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THE LEBANESE SECONDARY MARKET : PROSPECTS FOR  
ESTABLISHING A NEW FINANCE COMPANY

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A Research Topic

Presented to Business Division

Beirut University College

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In Partial Fulfillment

of the Requirements for the Degree

Master of Science in Business

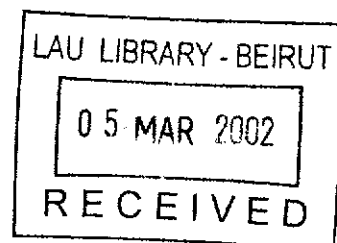
Management

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By

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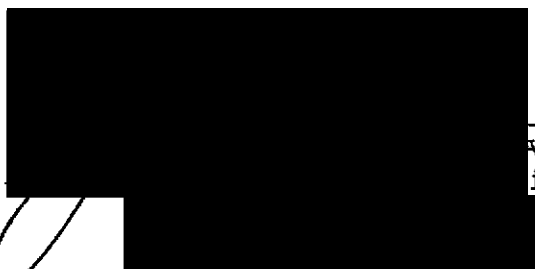
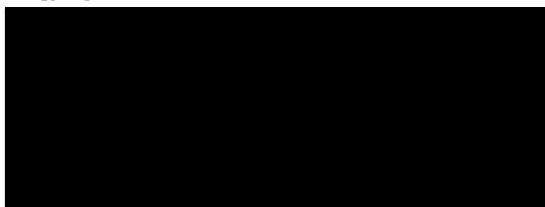
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TO MY PARENTS ,

## ACKNOWLEDGEMENTS

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## INTRODUCTION

The ongoing turmoil that has been affecting Lebanon for nearly eleven years , has had devastating repercussions on the infrastructure of the country . In fact , the destruction of the buildings and industries had its direct impact at both the financial and economic levels . After 1982 , the situation turned from bad to worse . Due to the repeated rounds of fighting ,and instability of the political situation , foreign banks , which were playing the active role of a simulated money market , curtailed their activities . In addition , local banks became reluctant to extend credit to individuals and buisnesses ; which resulted in an increase in their liquidity . This excess of liquididty , coupled with the absence of capital markets and efficient money market instruments , led to the emergence of the speculation fever throughout the banking system . The impact was disastrous on the Lebanese pound's value which started to tumble at a rapid pace .

Faced with this crisis , the Central Bank resorted to the creation of " Societé Financiare Du Liban " (SFL) in 1984 , with the objective of channelling funds in an attempt to create a secondary money market . It also suspended the operations of the brokerage firms which were actively supporting the speculation fever , as well as in taking positions against the Lebanese Pound . At the begining of 1985 , the SFL supported by credit lines from the Central Bank and owned by a large cross-section of active banks in Lebanon , became the only broker permitted to operate on the secondary money market.



The Central Bank also started the implementation of a tighter monetary policy . This policy alone was not sufficient . The country has been suffering from a long-run non-existent or at best , chaotic governmental administration with which it had to coexist . This policy to succeed should have been a part of a whole set of legislative and administrative reforms to encourage the investments needed for the rehabilitation and reconstruction of the country , and to at least hinder the speculative trends . What is needed at this stage is to mobilize the largest possible domestic savings and foreign capital . In order to do so , there is an urgent need to develop the financial intermediaries and instruments hence channelling these funds to prevent the complete collapse of the national economy .

Past experience has proven in many underdeveloped countries that the growth and development of financial intermediaries and instruments in the Gurley-Shaw (1962) sense of " financial deepening " have had a strong impact on growth and development of their economies . The Lebanese financial system has suffered not only locally , and even more severely regionally , for the Beirut financial market was the leading market in the area up to the beginning of the civil war .

Numerous institutions have been either destroyed by the war or could not bear the costs of the heavy damages inflicted , and decided to close down ; or simply opted out of the market until such time as peace and tranquility returned . Instruments for deploying the savings and the savings themselves , particularly of the Lebanese expatriates , who have lost faith in this market contracted .

Instruments and markets in Lebanon are currently and largely restricted to one or two roles: foreign exchange dealing and financing the government deficit , primarily through subscriptions in Treasury Bills .

Speculation and shallow finance of this nature should come to an end , because it carries the germs of the collapse of the national economy.

### Statement of the Problem

This study is concerned with investigating the feasibility of setting up a new financial institution and how this institution could contribute to developing Lebanon's money market operations at the local as well as the regional level.

### Problem Questions

- 1) What would be the impact of the introduction of a new financial institution on the promotion of the money market operations ?
- 2) What are the possible contributions of such a new financial institution in terms of the promotion of new money market instruments and markets ?

### Statement of the Purpose

The primary purpose of this study is first , to evaluate the present situation of the Lebanese money market , and show the urgent need for the creation of a new financial institution(s) . In addition to this , the study aims at pointing out the role of one such financial institution in promoting the financial market , in terms of instruments , while acting as a competitor to the present " Société Financière Libanaise " (SFL) . Finally , the study discusses the total effect of financial intermediation on the implementation of the monetary policy of the Central Bank.

## Performance Objectives

The aim throughout this study is to drive through the point that there is an evident need for an additional financial institution , which would compete with (SFL) in terms of capability as well as in terms of promoting and introducing additional financial instruments . On the other hand , this study aims to show the potential effect and impact on the Lebanese economic scene and financial markets of the creation of an additional financial institution.

## CHAPTER TWO

### PREREQUISITES FOR THE DEVELOPMENT OF THE FINANCIAL MARKET

In this chapter the prerequisites for the development of money market are emphasised , as this research is concerned with those markets to the exclusion of the capital market . Two important conditions should be met for a proper and rapid development of the money market . First , the presence of financial intermediaries or institutions operating in diverse markets . Second the availability of a wide menu of financial instruments .

#### A- Financial intermediation

##### 1)-Definition :

Rose and Fraser define a financial institution as " a buisness firm whose principal assets are financial claims stocks , bonds, loans instead of real assets like buildings equipment , raw material ..." (1) Financial institutions are part of a financial system composed of a network of financial markets , institutions , buisnesses , households, and governments that participate in that system to transfer loanable funds from " saving-surplus units " to " savings-deficit units . " Financial institutions can be broadly divided into financial intermediaries and other financial institutions . Financial intermediaries acquire the primary securities issued by borrowers , and sell their own secondary securities to savers .

Financial intermediaries are grouped or classified into four major categories , according to the life expectancy of their assets and the composition of their asset portfolio . First , there are the deposit-type financial intermediaries which include , commercial banks , saving and loan associa-

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(1) Rose , P.S.and D.R.Fraser , (1985) . Financial Institutions ( Plano , Texas : Buisness Publications Inc.) Chapter 1 , p 3 .

tions mutual saving banks and credit unions . These institutions play an important role in the channelling of savings by individuals into loans and business investments , and loans to the governments . The second category relates to contractual savings institutions which are classified as such , because they involve relatively steady inflows of money . These are insurance companies , pension funds , state and local government retirement funds . These institutions play an active role in supplying funds to business firms by purchasing bonds and stocks to the housing sector by purchasing real estate mortgages , and to the governmental units by purchasing their debt issues . The third type, or the investment type institutions . They are investment companies , personal trust funds , real estate investment trusts . These kind of financial intermediaries offer small investors diversification and expert management of their funds . The fourth category consists of finance companies , commercial finance companies . They provide loanable funds to customers and businesses that are not obtainable from deposit-type institutions .

Financial institutions , on the otherhand , do not create their secondary securities ( or IOU's) as financial intermediaries do . Financial institutions include security brokers , dealers , investment bankers , and mortgage bankers . These institutions merely act as a conduit for the offering of the securities issued by other institutions to other investors . Whereas " investment bankers " underwrite new issues of corporate stocks and government securities , and " mortgage bankers " acquire mortgage securities before placing these securities with long-term lenders , " brokers " act as middlemen for buyers and sellers of securities charging commission fees for their services . Finally , security " dealers " provide similar services to those of brokers , but they also purchase securities outright and then line up willing buyers to take these securities into their portfolios at a higher price . Both brokers and dealers create a secondary market for financial instruments and improve the flow of information among market participants .

## 2)- Role of financial institutions :

To simplify the exposition , the term financial institutions (FI) can be used to cover both types , that is intermediaries and other institutions . In this broad sense , FI's provide the link between the sources and uses of funds in an economy : they intermediate in the sense of channelling the savings made by people who place their funds with them into investments undertaken by investors . They have the power to do so because " they offer the qualities desired by savers as safety of principal liquidity , convenience and availability in small denomination one or more of which are often lacking in market instruments ." (2) Hence the existence of FI's , has the positive impact of broadening the available menu of assets to savers as well as enabling the overall expansion of investment by transferring the purchasing power of savers to ultimate borrowers who need money for their investments . This enables FI's to tailor the asset and liability structure of the financial system , in order to satisfy both ultimate savers and borrowers and separate the saving decision from the investment decision .

Intermediation also encourages investment by providing a variety of available sources of funds to the deficit units . Therefore , the intermediation process of financial institutions definitely contributes to the economic growth by " making borrowing and lending more attractive , leading to full-employment saving and investment rates and therefore , the growth rate of capital and income are increased over that which would exist without financial intermediation ." (3)

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(2) Welshams M.T and R.W Melicher . Finance : An Introduction to Financial Markets and Institutions ( South-Western Publishing Co.) p 12 .

(3) Hemple G.H and Yawitz J.B , ( 1977 ) p 8 . Financial Management of Financial Institutions ( Prentice-Hall Inc ).

On the other hand , these institutions tend to reduce risk to both surplus and deficit units . In fact , by pooling their assets , FI's reduce the risk of default to surplus units , and deficit units have a greater availability of funds in a form better suited to their payment capability . Thus FI's contribute to the real productivity of the economy and to the overall standard of living since they are able to satisfy simultaneously the needs and preferences of both surplus and deficit units . In addition , specialization of labor and efficiency of size and scale allow financial institutions to act in a cost-reducing role , with surplus units receiving higher return and deficit units paying less for their funds than would be possible in the absence of their role .

The operations of financial institutions could be divided into two markets . The capital market , which includes the market for long-term (more than a year) debt securities (notes and bonds) and instruments (mortgages) as well as corporate stocks . The money market , which is the market where debt instruments are short-term , that is one year or less are traded. It plays the role of enhancing the liquidity and marketability of asset holdings financial institutions and surplus units . This is the market which financial authorities have access to through trading treasury bills in order to implement the appropriate monetary policies when there is a need to do so . The ultimate role they can play is the role of a link between the local and international financial system .

### 3) Characteristics of Financial Intermediaries :

#### a) - Commercial Banks :

They are an important component of the money market and powerful intermediaries in the financial market . Their basic role is to accept deposits from people , in order to provide short-term loans to business borrowers , as well as buying government securities .

b)-Specialized (Medium and Long-term) credit banks :

These institutions are very important to the economy due to their engagement in long term financing . The funds they extend in loans originates mainly from issuing securities in the market rather than deposits from people .

They play also the very important role of promoters of potential financial instruments (securities , bonds , etc...)

c)-Investment Banks :

" Investment bankers are often characterized as middlemen... securities do " go through ". (4) These banks are an important contributor to both the primary and secondary money markets . In the first they raise the funds to finance medium and long term projects . The secondary market is where there is an exchange of the already existing obligations , securities or whatever instruments are used to establish the claim on such fundings .

d)-Securities exchange office (Bourse):

This institution plays a very important role at both the primary and secondary market levels . " It's objective is to provide a convenient meeting place where where buyers and sellers of securities may transact business ." (5)

e)-Investment companies :

These companies engage principally in the purchase of stocks and bonds of other corporations . " They permit the pooling of funds of many investors on a share basis for the primary purpose of obtaining expert management and wide diversification in securities investments ." (6)

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(4) Saliba Nassim , " Development Prospects of the Financial Market " May 1979 .

(5) Francis Jack C. ( 1972 ) pp 63 . Investments : Analysis and Management . New York : Mc. Graw Hill , Inc .

(6) Welshams M.T and Melicher R.W , Op.cit , p 242 .



The main concern of these companies is to provide an increased return to the investor .

f)- Insurance companies :

The contribution of such companies to the financial affairs of the nation may be divided into being a source of capital for buisness and government and a direct benefit to the insured .

g)-Pension Funds :

These institutions , in so far as they function on the capitalization principle in accumulating funds from contributions of employee and employers for retirement purposes are important to the money market .(7)

h)- Brokers :

These are firms who play the role of a third party or proxy in financial deals between buyers and sellers for a commission . Only when the deal is struck , will the broker pass the names of the banks counterparties to each other . This anonymous service they are rendering to the banks helps them undertake their activities without fearing any risk of market push against the bank's further interests . " By definition , and unlike dealers , brokers do not position ." (8) They inform bank's dealing rooms about all the changes in the foreign exchange and currency deposit markets , market liquidity trends , and other economic and financial news that are likely to have an impact on the market . " The volumes of funds and securities that are brokered each buisness day are staggering ." (9) However ,

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(7) Saliba Nassim , Op.cit .

(8) Stigum Marcia , (1983) , pp 525 . The money market .  
Homewood , Dow-Jones , Irwin .

(9) Welshams M.T and Melicher , Op.cit . , p 314 .

because of the anonymous nature of the deals , data are not collected and hence it is impossible to put precise figures on these amounts . Nevertheless , these volumes of trades are of vital importance to brokers , because they operate on a commission basis as the only source of income they get . In addition to the fact of being active agents in the money market , brokers are used particularly in the money market brokers are used particularly in the implementation of monetary policies because their screens could provide a means for traders who can paint pictures and play other trading games .

i)-Dealers :

Being one of the money market main participants dealers play the role of welding the market's many participants into a unified whole due to the modern communication techniques that make it possible . Dealers engage in various activities that come close to brokering , however , and contrarily to brokers they can buy and sell for their own account , that is they trade with retail and other dealers off their own positions . In addition , they play a role in underwriting new issues , and constantly quote bids and offers at which they are willing to buy and sell .

