoua); the number of active borrowers ranges from 265 (CLD) to 12,000 (Ameen s.a.l.). At the end of 2008, only the two market leaders (in addition to Al Qard Al Hassan, according to some sources) had an active client base exceeding 10,000. The leading MFPs struggle to find sources of funding to expand their operations, while other MFPs continue to be heavily subsidized and are far from achieving their significant growth potential.

The minimal expansion of Lebanon's microfinance industry is largely due to the limited capacities of the NGOs -- specifically, the management and multidisciplinary mission of the NGOs. Though engaged in microcredit, most of these NGOs are also involved in a number of other development activities and have not invested significantly in improving their management or growing their portfolios. Most of Lebanon's MFPs lack the sound financial and operational capacity to manage funds at a significant scale. Even the outreach of the few MFPs that are specialized in microfinance and have higher figures (clients, aggregate outstanding portfolio) is limited compared to other microfinance institutions of similar age in the region. This is also due to their capacity as well as their reluctance to expand rapidly in a politically unclear environment. One of these MFPs, Al Majmoua, has begun to grow at a faster pace but securing the funds to finance further growth is challenging.

As noted above, most of the MFPs are microcredit-focused, which is also the case with other countries in the region. (See Annex I for the characteristics of the primary MFPs and their loan products.) Although the current legal and regulatory framework would not permit non-banks (other than cooperatives -- see discussion below) to take deposits, none of the MFPs currently has the institutional capacity to offer savings services. Products such as microinsurance<sup>5</sup> have not been piloted and offered in Lebanon.

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By Micro and Small Enterprises" ("IFC 2008 Report") cites a 2006 CHF International paper as approximating the number of active borrowers at 8,500. (The IFC/Grameen-Jameel study also notes that other sources have estimated Al Qard serves between 25,000-100,000 clients.) A 2006 Wall Street Journal article interviewing the founder of Al Qard Al Hassan, Hussein Al Shami, puts the number at 26,000.

<sup>5</sup> Al Majmoua currently charges an extra US\$5 up front to each individual loan. This charge goes to the Takaful Fund. Should the borrower die or have a permanent disability/serious illness before fully repaying her/his loan, the balance of the loan will be covered from this fund. Al Majmoua also pays the family of the borrower an amount to cover funerary expenses in case of death.

**Table 1: Microcredit Supply in Lebanon by primary MFPs<sup>6</sup>**

	Name	# of Active Borrowers	O/S Portfolio (US\$)	Date of Data
1	ADR	1,127	1,683,481	2008
2	AEP	602	1,785,000	2008
3	Ameen s.a.l.	11,851	11,619,066	2008
4	Al Qard Al Hassan <sup>7</sup>	8,500- 26,000	11,000,000- 22,500,000	Sep,2007 and 2006
5	Makhzoumi	423	426,447	2008
6	UNRWA	1,290	1,714,471	2008
7	Al Tamkeen	635	1,300,000	Q1 2008
8	Al Majmoua	12,017	9,320,446	2008
9	CLD (Lebanese Cooperative for Development)	265	900,000	July 2007
10	PAWL (Palestinian Arab Women League)	882	1,115,335	2008
11	Caritas	1,500	1,600,000	Dec 2007
	Total	39092 – 56,592	42,464,246– 53,964,246	

Source: Sanabel, individual MFPs

#### 1. The three largest MFPs

The three largest MFPs in Lebanon are Ameen s.a.l., Al Majmoua, and Al Qard Al Hassan. Only Ameen s.a.l. and Al Majmoua consistently follow international best practices.

**Ameen s.a.l.** began operations in 1999 as a project of CHF International and established itself as a joint stock company in 2003. In 2007, Ameen s.a.l. became a licensed financial institution. (The licensing process was time-consuming, requiring the submission of detailed documentation and the receipt of approvals from CHF International and the Central Bank.) To meet the challenges of being a licensed financial institution, which include submitting monthly financial reports to the BDL and complying with applicable prudential regulation, Ameen s.a.l. has developed a new management information system and upgraded various systems. Ameen s.a.l. management reported that the new institutional status will enable the institution to develop new microfinance products.

