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AL SAUDI BANQUE - FRANCE S.A. CRISIS
A CASE STUDY

A RESEARCH TOPIC
Presented to the Graduate Faculty
BEIRUT UNIVERSITY COLLEGE

In Partial Fulfillment
of the Requirements for the Degree
Master of Science
in
Business Management

By
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January 1991

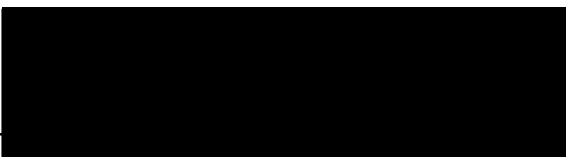
AL SAUDI BANQUE - FRANCE S.A. CRISIS

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ACKNOWLEDGEMENTS

I would like to express my gratitude and appreciation to all Méditerranée Group Services, SARL departments and staff; their help in providing valuable data contributed to the completion of this project.

My deep admiration and special thanks goes to Miss Layal Rifaat who cheerfully and neatly did all the typing of this project. Her continuous efforts, patience and technical assistance are evident throughout the pages of this project.

The assistance of Miss Jinan Tutengy and Suzan Ashour are appreciated as well.

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INTRODUCTION

The purpose of this project is to study, analyse, and expose the causes of Al Saudi Banque-France S.A. crisis; it uncovers the underlying reasons which gave rise to one of the most embarrassing banking failures among the European-based Arab banks, particularly in France.

The Bank, established during the oil boom era, and involved heavily in advancing credit facilities to the Gulf and third world countries, faced a serious liquidity problem due to the deterioration in the Gulf economies and the incapability of developing countries to settle outstanding debts even after setting a rescheduling plan. The shareholders' failure to cover such risks by securing required provisions was the core reason for the crisis. Moreover, the competition among banks with activity oriented towards the Middle East and Gulf area, limited the profit margins and increased the cost of exploring new fields of activity.

The concentration of loans and deposits, and the excessive advances to sister companies owned wholly or in part by the Group holding company contributed to the weak financial position of the Bank.

The research methodology followed in this paper depends primarily on information gathered from the Bank's annual reports, manuals, minutes of the board of directors meetings, audit and financial investigation reports, agreements as well as printed materials in newspapers and magazines and other periodic publications. The acquaintance and involvement by the writer of this project in two departments at one of the Bank's shareholders companies made the topic accessible.

The project is divided into six chapters. The first presents an overview of the performance of Arab Banks in France. The second describes the background of the crisis. The third analyses the underlying reasons for the crisis and exposes the financial performance of the Bank and the volume of risks undertaken. Chapter four discusses the resolution of the crisis and the formation of a new bank, Banque Francaise de l'Orient, on the ruins of Al Saudi Banque. The future prospects of the new Bank and the upcoming challenges are discussed in Chapter five. Chapter six provides a brief evaluation.

CHAPTER I

OVERVIEW OF THE PERFORMANCE OF ARAB BANKS IN FRANCE

Over the past ten years, banking activity was characterized by the persistence of a number of factors that did not fail to leave their traces on the performance of banks under Arab control in France: the general weakening of interest rates and the drop in the dollar rate as well as the transformation of the financing needs of French companies through the introduction by monetary authorities of new products which gave these companies a direct access to capital markets to ensure their financing needs. The consequences of these factors are still being presently noted following a period of rapid expansion during the seventies' oil boom.

The deterioration in oil prices to their minimum levels in 1986, and the subsequent decline in oil revenues, left many negative impacts on the performance of Arab banks operating in the Middle East and European markets.

Moreover, the effects of the Iran-Iraq war and its incidence on the economic situation in the Middle East countries as well as the continuing political instability in

Lebanon, lead banks under Arab control to increase their provisions and to become more selective and more careful in their credit operations.

In an environment of stiff competition, banks under Arab control continued-not without problems-the process of transforming and adapting their activities in order to better cope with the requirements of this evolution. However, the results of these efforts were not positive for overall banks under Arab control.

The internationalization of financial activity, the growing complexity of banking techniques, the high volatility of rates, the greater demands of clients and the narrowing of margins under the pressure of competition as well as the problems of loans granted to third world developing countries, rendered, among other reasons, the measurement and supervision of incurred risks a more delicate undertaking, which lead the Banks Control Commission to intervene and take drastic decisions. Many banks were heavily burdened by the requirements to book substantial provisions to cover the respective risks.

In fact, four of these banks witnessed serious difficulties which lead the Banking Commission to withdraw, during 1989, the license from three of them: Bank de Participations et de Placements, the United Banking Corporation

and the Lebanese - Arab Bank (France). The fourth bank, AL SAUDI BANQUE S.A., experienced in 1988 a very serious liquidity crisis which will be discussed in details in this paper. The recovery plan used to resolve the crisis will be discussed also.