In their trading activities , the dealers give the secondary market for money market instruments two important characteristics . " First , they ensure that any moment a single price level will prevail for any instrument traded in it . Second by standing ready to quote firm bids and offers at which they will trade , they render money market instruments liquid . " (10) That is why they are considered as market makers .

Dealers have many sources of profit , first but of less importance than the others , the commissions they earn on selling financial instruments of all kinds . Another source

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(10) Stigum Marcia , Op.cit , p 529 .

of profits coming from the difference between the financial costs and the yields on the securities they are carrying or profit from positive carry . Day to day trading is also a source of profit to dealers . However , the main source of profit to dealers is position plays . That is taking into position huge amounts of securities when they anticipate that rates will fall and securities prices will rise or by shorting the market when they are bearish . Contrary , to brokers , dealer's activities are characterized with risk taking . In fact , the money market instruments they are dealing with bear a certain amount of risk , along with the risk of taking positions. " Like a banker , the dealer faces risks : credit risks , a rate risk or market risk , and a liquidity risk.

#### The Lebanese financial institutions :

This section presents the main participants in the Lebanese money market and analyses their contribution to this market. The major players in this market are presented in descending order of importance .

##### a- Commercial Banks :

Commercial banks in Lebanon accounted for approximately 78 percent of the consolidated balance sheet of the Lebanese financial system at end of 1985 . From this high ratio , it follows that commercial banks represent the most important segment of the financial market in Lebanon . Their survival during the events which have badly affected all other productive sectors of the economy are testimony to the efficiency and high degree of organization of this sector .

At the end of 1985 , the number of banks operating in Lebanon stood at 93 . This is a larger number

than required for Lebanon's strictly domestic requirements . Dr.Salim Hoss , once described the country to be practically overbanked . But according to him this situation was justified by the prospect of a substantial volume of external buisness in addition to the foreign banks faith in Lebanon's prospects of developing into an international financial center .(11) Of the 95 presently (1986) active banks , some have a strong relationship with the international markets because of the diversity of the nationalities of their owners , and the nature of their capital formation and the diversity of the sources of funds of their depositors . Commercial banks in Lebanon would therefore be classified according to the Banking and Control Commission at the Central Bank as follows :

- 47 Banks (SAL) of Lebanese control ,
- 7 Banks (SAL) of Non-Lebanese Arab control ;
- 15 Banks (SAL) of Non-Arab foreign control ,
- 5 Branches of Arab Banks ,
- 13 Branches of foreign Non-Arab Banks
- 4 Meduim and Long-term lending Banks under Lebanese Control .

Characteristics of the consolidated balance-sheet of commercial banks :

The consolidated balance-sheet of the commercial banks for the period 1980-1985 , reveals the following features :

1)-Foreign assets , which represent claims on non-resident and on non-resident banks , and which have for a long time represented a major component of

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(11) Hoss Salim ,(1974) " The development of Lebanon's financial markets " . Paper presented at a seminar organized in Nov 1974 by the banks .

of total banks assets , accounted for 28.6 percent of total assets of commercial banks in December 85 compared with 23 percent in December 83 , and 40 percent at end of 1981 . This decline could be explained by first , the decrease in volume of bank's deposit liabilities in foreign currencies , from non residents and non resident banks , and second by a change in the exchange rates . In fact Lebanon has been mainly an exporter of funds as bank's foreign assets have been persistantly higher than their foreign liabilities by a sizeable margin .

Another reason explaining the importance of foreign assets is the high interest rates prevailing abroad and decline in domestic profitable investment opportunities .

2)-Claims on the public sector have been increasing since 1977 , due mainly to two factors :

First , the increase in government borrowing from commercial banks in order to finance emerging budgetary deficits , and second , the policy followed by the authorities to limit the excess liquidity of the banking sector prevailing during that period .

Thus the state increased its indebtedness to the commercial banks , the main holders of Treasury Bills . The net claims of the commercial banks on the public sector rose from L.L 14,712 million in December 1983 to L.L 28,057 million in December 1985. These constituted around 18 percent of the consolidated balance-sheet of commercial banks .

However , if we look at table I , we can see that credit to the public sector increased by 48.5 percent from 1984 till 1985 compared to an increase of 3.7 percent from 1983 till 1984 ; and that it

constitutes an important share in the uses of funds of commercial banks .

Consequently , the share of the public sector in total commercial bank credits reached approximately 33 percent in 1985 compared to 30 percent in 1983 . These figures reflect the fact that the banks , in the absence of other effective financial instruments , have considered financing the state deficit to be a sound use for their sources in the prevailing uncertain political and economic environment which has increased their liquidity beyond normal limits . Also the official authorities had a role in attracting these amounts of treasury bills by increasing the interest rate paid on their holding , at first to match the effective Eurodollar deposit rate . In fact reserves have increased in 1985 by 67 percent compared to 20.4 percent in 1984 .

3)-Claims on the private sector have decreased mainly because of the critical and unstable situation and because of the increase in bad debt accounts . Though in nominal relative terms they have increased but this increase is not in absolute terms of credit extension . The increase largely reflects " rolled-over" nature of these facilities and their interest. These facilities are largely to the trade sector because of the short-term nature of these credits , and low risk involved .

#### 4)-Deposit Liabilities of the Banking Sector :

The main feature of this component of the consolidated balance-sheet shows an increase amounting to approximately 58 percent in 1985 compared to 25 percent increase from 1983 to 1984 .

These deposits are mainly of short-term nature , and constitute nearly 99 of total deposits . This

reflects the liquidity preference of residents as well as non resident depositors . The bulk of deposits are either on demand or have maturities of six months and less .

Second , the major part of deposits is held in saving accounts which are withdrawable on demand or maintained for a fixed period ranging between one and six months . It is noteworthy to add that even the fixed saving deposits could in many cases be withdrawn on demand without exacting a prohibitive penalty .

#### 5)-Foreign Liabilities of Commercial Banks:

These consist of non-resident and liabilities to non-resident banks. These liabilities have increased and specially the second component has increased by more than 150 percent beside its increase as a main use of bank's sources . Foreign liabilities represented 28.6 percent of the total liabilities of the banking sector , that is to say , by an increase of 77 percent from 1984 , compared to 26.2 percent and an increase of 45 percent from 1983 . ( see consolidated balance sheet of banks ) .

#### 6)-Bank Treasury Position Versus Client Position :

On the bank's treasury position appearing from table and table we can see that there is a difference between the asset and the liabilities side of the bank treasury position amounts to L.L 57,866 million , the amount of uses in excess of resources of the Treasury. The clients position in 1985 , shows the difference between the claims on the of the private sector L.L 57,707 and its deposits with the banking sector L.L 108,800 to constitute approximately 47 percent of the deposits of the

TABLE I : TREASURY BILLS in circulation ( in billion L.L. )

	1982	%	1983	%	% change 83/82	1984	%	% change 84/83	1985	%	% change 85/84
Subscriber	1982	%	1983	%	% change 83/82	1984	%	% change 84/83	1985	%	% change 85/84
BDL	0	0	0	0	0	1.010	5.279	0	0.397	1.040	- 60.69
Public Inst	1.019	8.299	1.486	9.372	45.829	2.056	10.747	38.358	+ 0	0	- 100.00
Banks	10.975	89.380	14.133	89.133	28.774	14.610	76.386	3.375	27.389	71.735	87.46
SFL	0	0	0.70	0.441	0.	0.895	4.678	1178.571	4.704	12.320	425.58
OTHERS	0.285	2.321	.167	1.05	41.404	0.56	2.927	235.329	5.691	14.905	916.25
TOTAL	12.279	100.00	15.856	100.00	29.131	19.131	100.00	20.655	38.181	100.00	99.57

Source : BDL unofficial statistics .  
 After 1985 this item + was combined with " Others".



INTERNAL PUBLIC DEBT IN LEBANON

1979 - Mid 1986

( In Millions of L.L )

	1979	1980	1981	1982	1983	1984	1985	1986
Borrowings from								
BDL (1)	1,487	1,952	1,982	1,752	5,307	11,639	15,039	18,043
TB's in Circulation (2)	1,166	2,476	4,910	12,279	15,856	19,131	38,181	48,260
Internal (1+2)								
Public Debt	2,653	4,428	6,892	14,031	21,163	30,766	54,368	62,694
% (2) / (1+2)	43.95	55.91	71.24	87.51	74.9	62.18	70.22	76.97

Source : BDL , unofficial statistics , 1986 .

CONSOLIDATED BALANCE SHEET OF LEBANESE

COMMERCIAL BANKS .

( Amounts in millions of L.L. )

	1983	%	1984	%84/83	%	1985	%85/84	%
Reserves	4,396	5.6	5,292		5.3	8,848		5.4
External Assets	18,033	23	26,208		26.2	46,317		28.6
Credits/private	33,604	42.8	43,268		43.2	57,707		35.6
Credits/Public	14,712	18.7	15,241	..	15.2	28,057		17.3
Fixed Assets	1,291	1.6	1,405		1.4	1,864		1.1
Non-Classified Assets	6,460	8.3	8,621		8.7	19,151		11.8
<b>ASSETS = LIABILITIES</b>	<b>78,496</b>	<b>100</b>	<b>100,035</b>	<b>+ 27,5</b>	<b>100</b>	<b>161,944</b>	<b>+ 61,8</b>	<b>100</b>
Deposits	55,375	70.5	69,326		69.3	109,505		67.61
External Engagements	8,804	11.2	12,361		12.3	18,448		11.38
Capital	2,978	3.8	3,384		3.4	3,783		2.3
Non-Classified liabilities	11,339	14.5	14,964		15	30,211		18.6

Source : BDL , Annual Bulletin , 1985.

TABLE III :

SOURCES OF COMMERCIAL BANK'S DEPOSITSAND CURRENCY DENOMINATION

( Amounts in million of L.L. )

	1983		1984		1985		1986	
	Amount	%	Amount	%	Amount	%	Amount	%
Deposits	1983	%	1984	%	1985	%	1986	%
Short-term in L.L	57,523	99.2	73,075	99.2	116,592	99.3	117,468	99.3
Long-term in L.L	447	0.8	535	0.8	876	0.7	876	0.7
TOTALS	57,970	100	73,610	100	117,468	100	117,468	100
Residents in L.L	40,241	69	47,281	64	70,616	60	70,616	60
Residents in F.X	14,400	24.8	21,301	28	38,184	32.5	38,184	32.5
Non-Resident in L.L	888	1.6	1,105	1.5	2,015	1.7	2,015	1.7
Non-Resident in F.X	2,441	4.2	3,923	5.3	6,653	5.6	6,653	5.6
TOTAL	57,970	100	73,610	100	117,468	100	117,468	100

Source : BDL , Annual Bulletin , 1985 .

private sector . However , under Bank of Lebanon rules the banks must match their foreign exchange liabilities with their foreign exchange assets , except a net liabilities position of no more than fifty percent of capital . It follows then that this excess balance of L.L 51,093 million has been mainly used by the commercial banks to have purchase treasury bills and to hold sight and time deposits abroad in non-resident banks .

This leads us to the conclusion that presently the commercial banks's excess funds derived from clients operations are mainly absorbed by the purchase of treasury bills , legal reserves , and deposits abroad . This exposes the malfunctioning of the commercial banking system as well as the absence of other attractive alternative uses of their funds : Commercial banks are merely operating as administrators of funds , they are no longer " intermediating " between savings-surplus units and savings-deficits units . Hence we can infer from the above , that there is an immediate need for the availability of a diversified set of financial instruments and a more developed money market .

#### Medium and Long-term Credit Banks :

These banks are engaged in long-term financing , and have been established in Lebanon to fill a gap in the credit structure which commercial banks could not fill satisfactorily . They are small in number , and consist of the following :

- 1)- Investment and Finance Bank SAL ( INFIBANK )
- 2)- The Housing Bank SAL .
- 3)- The National Bank for Industrial and Tourist Development SAL .
- 4)- The Finance Bank .
- 5)- Bank of the Near East , SAL ( not operational at present ) .

6)- Banque de Credit Agricole , Industriel et Financier SAL , ( not listed in the official list of banks and not subject to the secrecy law .

The role of specialized banks has been very limited and declined since the beginning of the war . This stagnation incited specialized banks to call for government measures to enable them to play a more active role in providing credits to the economy . Under Legislative Decree N° 108 of June 30 , 1977 , the specialized banks were not allowed to accept deposits for a period of less than two years , or issue certificates of deposits with maturity of less than 18 months . Furthermore , their borrowings from other banks or financial institutions were limited to a minimum maturity of one year . Moreover , in July 1983 , Legislative Decree N°108 was replaced by another Decree N°50 which amended some of the provisions of the earlier decree in favour of specialized banks to allow these banks greater flexibility in their operations . This new legislation permits specialized banks to accept time deposits for six months against the issue of nominal , to order , or bearer of evidenced deposit . Moreover , loans and advances to any one establishment should not exceed 25 percent of the bank's own fund provided that a priori approval is obtained from the Bank of Lebanon . These institutions are also playing the role of agents for the Council of Development and Reconstruction CDR , as well as extending loans to individuals to help them in reconstructing what they lost during the war . Though the bulk of their credit extension is directed to the industrial sector , some of these banks have extended loans lately to other sectors namely the Agricultural sector .

## Investment and Finance Companies :

The most important investment company on the Lebanese financial scene is the Intra Investment Company , SAL , which has a capital of L.L 280 million and 13 affiliate companies , 2 sister companies in addition to other major investments . Intra Investment Company also operates on the international financial market . After a slow down of activities , it started to peak up again in 1980 with its participation in underwriting some 10 bonds issues in FF. and U.S dollars .