<sup>6</sup> The table excludes commercial bank programs but includes loans made by MFPs and banks pursuant to partnership arrangements with banks.

<sup>7</sup> See footnote 4 above regarding lack of data for Al Qard Al Hassan.

Ameen s.a.l. pioneered a partnership model in which the MFP works with banks to extend services down-market. Specifically, the bank makes loans to clients identified by Ameen s.a.l. (and approved by a credit committee on which the bank sits) and Ameen s.a.l. manages the portfolio. The partnership agreements between Ameen s.a.l. and its banks specify the funds committed by the bank, the interest to be charged to microborrowers, and the allocation of risk between the MFP and the bank. Ameen s.a.l. may fund a portion of the loans funded by the bank,<sup>8</sup> in which case the bank and Ameen s.a.l. split the risk according to the percentage of the loan funded by each. (However, if a loan is funded 100% by the bank, then Ameen s.a.l. bears 100% of the risk.) Each loan is disbursed and all repayments are made at the bank.<sup>9</sup> Ameen s.a.l.'s current partner banks are Jammal Trust Bank, Crédit Libanais, Lebanese Canadian Bank and Fransabank s.a.l.

From its inception through 2008, Ameen s.a.l. disbursed more than 63,000 loans totaling over US\$ 85 million. Using an individual lending methodology, in 2008, Ameen s.a.l. and its partner banks together maintained an active client base of 11,850 and had an outstanding portfolio of US\$11.6 million at year-end.

**Al Majmoua** began operations in 1994 as a program of Save the Children (funded by USAID). The program spun off from Save and registered as an NGO in 1998. Al Majmoua offers group and individual loans, with the latter categorized as general loans, business development loans, and worker loans. The group-guaranteed lending product targets only women, while the individual lending targets both men and women entrepreneurs. From its inception through 2008, Al Majmoua disbursed more than 70,000 loans totaling about US\$ 95 million to over 30,000 borrowers. As of December 2008, Al Majmoua had a credit portfolio of almost US\$9.32 million and more than 12,000 active clients, 90 percent of whom are informal entrepreneurs. Al Majmoua has been operationally sustainable for the last five years.

**Al Qard al Hassan Association** began operations in 1983 as an unregistered initiative of Hussein Al Shami.<sup>10</sup> It was renamed Bayt Al Mal in 1985 and was registered with the Interior Ministry as Al Qard al Hassan in 1987. The MFP makes small and microloans to enable clients (mainly Shiite Muslims) to set up small businesses or pay school fees. Al Qard al Hassan does not report to the Microfinance Information Exchange (the MIX<sup>11</sup>) or to Sanabel. However, it appears to have the largest market share of all MFPs in Lebanon. As noted above, there are estimates of its credit

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<sup>8</sup> Only that portion of a microloan that is funded by Ameen s.a.l. appears on Ameen s.a.l.'s balance sheet.

<sup>9</sup> A smaller MFP, ADR (Association for Rural Development), has an arrangement with Libanpost pursuant to which Libanpost agrees to collect loan repayments by ADR's clients for a per transaction fee of \$1. (The loan agreements are signed at ADR's offices and the loans are disbursed by Audi bank) Libanpost has no liability with respect to the loans.

<sup>10</sup> Al-Qard Al-Hassan is one of the charity organizations of Hizbullah.

<sup>11</sup> The MIX is a global, web-based microfinance information platform that provides information on MFIs worldwide based on standardized microfinance benchmarks. See [http://www.mixmarket.org/en/home\\_page.asp](http://www.mixmarket.org/en/home_page.asp).

portfolio ranging from approximately US\$11-22.5 million and of its clientele ranging from 8,500-26,000 active borrowers.

## 2. Loan Products

All the MFPs in Lebanon use individual loan methodology; a few of them also use the group lending methodology. As indicated in Annex I, although all of the MFPs provide loans for entrepreneurs, a few also provide loans for start-ups, housing, consumption and agricultural purposes.