Evolution and Financial Structure of Banks

Under Arab Control

The activity of banks under Arab control, measured by the volume of operations increased 4 percent in 1988 (compared to 5 percent in 1987), whereas the consolidated balance sheet of overall banks in France rose by 16 percent and that of overall banks under foreign control by 24 percent that same year.¹

This means that the share of banks under foreign Arab control operating in France continued to drop .

The activity of banks under Arab control is highly characterized by three major factors: The importance of operations in foreign currencies (about 75 percent), the predominance of interbank operations in assets and liabilities (about 60 percent) and the weight of the non-resident clientele (about 80 percent).

¹Banks Under Arab Control in France, BANKDATA, Vol. 5, (1989): 15.

Market Shares of Banks

Under Arab Control

The share of banks under Arab control in total banking activity declined in 1988, dropping by 0.3 percent with respect to the consolidated balance sheet. Loans and discounts decreased by 0.2 percent whereas deposits dropped 0.1 percent and capital stock remained at 4.2 percent.

As to their share in the consolidated balance sheet of banks under foreign control, it dropped by 4 percent for loans and discounts, 3.2 percent with respect to the balance sheet, 1.3 percent for the deposits and 0.2 percent for the capital stock.²

The development of the market share of banks under Arab control is detailed in Appendix # 1.

Solvency of Banks Under

Arab Control

The capital adequacy ratio, the ratio of shareholders' equity to total assets, rose from 3 percent in 1986 to 3.3 percent in 1987 and 3.7 percent in 1988 (2.7 percent for

²Ibid., p.10

overall banks under foreign control and 2.2 for overall French banks).³

The relative weakness in the shareholders' equity of banks under Arab control, despite their relative increase in 1988, was at the root of their shortage in risk coverage.

Normally regulations on bank management set the level of this ratio at 5 percent. However, the weakness in this ratio is a characteristic of overall French banks which are in general slightly under-capitalized. According to the Basle agreement requirements, the level of this ratio should be 8 percent by 1992.

Nevertheless, the most significant development in 1988 was that the equity of banks under Arab control remained in the first place, ahead of banks under foreign control and overall banks in France.

Analysis made during 1988 showed that the most capitalized banks were the North African banks with a ratio of 5.7 percent, followed by banks under Lebanese control (4.6 percent), banks under Near and Middle East control (4.1 percent) and finally consortium banks (3.0 percent).⁴

³ Ibid., p.22

⁴ Ibid., p.21

CHAPTER II

BACKGROUND OF THE AL SAUDI BANQUE CRISIS

Historical Overview: Legal and Organizational Structure

AL SAUDI BANQUE S.A. was incorporated in France in 1976 as a recognized deposit taker under French legislation. The Bank is mainly engaged in money market placements, lending activities and other credit facilities (L/Cs, L/Gs, acceptances, etc...).⁵

AL SAUDI BANQUE S.A. FRANCE is a subsidiary of "AL SAUDI BANK HOLDING N.V. - ROTTERDAM", which is ultimately owned by "SAUDI ARAB FINANCE CORPORATION INTERNATIONAL, SAFICO I", a joint stock holding company established in the Grand Duché of Luxembourg in June 1976 with authorized and paid in capital of Saudi Riyals 221 Million. "SAFICO I" shareholders are a selection of businessmen and investors mostly from the Kingdom of Saudi Arabia. The holding company and subsidiaries undergone several changes in their legal structure following a series of ownership changes.

⁵Mediterranee Group Services SARL, Annual Financial Study, (March 31, 1986): 1.

The last reorganization process of "SAFICO I" went underway in 1982 which culminated in the structure of the group as summarized below:

1. The mother holding company "SAFICO I" having its head office in Luxembourg.

2. Two specialized holding companies:

a. One in the field of banking and finance: "AL SAUDI BANK HOLDING N.V." registered in the Antilles and in Rotterdam, Holland. This company owns all the group's investments and participations in the fields of banking and finance as listed below:

- AL SAUDI BANQUE S.A. FRANCE with its branches in Paris, Cannes, London and Bahrein.
- Saudi Finance Corporation S.A. - Geneve
- Arab Finance Corporation S.A.L. Beirut.
- Arab Finance Corporation, Amman.

b. The real estate company with its head office in Luxembourg with subsidiaries in New York, Paris and Beirut.

The group's organization chart is detailed in Appendix # 2. This case study is restricted to AL SAUDI BANQUE S.A. - FRANCE and its established branches in Bahrein and London with

reference to the holding and sister companies whenever found necessary.

