Islamic Finance in Lebanon

Introduction

Lebanon, which is a secular country in terms of its obligations, contracts and commercial transactions, has recently acknowledged Islamic finance by enacting a set of laws and regulations pertaining to Islamic banking.

Islamic finance in Lebanon is an alternative approach to the traditional financial model, driven by religious ethics and featuring an array of peculiar financial instruments. It is recognised by the legislator within the boundaries of the existing laws and regulations.

Islamic banks are a new arrival in Lebanon's banking landscape. They benefit from the country's renowned conventional banking system, and draw on its long-standing banking confidentiality laws and sound banking regulations.

Beyond the traditional, universal characteristics of Islamic banking, Islamic banks in Lebanon offer a number of non-banking services, such as fiduciary, real estate and consultancy services. Lebanese Islamic banks strive to remain faithful to their duty to contribute to the community's social welfare.

1. Islamic finance in Lebanon: legal and regulatory framework

Islamic finance in Lebanon is embodied in the following laws and regulations:

- Law No. 575 of 11 February 2004 on the Establishment of Islamic Banks in Lebanon
- Law No. 705 of 9 December 2005 on Securitisation (mainly articles 44 to 46, which deal with Islamic Securitisation Funds)
- Law No. 706 of 9 December 2005 on Collective Investment Schemes (mainly articles 45 to 53, which cover up Islamic Investment Funds)
- The Circulars of the “Banque du Liban” (the Lebanese Central Bank): 22 in total, which are broken down into 13 main Circulars and nine amending Circulars. These Circulars deal with the Conditions for Establishment of Islamic Banks in Lebanon, the Operations of Islamic Banks, the Financial Statements of Islamic Banks, the Monetary Reserve, Minimum Special Reserve and Required Investments for Islamic Banks, the Shareholders' Equity of Islamic Banks, the Islamic Collective Investment Schemes, the Murabaha, Musharaka, Mudaraba, Salam, Istisna’, Ijara and Ijara wa Tamalluk transactions, as well as the issue of Corporate Governance in Islamic Banks.

According to article 1 of Law No. 575, Islamic banks are those whose constitutional documents feature an obligation not to contradict the Islamic Shari’ah and more particularly an obligation not to deal with interest in the transactions they undertake.

Absent any legal provision to the contrary, the laws and regulations that generally apply to banks in Lebanon (such as the Commercial Code, the Code of Currency and Credit and the Banking Secrecy law) also apply to Islamic banks.

Islamic banks in Lebanon may undertake all banking services and transactions, including without limitation forming companies and participating in projects, as well as acquiring real property for the purposes of investment projects.

Pursuant to the Lebanese Central Bank’s Basic Decision No. 8829/Basic Circular No. 95, Islamic banks are subject to a minimum capital requirement of US$100 million, which can be reduced to US$20 million if certain conditions are met.

It is also worth noting that the Lebanese Central Bank requires that half of any Islamic bank’s assets be invested in Lebanon.

Each Islamic bank must have a three-member Shari’ah Consultative Body, which shall be appointed for a renewable three-year term. Shari’ah Consultative Bodies opine on the non-contradiction of the bank’s transactions with the Shari’ah and issue reports to the bank’s board of directors and shareholders’ meetings in this respect. They can also
proactively prepare proposals with a view to helping the bank generally to accomplish its goals in accordance with the Shari'ah.

2. The limits of Islamic finance within the Lebanese legal system

According to article 4 of the Lebanese Central Bank's Basic Decision No. 8829/Basic Circular No. 95, the constitutional documents of Lebanese Islamic banks must include specific provisions that relate to the Shari'ah Consultative Body. These provisions shall ensure “the bank's compliance, in all of its transactions and operations, with the provisions and principles of the Shari'ah that are consistent with those applicable laws that do not contradict Law No. 575 or the Circulars issued by the Lebanese Central Bank for the implementation of such Law”.

Thus, in the Lebanese banking world, Shari'ah seems to be an alternative approach to financing, which can be chosen subject to and within the boundaries of applicable law.

Article 6 of the Lebanese Central Bank's Basic Decision No. 8828/Basic Circular No. 94 clearly confirms this. It states that Islamic banks must obtain the prior approval of the Lebanese Central Bank before adopting operations, mechanisms, structures or products of any sort, where all or any of the latter aim to create Islamic investments other than those regulated or expressly provided for in the Lebanese Central Bank's regulations.

Therefore, Islamic finance in Lebanon appears to be a set of exhaustively enumerated tools and techniques, to be applied in the manner prescribed by the regulations that specifically provided for them.

In this context, the Shari'ah Consultative Body's role is only to bless or sanitise transactions that are expressly mentioned in the Lebanese Central Bank's Circulars, as opposed to creating norms and standards.

3. Basic statistical information on Islamic banking and tools

As of today, there exist four licensed and operational Islamic banks in Lebanon: BLOM Development Bank, which is owned by BLOM Bank; Lebanese Islamic Bank, which is part of the Crédit Libanais group, itself now controlled by EFG-Hermes; Al Baraka; and Arab Finance House. The Lebanese Central Bank has recently issued a licence for a fifth Islamic bank, which has not yet started operations.

Interestingly enough, among the strictly enumerated tools of Islamic finance in Lebanon, the murabaha is by far the most popular (73 per cent), followed by the musharaka (19 per cent). The reasons for the market's lack of diversification on this front are, on the one hand, the fact that Islamic finance is a fairly new approach to banking in Lebanon and, on the other hand, at present there are not enough tax incentives to encourage greater use of istisna or ijara and ijar wa tamalluk transactions, for example. The volume of Islamic finance transactions is also still relatively small (see table below).

<p>| Instruments of Islamic finance in Lebanon (US$ million) |</p>
<table>
<thead>
<tr>
<th>Mode of finance</th>
<th>2005</th>
<th>% of total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Murabaha</td>
<td>58</td>
<td>73</td>
</tr>
<tr>
<td>Musharaka</td>
<td>15</td>
<td>19</td>
</tr>
<tr>
<td>Mudaraba</td>
<td>0.5</td>
<td>1</td>
</tr>
<tr>
<td>Ijara</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Istisna</td>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>Salam</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>79.5</td>
<td>100</td>
</tr>
</tbody>
</table>


Conclusion

Lebanon's laws and regulations in the area of Islamic banking are undoubtedly state-of-the-art. Their sophistication mirrors that of the sector's regulator. Indeed, the Lebanese Central Bank believes that Lebanese banks have an important role to play in this field and remains strongly committed to helping them achieve this result.

There is a growing appetite for Islamic finance in Lebanon, as attested by the success of the recent first Beirut Islamic Financial Institutions Forum (BIIFIF), which was held on 4-5 November 2010 under the auspices of the Lebanese Central Bank.

However, a number of improvement areas are to be brought to the legislator's and the regulator's attention. For instance, due consideration should be given to the question of allowing Islamic finance to apply beyond Islamic banking in Lebanon. Other more pressing measures include: allowing Islamic banks to invest less than half of their assets in Lebanon; allowing term deposits in Islamic banks to be for terms shorter than six months; and exempting certain Islamic transactions from situations of double taxation (in terms of both VAT and real estate transfer tax).
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