## 3. The Gap between the Supply and Demand for Microcredit

The estimates in studies conducted over the past decade vary widely as to the size of the potential market for microcredit in Lebanon.<sup>12</sup> Based on a very rough estimate of 190,000 eligible potential borrowers multiplied by an average loan balance of US\$1,100,<sup>13</sup> the potential market is roughly US\$200 million. Based on this estimate, with an aggregate outstanding portfolio for all MFPs in Lebanon of US\$ 41-53 million, supply is in the range of 20-26 percent of demand. However, it is likely that demand is much greater than the studies indicate given the strong entrepreneurial spirit of the Lebanese, and the experience of countries in the region where the microfinance industry is more mature (e.g., Morocco).

**Table 2: Potential microcredit market gap in Lebanon (based on the largest MFPs) as of December 2008**

Estimated number of interested, eligible MSEs	190,000
Number of active borrowers	39,000-56,600
Potential national microcredit market (US\$ millions)	US\$200,000,000
Outstanding microloan portfolio	US\$42.5-54 million
Current percentage of market with access to microcredit	21 - 30 %
Current outstanding microloan portfolio as percent of national market	21-27%
Market gap	70-79 %

<sup>12</sup> The studies rely on assumptions using secondary statistics of the labor force and the population. The broad discrepancies are due both to differences in assumptions and to the lack of consensus on the size of informal sector, especially in the Palestinian refugee camps where microentrepreneurs are very active. Some MFPs have carried out their own demand studies; however, these studies have not been shared publicly.

<sup>13</sup> Today, the average loan balance is about 1,000 USD and it is expected to increase over time as a result of inflation.

## Micro Savings:

As noted above, most of the MFPs are microcredit-focused, which is also the case in other countries in the region. There has been no demand study for microsavings in Lebanon although there is a general sense that the demand for microsavings is far higher than the demand for microcredit.

### 3. Challenges Facing the Microfinance Sector

**Political and Economic Instability:** Leaders of the major Lebanese MFPs attribute the stagnation of the microfinance sector to the political and economic instability: the harsh repercussions of a 15-year civil war (1975–1990), the continuous unrest, military clashes and political strife, the assassination of Prime Minister Rafiq Hariri in February 2005, the continued political tensions among the local political parties and the war with Israel in 2006. However, although the peak of this instability was during the war with Israel in 2006, the two leading MFPs' figures indicate that their outreach had been stagnating before the war and that both institutions witnessed relatively significant growth in the years after the war.

**Table 3. Outreach of Ameen s.a.l. and Al Majmoua:**

		2004	2005	2006	2007	2008
Number of active borrowers	Ameen s.a.l.		7,829	7,867	7,227	11,238 <sup>14</sup>
	Al Majmoua	6,027	6,089	6,275	9,069	12,017
Loan portfolio, gross (in USD)	Ameen s.a.l.		6,152,830	5,979,571	7,302,681	10,639,444
	Al Majmoua	5,150,089	5,586,641	5,308,259	7,782,535	9,320,446

Source: The MIX.

Table 4 shows although the Portfolio at Risk (PAR) of Ameen s.a.l. and Al Majmoua increased in 2006 (during the war with Israel); it was brought back to historical levels in year 2007 and 2008. It also shows that the PAR was not brought down by writing off loans but by collecting those delinquent loans. In the case of Ameen, the written-off ratio in 2006 and 2007 was similar to 2005. In the case of Al Majmoua, the written-off ratio went up in 2007 to almost double its historical rate but in 2008, the ratio is negative, meaning that the institution managed to collect most of their written-off loans (which would reduce the 2007 ratio to its historical average).

<sup>14</sup> The figures for Ameen s.a.l. (based on the data in the MIX, which are as of September 30 2008) differ from those in Table 1, which included figures as of December 31<sup>st</sup> 2008.

**Table 4. Ameen s.a.l. and Al Majmoua: PAR and Write-off Ratio**

		2004	2005	2006	2007	2008
Ameen s.a.l	PAR > 30 days	1.11%	1.01%	5.98%	1.41%	1.60%
	Write-off ratio	1.11%	0.05%	0.22%	0.42%	—
Al Majmoua	PAR > 30 days	2.29%	1.63%	24.43%	3.96%	2.43%
	Write-off ratio	1.81%	1.32%	1.60%	3.63%	-1.08%

**Building MFPs' Capacity.** It is evident that there is still significant room for growth within Lebanon's microfinance industry, given the sizeable unmet demand for microcredit. The potential market for microcredit has only increased in the aftermath of July 2006 war as poverty and unemployment levels have risen in some places dramatically. The existing MFPs need to improve their internal capacities and develop more innovative approaches to actively promote their products and services. Notably missing from the industry is active leadership, which has resulted in limited coordination among the MFPs to jointly build capacity and grow.