The board of directors of the Bank is headed by Dr. Chafik Akhras. The names of other board members are detailed in Appendix # 3.⁶

General Policies and Financial Position

Being a bank under Arab control and headquartered in Paris, AL SAUDI BANQUE S.A. lacked the proper home base and consequently the firm and widely structured base of clientele. This led the Bank, whether in Paris, London or Bahrein, to be involved in lending operations to third world developing countries similar to those undertaken by large world wide banks. These operations were beyond the existing capabilities and capacities of the Bank.

This policy was adopted by the Bank's management without taking into consideration the consequences that might result from such lending operations.

In fact, the economic developments and the financial problems that most of these debtor countries faced, left them incapable of settling their outstanding loans as scheduled,

⁶The Organization Manual, Al Saudi Banque S.A., (January 1986): 1.

Poland and Peru for exemple; other countries like Soudan and Bolivia were not capable of repaying their debts even after rescheduling them. Some other countries, like Morocco and Egypt, were expected to stop paying in a very short period.

Since this type of lending represented a considerable part of the Bank's portfolio of earning assets, AL SAUDI faced problems in three major areas:

- A significant part of these assets turned to non performing assets. Moreover, the possibility of collecting these loans became difficult. Consequently, it was impractical to account for their interest as a main source of income for the Bank; this affected negatively the bank's profitability.

- When negotiating the rescheduling of these countries' loans, it was among the latters' conditions to maintain the same level of other credit facilities as at the date of rescheduling so as to enable them to repay their debts. Similar to other banks, AL SAUDI deposited large sums of money in these countries' banks, an act which conservative banks would have avoided.

Such placements could not be classified as sight or time deposits to draw upon request or maturity; consequently the possibility of withdrawing these

amounts was very limited. Moreover, their maturities were not specified or determined.

- In addition to non-earning loans and advances granted to developing countries, the loan portfolio of AL SAUDI contained other facilities granted to clients in the Gulf area, a region still facing a period of economic stagnation.

As the Bank did not account for developments taking place in these countries' markets, the possibility of settling or repaying the credit facilities decreased significantly .

Based on the running country risks mentioned above, AL SAUDI management turned to reconsider the ongoing policies towards local market in France and the U.K. Moreover, management tried to diversify the Bank's sources of income and financing through establishing new banking and financial services and issuing bonds. However, these measures were too late to have any impact on the Bank's position.

Liquidity and Funding

AL SAUDI BANQUE faced significant liquidity and subsequent funding problems due to many factors. A major part of the

Bank's assets represented non-earning, doubtful, litigious loans and advances. This implies a substantial decrease in the value of the bank's actual assets; consequently, an evident but hidden deficit in these assets made the Bank incapable of meeting its full obligations.

As some of the Bank's placements were held in third world banks, most of these placements turned to loans with an unspecified maturity or repayment date; this affected negatively the value and the amounts of liquid assets needed to support the liquidity position of the Bank.

As for funding, AL SAUDI depended to a great extent in financing its assets, upon short term interbank borrowings. The banks with which AL SAUDI dealt were not qualified among prime rated banks. In return, and based upon certain agreements, AL SAUDI deposited smaller amounts in these banks for longer time maturities.

The above described method followed by AL SAUDI in financing its assets, exposed the Bank to three major dangers:

1. The probability of not being able to collect placements kept with such banks was very high if compared with placements with first rated banks. The probability of transferring the placements into long term doubtful loans turned very possible.

2. As the creditworthiness of the banks with which AL SAUDI was dealing was subject to doubts, a conservative bank could not account on such banks as a permanent and primary source to finance assets.

3. The intensive use of short term borrowings to finance long term loans, lead to a significant liquidity problem if such borrowings were not renewed upon maturity; taking into consideration that such maturities were not matched with assets' maturities. For this reason, the Bank's profitability could not be insured due to differences in interest rates traced to distinct maturities between assets and liabilities.

Moreover, the concentration of deposits was noted as a significant additional factor for the Bank's problems. One client's deposits for about \$US 120 Million represented 47% of overall clients' deposits. This was considered as a direct threat to the Bank's liquidity.

As a result of the Bank's investment in loans to developing countries as well as other doubtful loans which were classified as non-performing, these loans amounted to about \$US 400 Million .

A thorough study of AL SAUDI financial position and statements revealed many doubtful loans and advances, which

were not classified as such by management. These loans and advances could be classified as follows:

- Loans and advances granted to developing countries or institutions in these countries facing financial difficulties. This represented significant country and commercial sovereign risks. Moreover, part of AL SAUDI placements in these countries were still erroneously classified as placements even though they turned years ago into loans for unspecified maturities.
- Investments, loans and advances granted to companies or individuals including facilities granted to real estate sister companies facing financial problems.
- Loans and facilities to old and new shareholders and members of the board of directors.