In addition , Intra has developed its land holdings in Lebanon . On the other hand , it has launched an advertising campaign whose aim is to promote its role in the Lebanese financial market and in the Arab World ; strengthening and reactivating the control of Bank El-Mashrek , and lately of the bank de Credit National as well .

Intra Investment company expected to play the role of an investment bank due to its efforts in offering its company's stocks purchase the stocks of its affiliate companies in the stock exchange which can be considered as open opportunities for investors especially with regard to the issuing of new stocks. In addition to this , Intra Investment Company's high contribution in many financial real estate and service companies illustrate its active role in developing the Lebanese financial market .(12)

There are 7 finance companies registered at bank of Lebanon , with a capital of L.L 15 million each except for the Finance Company of Lebanon , which enjoys a special status and will be discussed apart. These are the following :

- 1)-Arab Finance Corporation SAL ,
- 2)-Investment Trading Corporation ,

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(12) Arab World File - Lebanon - Companies ( Investments ) ( Lbn-2702/1 ) .

- 3)- Est Rapid d'Exploitation et de Financement SAL ,
- 4)- Credit Commercial et Fonciers SAL ,
- 5)- United Financial Company SAL ,
- 6)- Societé d'Investissements Financiers ,
- 7)- Finance Company of Lebanon SAL.

These companies raise their funds through the sale of their own shares and bonds and invest the proceeds in a portfolio of securities.

They are different from Investment Banks in that they constitute a channel through which individuals acquire a claim on bonds and stocks . They use these funds to buy outstanding securities in the secondary market , rather than to finance new capital issues as in the case for investment banks.

#### Insurance Companies :

There is a large number of insurance companies in Lebanon , approximately 100 , of which 68 are foreign companies while the remaining are Lebanese companies . Only 69 companies are registered at ACAL ( Association des companies d'Assurances au Liban ) , and out of these 42 are foreign while the remaining are 27 Lebanese .

Thus most of the insurance companies operating in Lebanon are agents representing foreign companies. The Law in Lebanon requires the investment of all reserves against insurance policies denominated in Lebanese pounds and 50 percent of foreign contracts to be invested in Lebanon . However , the flow of companies to Lebanese corporations and the government has not been very important . This is mainly due to the fact that most premiums collected are from foreign contracts and that all insurance companies are obliged by most foreign laws , specially in

Kuwait , Jordan , UAE , to keep all outstanding claims and unexpired risk amounts abroad in a blocked account in a bank for the protection of the interest of the locally insured in these countries . Furthermore , due to the absence of a developed securities market most insurance companies often prefer to deposit the larger part of their funds in banks , and use the rest in treasury bills subscriptions , or invest in foreign securities or exchange . However , they could be considered as the potential investors in financial instruments in case they would be promoted or introduced to the financial market .

Bank of Lebanon ( BDL ) :

Bank of Lebanon's function as dictated by the code of Money and Credit is " to control the money supply , in order to ensure the basis of continuous economic and social growth . " This also comprises in particular , the preservation of the monetary system in Lebanon , economic stability and the banking system in addition to the development of the monetary and financial market . In order to do so , the Central Bank ( BDL ) is :

- Allowed to act as a fiscal agent for the government and plays an important role in issuing and marketing of government securities , mainly treasury bills .
- It is also responsible for the liquidity risks that might face any banks , hence it has to intervene in the case of any financial institution faces liquidity problems , in order to safeguard the financial system's reputation . It has



recently demonstrated massive support to the First Phoenician Bank SAL , and is now expected to help other banks like Capital Trust , and extend them special loans in order to cover up for their liquidity problems . (13)

Since 1979 , the Central Bank has been trying to stop the expansion of the money supply and the banking system's liquidity , and to decrease the pressure on the Lebanese Pound by narrowing down the interest difference in favor of the U.S dollar. In order to do so , it has imposed almost prohibitive reserve requirements on credit granted in Lebanese pounds , to purchase foreign exchange which was used as a security deposit for this type of credit . Also in 1979 , and in order to tighten its policy , and check the credit expansion of commercial banks , BDL imposed in stages a 15 percent reserve requirement on bank's deposit liabilities denominated in Lebanese Pounds . However , the efficiency of this measure was reduced by allowing banks to hold half of the reserve requirements in medium-term and six months treasury bills issued specifically for this purpose at lower rates than those prevailing in the market .

In June 1979 , BDL , imposed a credit ceiling on banks , and banks substituted for it the regular use of treasury bills in order to control their liquidity . (14) Thus , treasury bills carrying attractive interest rates and having different maturities ranging between the three months and five years were issued at regular intervals . This step aimed not only at financing the government budget deficit , but also at regulating the liquidity of the banking system in line with BDL's monetary and interest rate policies .

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(13) Sarkis André , " Development of a Capital Market in Lebanon " , AUB Thesis , ( 1980 ) , p 24.

(14) Saliba Nassim , " Development prospects of the

In 1981 , and with the continued high levels of interest rates on the U.S dollar and the increased pressure on the Lebanese Pound , the rate on treasury bills was increased to 11.5 percent , in January 81 and to 14 percent in April of the same year . Discount rates at BDL were increased from 10 percent to 13 percent . Banks increased the interest rates on three months deposits to 12 percent and interbank rate rose to 15 percent . In May 81 , however , as the Lebanese Pound's depreciation reached 7 percent , the financial authorities opted for the defensive weapons , and Circular N° 227 May 12 , 1981 was issued comprising the following : (15)

- a)- Banks were prohibited from holding net debtor balances in foreign exchange exceeding 50 percent of their authorized capital .
- b)- Banks were prohibited from holding net creditor foreign exchange positions .
- c)- A ceiling of L.L. 500,000 was placed on forward foreign exchange operations , and banks were prohibited from exceeding this ceiling unless such operations involved the financing of foreign trade transactions .
- d)- Banks were prohibited from giving loans to non-residents in Lebanese Pounds .
- e)- Banks were prohibited from giving loans in Lebanese Pounds against guarantees from non-resident banks unless such loans were to be used for investment or commercial purposes in Lebanon .

The rate of interest on treasury bills was also increased gradually during the year 1981 . This helped commercial banks to increase the rate of

interest on time deposits in Lebanese Pounds which in turn limited the trend towards greater deposits in foreign currencies . Nevertheless , the Lebanese Pound continued to depreciate against the dollar because of the rise in the exchange value of the dollar on the world markets .

In 1982 , the bank of Lebanon concentrated its efforts on containing the pressure on the Lebanese Pounds . Its intervention on the market by selling or buying respectively was limited and cautious because of the risks involved in committing a substantial part of its gold and foreign exchange holdings to stabilize the exchange value of the Lebanese Pound .

In 1983 , BDL moved to strengthen its control of the commercial banking sector aiming at raising standards of banking practices . Thus , the Circular N° 435 of October 26 , 1983 imposed minimum obligatory liquidity and solvency ratios for the first time in Lebanon's banking history . Commercial banks had to the end of 1984 and 1985 to realize a liquidity ratio of at least 25 percent and a solvency ratio of at least 3 percent respectively .

By issuing this Circular , BDL , anticipated to pressure on the liquidity of the commercial banks and thus avoid the risk of a bank collapsing ; which would have severely damaged the reputation of the Lebanese banking system . This Circular also aimed to help the weak banks strengthen their position by increasing their capital if their current level of lending was to be maintained . Alternatively , and if increase of capital was not possible , then such banks would be encouraged to merge . In fact 1985 was a year fruitful in this respect since we have witnessed the acquisition of three banks by a leading bank .

In addition , BDL and after the consultation of the International Financial Corporation , opted for the creation of discount house , namely (SFL) Société Financière du Liban , in 1983 . The aim behind the creation of this company was the creation of a secondary money market and money instruments , which were expected to help BDL tighten its control of the liquidity of the banking sector .

These measures however , did not stop the devaluation of the Lebanese Pound , which continued to loose value , neither did it help BDL gain control over the bank's liquidity . In March 86 , BDL decided to issue treasury bills for public use and hence exercising more pressure to decrease the volume of the bank's deposits , which would accordingly result in a change in the money supply structure . This result was already forecasted by Dr.Chaib in his research on the issuance of treasury bills for the public in a study which appeared in BDL's bulletin in 1982 .

Treasury bills for the public were issued therefore at a high discount rate to match the interest rates on the U.S dollar in order to attract investors to invest in these instruments and deviate their attention from speculation . In June 86 , in response to the increase in the exchange rates and in order to maintain consistency in its policy , BDL increased the discount rates .

#### The Finance Company of Lebanon ( SFL ) :

Encouraged by the Bank of Lebanon , 33 commercial banks , including the major ones , established in early 1983 the Finance Company of Lebanon with the a paid up capital of L.L 10 million , which has

been raised lately by the additional contribution of 11 additional banks to L.L 20 million . Bank of Lebanon's contribution to the creation of this company was through its negotiations with the Bank's Association to formally recognize this company as the only brokerage firm operating locally . The agreement that followed early in 1985 precluded privately owned brokerage houses such as Tullet and Riley and Guy-Butler from the market ; the latter two being accused by BDL of illegal speculation , in the sense of taking foreign exchange positions , contrary to international brokering regulations , and also for perpetrating the inflation of the foreign exchange market as well as isolating the BDL's stabilization fund managers from intervening to support the national currency . These brokers eventually suspended their operations in Lebanon . BDL also contributed to SFL 's activation through its extension of a L.L 200 million credit line augmented later to reach L.L 400 million or 40 times its paid up capital . Although it is a profit seeking institution its main objective is to provide " Public Service " by developing short-term and long-term financial markets . The main activities of SFL were designed to meet the following objectives :

- " 1- Expanding the primary market through the creation of a secondary market for government securities by acting as a dealer/broker in these securities ,
- 2- Taking an active role in creating markets for new debt instruments , such as certificates of deposits , commercial paper and banker's acceptances ,
- 3- Expanding the interbank market and improving

its technical and professional standard ,  
mainly by acting as a dealer/broker in secured  
interbank funds ,

- 4- Playing a key and professional role as a broker  
in the domestic foreign exchange market ,
- 5- Cooperating with the Bank of Lebanon to facili-  
tate the implementation of its monetary and  
foreign exchange policies . " (15')

## CHAPTER THREE

### TOOLS OF SECONDARY FINANCIAL MARKETS

#### A- Financial Instruments

The second important condition for the growth of the money market is the creation and existence of a variety of financial instruments suiting the needs of different types of savers and investors . In the absence of such debt instruments, financial institutions will not be able to attract the funds needed for the proper functioning of the money markets , and consequently mobilize level of savings necessary for the development of the economy .

Money market instruments should ideally possess a high degree of liquidity since , by definition , these instruments are short-term of days and at most of not longer than a few months . The proper functioning of the liquidity adjustment mechanism at the market level, therefore , requires a priori a well oiled secondary market for these instruments .

The main debt instruments usually traded in secondary money markets are treasury bills , certificates of deposits , promissory notes , commercial papers , bankers acceptances , interbank funds , repurchase agreements (Repos) , and finally post-dated cheques . This chapter outlines the characteristics of the debt instruments , in general and those available on the Lebanese money market .

#### a)-Treasury Bills :

These are treasury obligations which bear the shortest of the maturities and are typically issued for 30 , 91 , and at most 182 days . " Treasury bills , provide the treasury with a convenient financial mechanism to adjust for the lack of a regular flow of revenues into the treasury. "(16)

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(16) Welshams M.T and Melicher R.T , Op.cit , p 314.

For investors they are considered as the safest investment alternative because of their liquidity , short-maturity and government backing . Their interest rates tend to be on the bottom of the rate spectrum and are often used as the reference point for other rates . Typically , treasury bills do not bear interest , but are issued at a discount through an auction system giving several dealers an opportunity to bid ; they mature at par value .

b)-Interbank Funds :

These are funds usually borrowed by banks from other banks , in the interbank market or from the central bank through discount facilities or a repurchase contract window . This happens often at the end of each working day , when banks need to balance their books in case of shortfalls. Maturities range from one day ( overnight) to as much as one week and one month , to as much as several months . The main participants on the interbank funds market are banks as well as brokers or investment banks who serves as intermediaries , usually on a commission basis . Even in the absence of all money market instruments , a de facto interbank market nearly always exist , unless there are legal or tax obstacles.

c)- Negotiable Certificates of Deposits :

" Among the cash securities traded in the money market , the certificates of deposits is the youngest , the first domestic negotiable CD's backed with a dealer commitment to make a secondary market in them were issued in 1961 . Since then , they have become a major money market instruments ."(17)

A certificates of deposit is in essence a receipt issued by a bank in exchange for a deposit of funds.

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(17) Van Agtmael A.W. (1984) , Emerging Securities Markets , Euromoney Publications , p 53.



The bank agrees to pay the amount deposited plus interest to the bearer of the receipt , on the date specified on the certificate . Hence CD's could be considered as time deposits issued by the banks usually in large denominations , to institutional investors and high net worth individuals corporations and sometimes government money market funds . However, CD's differ from the usual time deposit accounts in the sense that they are not subject to interest restrictions , and being negotiable could be traded on the secondary money market , before maturity . Therefore from the depositor point of view they are more attractive than time deposits, and provide a satisfactory rate of return as well .

The rates paid on negotiable CD's usually parallel rates on other money market instruments such as commercial paper and banker's acceptances . For short maturity CD's (up to three months ) rates tend to be fixed for long maturities , variable rate CD's may be offered , hence allowing competitiveness (i.e banks competing on the basis of interest rates ) . (18)

The rates at which top banks issue their CD's are higher than others because of their credit worthiness.