**Igniting Competition.** In other countries in the region (e.g., Morocco, Jordan), one of the main factors driving growth in the microfinance sector has been competition between the MFPs as they work to keep pace with the new competition. The level of competition in the microfinance sector in Lebanon is very low, primarily because there are not many significant players, resulting in lackluster performance and an agreed division of the market among the existing MFPs. (MFPs are more concerned with the country's political and economic stability and the impact of that on their operations and portfolio than competing for clients.) For this reason, as well as the MFPs' limited internal resources (i.e., human and management information systems), growth in the sector has been relatively stagnant over the past five years,<sup>15</sup> including a lack of product and service innovation and diversification. It is hoped that the new MFP<sup>16</sup> - which is beginning with significant funding from the founders (members of the Al Hariri family) - will ignite competition (and hopefully growth).

**Financing.** Although there is excess liquidity in the banking system, it has not translated into investment in microfinance (or specifically, microcredit). This is due primarily to the relatively short track record of success among MFPs and their limited ability to gain the confidence of commercial banks and secure partnerships or funding for their microfinance portfolios. In addition, the instability of the current political environment deters banks from exploring new investment prospects.

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<sup>15</sup> Although both Ameen s.a.l. and Al Majmoua witnessed some significant growth rate in 2007-2008, the overall figures continue to be low.

<sup>16</sup> The new MFP will be a part of Emkan, a division of the Hariri Foundation, which is headed by the founder and former director of Ameen s.a.l.

## II. CURRENT LEGAL AND REGULATORY FRAMEWORK FOR MICROFINANCE ACTIVITIES IN LEBANON

*Currently available legal forms.* Lebanese law does not require an institution to obtain permission to engage in lending. Today, the following types of institutions engage in microlending:<sup>17</sup> NGOs (which includes civil associations), financial institutions, cooperatives and banks. In addition there is the UNRWA program.

**NGOs** are overseen by the Ministry of Interior. NGOs must keep their financial and administrative books and records available for inspection. The Ministry does not have microfinance-trained supervisors nor does it require NGO MFPs to use a specific accounting system. Most of the MFPs in Lebanon operate as NGOs.

**Financial institutions** are licensed and regulated by the Central Bank. A financial institution, which must be formed as a joint stock company, must meet the minimum capital requirement of LBP 2 billion (approximately US\$ 1,333,333). Financial institution may engage in lending and, in accordance with applicable laws, various other activities including: financial intermediation, financial studies and consultations, real estate property management and assisting in the issuance, marketing and underwriting of securities. Financial institutions are not permitted to take deposits. Financial institutions are supervised by the Central Bank and are required to comply with monthly financial reporting requirements and some prudential regulation, including loan loss classifications and provisioning.

There is one MFP – Ameen s.a.l. – that is a licensed financial institution. (It "transformed" from a commercial services company to a financial institution in 2007.)

**Cooperatives** may, pursuant to the Cooperatives Act, take deposits from the public and make loans to their members. The law does not specify what types of deposits (e.g., demand deposits, time deposits) a cooperative may accept and it does not address the issue of whether a cooperative may mobilize deposits (i.e., intermediate). (It does not appear that anyone has pushed the issue regarding how these provisions of the Cooperative Act work together with the Code of Money and Credit, which permits only licensed banks to mobilize deposits.) Cooperatives are supervised by the Cooperatives Directorate at the Ministry of Agriculture and are subject to basic reporting and audit requirements. Specifically, they are required to file (i) the balance sheet audited by a certified auditor and approved by the general assembly and (ii) a copy of the minutes for meeting of the general assembly and board of directors.

Currently, there is one cooperative engaged in microlending: Coopérative Libanese pour le Développement (Lebanese Cooperative for Development or CLD).