Moreover, the Bank did not book any provisions for foreign exchange risks regarding loans and facilities granted in foreign currencies.

Based on the above, the Bank was required to constitute additional provisions regarding country risks of developing countries and other clients' commercial risks.

CHAPTER III

THE CRISIS: ERUPTION AND CAUSES

Eruption of the Crisis

Al SAUDI BANQUE S.A. crisis started from the financial perspective in 1986, when Mr. Rafic Hariri acquired about 20% of the mother holding company "SAFICO I" outstanding shares from Prince Salman Bin Abdel Aziz, King Fahd's brother and Governor of Riyadh, the Saudi Arabian Capital. However, the symptoms of such a crisis, from a managerial perspective, started during the first years following establishment, when differences among shareholders regarding the Bank's operating policies came to face.

The financial crisis reached its climax in June 1988, when the Bank failed to secure necessary provisions requested by the "Commission Bancaire" following an audit performed on the Bank's consolidated portfolio of earning assets as at December 31st, 1987. The mission undertaken by the "Commission Bancaire" started on December 1st 1987 and was concluded by March 31st 1988. The Commission submitted its report to French monetary authorities on April 14, 1988.

The commission report required the following:

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1- To start constituting provisions for FF 947 million (C/V \$US 177.4 million), so as to cover sovereign risks regarding facilities granted to third world developing countries, private commercial risks, risks on facilities granted to group sister companies and diverse risks.

2- To book all shareholders equity amounting to FF 386 million, as provisions against doubtful and litigious loans and to reconstitute the Bank's capital.

3- To be able to secure the above mentioned items in the financial year ended December 31st 1987, i.e. before approving 1987 financials by the Ordinary General Assembly of the Bank.

4- To finalize quickly a recovery plan to cover foreseeable losses and restore the financial standing.

Sovereign risks were estimated by the Banks Control Commission at FF 519 million (\$US 97,2 million). Private commercial and other diverse risks were estimated at FF 428,3 million (\$US 80.2 million).

As the management of Al Saudi was for many years aware of the existence of some non performing loans, many past attempts were undertaken to constitute estimated partial provisions. However, these attempts were not successful; partial provisions

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were booked and canceled later on as the Bank was financially incapable of securing necessary funding from its operating income. Moreover, constituting these provisions meant reflecting considerable negative results in the profit/loss statement which the Bank could not afford to show neither to its shareholders nor to the public.

The management of Al Saudi, represented by Dr. Akhras, exerted efforts for about six months trying to raise funds from different sources to rectify the Bank's financial position and meet the Banks Control Commission requests.

The Saudi Monetary Agency (SAMA), refused Dr. Akhras' proposal for a US Dollars 100 million loan after verifying the Bank's position; SAMA justified such refusal by its ongoing policy of not advancing loans to banks operating outside Saudi Arabia. Moreover, the Bank had no relation with the Saudi authorities from a legal point of view.

Dr. Akhras headed then towards multinational Arab banks operating in France. He was successful in convincing a consortium of four banks to manage a syndicated loan in favor of the Bank for US Dollars 25 million, the loan was channelled through the mother holding company SAFICO I. However, as the Bank's position became clear to the financing banks, they resorted to legal instruments stated in the agreement to secure their outstandings: confiscating and withholding the Bank's assets and shares.

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Eventhough many shareholders declined to accept the fact that their shares had a zero value, provisions for the total amount of equity funds were booked. Al Saudi passed provisions amounting to FF 438,8 million (C/V \$US 82,2 million) which corresponded to the total amount requested by the Banks Control Commission, with exception of sovereign risks provisions.

The specifications of the amount booked in 1987 financials and the subsequent loss in shareholders equity is detailed in Table 1.

TABLE 1
PROVISIONS BOOKED IN 1987 UPON BCC REQUEST

Million of F.F.

=====

| | | |
|---|-------------|-----------------|
| - Provisions for Doubtful Commercial Loans: | | |
| Paris | 78.2 | |
| Bahrain | 166.3 | |
| London | <u>14.9</u> | |
| | 259.4 | 259.40 |
| - Provision for Group Risks | | 85.00 |
| - Provision for Depreciation in Securities | | 82.00 |
| - Provisions for Other Diverse Risks | | <u>12.40</u> |
| Total Booked Provisions | | 438.80 |
| - Net Income for 1987 | | <u>0.104</u> |
| Loss Before Tax | | 438.696 |
| - Tax | | <u>1.200</u> |
| Loss After Tax | | 439.896 |
| - SAFICO Subordinated Loan: \$US 10 million | | <u>(53.400)</u> |
| Net Loss for 1987 | | 386.496 |
| | | ===== |

SOURCE: Banque Indosuez Financial Study, Al Saudi Banque,
(August 29, 1988): 27, Annex 6.