Banks issue a lot of CD's through dealers , though they prefer writing them directly to customers . They do so because in times when money is tight and banks need to write a lot of paper to fund growing loan demand , dealers are the best qualified to help them to position their paper and providing them with a sales force . On the other hand , when banks are writing CD's in big amounts , operating through a dealer , they will help them to get in and out of the market , at a single price and stop the speculation they might have encountered otherwise .(19)

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(18) Ibid , p 54 .

(19) Ibid , p 56 .

Negotiable CD's are issued usually when there is a trend at the banking system level for the use of such instruments , that is to say when monetary authorities want to squeeze the excess of liquidity from the money market ; or when the higher rates offered can be offset by lower administrative and overhead costs , given the fact that they are issued in large denominations .

Finally CD's are an important component of the secondary money market , in the sense that they combine the fixed-term feature of a time deposit with the marketability feature of an open market security , and usually help to combine the issuing bank's preference for long-term funds with the depositors preference for highly liquid placements . They have become more and more a means of interbank funds borrowing and lending than financial instruments to attract funds into the banking system . In fact they could ensure the system with stable three to twelve month deposits .

d)- Commercial Papers :

These financial instruments are usually issued by large corporations , as well as finance companies , as a source of funds that is cheaper for them than bank loans . Commercial papers are negotiable instruments , which could be traded on the secondary money markets , and the maximum maturity for which a commercial paper could be sold is 270 days . However , most papers sold are of the range of thirty days and under. They are sold at a discount rather than bearing a coupon rate.

" For commercial banks , commercial papers could be an ideal instrument for holding as secondary reserves. The risk of loss is negligible ; it is paid at maturity with no possibility of extensions , and usually the diversity of issues provide convenient maturity

dates ." (20) Also , because of their marketability in the open market , they are considered as liquid instruments .

e)-Banker's Acceptances :

These are time drafts usually representing finance of a trade transaction , which are accepted (i.e guaranteed ) by a bank and then discounted in the money market by that bank . Under normal circumstances , these acceptances should be closed by the time they come to maturity . However , because they carry the guarantee of the bank whose name is on the payment obligation , they could be traded on the secondary market ; and hence facilitate trade transactions of customers . Since they are guaranteed by the accepting bank , banker's acceptances are less risky than commercial papers . The latter being guaranteed only by the issuing company or corporation .

f)-Post Dated Cheques :

These are not really money market instruments , but rather a kind of a contract made between a buyer of goods and a seller who agrees to take a post-dated cheque for three months period . The seller receives the value of the cheque after subtraction of the amount of the discount which represents the interest for the period .

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(20) Robinson , Boehumber , Gane and Farwell , " Financial Institutions ," Third Edition , p 204 .

Post-dated cheques are not actively traded on the money market and the ultimate source of financing is not the general public . However they constitute a major source of finance for small buisness in many countries when discounted .(21)

f)-Promissory Notes :

These notes are usually similar in nature to commercial papers . Issued by finance companies to aquire funds which are used afterwards for consumer credit. They may be of negotiable or non-negotiable type , depending on restrictions of commercial codes .(22)

g)-Repurchase Agreements and Reverses (REPOS):

These are strictly interbank transactions on treasury or government papers . " More technically , they are a sale of government paper at a certain price to another banking institution , with an agreement to repurchase it at a predetermined price or an agreed future date (often overnight) ."(23)

The price differential constitutes the interest earnings for the period . These operations are used by banks as well as by dealers as borrowing means , which is the cheapest alternative available because they do not entail interest rate changes which would have happened in case they had borrowed the funds using their securities as a collateral .(24)

Reverse RP is used by dealers to borrow securities , in times when they are short on the market . It is simply the technical reverse progress of an RP . In this case the dealer will buy securities from an investor who is holding securities and wants to dispose of them . This is done under an agreement that he will resell the same securities to the investor at a fixed price , on some future date .

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(21) Van Agtmael A.W , Op.cit , p 54 .

(22) Ibid , p 55 .

(23) Stigum Marcia , Op.cit , p 40 .

"In this transaction the dealer , besides obtaining securities , is extending a loan to the investor for which he is paid some rate of interest ."(25)

Because they are typically the same , the only difference between an RP and its reverse depends on who is initiating the deal .

B- Lebanon's Secondary Market Instruments :

Operations of Lebanon's secondary markets were restricted to interbank lending prior to the establishment of SFL in 1984 . Since the beginning of 1985 , after the newly appointed governship of Lebanon's Central Bank activated SFL and appointed it as the sole broker , other instruments were introduced . These instruments are : Treasury Bills , Interbank deposits and Repurchase agreements . These money market instruments were traded side-by-side with foreign exchange trading . These instruments are discussed in the following paragraphs .

Treasury Bills :

Over the period 1967-1972 , the Lebanese government issued L.L 284 million of treasury bills . However , this volume increased significantly and reached L.L 527.4 million at end of 1977 , and L.L 38.182 billion by the end of 1985 . Between 1982 and mid of 1986 the financing by treasury bills has been growing at the average geometric rate of 53 percent as it appears on the table IV .(x)

Because of their short-term nature , these securities were always renewed , to cover treasury deficits and domestic debt . This debt is becoming a permanent feature of the Lebanese economy , in many ways similar to domestic debt in other countries where it is rarely monetized . Bills with maturities of three months ,

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(25) Ibid , p 42.

(x) FN ( 62,694 ) = ( M1986 )

six months and one year were offered on a regular basis periodically issued every Thursday .

" Interest rates on treasury bills have also been raised since 1979 . In 1982 these rates stood at 8.42 percent as compared with 3.14 percent in 1979 , then gradually increased to reach 15.5 percent in 1984 . The same amount of interest rate was paid for all maturities of treasury bills , however advance payment of interest has made actual yields higher than their nominal yield ." (26)

Accordingly , the yield on treasury bills with maturities of three months , six months , and one year issued with a nominal rate of 15.5 percent amounted to 16.12 percent , 16.8 percent and 18.34 percent respectively in 1984 . The difference between effective rates on the three months and year period bills stood at 4 percent at the beginning of 1986 . Yields reached 19 percent for three months bills , 21.5 percent for six months bills and 23 percent for one year bills . By June 1986 , the BDL raised the yields on its sales of secondary treasury bills ( T/B's ) on the open market ( OMO ) to 20 percent for the three months bills , 22.22 percent on the six months bills , and 25 percent on the one year bills .

The main reason behind the increases in interest rates , from 18 percent to 20 percent on the three and six month maturity bills , was the desire of the Central Bank's authorities to attract more investments in treasury bills . They expected to be able to absorb a great portion of the excess bank liquidity , for longer terms than before , the interest differential being borne by the BDL . The absorption of this excess liquidity , which constitutes an effective subsidy by BDL , was hoped to reduce the pressure on the exchange rate of the L.L. As previously mentioned , treasury bill issues were floated to meet budgetary deficits ; by BDL regulation only Commercial Banks and government financial entities were permitted to subscribe to directly . These issues , since a secondary market did not exist , were held to maturity . Nevertheless ,

the activation of the open market operations by BDL has rendered trading in treasury bills to be an important tool in the money market since 1985 .

#### Treasury Bills to the Public :

As was mentioned earlier the issues of treasury bills to the public was introduced by the BDL on March 13 , March 1986 in order to attract part of banks liquidity. People rushed to withdraw their deposits from banks in order to subscribe in treasury bills providing a higher return than banks deposits ( of some four to six points ) . As a result the treasury bills volume increased during the month of March . However , this increase did not result only from public subscriptions but from the increase in legal reserve requirements obliging banks to buy treasury bills as well . Nevertheless , one cannot deny the contribution of the public both resident and non-resident in buying treasury bills . Had BDL authorities given treasury bills more publicity , larger amounts of subscriptions may have resulted . In addition , if we look at the structure of treasury bills specially those subscribed to by the public , it is clear that the highest percentage contribution 73.8 percent , is for the one year maturity . This shows the power of attracting individual savings through higher interest rates provided by the treasury bills , to the disadvantage of bank's term deposit rates . In addition , the scale of these T/B's to the public is made more attractive than bank's term deposits because , first being sold to the public in small denominations , the smallest being the value of a single T/B of L.L 5,000 . The other reason is that the BDL does not penalize individual suscri-

TABLE IV:  
TOTAL T/B'S IN CIRCULATION AS OF  
12/12/1986

	Amounts in thousands	Percentage
	L.L	
BANKS	37,549,730	70.11
BDL for its account	9,121,790	17.03
PUBLIC	2,622,870	4.90
PUBLIC SECTOR	3,361,000	6.28
OTHERS ( including SFL )	901,130	1.68
<b>TOTAL</b>	<b>53,556,520</b>	<b>100</b>

Source : BDL , unofficial information , 1986 .



PERCENTAGE TB'S IN CIRCULATION

ACCORDING TO THE CATEGORY

	1983	1984	1985	1986						
				Jan	Feb	March	April	May	June	
ORDINARY										
3 Months	29.66	27.65	17.78	17.96	15.71	13.36	13.19	22.23	26.90	
6 Months	16.79	20.01	16.54	16.07	16.33	14.41	16.63	17.68	18.16	
One Year	46.08	44.06	64.86	65.97	67.96	73.23	70.18	70.18	57.94	
One Year and Half	4.31	4.66	-	-	-	-	-	-	-	
2 Years	2.65	3.71	0.82	-	-	-	-	-	-	
5 Years	0.51	-	-	-	-	-	-	-	-	
TOTAL	100	100	100	100	100	100	100	100	100	
Special/ Total	18.93	18.62	14.71	14.21	15.17	15.05	14.16	13.30	10.0	

Source : BDL , Unofficial statistics .

TABLE VI :  
OUTSTANDING T/B'S Brought by the Public up  
to November 1986 .

( Amounts in L.L. )

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FINANCE BANK :	L.L	767,625,800
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SFL :	L.L	181,800,000
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BDL :	L.L	1,155,150,000
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Source : BDL unofficial statistics , 1986 .

MATURITY DISTRIBUTION OF OUTSTANDINGT/B'S BOUGHT BY THE PUBLIC

(Amounts in L.L.)

<u>PERIOD</u>	<u>INTEREST RATE</u>	<u>UP TO BEG. NOV 1986 FACE VALUE</u>	<u>CATEGORY PERCENTAGE</u>
3 Months	18%	215,475,974	21.5
6 Months	20%	73,866,625	7.3
12 Months	20%	712,147,767	71.1
<b>TOTAL</b>		<b>1,001,490,366</b>	<b>100</b>

Source : BDL unofficial statistics , 1986 .

bers , wishing to liquidate their T/B's . Only a small rediscount margin of 1/8 percent is charged to brokers , such as the Finance Bank or SFL when liquidation occur on the T/B's they had underwritten from their own portfolio of T/B's .

The Société Financiare du Liban and the Treasury Bills Market :

Being one of the main dealers in treasury bills through BDL's OMO , SFL's treasury bill holding has also increased , from L.L 15,651 million in 1984 to L.L 32,825 million in 1985 , or an increase of 453 percent in one year . Also , the company's T/B's portfolio represented 12.32 percent in 1985 of total bills outstanding as compared to 4.44 percent in 1984 , as shown in table (i) below .

T/B'S Outsanding for SFL

TABLE (i)

( Amounts in thousands of L.L )

Year	(1)		Ordinary Bills	(2)	
	Total T.Bills	Special Bills		SFL.Bills Held	percent-age(2/1)
84	19,131	3,480	15,651	850	4.44 %
85	38,181	5,325	32,856	4,704	12.32 %

Interbank Market :

This market was at a very crude stage before the establishment of the SFL , which has played a role in regulating and activating this market . Banks in Lebanon enter the interbank market for the purpose of extending

loans or to meet unpredictable demand for funds particularly to cover their foreign exchange market transactions ; while banks with excess liquidity , convert them to an earning asset through this market . It is clear,therefore , that interbank funds are a liquidity instrument for both the selling and buying banks and not only an adjustment of reserve positions.

This market is not highly competitive , however , in the sense that interbank rates are subject to many fluctuations , because of the absence of competitive bids and offers . The reason for this , is the absence of alternative investment opportunities. Hence the movement in this market is dictated by trend tendencies and needs for liquidity . In times of high need of liquidity , or "bullish" demand , interbank interest rates tend to be on average as high as 19 percent, records of 120 percent were achieved in March 1986 , but for very short intervals of a day or two . While in times of low needs of liquidity , or "bearish" demand , interbank interest rates tend to be as low , as much as 4 percent .

TABLE(ii)

Average Interbank Interest Rates

<u>1984</u>	<u>1985</u>	<u>Mid of 1986</u>
11.75%	14.40%	17.16%

The increase in interbank average rates albeit in small amounts , reflects the efficiency of the Central Bank's policy in tightening the control over the liquidity of the banking system , as well as the close cooperation and effectiveness of SFL as the only broker/dealer in the market .

## SFL and the Interbank Market :

SFL has been operating in the interbank market by borrowing from banks who have excess funds and relending them to other banks having liquidity shortages against T/B's as collateral or , on a bank to bank basis , with the SFL operating as a third party broker . Designated to be the major lender , insuring immediate liquidity on the interbank market it has supplied banks with L.L 2,644 million during 1985 through its purchase of treasury bills , with a daily average of around L.L 200 million . (27)

In addition , the company has met the needs of commercial banks for short periods as one day , by purchasing treasury bills with a sell back provision , irrespective of their current maturity , hence instituting what is well known as repurchase agreements or "REPOS" , a major ( OMO ) instrument . Thus , a bank short of cash , would sell treasury bills of the SFL of much longer maturities and at the same time enter into an agreement to repurchase these bills at a later date , "REPOS" which represent a secured loan extended to banks with the bills sold as collateral. During 1985 , these "REPOS" transactions amounted for L.L 71,600 million or 17 percent of the value of total transactions .(28)

SFL has , therefore , assumed the development of this market from the monetary as well as from the technical point of view through the availability of spot market information . On the other hand , SFL has allowed banks to invest their excess balances in selling them treasury bills or in the company's deposits . According to SFL's data , treasury bills amounting to L.L 4,464 million were sold by the company to banks during the period of 1985 .