**Banks** are licensed and supervised by the Central Bank and provide a range of financial services, including deposit-taking. Banks are subject to prudential and non-prudential requirements.

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<sup>17</sup> Although commercial companies are allowed to engage in lending activities without having to ask for a license or fall under BDL's supervision, there was no data available about any commercial company engaged in microlending.

*Central Bank Circular on Microloans.* In 2004, in an effort to stimulate banks to grant microcredits either directly or through partnering with or financing of MFPs, the Central Bank issued a circular<sup>18</sup> permitting commercial banks to use up to five percent of their mandatory reserve requirement for extending "small loans"<sup>19</sup> to or through "small loan institutions." The Central Bank circular defines "small loans" and "small loans institutions" as follows: A small loan is a "Lebanese currency loan granted by a 'small loans institution' or a financial institution to individuals or small establishments that comprise no more than four persons to assist them in creating and developing production (industrial, agricultural, crafts), services, tourism or trade projects, provided that the loan amount does not exceed LBP 10,000,000 (US\$7000) with a maturity of no more than three years." A "small loan institution" is a civil association or non-governmental organization that may, upon the approval of the Central Bank, enter into a partnership agreement with banks to directly or indirectly disburse small loans.

Specifically, the circular permits a bank to reduce its reserves by an amount equal to the aggregate balance of small loans in Lebanese currency, up to a maximum of five percent of the compulsory reserve imposed on the in the preceding fiscal year (as shown in the bank's balance sheet).

The circular has resulted in very little investment in microfinance (whether through direct microlending by banks or lending to microlending institutions). As indicated by Table 5, although the percentage of funds lent to funds available increased since 2005, it was only 3.5% in June 2009. This appears to be due mainly to the lack of capacity of most of the MFPs as well as the fact that most of MFIs loans are in US dollars and not Lebanese pounds.

Table 5.

in millions of L.L	2005	2006	2007	2008	2009
<b>Deposits in lebanese Currency</b>	23,080,665	21,763,131	22,986,982	35,676,080	42,678,516
<b>Deposits in USD and foreign currencies</b>	62,845,900	69,754,048	78,447,668	81,576,768	86,633,092
<b>Reserves</b>	3,507,338	3,307,125	3,493,102	5,421,337	6,485,791
<b>Available for lending for micro and small enterprises</b>	175,367	165,356	174,655	271,067	324,290
<b>Amount that banks lend to micro and small enterprises</b>	423	1,716	2,564	3,891	11,331
<b>% of Deposits in Lebanese Currency to All</b>	27%	24%	23%	30%	33%
<b>% of Lent to Available Funds</b>	0.2%	1.0%	1.5%	1.4%	3.5%

*Working with banks.* MFPs have been working with banks in the following ways:

1. "partnering" with banks, as is the case with Ameen s.a.l.: Ameen identifies potential borrowers; the bank funds the loans, either 100% or together with the MFP. Typically, the MFP identifies potential clients and manages the portfolio and the bank disburses the loans and collects repayments thereof.

<sup>18</sup> BDL Basic Decision No. 8779 dated July 13, 2004. To date, the circular is the sole regulation relating specifically to microcredit activities in Lebanon.

<sup>19</sup> This term is a direct translation from Arabic but should be read to include both small and microloans.

2. borrowing from banks and onlending, as is the case with CLD. Al Majmoua has been negotiating with commercial banks for a similar type of borrowing (partially guaranteed by donors like AFD or Grameen-Jameel) to finance the planned growth of Al Majmoua.
3. using the bank tellers to disburse loans and collect payments: typically, the MFP manages the portfolio and arranges for disbursements and loan repayments to be made at the bank's tellers.<sup>20</sup>

*Outsourcing banking services.* As a general principle, financial services may only be conducted by entities regulated by the Central Bank and each such entity may only offer the financial services that fall within the scope of its license. The Central Bank does not provide for any express general regulations for the outsourcing of financial services (nor are there any restrictions on outsourcing) although there is at least one instance in which a bank obtained Central Bank approval to outsource back office activity. (NB: the Central Bank has issued a decision<sup>21</sup> that permits banks to outsource their internal audits.) If a bank were permitted to outsource banking services, it is probable that such entity or person would be subject to the restrictions applicable to those employed by a bank.