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In booking private risks provisions, Al Saudi exhausted fully its equity funds which turned to zero as at December 31st 1987, (Ref. Appendix # 6).

On June 30, 1988, an extraordinary general assembly was called upon by Dr. Chafic Akhras to discuss the financial position of the Bank and the demands of the "Commission Bancaire". The assembly decided to issue 350 million new shares for a par value of FF 1.- starting January 1st, 1988. However, the shares had never been subscribed to by the shareholders, many of them abstained from pumping new funds into the Bank. Dr. Akhras, a holder of 35% of the shares, offered FF 50,000.-, other shareholders offered FF 2,000.- each⁷ which seemed to be a symbolic gesture, rather than a serious willingness to save the Bank.

With regard to the shareholders' failure to secure additional funds to finance sovereign risks provisions amounting to US Dollars 97.2 million, Al Saudi faced the serious threat of announcing publicly its bankruptcy.

Evolution of Management Difficulties

On September 27, 1976 AL SAUDI BANQUE S.A. FRANCE (ASB)

⁷"The Birth of Al Saudi Banque-2", Al Iktissad Wal Aamal, (November 1988): 30.

was established by a group of Arab investors from Saudi Arabia and other Arab countries in association with two foreign banking institutions. The total paid in capital of ASB was FF 200 million (raised gradually to 350 million by 1987). The capital ownership structure included SAFICO I (75%), Bank de L'Union Europeene S.A , Paris (10%), Manufacturers' Hanover Holding (Delaware) Inc. (7.5%), and Arab Finance Corporation Intl. S.A. Luxembourg (7.5%), (Ref. Appendix # 4).

Changes in Ownership Structure

This ownership structure was supposed to secure financial support through Arab financiers, as well as western banking experience, through western banking skills. However, during the first five years following establishment, many differences in points of view regarding administrative and financial policies came to face; distribution of dividends and delegation of responsibilities to mention some. As these differences reached the point of no return, many shareholders sold their investments in ASB to existing or new shareholders. Efforts were undertaken by Dr. Chafic Akhras, Chairman, to secure the participation of new shareholders. These efforts were successful to a certain extent; however, they did not conceal Dr. Akhras's individualistic approach in managing and setting the Bank's policies.

By 1983, two professional shareholders, Manufacturers'

Hanover Holding and Bank de L'Union Europeene, sold their shares to AL SAUDI BANK HOLDING N.V. (Rotterdam), a company fully owned by SAFICO I, later to take over fully the ownership of AL SAUDI BANQUE S.A. (Ref. Appendix # 5)

It has been brought to light by some board members that the two banks were "driven out" and "forced" to sell their shares and leave ASB.⁸ These board members expressed their dissatisfaction regarding such a practice, as their banking skills provided a helpful hand for other non - professional stockholders.

As for individual shareholders represented in the board of directors, seven of them sold or transferred their stocks to other new shareholders, (Ref. Appendix # 5).

During the same year, a reorganization process was underway, whereby the shares of SAFICO I (75%) and AFC I (7.5%) were transferred to AL SAUDI BANK HOLDING N.V. (ROTTERDAM) for some tax advantages, consequently, the Bank was fully owned by this company (99,95%). Directors held a participation for 0,05% .

Dr. Chafik Akhras, Chairman, did not conceal his disputes with old shareholders: "since the very beginning I had problems

⁸ Ibid. p. 31

between the Kuwaities and the Saudis regarding the allocation of shares among them and finally I sided with the Saudis so that they took a certain portion of the shares."⁹ Moreover, Dr. Akhras expressed his sufferings with his shareholders, particularly those who sold their shares to the existing ones and the way they handled the matter with him.

During a period of seven years, AL SAUDI BANQUE S.A. turned into a conglomerate of Arab financiers looking for a banking investment opportunity. Most of these financiers were investors in the real estate sector, a sector with limited opportunities during the Gulf recession period. Moreover, these investors lacked the necessary banking experience.

Operating and Organizational Problems

A thorough operational and financial study by the audit firm of Arthur D. Little Inc. during the last quarter of 1985, revealed that the operations and systems were limited in capabilities. The Bank lacked the systems to provide sufficient records or reports for the overall effective management of its existing business.

In London and Bahrain, where operations are smaller, the

⁹Mediterranee Group Services, sarl., Interview with Dr. Chafic Akhras, January 17, 1986.

systems and procedures to generate the books of account and financial reports and customer information were, at best, adequate. New systems were introduced to improve operational efficiencies; however, the systems were structured some what differently in each office and communication between them or transfers of information was extremely difficult if possible at all.