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(27) SFL , unofficial statistics , 1986 .

(28) Ibid .

## Dealing in Foreign Exchange :

As was previously mentioned , with the creation of SFL , all other dealers and brokers in the foreign exchange market had to stop their operations , leaving SFL to enjoy the privilege of being the sole broker and dealer on this market . Though the company is not allowed to take exchange positions to avoid conflict of interest , it has nevertheless profited from this monopolistic power .

SFL is supposed to contribute in the implementation of monetary policy to stop the harmful increases in exchange rates . In fact it operates concomitantly with BDL's interventions on the foreign exchange market . However , despite all the efforts deployed by SFL , the rate of exchange of the Lebanese Pound against the U.S Dollar depreciated by 100 percent reaching 18.25 to the Dollar at end of 1985 , compared with L.L 8.89 at end of 1984 . Similarly the pound fell against the Deutch Mark by 68.25 percent , the Japanese Yen by 75.6 percent , the French Franc by 68.14 percent , the Swiss Franc by 61.38 percent , and against the Sterling Pound by 50 percent . The depreciation of the Lebanese Pound in the Foreign exchange market was caused by the same factors that led to the high inflation rate , namely , the increase in money supply , the decline in real productivity and the rise in foreign interest rates .(29)

The rise in foreign exchange rates was due to the increasing demand for foreign currency by banks as well as non-banking institutions and individuals as speculators attempted to realize larger gains on the high interest rates paid on foreign currency , mostly the U.S Dollar and hence , effecting a further deterioration in the Lebanese Pound . In order to

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(29) Saidi Nasser , (1985). Bank of Lebanon ,  
" Bulletin Trimestriel" No. 21-23 .

restrict such movements , the Central Bank intervened in the foreign exchange market buying and selling large amounts of foreign currencies in order to limit the demand for the latter .

While , at the same time , SFL in coordination with the Ministry of Finance raised interest rates on treasury bills to encourage banks to invest their assets in Lebanese Pounds rather than Dollars .

It was expected that this matching between the Central Bank's intervention and the SFL's policy would cause a higher demand for the Lebanese Pounds and an increase in the cost of holding U.S Dollars .

The final result was a decrease in the activities of the foreign exchange market , as well as at the speculation level . However , this policy's implementation did not succeed , on the contrary , it had an adverse effect on the volume of BDL's holdings of foreign currencies which started to decrease .

In addition to the above policy, the Central Bank also raised in 1985 the legal reserve requirements in two steps from 15 to 22 percent as previously stated and lowered the foreign exchange positions permitted to banks from 50 percent to 15 percent of their individual capital .

All these actions however , did not stop the rates of exchange on the foreign exchange market from increasing . At present , the depreciation of the Lebanese Pound against the Dollar is even higher , it has reached 210 percent since the beginning of 1986 reaching 70 L.L/U.S Dollar at the end of November 1986 , compared with L.L 18.25 at end of 1985 .

#### Repurchase Agreements and Reverses :

The use of this money instrument has been increasing specially since the creation of SFL , which has



previously mentioned could secure banks with loans on the interbank market through RP operations . Banks have been using these instruments in dealing with the Central Bank , buying treasury bills on an agreement to sell them back later to the BDL on a date specified in the RP agreement ( a closed end RP ) , open end RPs , i.e with no specified maturity date in the agreement , are not offered by the BDL to banks , as yet . The increase of the reserve requirement rate has also been a factor in leading to an increase in the use of these instruments . The volume of " REPOS " traded from the beginning of 1986 , and up till mid of November 1986 , has been L.L 36,740 million representing approximately 30 percent of the volume of total T/B's traded on the money market for the period . However , increases in the volume have been reported to have occurred specially after April 1986 .

## CHAPTER FOUR

### EVALUATION OF SFL PERFORMANCE

This chapter will present the evaluation of the role of SFL in the secondary market , to reach the conclusion that there is an undeniable need for an additional financial company .

#### The contribution of SFL

SFL has been successful in strengthening the effectiveness of the Open Market Operations which initially were introduced by the company itself , hence laying the solid basis for the secondary market for government securities . As stated earlier , it has managed to increase its portfolio of treasury bills to L.L 4,407 million by the end of 1985 , and has been a major dealer ( in the sense of holding T/B positions of its own ) within the guidelines designed by the Central Bank , and with the support of the latter's credit line . In addition SFL has benefited from the Central bank's treatment with respect to the interest rates on treasury bills specially during the crisis it has faced in August 1985 and later in December 1985 .

In August 1985 , the company was faced with a decrease in investments . The company responded , however , by raising the interest rates to encourage investments again in treasury bills . Then in December 1985 , when the company faced a situation of similarity between interest rates on treasury bills and deposits with the company , which had led to a decrease in the yield on treasury bills versus

interest on the company's deposits . This resulted in a decrease in treasury bill operations in favor of the deposits with the company . It was then , that the Central bank intervened . This situation had been the result of the high commission charged on treasury bills for short-term maturities thus discouraging potential investments in treasury bills. In order to induce investors to revert to treasury bills investment use and not to waste the development of the secondary market already reached , the Central Bank came out with a formula which matches between the interest paid on deposits with the commission charged on bills in order to make both alternatives equally attractive . Thus , interest paid on deposits became equivalent to the yield on treasury bills .

Therefore with respect to its objective of expanding the interbank market and improving its technical and professional standard , it is clear that SFL succeeded in this respect . It succeeded in fact in regulating this market , leading to the relative stabilization of the average interest rates on interbank loans , hence adding more harmony to these rates and other market rates specially those paid on treasury bills . The fact that Société Financière du Liban has been able to bring about a constant demand and supply for funds has smoothed the fluctuations in interest rates . Since the beginning of the operations of SFL , interbank rates have shown more or less stable trend , and have been seen to move in harmony with treasury bills rates as it is shown in table (ii) . With respect to its operations on the foreign exchange market , SFL has become the sole broker and dealer on this market since the beginning of 1985 . Therefore , together with its contribution to maintain high interest rates on treasury bills , concomitantly with BDL's policy

of intervention on the foreign exchange market as was previously mentioned , it can be argued that SFL has contributed somewhat to curbing the speculation on the foreign exchange market . However , as it is well known there are other factors leading to speculation which could not be countered by the SFL or the BDL itself .

Some Ratio Analysis :

An examination of changes of two key ratios is useful in the evaluation of the SFL's operations . These ratios are :

$$(1) \text{ Return on assets} = \frac{\text{Net profit after Tax}}{\text{Total assets}}$$

This ratio has increased from 0.2 in 1984 to 0.60 in 1985 .

$$1984 = \frac{1,760,205}{883,380,692} = 0.199 \quad 1985 = \frac{28,440,109}{4,716,680,088} = 0.60$$

The large increase in this ratio is mainly due to the increase in the turnover of operations of the company as well as the treasury bills held by SFL in addition to the back up it has been receiving from BDL .

$$(2) \text{ Return on equity} = \frac{\text{Net profit after Tax}}{\text{Common Earnings}}$$

$$1984 = \frac{1,760,205}{10,841,969} = 0.16 \quad 1985 = \frac{28,440,109}{12,602,174} = 2.25$$

This ratio has increased also from 0.16 in 1984 to 2.25 in 1985 . This increase is due to the

capital gains on operations resulting from the spread between interest paid by the company and the interest earned on treasury bills .

Financing the Company's Portfolio :

The main financing of SFL's portfolio has been done through overnight and call money from banks , in the form of short-term loans , and the company's often "unavoidable gapping" , when some loans mature before the receipt of earnings on assets .

The only resort in this case for the company was its credit line from BDL . Hence the success of SFL's operations depends to a great extent on its relationship with the Credit Department of BDL , to ensure its coverage ratio and be able to meet interest and principal payment without going bankrupt .

$$(3) \text{ coverage ratio} = \frac{\text{Earnings Before Income Taxes}}{\text{Interest paid on debt}}$$

$$1984 = \frac{34,033,000}{31,550,000} = 1.08 \text{ times .}$$

$$1985 = \frac{312,250,210}{274,990,021} = 1.13 \text{ times .}$$

This ratio shows that SFL is only covered one time and hence the company would face hard times, if it operates without the BDL's line of credit . However, the current year might show an increase in the company's capital .

COMPARATIVE BALANCE SHEET OF SFL

(Amounts in Million of L.L.)

1953      1954      1955

ASSETS

CASH & BANKS	0.7	0.6	0.3
LOANS TO LIBRARIANS			
TREASURY	74.5	352.5	4,701
T/B'S	—	195	—
FIXED ASSETS			
LESS DEPRECIATION	0.2	0.9	2.8
OTHER ASSETS		0.5	3.4

TA = TL      25.4      549.5      4,703

LIABILITIES

BORROWINGS FROM BANKS	52.1	515.3	4,238
DEFERRED INTEREST	—	15.5	372.9
OTHER LIABILITIES	2.4	2.2	44.7
CAPITAL	10	10	10
LEGAL RESERVE	—	0.1	0.3
R.F.	—	0.8	2.3
CURRENT PROFIT	—	4.8	39.6

SOURCE : IMF REPORT

### Problems Facing the Company :

Société Financière du Liban , has been suffering , like all companies in Lebanon irrespective of the nature of their activities from the political and security instability .

The longer the climate of political uncertainty persists , the harder it will be for the company and any other finance company of the kind , to develop an efficient secondary money market . To divert the investor's interest from speculation , or from using foreign currencies as a store of value , instead of long-term or even short-term maturity debt instruments , is an impossible task .

In addition , remittances from abroad have been decreasing , because expatriates are losing faith in the Lebanese Pound as a means for their savings . Hence , the prospects of SFL and any other company of the same kind will depend to a great extent on the factor of political and security stability .

### Dealers Lack of Skills :

The second problem SFL had to face since it started its operations was the lack of trading skills at level of bank dealers . Commercial bank traders suffer from the lack of technical skills in managing portfolios of money market securities , particularly treasury bills , which they keep until maturity ; this reduces the SFL dealing activities in these securities . Hence , SFL or any other company would have to face this problem and should find a solution to it by trying to publicize to the banks the ideas concerning trading skills to be developed at both dealer and management levels in the banks as well .

## Credit Mismanagement :

Mistakes were committed by SFL on credit extension , specially when credits were extended to banks at times when the company had other obligations such as paying interest rates , for cover instead of maintaining the necessary liquidity to match it . In order to avoid such risk of becoming insolvent , proper portfolio management should be followed by SFL , primarily by avoiding unnecessary maturity mismatching of their T/B lending portfolios . On the other hand , in order to play its role on the money market and keep on making profits even if it still carries on with its loans , SFL should expand its capital base to cover at least five times its operations and , ensuring its solvency .

## The Need for Another Company

McKinnon (1973) described less developed countries as fragmented economies where financial intermediation is in a rudimentary state imposing serious financial constraints on external investment in new technologies which yield high rates of return , while investment proceeds in the other self-financed sectors which yield low rates of return FN/YC .(30)

As a result , where nominal finance takes the high growth path , real finance takes the low one .

" Then finance is "Shallow" partly because it is being taxed by inflation ." (31) According to Shaw , where finance is "shallow" , in relation to national income of non-financial wealth , one finds that it bears low , often negative real rates of return . Holders of financial assets including money , in such a context , are not rewarded for real growth in their portfolios : they are penalized .

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(30) Galbis V. (1983). pp72 . " Financial Intermediation and Economic Growth in Less Developed Countries : A theoretical Approach " IMF .

(31) Shaw S.Edward (1973) pp 314 ." Financial Deepening in Economic Development ," Oxford University Press , NewYork



In addition , (a) the perpetuation of high rates of inflation , mainly caused by the widened gap between the demand and supply of funds , as well as (b) the appearance of an unofficial non-institutionalized financial market , often accompanying these trends in "shallow" finance , would force the authorities to create a certain credit rationing system .

Experience has proved that this official policy of credit rationing has not led to positive results . On the contrary , official credit rationing has encouraged the further development of traditional curb markets operating outside the scope defined by the monetary authorities , hence to the allocation of resources in opposition to the official design of these authorities .

The ultimate negative consequence of credit rationing is that it could turn into a force increasing the oligopolistic power of the banking system .

The Guerley-Shaw model of financial deepening is the remedy to "Shallow" finance . This model advocates the adoption of a liberalized financial policy as well as the removal of distortions in financial prices hence increasing liquidity reserves . The model is also concerned about the diversification of the menu of financial assets so that borrowers may adjust their debt structures and lenders adjust their portfolios by relatively small degrees at the margin .

Accordingly , financial deepening would stop and reverse capital flight abroad and should divert saving from being turned to satisfy a demand for construction of dubious social productivity which is a common evidence of "shallow" finance .

War-torn Lebanon is not an exception , it has all the characteristics of the less developed country's financial systems , the insecurity and political instability ingredients directly affecting the national economy . In fact , the limited production activities

in war-torn Lebanon has meant the investment-saving cycle , is overwhelmingly dominated by financial assets with little investment done in real productive activities (real assets) , particularly after the Israeli invasion in 1982 . Therefore , this situation, brought about by the stagnation and unprecedented contraction in the Lebanese economy , has led to the development of a greater appetite for speculative investment . With limited financial assets and instruments available on the market , speculators concentrated their operations in the local foreign exchange market . The volatility of this market which reflects speculative demand for exchanges , rather than a real one , emphasises the need to create real demand for financial markets and instruments in Lebanon .