*Feasibility of NGO Transformation.* Under Lebanese law, an NGO is not explicitly prohibited from selling or otherwise transferring its assets to a new or existing company. For example, an NGO may exchange its assets (including its loan portfolio) for a participation (i.e., an equity interest) in the company receiving the assets. The Ministry of Interior has confirmed that, in practice, such transactions are not prohibited provided that the income that the NGO accrues as a result of such participations is not distributed to the members of the NGO but is used for purposes of the NGO's non-profit activities. Provided that the NGO continues to pursue its stated mission (as articulated in the organization's constituent documents), it may be an owner of the transformed (for-profit) microfinance institution and continue operating – i.e., it will not be required to dissolve. (NB: Although the NGO law does not provide for a prohibition against appointing its representatives in the management of a company, since management activities in commercial companies bear a commercial nature, Lebanese counsel has advised that NGOs not participate in such activities.)

*Consumer Protection.* The Consumer Protection Law, which protects individuals and legal entities engaged in non-professional activities, addresses fraud, abusive practices and loan disclosure rules by banks and other institutions. Banks and financial institutions are also subject to the provisions of the Banking Law and Central Bank directives, which include protections for clientele, including a requirement that a bank or financial institution obtain written consent from a potential customer before conducting due diligence. If the bank or financial institution is lending to a microfinance

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<sup>20</sup> Some MFPs operating as NGOs have been advised that NGOs are not permitted to handle cash. This appears to be based on a misinterpretation of a provision in the NGO law regarding the prohibition on engaging in for-profit activities.

<sup>21</sup> Basic Decision No. 7737 dated December 15, 2000, as amended.

institution that is lending to a borrower, then the bank or financial institution must obtain written consent from the microfinance institution's customer before receiving statements regarding loans to such person. There are no comparable provisions applicable to NGOs or cooperatives in the NGO law or the Cooperatives law, respectively.

*Interest Rate Policies.* Lebanese law applies interest rate caps on civil transactions.<sup>22</sup> Loans to artisans for simple craftsmanship and to subsistence farmers for rudimentary farming are considered civil transactions. Interest rate caps do not apply to non-subsidized commercial transactions. A loan granted by a bank or financial institution – including a microloan – is considered a commercial loan for interest rate purposes. Regardless of the identity of the lender, small loans granted to borrowers that will use the funds for production (e.g., industrial, agricultural, crafts), services, tourism or trade are considered commercial and are not subject to interest rate caps.

*Stamp Duties Exemptions.* Loans granted by a bank and financial institutions benefit from stamp duties exemptions intended to develop the financial sector in Lebanon. Cooperatives are also exempt from stamp duties on loan agreements and related instruments. Loans extended by NGOs do not benefit from this exemption. (NB: NGOs and cooperatives are exempt from income tax.)

*Credit Information Services.* The Central Risk Unit at the Central Bank is the repository of all information provided by banks and financial institutions to the Central Bank. Specifically, banks and financial institutions are required to submit monthly statements to the Central Bank on all loans with an initial principal amount of at least LBP 7.5 million (approximately US\$5,000) and all "small loans" (i.e., loans made pursuant to the 2004 BDL circular regarding exemptions from the reserve requirement). Currently, none of the MFPs aside from Ameen s.a.l. (which is licensed and regulated by the Central Bank) has access to the information held by the Central Bank's Credit Risk Unit. The BDL is planning to automate the system in its Central Risk Unit in order to allow participants to use the system online. There is also a plan to establish a zero threshold which will make the system useful for the MFPs. However, the participation of the unregulated MFPs in the system will require the approval of the BDL

There is currently no private credit information market although many banks collect their own credit information on their clients and unofficially share such information with other banks. (This practice – if conducted without a client's approval – is inconsistent with bank secrecy rules and privacy.)

IFC is actively working, together with the Association of Lebanese Banks and the sponsorship of the Central Bank, to establish a credit bureau that would collect both positive and negative information. The project is still in the planning phase.