In Paris, the operating systems were outmoded. Transactions reporting and confirmations were not timely. Reporting practices of the Paris office were not synchronized with other branches, slower to report. Financial statements and customer account statements were not delivered on a timely basis. Reports of exposure to individual customers were available too late to be of much value. The accounting policies were not formalized and often applied unevenly, particularly the policies on reserving of interest.

These deficiencies were attributed to the lack of a consolidated business strategy for SAFICO I Group and subsidiaries. The Report concluded that "the Group is managed and directed at the subsidiary levels. Executive management has had a micro business organization perspective over time. Business activities have been defined narrowly by type or geography and assigned to subsidiaries with limited scopes."¹⁰

¹⁰ Arthur D. Little, "Special Report dated September 1985", p. i-5

As a result of these deficiencies, "a multi layered, multi-subsidiary corporate structure has resulted."¹¹ Communications between these subsidiaries were limited, only a few (one or two) officers of the holding company possessed a full understanding of the linkages and purposes of the subsidiaries and the rationale for the structure that has evolved. This approach resulted in a structure based on personal preferences, not on logical corporate organization considerations. No serious attempts were undertaken to provide a consolidated macro perspective of the overall activities of the holding company.

The Chairman, Dr. Chafik Akhras, served as the consolidator and coordinator of the group's business activities. This style made it difficult for directors and senior managers with business unit responsibilities to operate. Further, the Bank had extreme difficulty in retaining a sufficient cadre of top caliber officers.

Arthur D. Little reported that management in Paris "does not spend enough time coordinating the activities of its London and Bahrein branches."¹²

¹¹ Ibid.

¹² Ibid. p. i-6

Overstaffing

In his Report, Arthur D. Little, noted that AL SAUDI BANQUE S.A. was overstaffed. The level of employees could be "as much as 10 - 30% in excess of needs, depending on the business unit and the location."

The report underlined two major reasons for overstaffing:

- The multi - layered corporate structure with inadequate operational support systems at each level resulting in the duplication of functions. Much smaller staff could deal with record keeping functions and management information reports if efficient operations support and information handling systems were in place.
- The tendency to hire new clerks or professionals to deal with new needs, rather than attempting to assign a present staff member.

AL SAUDI BANQUE S.A. was in a great need for upgrading and rebuilding operational and support systems, so as to emerge from the maintenance strategy towards new directives.

Analysis and Evolution of Financial Performance

Conceptual Framework of Financial Analysis

This part discusses the major financial ratios considered necessary to assess the financial position and performance of AL SAUDI BANQUE S.A. The analysis is performed on the consolidated Balance Sheets (Ref. Appendix # 6) and Income Statements (Ref. Appendix # 7) of the Bank (Paris Head office and established branches in Cannes, London and Bahrain OBU). The analysis spots a light on the liquidity, capital adequacy, asset quality, return on equity as well as other financial ratios. It is appropriate to describe the conceptual framework that is used to carry out the analysis and mention some caveats regarding the financial information used.

The approach hinges on two basic blocks of analysis: liquidity and leverage, and profitability analysis.

The objective of liquidity and leverage analysis is twofold. Liquidity analysis serves the purpose of assessing a bank's capability to face a liquidity crisis, that is, a situation in which a bank needs to meet its short term financial obligations.

In general, the improvement in the liquidity position reduces risk but at the same time limits the profit

opportunities. Three ratios were analysed in this regard.

Leverage analysis has the objective of assessing a bank's capital structure and its implications in terms of return and risk. Higher leverage, that is a higher level of assets for a given level of capital, enhances profitability if a positive spread on assets can be earned, assuming a less than proportional increase in operating expenses. However, higher leverage does raise the level of risk because a smaller amount of capital is available to cover potential losses arising from poor asset quality.

A ratio of capital to assets of about 5% is considered adequate for a bank with a loan portfolio of average quality.

The evaluation of the quality of a bank's assets revolves around its loan portfolio and securities held in investment and trading accounts. Judgements concerning the securities portfolios are relatively straight forward because market values of the securities on statement dates can be compared with original cost or other carrying values.

Loan portfolio evaluations are far more subjective and require the collective judgement of a bank's lending officer's credit committee, and top management. These judgements are made periodically, usually quarterly. The loan portfolio is categorized into performing, substandard, doubtful,

non-performing, write-offs and recovery categories.

The non-performing category usually includes all loans on which no interest or principal repayment have been received for 90 days or more. Further, interest accruals to income are usually discontinued.