What is needed now at the national level , is in fact to arrive at the stage where financial intermediaries will be able to affect the structure of the money stock . We base our hypothesis on the already proven theory which was initiated by Goldsmith (1966 , 1969), Gurley and Shaw (1955,1960) Wai and H.Patrick (1966), Porter (1966) , who have emphasized the importance of financial deepening by which they mean a greater spread of financial intermediaries , as well as financial instruments in less developed countries . Without that , they argue , financial growth and more importantly internal economic development cannot take place . The introduction of "securities" to such a market , may be viewed as a short cut to financial intermediation in that the savers pass their surplus funds directly to investors rather than depositing with the banks for them to lend to investors ". (33)

Hence by reinstating the disequilibrium of the interest rates , and allowing for a higher return on assets and on investments, those new investments and institutions should turn out to be the prospects for a future acceleration in the overall rate of economic growth .

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(33) Meier G.M , (1964). Leading Issues in Developing economies , p 193 .

The need for setting up financial institution is all too clear : Financial deepening requires a priori , such institutions to promote financial instruments . Such an institution should also provide healthy competition to Société Financière du Liban . Though the same constraints which have been confronting SFL should potentially encounter the proposed company , yet the positive impact of its competition with SFL should outweigh the negative factors .

## CHAPTER FIVE

### FEASIBILITY OF THE PROPOSED COMPANY

This chapter investigates the feasibility of the proposed company and its operations , in order to come to the final conclusion of justifying the viability of such a company .

First the aim is to investigate the demand for the services provided by the company . Then it attempts to show that there are sufficient investors interested in investing in short-term debt instruments at a yield higher than the one they are receiving now from the present means of investment in Lebanese Pounds .

The experience with treasury bills for the public is the answer to this question . Data obtained from the Central Bank shows that there is a positive increase in the amount of treasury bills underwritten since March 1986 , when they were first introduced to the public . The balance of treasury bills for public increased from L.L 605 million in March 1986 to reach L.L 1,967 million at the end of October 1986 . This represents an important increase during a small period of time of eight months , which is in fact the time that was required for people to become familiar with the idea of treasury bills and to understand that they are getting a higher yield on their treasury bills rather than keeping their money in deposit form in banks . The other factor which is of importance and to be taken into consideration , is the response of investors to the increase in interest rates and hence the yield on treasury bills . In fact , since the beginning of September 1986 , BDL announced that the Finance Bank and SFL would be giving a higher yield on treasury bills underwritten through these two institu-

tions . That is , they would give higher interest rates on treasury bills , or their portfolio of treasury bills purchased from BDL , hence acting as an agent for the Central Bank . Since September 1986 , the balance of public subscription at SFL and the Finance Bank , increased from L.L 58.280 million in July to reach L.L 767.670 million for the Finance bank and from L.L 2.500 million to L.L 181.800 million for SFL , at the end of October 1986 . In addition , data from the Central Bank shows that the major portion of public's subscriptions is in the one year portion of treasury bills , accounting for 73.8 percent of the public treasury bills portfolio .

The most attractive feature for the public , which people have understood and are taking advantage of is , the fact that they can hold subscriptions of treasury bills for one year and yet could terminate them at any time after one month only losing the interest rate on the days for which the treasury bill was not kept . On the other hand , banks are obliged to hold treasury bills as legal reserve requirement in addition to their holdings of treasury bills as a means of investment for their use in the interbank market . The total amount of treasury bills in circulation reached L.L 48,534 million by mid-November 1986 . While the volume of "REPOS" that has been covered over the period from the beginning of 86 and till mid of November 1986 , came up to be L.L 36,643 million showing the large use of treasury bills in the interbank market as a liquidity instrument .(34)

There is also a possibility that banks will be obliged to hold more treasury bills in case the legal reserve requirement is increased as a monetary weapon to stop the devaluation of the Lebanese Pound . This alternative should be taken into consideration as a potential need for more short-term money instruments in order

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(34) BDL , unofficial statistics , 1986 .

to create a larger menu of financial assets and make it available for investors to invest their earnings at high yields .

Another thing to be taken into consideration , is that SFL was not able to meet one of its objectives with respect to the introduction of additional money instruments , since up till now it has been unable to do so . In conclusion , we can say that there is a large potential demand for short-term money instruments . Hence our proposed company is bound to find investors who would be willing to buy the proposed instruments , providing a good marketing strategy is established , that is , people are informed of the profitability of the outlets provided by the company . It is also relevant to mention at this stage that the importance of the potential contribution of insurance companies , investment companies the social security national fund , and the deposit insurance company to the financial market should be taken into consideration .

#### Supply :

As it has been made clear earlier, the supply for such instruments as treasury bills will be available for a long time on the money market . In fact , the deficit of the treasury is large and until enough time of security and peace has prevailed , it would be very difficult to finance this deficit from another source than public debt . This , on the other hand would lead to a fast rate of monetary expansion , the goal being to minimize this expansion , rather than the fiscal deficit , interest rates will have to be increased . In the short-run , the authorities will have to follow a tight monetary and credit policy and increasing the interest rates substancially to the

rate of depreciation and inflation , hence leading to the increase in the cost of borrowing for speculation in foreign currencies .

On the other hand , the only means to slow the monetary expansion would be through financing as much as possible through the sale of treasury bills to public and commercial banks to reduce the money stock . Hence the supply of public debt instruments will still be available. On the other hand , the country needs reconstruction and there is a need for large amounts of investments to do so . Hence municipal bonds and CDR bonds might become longterm means of investment issued by the concerned government agencies as well .

#### Competition :

The reaction of the commercial banks to the creation of an additional company would be to try to delay its development as well as to prohibit the development of the money market as they did for the public treasury bills issuances . However , they need a diversification for their portfolio holding , hence the creation of new instruments by the proposed company could help banks to find out new outlets to their investments and they might be more positive towards its creation than they were towards the marketing of public treasury bills by the BDL in March 1986 . One should recount the war declared by banks on the sale of T/B's to the public and all the rumours they have circulated to make this policy fail as it was viewed to represent a threat to them , leading to the reduction of their deposits volume and therefore , their oligopolistic power over the money market . On the other hand , the proposed company does not constitute a threat to the operations of SFL , since the market is still at the embryonic stage and there

is room for any company which has the professional capability and the technical skills to work efficiently on the market .

#### Inflation :

Inflation has been turning into a galloping trend , with the rate for 1986 expected to reach 100 percent . Prices are increasing very fast as a result of the rapid devaluation of the Lebanese Pound , in addition to the increase in the public debt . Investors are , therefore , interested in keeping their money in short-term instruments , with maturities ranging from one month to one year , in order to match their increasing liquidity needs . This liquidity preference is expected in periods of running inflation . The proposed company should therefore introduce a new variety of short-term high yield money instruments to satisfy the specific needs of those investors . Hence there is no doubt that it will be able to find itself a niche in the market . The introduction of one month treasury bills by the treasury and the trade of the latter through the proposed company , as well as other money instruments such as CD's , NOW's would attract investors keen to diversify their portfolios .

#### Negotiability of the Instruments Introduced :

The instruments to be introduced by the company should be of negotiable type , in order to be attractive to investors , who would be keeping them as liquid assets or a safety margin . The negotiability element of the instruments to be introduced is also of great importance to attract banks as well to invest their excess liquidity , and be sure to have access to it at any point in time in case they need it .



On the other hand , this element will reflect on the market itself , creating a certain flexibility in the trade operations . The impact will be therefore , to increase the efficiency of the development of the money market , as well as the effectiveness of the monetary policy implementation . Usually , the trade in negotiable instruments is sensitive to the changes in interest rates .

#### Taxes :

Savings instruments such as bank deposits and T/B's have been exempted from taxation , as per law stated in the Code of Money and Credit . The instruments to be introduced by the proposed company should benefit from tax exemptions , being convertible at any point in time to liquid assets .

#### Attitude of the Monetary Authorities :

It should be recalled that , public treasury bills were initiated by the Central Bank in order to have an additional means to control the expansion of the money supply . Moreover , SFL was created in response to the encouragement of banks by BDL , which has contributed to a great extent in the development of the company's activities . The monetary authorities are well aware of the necessity to promote additional non-bank financial institutions as well as the need to create additional instruments to make available to investors a wider menu of short-term high yield assets . On the other hand , public debt needs to be financed and the best way to do it , is to use financial intermediaries and treasury bills and other

available instruments . This would permit the authorities to have a tighter control over the money supply through open market operations . The creation of an additional non-bank financial institution will enable the diversification of the public debt risk . It may also permit maturity transformation of this debt from short-term maturities due to the banking system to longer maturities . The effect will be a decrease in the velocity of circulation of the Lebanese Pound . The growth of the non-bank financial institutions will also help reach a level of disintermediation needed at this stage to decrease the oligopolistic power of the banking system . On the other hand , the Central Bank is willing to "bail out" the company in its dealing in short-term papers as it did for SFL acting as a lender of last resort for the company .

#### Activities of the Proposed Company :

Since the main purpose of the creation of our proposed company is the further development of the money market , as well as the creation or promotion of additional financial instruments , it has to compete with SFL to realize for itself a market share and a niche on the financial scene . In order to do so , its activities should be tailored to meet these two objectives . Hence , the activities of the company should be characterized by the following :

- The company should be able to ensure at any point of time , the trading of every type of government and non-government securities , at a single prevailing price level , acting as a marketing agent ,
- Standing ready at any moment to quote firm bids and offers at which it will buy and sell , hence rende-

ring negotiable debt instruments highly liquid , while operating as a broker on the interbank as well , act as an official dealer , in the foreign exchange market .(34)

These as previously stated , provide investors with more attractive outlets than those already provided by SFL and which are badly needed to create the diversity of financial instruments concomitant with proper portfolio management .

First with respect to treasury bills and open market operations , SFL has been already established in the market , however , the proposed company will still have a share of the market , since the market is still at its early stage of development and has not reached the saturation level . In addition , treasury bills will still have to be supplied in large amounts . Demand for these being present , the proposed company will have to use its skills and better technical efficiency in order to compete with SFL on the basis of strategic management . On the other hand , the company will be able to have a greater possibility to do so providing the following factors are met :

- 1-It is granted with a similar line of credit from BDL .
- 2-It has a larger capital endowment than SFL's capital which has been increased to L.L 20 million this year .
- 3-Agreements are reached with BDL , so that the proposed company will be given the privilege to pay lower interest rates to BDL , for the loans it is

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(34) SFL , " Annual Bulletin " , 1985 .

granted to cover its daily transactions in case of overdrafts in its accounts at the Central Bank .

4-The proposed company is given the privilege of higher discount rates on the volume of treasury bills sold by the company so that it will ensure itself a higher commission and still be paying high yields on treasury bills , hence competing with SFL on this basis . This would stimulate the money market in favour of the proposed company's activities as well as activating the open market operations , hence indirectly increasing the control of the monetary authorities over the money supply .

Second with respect to the interbank brokerage , the size of this market has also not attained the maturity stage . In fact due to the excess liquidity available on the market , it is witnessing rapid changes in interest rates in tandem with the liquidity needs . Both demand and supply for funds are large .

The market share of the interbank operations out of total treasury bills is 12 percent . However , it is expected to increase . On the other hand , SFL is not covering up for the optimal size of the market. There is still room for another company to operate on the market and take the role that has been carried by large banks for sometime . In fact some large banks are operating as funds managers to provide fund management services for smaller banks , who do not have neither the contacts nor the outlets to invest their funds . Hence the proposed company will benefit from making arrangements for those small banks and earn a revenue on these services creating itself a market share . On the other hand , the proposed company will benefit from its partnership with a foreign dealer/broker(s) company and will compete with SFL on the basis of operational costs , and of larger and tighter contacts on both the local and international

markets . This will contribute to a large extent in giving it the reliability it needs so that it will be trusted from the small banks who will seek its cooperation .

Third , with respect to dealing in the foreign exchange markets , SFL was created with the aim to eliminate the role of the other dealers on the foreign exchange market , who were taking speculative positions against the national currency . Through the elimination of the role of the latter SFL emerged as the sole dealer in the foreign exchange market .

Though the company does not have the privilege and under no circumstances it may carry exchange positions to avoid conflict of interest , yet it has monopolized its power . It has been reported that it has been giving preferential treatment to some banks . In fact, dealers in dealing rooms at the banks have been complaining and reporting changes in the posted quotations representing the lowest and the highest bid on a certain currency . The proposed company could compete with SFL and gain the confidence of the dealers in this market on this count .

In order to limit speculation , the company could resort to competing with SFL by offering clients higher interest rates on treasury bills and deposits held with the company , to attract the investors to save in Lebanese Pounds , thereby , working closely with BDL to help achieve a stable domestic foreign exchange market .

#### Instruments to be Introduced

The proposed company is to concentrate on the market making of untrapped financial instruments needed as a

diversification in order to channel national savings. Along with this activity the company is to act as a link between the local and foreign markets , integrating the national money market with the international ones. The instruments to be introduced are the following :

- 1- Certificates of Deposits ,
- 2- Commercial Papers ,
- 3- Banker's acceptances ,
- 4- Negotiable orders of withdrawal , N.O.W
- 5- Activate "REPOS" ,
- 6- Futures markets .