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<sup>22</sup> For civil transactions, the interest rate limit is 12% per annum. In this respect, Article 661 and seq. of the Lebanese Penal Code provide for "usury" sanctions against lenders that impose an interest rate in excess of 12% per annum.

*Anti-Money Laundering (AML).* Applicable law requires banks and financial institutions to, among other things:

- (i) verify the identity of their permanent clients and that of the beneficial owner, if any;
- (ii) apply "know your customer" procedures to transient clients when the value of the operation exceeds US\$ 10,000;
- (iii) keep copies of all operation related documents, as well as identity documents for at least five years after the completion of the operation or closing of account; and
- (iv) identify any indications of money laundering operations and set out the basis for diligently uncovering suspicious transactions.

MFPs other than banks and financial institutions must keep records for any transaction that exceeds the equivalent of US\$ 10,000. The records must be kept for no less than five years. The law (in the original Arabic) is ambiguous regarding whether such requirement applies to smaller transactions. The law is also ambiguous regarding whether such institutions must - regardless of the size of transactions – comply with the requirement to verify, through official documentation, the identity and address of each client. At this point in time, the Special Investigation Commission in the Central Bank does not monitor compliance by institutions that are not regulated by the Central Bank.

### III. GENERAL RECOMMENDATIONS FOR POLICY-RELATED ACTIVITIES IN LEBANON

*Capacity building.* Well-designed capacity-building programs for both existing programs and new programs are much needed. These programs can help develop a better growth rate, more diversified products and more active players in the market.

*Encouraging bank partnerships.* Partnerships between MFPs and banks should be encouraged. Notwithstanding the 2004 Central Bank circular, which was intended to encourage banks partnering with MFPs by exempting 5% of a bank's reserve requirement if used for making "small loans," there are few such partnerships. As noted above, the circular requires that such loans be in Lebanese pounds. Given that most microloans are in US dollars, the currency limitation may have had a dampening effect on the use of the reserve exemption. It is recommended that the Central Bank consider eliminating the currency limitation.

*Outsourcing.* Current law is not explicit regarding banks' permitted outsourcing of services, including in particular financial services. Although it is possible for a bank to seek permission from the Central Bank to outsource bank operations (whether back office, financial or otherwise, such as KYC activities), banks might be more inclined to explore the possibility of outsourcing to MFPs if there were greater legal clarity. This may prove of significant importance regarding the possibility of taking savings.

*Transformations.* The MFP community is unclear about how to transform from an NGO into a for-profit institution. The current state of the law does not prohibit an NGO from selling its loan portfolio provided that (i) the NGO uses the proceeds in advancement of its permitted activities and mission and (ii) there is no distribution of profits by the NGO to its members. The same

analysis would apply to the transfer by the NGO of its portfolio to a company in exchange for shares in the company (or other assets). The key issue – as in all transformations – is to ensure that the exchange is "for value": specifically, the portfolio should be assessed by an independent valuation expert and any non-cash items (such as shares in a company) that the NGO receives in exchange for the portfolio (and other assets it might transfer) should also be assessed if the market value is not apparent (e.g., if the shares are privately held).

Given the confusion among MFPs regarding transformation, it would be helpful to get clarification from the relevant policymakers.

*Credit Information.* The establishment of a credit information market – including laws that would support such type of activity – would likely benefit the MFPs, bring down costs and perhaps encourage banks to increase their involvement. The IFC is working on establishing a private credit information bureau. It would in theory be possible under current law to establish a private credit information bureau although there currently is no legislation on point. Pursuant to the Lebanese Bank Secrecy Law, banks and financial institutions would be permitted to share information on their clients only if clients were to give prior written consent. As for other providers of credit information (MFPs operating as NGOs or cooperatives, utilities), it would be advisable for them to also obtain prior written consent before sharing their clients information. In all cases, the request for consent should be accompanied by a clear explanation of how the information would be used. In order to ensure the development of an accurate and fair process, it would be important that other restrictions and requirements often imposed on private credit information bureaus be imposed (e.g., retaining information for a specified period of time, correcting information when informed of its inaccuracies).

In the interim (i.e., prior to the establishment of a private credit information bureau), it is important to take measures to address the current unofficial sharing by banks of information regarding clients.

