

Executive Program

RISK MANAGEMENT

What We Have Learned

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March 15-18, 2010 Beirut, Lebanon

Ladies and Gentlemen

Good morning

It gives me great pleasure to officially open the 2010 Executive Program on Risk Management, offered by the Institute of International Finance, in cooperation with the Association of Banks in Lebanon. On behalf of the Association of Banks in Lebanon, please allow me to warmly welcome all speakers and participants, and commend on the diligent efforts of organizers in putting together this Program.

The presence of the Institute of International Finance for the first time in Lebanon and its cooperation with our ABL on a seminar on Risk Management, as well as the diversity of participants coming from various countries, highlights the importance of this subject, which is currently preoccupying the world and its leaders.

Ladies and Gentlemen,

In our ever-evolving, and inter-connected world, especially following the crisis that hit the global-village fast and big, we have no doubt, entered a new era in the global financial and risk management systems. Policies calling for non-intervention, deregulation, liberalization, and greater openness to the world markets are now in retreat, giving room to government intervention, more regulations, reforms and tighter controls and risk management practices. The “***financial tsunami***” demonstrated that the principles of globalization, long perceived as a blessing, turned out to be, a curse.

The turbulence situation also underscored the dire need to revamp new techniques for supervision and risk management of large, complex and internationally active institutions, primarily to those who had a direct hand in the eruption of the crisis.

Ladies and gentlemen,

What really caused the worldwide financial crisis, is not only insufficient or deficient regulations or control policies: the responsibilities also lie heavily on the shoulders

of those “players” and “market makers” who demonstrated greed for easy money, and lacked clear vision for sustainable growth and development. Furthermore, those “market makers” entered into fierce competitions for gain, while ignoring shareholders’ interests. All these factors led to the current chaotic situation the world is still struggling to deal with today. Repercussions were like a domino wave of worldwide bank failures, and the lessons learned will be embedded in risk management practices for years to come. With the losses in trillions of dollars, came also disastrous social repercussions resulting from losses of homes, incomes, savings, funds for education and even retirement savings that people worked hard all their lives to earn.

Deficiencies in the financial markets and the regulatory frameworks were magnified by **leverage and lack of transparency**. Yet excessive high leverage is not the only reason. Looking at solvency ratios based on the Basel 2 requirements, some collapsing banks were among the best capitalized large international banks in the world. However, looking at simple leverage, the same institutions were among the worst-capitalized banks. It is obvious then, that even greater emphasis on the risks of excessive leverage and poor risk management should be taken into account.

Credit rating agencies played an important role at various stages in the global crisis. It is highly imperative that regulations subjecting such agencies to mandatory oversight are put in place, in order to increase transparency and reduce conflicts of interest in the rating process.

Executive compensation incentive structures also contributed to the crisis by rewarding risk-taking on the part of executives that jeopardized the health of the institutions by which they were employed. Compensation policies tied up to incentives to increase returns should take into consideration the associated risk in addition to the value for shareholders. This should be the aim of any good corporate governance structure. Governance structures and compensation policies which place too few incentives on monitoring risk are inconsistent.

If we have learned anything from the late financial crisis is that the **effective supervision** must be a priority in our banking institutions, and supervisory authorities must observe a prudential and vigilant policy approach. In fact, in

Lebanon, and paradoxically enough, despite the inter-connectivity of world financial markets and the contaminating effects of any crisis onto other markets in the world, Lebanon has shown an impressive resilience to the crisis, owing to the sound, solid and efficient regulatory framework put in place by the Central Bank of Lebanon and its controlling arm, the Banking Control Commission, added to the open dialogue with Banks via the Association of Banks. They all joined forces and rightfully avoided the looming hazards of investments in mortgage-backed securities. In Lebanon, banks weren't allowed by the Central Bank to take on too much debt and they had to keep at least 30% of their assets in cash. They were not allowed to speculate in risky packages of bundled up debts. Weak banks were driven to merge with bigger ones before they got into trouble. Thus, Lebanese Banks had no exposures to toxic assets. All structured products are to be approved by the Central Bank, which has limited Banks' appetite for investing in such products. No more than 5% of a commercial Bank's equity could be invested in structured products. Also, since 2004, the Central Bank of Lebanon has banned Banks from making any sub-prime investments.

Moreover, the decision of the authorities for an early implementation of the Basel II regulatory framework has also been one of the major powerful arms of our banking strength. While preparing for Basel II, the Central Bank of Lebanon and the Banking Control Commission issued a series of regulatory circulars and directives to facilitate the implementation process. Regulations are therefore serving as a regulatory umbrella for the implementation of a sound and effective risk management program covering Basel 2 pillars, commensurate to the size and complexity of each financial institution.

Moreover, Lebanon's system is now considered by international instances, as a well tested and immune system against very severe stress test scenarios: internal and external wars, as well as political instabilities. The world testified that we are an economic example to follow, and mostly, a banking model in terms of managing crisis, and prospering in hostile work conditions.

Ladies and Gentlemen,

Surely, this is a time of remarkable challenges, but also a time of opportunities, to move ahead through these adjustment phases on the international scene. Implementation of a good risk management framework in banks is not just a regulatory compliance but rather a culture to be embedded at all levels of any organization.

Lessons learnt from the crisis could be summarized in the need to:

- Establish a new system of regulatory requirements to ensure that banks carry sufficient levels of liquidity
- Put in place regulations subjecting rating agencies to mandatory oversight in view of increasing transparency and reducing conflicts of interest in the rating process.
- Implement the two consultative documents issued by the Basel Committee, which contain proposals to strengthen the global capital and liquidity regulations, thus promoting a more resilient banking sector
- Enhance means of measuring counterparty credit risks
- Avoid crisis by a vigilant culture of risk management by effectively and timely communicating risks to top management, risk committees and boards.
- Enhancing current risk-weighted capital requirements with a simple leverage ratio is very important safety valve against weaknesses and shortcomings of risk weighted requirements. It ensures the built of a minimum capital buffer during good times that protects banks against unexpected losses and underestimation of risks.

A wise risk management is an essential element in banking and financial institutions practices, one that constitutes the very foundations of growth, stability, and sustainable development of banks and economies.

Finally, I would like to take the opportunity to welcome you again to Lebanon. Please allow me to wish you an enriching dialogue and all the success to this 2010 Executive Program on Risk Management.

Thank you for your attention