The evaluation procedure involves the determination of:

- Loans that should be charged off.
- Allocation of amounts in the loan loss reserve to specific loans.
- Requirements to increase the loss reserve for recent developments regarding doubtful loans; and Amounts that can be credited to the loss reserve due to recoveries of loans previously charged off.

The net result will be a restatement of the bank's loan loss reserve. Its sufficiency can then be judged by comparing the reserve to the gross loan portfolio. A reserve that equals 1.5% to 2.0% of loans is usually felt to be sufficient. Its actual sufficiency, however, depends upon the overall quality of the loan portfolio and the proportion of substandard, doubtful and non-performing loans it contains.

A measurement of non-performing loans as a percentage of the total loan portfolio and as a percentage of a bank's

capital funds can give some indication of quality. Non-performing loans in excess of 3% of loans is generally felt to be a high level indication of a poorer quality portfolio. As no regular classification of non-performing loans was provided by the management of AL SAUDI BANQUE S.A., calculating these ratios seems impossible.

For AL SAUDI, a Group policy on non-performing loans and on interest reserved was in existence. However, exceptions to these policies on providing for non-performing loans or reserving interest were made at the behest of senior management.

The result has been the fact that practices regarding establishment of provisions for such accounts differed from written policies of subsidiaries and holding company.

The holding company had a Central Credit Secretariat which maintained records of the Group's loan portfolio and performed advisory and inspection functions concerning loans at AL SAUDI BANQUE S.A. branches and subsidiaries outside of Paris. This function was not performed regarding loans of AL SAUDI BANQUE's Paris head office. The credit secretariat (with the exception of Paris) used to work with subsidiaries and branches in the evaluation and reclassification of loans, the allocation of loss reserve to specific loans, and the need for changing planned loss reserve provisions to be charged to earnings.

AL SAUDI BANQUE S.A. continued to accrue interest on non-performing loans and include these amounts in gross interest income in financial statement presentations to management and directors. A charge to income as provision for reserved interest was deducted from pretax income. The result was an overstatement of net interest income and the net interest margin. The auditors of Al Saudi, Streco Durando, member of Arthur Young International, did not qualify this accounting treatment in their reports. Such accounting practices were stated in 1985 by the audit house of Arthur D. Little.

The report of Arthur D. Little, submitted to the Bank management, expressed deep concern for the volume of non-performing loans "not only in relation to the loan portfolio, but also in relation to the loss reserve that has been accumulated."¹³

The profitability analysis has the objective of identifying what are the key determinants of the return the shareholders receive on their invested capital. It evaluates the after tax return on equity (ROE) of an entity against the opportunity cost of invested funds to the shareholders. From the shareholders' perspective, a sound investment is one that yields a rate of return on equity that exceeds the opportunity

¹³ Ibid. p iii-1

cost. The latter can be approximated by taking a non-risky long term bond and adding a risk premium.

Matching funds ratios are good indicators of the bank's capability to repay his obligations from the respective category of funds. Three ratios are exposed in this regard.

Table 2 exposes the evaluation of financial ratios for AL SAUDI BANQUE S.A. and compares the figures with the consolidated ratios of banks under Arab control in France for 1986 and 1987.

Analysis of Consolidated Financial Ratios

Liquidity Ratios

Net Loans / Clients' Deposits

The evolution of this ratio reveals that AL SAUDI BANQUE S.A. lent more than what it received in customer deposits. The funding gap has been evident since the early years of establishment. Efforts undertaken by management to secure customer deposits were successful in reducing this gap to a minimum of 104% in 1982. However, the trend continued to increase afterwards to step a maximum of 380% in 1987.

Although the high percentage of this ratio is a general characteristic of the consolidated balance sheet of Arab banks in France, AL SAUDI BANQUE S.A. ratios go far above the sector averages of these banks: 156% in 1986 and 136.30% in 1987.

Net Banks / Clients Deposits

This ratio reached a maximum of -6% in 1982 and a minimum of -279% in 1987, the ratio had never been positive for AL SAUDI BANQUE S.A.

The ratio for the consolidated balance sheet of banks under Arab control moved from -42.53% in 1986 to -28.25% in 1987. This reveals the unfavorable position of AL SAUDI with respect to the industry average ratio.

The negative nature of this ratio reflects the "net borrowing" position of the Bank, its net liquid assets being less than the sources of cash.

However, it is necessary to assess this ratio with considerable caution, because of the particular nature of operating activity in France, where the sector shows a structural financing needs. This implies that the liquidity requirements be borrowed permanently on the market.

Thereupon, the sector-based analysis showed that banks with a ratio of investment capital to permanent assets inferior to one had in general a positive liquidity ratio and banks with a ratio superior to one a negative liquidity ratio.