Certificates of Deposits (CD's) :

These are money instruments lacking on the Lebanese money markets . Due to the easy liquidity situation that has been prevailing until now , commercial banks have not felt the urge to resort to the use of these instruments to attract deposits . However , the activation of the money market will make the trade in treasury bills more and more active , then banks are most likely to resort to the issuance of such instruments , and this is expected to happen in the near future . The introduction of CD's on the market should serve the following purposes :

- 1- It will be an additional means of competition among banks for attracting local currency deposits , once the liquidity's control is tightened by the monetary authorities ,
- 2- The proposed company , profiting from its partner's experience in dealing with such instruments will ensure itself a leading position in the trade and marketing of CD's issued by large banks ready to issue such instruments ,

3- The persistent pressure which the Central Bank and the Banking Control Commission have been exercising on the commercial banks to keep a fair balance at all times between the maturity structure of their deposits and their investments , " is likely to compel banks in the face of increasing demand for longer maturity loans by the public authorities to explore all possible avenues for lengthening the average maturity of their deposit liabilities . One effective way would be the use of CD's . As this instrument combines the fixed-term feature of a time deposit with the marketability feature of an open market security , it would help to wed the issuing bank's preference for longer-term funds with the depositor's preference for highly liquid placements .(35)

This instrument is one of the convenient channels we are after to attract short-term funds and turn them into longer-term deposits , and instruments which can be used with the position of BDL as a lender of last resort .

Medium and long-term specialized banks such as , the Finance Bank , Infibank and others , would be interested in participating in the activation of these instruments as well . The proposed company will therefore help in promoting the development of the money market into a more sophisticated one . In addition , the company would act as an intermediary between investors and the issuers of CD's , hence tailoring the terms and conditions of these instruments to the requirements of the investors rather than those of the issuing banks .

#### Commercial Papers :

Up till now , there is no commercial paper market in Lebanon in the proper sense . Commercial banks themselves ordinarily possess a portfolio of bills arising

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(35) Hoss Salim (1974) , " The development of Lebanon's financial markets " , p 27.

from their loans to their clients , which are eligible for rediscounting at the bank of Lebanon . The need to promote this market may be important because it may draw the supply of such paper from domestic corporations of high standard who are in need of funds , under more favorable terms than bank credits .

" For commercial banks , commercial paper would be an ideal instrument for holding as a secondary reserves . The risk of loss is negligible , it is paid at maturity with no possibility of extensions and usually the diversity of issues provide convenient maturity dates Also if a bank wishes to obtain cash or build up reserves before the paper matures , it may resell it in the open market."(36) Hence these papers would present a means of channelling funds into efficient economic growth through providing the opportunity to expand industrial and commercial corporations . On the other hand it will add one instrument on the money market to be traded in the open market , hence , increasing the activities on the money market . Medium term and long-term banks could be interested to deal in these papers and help the company in the evaluation and studying of the financial situation of the corporations who are to issue papers .

#### Banker's Acceptances :

The promotion of such acceptances on the Lebanese market by the proposed company , would be a help provided to both importers and exporters . Importers will benefit in that adequate credits are secured for the merchandise they have asked for , and the importer's bank will benefit because it has charged a fee for the issuance of the commonly shared letter of credit as well as other services provided . For exporters , they would be secured with a high grade credit instrument with a definite short-term maturity .



Therefore , this additional instrument for the banks will have the impact of a contingent liability rather than direct loans , having the advantage of not being included under certain leverage or risk asset/capital ceilings . While as for the commercial activity , and specially with the devaluation of the Lebanese pound , and the fluctuations of the foreign currencies , such acceptances are lines of credit which could help exporters cover for their obligations . This way they may be able to buy commodities before having sold their previous stock to ensure the money needed . This instrument will then play the role of a finance source to support small buisnesses in these hard times . These acceptances will be an additional instrument traded on the money market , it will ensure both the liquidity as well as the investment opportunity for whoever is willing to buy it , creating a movement in and out of the market .

#### REPOS

The activation of this instument will have a positive impact on the trade of treasury bills . As described earlier , these transactions are strictly interbank transactions on either treasury or government securities . Because trading in these instruments involves price differentials , the activation of these "REPOS will permit our company to earn revenues from these differentials . On the other hand , these instruments provide banks with the liquid short-term financial instrument they can use to either keep the value of their own funds or secure a means of investment for these funds to benefit from interest earnings as well . The movement created by the trade of these instruments will reflect on the technical development of the market and have a positive impact increasing the efficiency of the monetary authorities policies .

Negotiable Orders of Withdrawals ( N.O.W's ) :

These are instruments still lacking on the Lebanese money market . They have not been promoted up till now because there was no need to do so .

However , their introduction should be considered because of the possible need to use them in the very short-term . As the secondary market continues its expansion , banks will need to explore the issuance of new instruments , to ensure themselves with contingency liquidity needs . Banks would also need these N.O.W's in their competition for deposits , willing to offer their clients more attractive outlets . Therefore , the introduction of N.O.W's would serve the following purpose :

- 1- Permit the competition between commercial banks as well as between the latter and non-bank financial institutions . It is well known that healthy competition is the trigger towards improvement and development .

N.O.W accounts will permit the depositor to make cheque-like withdrawals from an interest bearing account . The holder of a N.O.W simply writes a paper in the same way as writing a cheque .

On the other hand these accounts will permit non-bank financial institutions to hold deposits and issue cheques like banks .

" Thus the N.O.W account provides both types of institutions with the opportunity to compete on the same ground because N.O.W accounts are technically saving accounts since there is a provision for notice of withdrawal to be required . However , since the notice is waived , these accounts become interest bearing cheque accounts ."(37)

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(37) H.Carter , I.Partington , Op.cit , p 218 .

Statistics showed that , in 1982 , the balance required to avoid fees or charges on a non-interest bearing account was about U.S Dollar 300 , whereas the minimum balance on N.O.W accounts was almost U.S Dollar 800 . Hence the N.O.W deposit accounts are issued for larger amounts than those of the deposit accounts . Nevertheless , the introduction of such instruments on the U.S financial market was not only reflected through an increase in the competitiveness of commercial banks , but "thrift" institutions in general have been able to increase their competitiveness . As a result , savings and loan associations and mutual savings banks were permitted to move into new business activities , and N.O.W's became a constituent part of the M1 money supply .

- 2- It is an additional instrument available on the money market , of which the proposed company will take advantage over SFL , to attract to itself more short-term deposits to be channelled into longer-term investments .
- 3- The introduction of N.O.W accounts to the money market might have to be supported with legislative changes to the code of Money and Credit . Yet the introduction of such accounts will add one more sophisticated money instrument on the market . This is bound to reflect on its technical efficiency , which will render its operations more effective when monetary policies are concerned .

#### Futures Market :

" The most dramatic and successful innovation in the money market in recent years has been the introduction

of trading in future financial instruments ." (38)

This has led to an innovation in the money market type of transactions , enabling market participants , dealers , investors , and primary borrowers to engage in a wide range of transactions that were up till now impossible or all too often unproductive because of high transactions costs . The futures market differs from the market for government papers and other monetary instruments , which is usually called the cash market , on the basis of trade delivery .

In the latter , securities are traded for same or next day delivery , while the future market contracts in T/Bs or other kind of commodities , requires the delivery of the latter in a stated month in the future .

Usually traders are not really interested in making delivery of commodities . Therefore they close out their position in future delivery contracts before they mature .

If the ownership of the proposed company is to include a foreign broker/dealer company , and as such companies enjoy the privilege of operating on the commodity and exchange and stock market at the international levels , this proposed company should profit from the experience of its partners and could follow the same line of activities . This is because , the aim of this company is not merely the development of the secondary market , but also to open new outlets for these foreign stock exchange trade operations . Such outlets would support the integration of the local and international money markets .

In fact some operations are taking place between the local and these foreign markets , yet these are not important for most small banks . Presently , only

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(38) Stigum Marcia , (1981). " Money Market Calculations: yields , break-evens , and arbitrage ." Dow-Jones Irwin , p 151 .

large banks are taking positions in such operations as well as some individuals who are well informed and willing to trade in this market . There are many reasons for this attitude :

- 1)- The high cost of such operations , in the present context , ( telex and intermediation costs ) ,
- 2)- The unavailability of daily accurate reports on the operations taking place in these markets ,
- 3)- The majority of managers in the Lebanese banks are neither familiar with the mechanics of such markets nor well informed . Hence , they consider such investments to be very risky for them to undertake because they are afraid of incurring losses .

The proposition made here is to give small banks and individuals , the opportunity to trade in this market, eliminating as much as possible the negative factors and reasons that have been refraining the latter from participating in such operations . The expertise of the proposed company's partners and its staff , will help it gain the trust of investors who will seek its professional advice to trade in this market .

Accordingly , the proposed company could act as an agent to its foreign shareholders , benefiting from their reputation as well as from the facilities it could provide them through the tied information system with the head offices abroad . This system would comprise telex facilities , screens posting the prices of commodities and debt instruments all directly connected to the head offices abroad . Such installations are not costly and would give the proposed company the intermediation advantage , hence make it possible for banks to trade in the market at lower cost of intermediation than currently possible . On the other hand , this same constant contact with the head offices abroad will make it available for the company to receive the continuous reports on the movement and

trends of the international commodities market . The experience of some small companies presently operating on the Lebanese scene as correspondants to foreign dealer/broker(s) companies mainly serving individuals , is an evidence of the viability of such a company . In fact , data obtained in an interview with the manager of one of these small companies , reveals that yearly profits made by the company approximated U.S Dollars 300,000 , out of the commission collected on deals made by the company . This commission varies from 5 to 9 percent according to the type of the deal . The company could, therefore , benefit from the services it offers - and the corresponding large commissions - to the banking community at large . On the other hand , the company will have to present seminars to instruct bankers and other investors on the mechanics of this market , as well as the potential profits and risks involved . Finally , the company , through this kind of integration should introduce the following elements on the financial scene :

First , the positive aspect of such an integration would be the introduction of an additional investment outlet to investors who are risk takers . It is worth noting here , that the higher the risks the larger the profits , specially if these are realized in foreign currencies . Hence the profits expected by the company would become a source of foreign currencies which is to be taken into consideration .

The second positive aspect is that the operations provided by the company will attract speculators away from the local market , hence dampen the pressures on the Lebanese Pound exchange market .

The negative impact which is to be taken into consideration at this stage is that ; losses could take place reversing the situation from an inflow of funds to an outflow of funds , a thing which should be avoided specially at this time . The solution , however ,

is possible . What would be needed , is a participation on a national scale , specially at a later stage when the company is well established on the market . Then , only the management of the company could make swaps of the losing deals , selling to clients wishing to invest , the deals sold at loss by local investors. This would keep the foreign funds within the local system covering for potential losses , and avoiding the negative impact of such an integration with the international markets . For this purpose , the use of a sophisticated computerized system would be needed to make such swaping operations possible . In addition futures market in commodities and a local future market in currencies should be activated . The impact on the market would be to extend the control of the monetary authorities to the trend of increases in the foreign exchange rates . As a matter of fact this would make it possible to these authorities to intervene manipulating the expected rates , instead of leaving it to the speculator's whims . Upper lids to foreign currencies would be easier to be imposed by the monetary authorities , hence enabling tighter control of foreign markets to be reached .

#### Ownership of the Company

Several combinations and scenarios may be presented for the ownership structure of the proposed company . Nevertheless , the main prospective owners are : The Central Bank , Commercial Banks , the foreign dealers and brokers partners , insurance companies National Social Security Funds , and at a later stage the public . Here follows the main combinations of ownership scenarios :

First :

We could have a company equally owned by a mixture of :

- 1- Commercial banks who are willing to deal with the instruments traded through the company . They would have 25 percent of shares ,
- 2- with the Central bank to hold 25 percent shares ,
- 3- foreign dealer/broker firm (s) , to hold 25 percent of the shares , and
- 4- the national social security funds , together with the insurance companies ( Lebanese ) , to hold the remaining 25 percent of the shares .

Second :

- 1- Commercial banks , willing to deal with the instruments provided , they could obtain 30 percent ownership ,
- 2- with the Central , to hold approximately 20 percent of the shares ,
- 3- foreign dealer/broker firm (s), to hold in this case 25 percent ownership ,
- 4- The national Security fund and Insurance companies all Lebanese , to hold 20 percent ownership ,
- 5- and , individuals who are willing to invest in the shares of the company , hence the company acting as a mutual funds , could have 5 percent ownership .

Third :

- 1- Commercial banks , to hold not more than 30 percent , to limit their interference in the company's objectives and avoid clashes of interest .
- 2- Foreign dealers/broker firm(s) , to hold a maximum of 25 percent to ensure its objectivity in the operations .



- 3- the national security funds and Lebanese insurance companies , ( Local ) , to hold 10 percent ownership ,
- 4- and , individuals who are willing to invest in the company's shares to hold the remaining 35 percent .

This last combination could apply at a later stage , as a result of any other previous combinations , to ensure the proper launching of the company particularly that individuals may not be enthusiastic at the early stage to commit themselves to such a venture . This could be done by the Central Bank disposing of its shares to the benefit of the public .

#### Organisation of the Company :

The company should have a functional organization that would fit the purposes for which it was created for . The organisation structure of the company should reflect the organizational principles of the hierachical structure , line of authority , flexibility , span of control and delegation defined by the Chairman of the Board and General Manager to meet the current and organisational requirements of the company . The company could be divided into the following departments covering the basic functions :

##### (1) Treasury bills and Money Market :

- a) Subscribe or buy treasury bills from B.D.L , to sell them to banks and generate revenue to the company ,
- b) Accept local currency interbank funds on call notice and time basis .

- c) Create and activate a secondary market for the proposed instruments such as C.D's , N.O.W's , as well as activating the secondary market for treasury bills and RP's .
- d) Provide technical assistance and professional know how to clients on trading in securities ,
- e) Cooperate with B.D.L in the implementation of it's monetary policy .(40)

(2) Foreign Exchange Brokerage :

It is divided into a local market operations on currencies and a future market . A foreign commodities and future market .