*AML law.* It would be helpful to get clarification from the Central Bank regarding whether institutions other than banks and financial institutions (e.g., MFPs operating as NGOs and cooperatives) are required to maintain records on all clients regardless of the size of the transaction conducted. In addition, it may be helpful (in terms of increased use of bank-MFP partnership arrangements) if there were clarity regarding whether banks could outsource performance of its KYC obligations to third parties, such as MFPs.

*Exemption from stamp duties.* To create a level playing field, loans granted by all types of MFPs (regardless of legal form) should be exempt from stamp duty taxes.

*Minimum reporting requirements.* For transparency purposes and to encourage institutions to keep careful books and records, all institutions engaged in lending as a primary activity should be subject to the same minimum reporting obligations. Currently, some but not all Lebanese MFPs report to the Microfinance Information Exchange (the MIX) using the standard business reporting procedures as defined by MIX. The reports that MFPs are required to file by law depend on the institutional type and are not specific to microfinance. (As noted above, NGOs are required only to keep their financial and administrative reports available for inspection by the Ministry of

Interior.) All MFPs should be subject to the same reporting requirements (enhanced and standardized), which should be kept on file by the relevant regulator for inspection by the public.

*Savings Demand Study.* Given the importance of savings and the absence of savings services provided to the poor, a study should be conducted to understand the level of demand for micro and small savings services and types of products that would best serve the low-income market. Following an initial market study, MFPs and banks should be encouraged to explore means of providing such services, including through outsourcing.

**ANNEX I: Characteristics for Primary Microfinance Providers in Lebanon**

Name of Institution		Ameen s.a.l.	Al Qard Al Hassan	Al Majmoua	ADR	AEP	Caritas	Al Tamkeen	Makzoumi	PAWL	CLD	UNRWA
Began MC Activities		1998	1983	1994 <sup>23</sup>	1999	1984	1985	1996 <sup>24</sup>	1997	2001	1992	
Institution Type		S.A.L	NGO	NGO	NGO	NGO	NGO	NGO	NGO	NGO	Co-op	Donor
Methodology	IL	√	√	√	√	√	√	√	√	√	√	√
	Group			√		√	√		√	√	√	√
	Village banks						√					
	Coop					√						
Products	Start Up		√	√	√	√				√		
	Enterprise+ business	√	√	√	√	√	√	√	√	√	√	√
	Housing	√	√	√			√				√	√
	Consumer	√	√									
	Agriculture			√	√			√			√	
Demographic	Rural	√	√	√	√	√	√	√			√	
	Urban	√	√	√	√	√	√		√		√	
	Refugee Camps			√						√		√
Interest Rate	General	16.4% - 15.8% flat/yr	10-12% flat*/yr	1.4-1.5% flat/month+ 1.65% flat/month	12% flat+ 3% insurance	10% flat/yr		5.5% agri 9% commercial Flat/yr	18% flat/yr	7% /yr IL 10% flat/yr GL	7.5-8.5% flat depending on currency & maturity	7% flat/yr
	Avg monthly -flat	1.37%	0.7%	1.5%	1.00%	0.83%	NA	0.75%	1.5%	0.29-83%		0.58%
	Up-front fee/insurance	NA	NA	2% (IL)	3%	NA		NA	NA			NA
	Effective monthly rate**	2.42%		2.98%	1.54%	1.49%		1.35%	2.64%	0.58-1.65%		1.05%
Max Loan Amount (US\$)		5,000		10,000	4,000	5,000		3,000	5,000	500-1,000 GL and 2,000 - 40,000 IL	20,000	5,000
Avg MFP Loan Maturity (months)		18		24	24	24		36	18	12 (GL) 36 (IL)	Up to 36	36

Sources: Demand study by IFC and Grameen-Jameel Pan-Arab Microfinance Limited at <http://www.microfinancegateway.org/content/article/detail/50618>; individual MFPs

\*administration fee

\*\* Calculated on individual loan of \$3,000 with a 12 month maturity, various Lebanese MFPs, 2007

<sup>23</sup> Al Majmoua was originally a program of Save the Children and was spun off as an NGO in 1997.

<sup>24</sup> Al Tamkeen was created in 1996 and registered as an NGO in 2002.