Local market :

- a) Receive bid and offer rates from banks willing to buy or resell foreign currencies , and ensure a display of fair rates .
- b) Ensure equal impartial treatment to all clients
- c) Cooperate with B.D.L in the implementation of its foreign exchange policy ,
- d) Provide future market rates , for clients who are willing to trade on this market .

Foreign Future Market :

- a) Accept the bids and offers to trade in this market , from the clients who are willing to trade in this market .
- b) Provide clients with information and technical information and technical assistance and professional know how to clients , in their trading in foreign commodities .

- c) Make available to clients to follow up the movement of the commodities market .

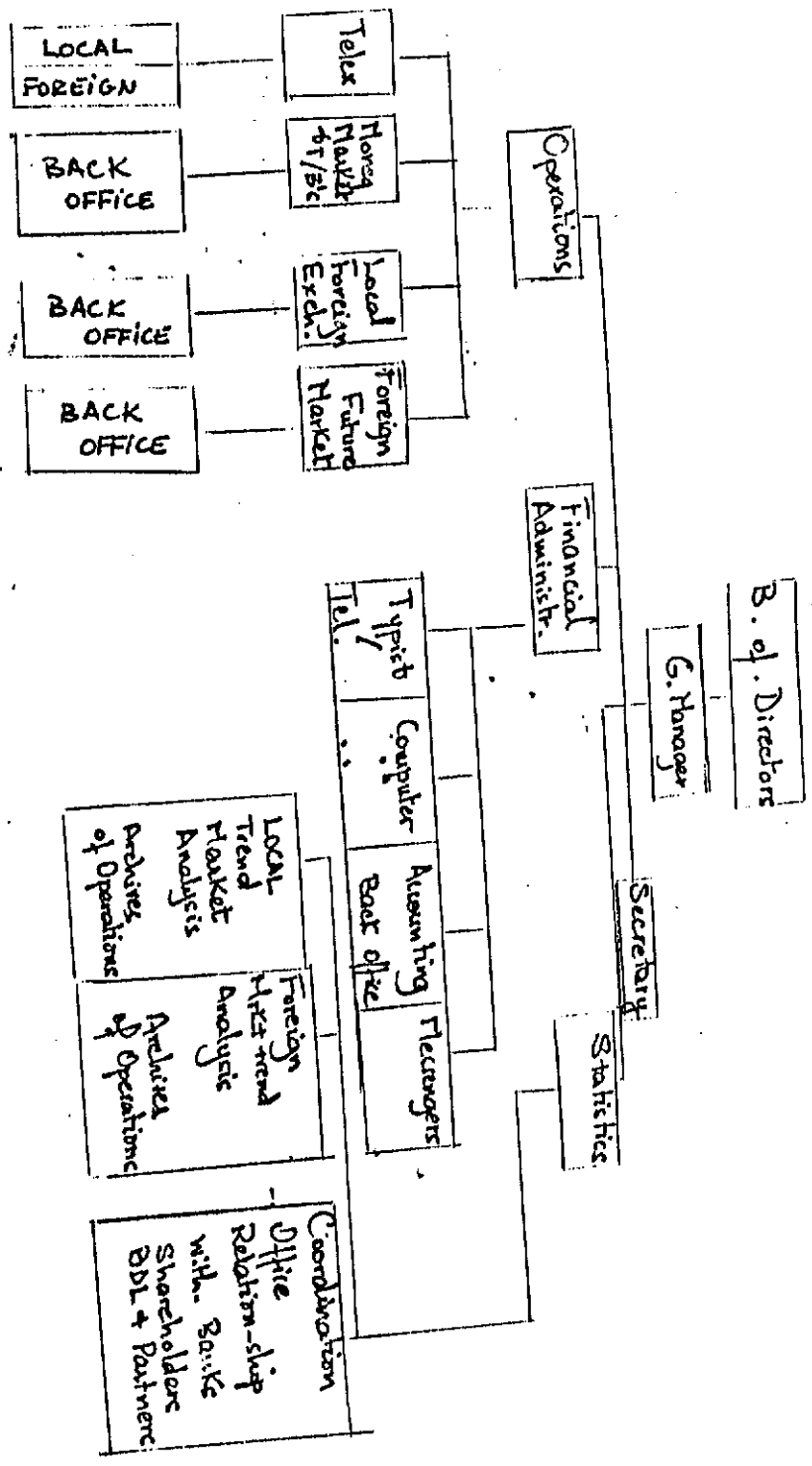
Money Market and Treasury Bills Back-office :

- a) The main task of this office would be to follow up with all the details , and execute the deals prepared by the concerned departments .
- b) To control the proper execution of the deals with respect to amounts , value dates , maturities and interest rates amounts .
- c) To send and receive written confirmations for each transactions , and ensure that confirmations are correct and in order .

Foreign Exchange Brokerage Back-office :

- a) Follow up every detail of the operations .
- b) The main task of this office is to keep daily lists of foreign exchange transactions ;
- c) To issue confirmations of trade transactions on the foreign future market ,
- d) Follow up every detail of the operations , from the offer and bids to sending written confirmations for each transaction .

The main tasks of the other departments is of the classical type and are well known . However , and in order to avoid clashes of interests , and to profit from their experience a team of foreign representatives of the foreign shareholders and Lebanese qualified



staff could be elected to run the company to its best interest and not to meet the proper individual shareholders interests , on the contrary the company's and public interest should be the main trigger behind strategic management of the company .

#### Management of the Company :

The management of this company should be entrusted by owner's percentage , to a team of qualified professionals . This team will therefore include representatives of the shareholders , however , in the early stages , it would be preferable , if the entire responsibility of managing this company would be entrusted to the foreign representatives . This preference is justified by the fact that they are better qualified professionally , due to their past experience to manage the company and initiate the other Lebanese partners into the activities of the company . In addition , they should have the responsibility of both issuing the new financial instruments , to be introduced by the proposed company , and their promotion , marketing in the money market . At a later stage , when the other partner become qualified , and in case of changes in ownership , management's responsibility could then be entrusted to Lebanese professionals .

#### Board of Directors :

An agreement here must be reached between all owners , and B.D.L , so that B.D.L and the foreign partners would be entitled to nominate the chairman of the board , who must be a non-bank officer , director , or shareholder , and who is supposed to be observing neutrality , hence seeking to reach a compromise between the profit of the company and the national

benefit or the participation of the company in the implementation of the monetary policy determined by monetary officials at B.D.L.

Directors would be nominated by each of the shareholders who have more than 10 percent shares . The memorandum of Association will have to clearly describe the role(s) of the board of directors , the chairman , the managing director , and the Executive Committee . In order to preserve confidentiality , the Board of Directors will not take any credit decisions nor have access to information on relationships and transactions between the company and individual banks . The chairman and managing director on the other hand , should have access to such information in order to prevent any possible partiality from the part of any member of the managing team .

The decision making authority for operations should be in the hands of the managing director , who would report and held responsible for his actions towards the board of directors . However , he should have as well as the managing team helping him , a total independence for the operational decision making , in order to preserve the effectiveness of the company's intervention on the market . As mentioned earlier , an Executive Committee should be established , by the board , and should consist of the managing director , in addition to three other directors who should not be non-associated with banks . This committee would , among other things , be responsible for establishing credit review procedure and credit lines for interbank transactions as well as rules governing interbank transactions , trading limits , inventory limits , and other operational guidelines .

In addition , the Committee should coordinate with the Central Bank's authorities in order to support the implementation of the monetary policy .

### Financing the Proposed Company :

The financing of the company is based on the ownership's percentage distribution . Since we do have four ownership scenarios , we are likely to have the same number of financing contribution scenarios . However , the important point to stress at this stage is that in order to be able to compete with SFL , which is already established broker/dealer , with a capital of L.L 10 million now running at L.L 20 million , the proposed company should be expected to have an initial capital greater than L.L 20 million . The capital could be as much as L.L 100 million , supported by long-term subordinated loans denominated in foreign currencies to enable the company to retain a high solvency ratio in the face of the weak Lebanese Pound . On the other hand , SFL has been benefiting from a L.L 400 million credit line extended by the BDL , for its daily operations . Hence , we expect the company to be provided with the same if not higher credit facilities from the Central Bank , because of the innovating theme inherent within the Memorandum of its Association . In addition , the company should be allowed to issue fixed or floating rate bonds and notes or commercial paper , subject to certain leverage restrictions to be determined by the Central Bank .

## CHAPTER SIX

### CONCLUSION

What the Lebanese economy has been going through in the past year or so , could perhaps be described as the beginning of the collapse of the national economy . What has happened during this period , is not the result of drastic structural changes . As a matter of fact , these have not changed to the extent of bringing the present crisis about . What has changed is that the economic factors and parameters have become more and more closely related to the security and political situation , and in many instances , manipulated to serve political ends . The Lebanese Pound's devaluation is largely the result of the speculation fever and the lack of control from the monetary authorities concomitantly with the deterioration of the situation . Therefore , the economic crisis could be said to be at present more of a political struggle than of purely economic one . The introduction of a company similar to the one proposed in this study will not have a positive bearing on the present crisis . The present possible solution of the problem lies in reaching , political agreement to be able to apply monetary as well as fiscal policies . The monetary policies applicable , are obvious , and their application had been lauched earlier this year . However , these policies were withdrawn under political pressures .

If political agreement is reached , to make the application of these procedures possible , then we would be able to consider that the economic factors and parameters will be reactivated as and entity in them-



selves and independently from the political influence .  
Only then , the introduction of our proposed company  
will have the positive impact already mentioned .  
This exposes the fact why the applicability of the  
results of this research are not closely correlated  
to the present situation .

The introduction of the proposed company and any NFI  
capable of effecting positive change and development ,  
in the sense of " financial deepening " , should be  
seen as serving the future development of Lebanon's  
financial system . The ultimate effect of the intro-  
duction of the proposed company is of a long-term  
nature . The impact of the development of the seconda-  
ry market on the whole economic development of the  
country , through the above mentioned company will be  
reflected at many levels .

At the macro-economic level , its development is the  
basis needed for the establishment of the primary  
capital market . It will also lead to a more effi-  
cient competitive financial system .

The growth of the financial market , through "financial  
deepening " , will stimulate market orientation and  
liberalized interest rate policies . On the other  
hand , the availability of alternatives for savers and  
borrowers provided , through this liberalization will  
end up reflecting a positive economic growth . The  
increased specialisation and improvement in the market  
techniques , promoted by the increased activity of  
non-bank financial intermediaries , will lead to more  
innovation and a decrease of the oligopolistic  
behavior of the banking system . Such oligopoly , it  
may be recalled leads to disintermediation .

The cost of financial intermediation should also be  
expected to decrease when new specialized financial  
institutions and a greater choice of investement media  
increase competition , thus increasing the efficiency  
of the financial system . Due to this increased effi-

ciency on the money market , resulting from the development of non-bank financial intermediation , a better savings mobilization is expected to be reached , hence , a better resource allocation . Competition should also reflect on market interest rates which are likely to become more of a positive real nature than "administrative" rates . Such rates would provide , on the other hand , better incentives to savers . Moreover , Non-bank financial institutions have the power to channel these short-term savings into longer-term savings , giving these institutions a comparative advantage over the banking institutions . In addition to this , " the introduction of non-bank financial intermediaries into the financial system can in fact be shown to increase the potential amount of credit that may be extended for any given increase in the liabilities of the Central Bank . This conclusion, can be extended without difficulty to a financial system where non-bank financial intermediaries are already operating grow relatively to the banking system ." (40)

The end result would be a more efficient allocation of resources , specially for long-term investment , which is expected to have a positive impact on economic growth as mentioned earlier . These results are very important if they could be realized at this stage , and in the present context of the Lebanese scene . In addition to this , the growth and development of non-bank financial intermediaries (NFI) has always been a factor which has increased the effectiveness of open market policy as an instrument of monetary control . The " (NFI's) have the power to strenghten and widen the scope for effective monetary control of the authorities ." (41) NFI's could , therefore , serve the purpose of controlling the forces of inflation and the depreciation of the national currency in Lebanon .

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(40) Richard S.Thorn , " Non-bank Financial Intermediaries Credit Expansion , and Monetary Policy " , IMF , Staff Papers , p 369 .

(41) Eugene A.Birbaum , " The growth of Financial Intermediaries as a factor in the effectiveness of monetary policy " , IMF Staff Papers , p 584 .

## APPENDIX I

The initial shareholders of the company SFL were the following :

- Banque de l'Industrie et du Travail SAL ,
- Fransabank SAL ,
- Banque Audi SAL ,
- Banque Libanaise pour le Commerce SAL ,
- Jammal Trust Bank SAL ,
- Investment and Finance bank SAL ,
- Bank of Beirut SAL ,
- Banque Nationale de Paris " Interc."
- Universal bank SAL ,
- The Arab Libyan Tunisian Bank SAL ,
- The British Bank of The Middle East SAL ,
- Banque du Liban et d'Outre Mer SAL ,
- Banque Saradar SAL ,
- Credit Commercial de France (M.O) SAL ,
- Globe bank SAL ,
- Mebco Bank SAL ,
- Transorient SAL ,
- Credit Libanais SAL ,
- Sté Générale Libano-Européene de Banque SAL ,
- Banque du Crédit Populaire SAL ,
- Banque G.Trad ( Credit Lyonnais ) SAL ,
- Arab African International bank
- Banque de la Méditerranée SAL ,
- Banque Beyrouth pour le Commerce SAL ,
- Bank of Beirut and the Arab Counties SAL ,
- Capital Tust Bank SAL ,
- Société Bancaire du Liban SAL ;
- Arab Bank , Ltd.
- Banque Libano-Francaise SAL ,
- Banque Al-Mashrek SAL ,
- Société Nouvelle de la B.S.L SAL ,
- Byblos Bank SAL ,
- United Bank of Saudia and Lebanon SAL .

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