Due from Banks + Marketable Securities / Due to Banks

This ratio indicates the heavy borrowing position of AL SAUDI BANQUE S.A. The ratio had a maximum in 1982 and 1983 when customer deposit reached their maximum levels, and a minimum of 39.80% in 1987 when rumors regarding the weak financial position of the Bank became publicly realized.

Adequacy Ratios

Equity / Assets

Al Saudi adequacy ratio had a decreasing trend to a minimum of 2.01% in 1983. The ratio increased afterwards following a series of gradual capital contributions raising the capital from FF 125 million in 1983 to FF 350 million by 1987.

The capital adequacy reached 3.95% in 1986 which compares favorably with the consolidated ratio of overall banks under Arab control of 3.0%. Although the capital adequacy had an improving trend after 1983, the Bank was still in need for

further capital injections to absorb the potential capital erosion due to non - performing assets as discussed in other parts.

The relative weakness in the shareholders' equity of banks under Arab control, despite their relative increase in 1987 and 1988, was at the root of their general shortage in risk coverage. Normally, regulations on bank management in France set the level of this ratio at 5%. However, the weakness in this ratio is a characteristic of overall French banks which are in general slightly under - capitalized.

Loans / Equity

The ratio assures the deficient adequacy ratio of the Bank which reached a maximum of 25.63 times the capital of the Bank. The ratio improved afterwards following a series of increases in the paid in capital.

Profitability Ratios

Return on Equity

The record of performance of Al Saudi Banque SA shows poor profitability ratios since the early years following establishment. The inflated profitability in the 1984 ratio, 11.4% from 1983 ratio of 1.08%, is mainly due to booking unusual low provisions for loan losses. A subsequent drop in

return on equity was evident in 1985 (1.69%) and 1986 (0.44%).

For overall Arab banks in France, profitability moved from 2.4% in 1986 to 2.11% in 1987. This means that the Bank's shareholders were not earning an attractive rate of return on their investment.

The profitability of the Bank has been limited by necessity in view of the weakening and contracting loan portfolio. Emphasis has been upon short term loans at the urging of directors. The policy, starting 1983, has been towards seeking deposits from every available source emphasizing maturities of six months or more to minimize exposure to interest rate volatility. Implementation of this short term maturity strategy, during a period when a normal yield curve exists, forces the concentration of assets in the lowest earning level segment. Further, pursuit of this strategy was implemented at a time when extreme competitive conditions in the international, interbank, and large company segments of the credit market have pushed spreads between earning asset rates and costs of deposits to the narrowest levels. Implementing such policy, seemed to Al Saudi management as the best alternative while dealing with its credit quality problems. However, the policy limited severely the generation of earnings because a significant proportion of activities were concentrated in activities where profit margins are the lowest.

Looking for new fields of operation to improve profitability, the management of the Bank pursued new sources of income through non - interest income from trade finance services (letters of credit and guarantees), fees and commissions from securities underwriting and money markets dealing, etc... These sources of income, slow to build, were not large enough to have a material impact upon the Bank's profitability. Narrow net interest margins continued to exert the principal influence on profits.

The evolution of the ratio of non interest income to total assets reflects a gradual increase to a level of 0.43% in 1986 and a subsequent decrease to 0.28% in 1987.

Restoration of the loan portfolio to a sound condition with adequate reserves seemed to be the only way to improve the Bank's profitability.

Asset Quality Ratio

Loan Loss Provision /Total Loans

The loan loss provision of the Bank reached 3.09% of the total loan portfolio, a fairly conservative proportion by international banking standards. However, the magnitude of the Bank's non - performing loan category calls for considerable concern. Prior to the eruption of the crisis, there were many

requests by the Banque de France for the Bank to increase its loss provision because of its involvement in problem-countries.

At the urging of the Banque de France, the largest banks in France booked provisions (from earnings to their loan loss reserves) and allocated proportions of those reserves to loans in a number of countries around the world. The management of Al Saudi was reluctant to book full provisions regarding such loans as this will reflect negative results in the profit/(loss) statements, due to the Bank's incapability to finance such provisions from its operating income.

Other Ratios

Matching Funds

The evolution of matching funds ratios reflects the operating deficit which was financed through loans from local and international money markets.

The ratio of sources of cash to applications of cash for overall banks under Arab control moved from 1.158 in 1986 to 1.120 in 1987.¹⁴ This represents the unfavorable ratios of Al Saudi: 2.08 in 1986 and 3.33 in 1987.

¹⁴ Banks Under Arab Control in France, BANKDATA, Vol 5, (1989): 21.

FINANCIAL STATEMENTS
 STATEMENT OF FINANCIAL CONDITION
 STATEMENT OF INCOME

| | 1997 | 1996 | 1995 | 1994 | 1993 | 1992 |
|-------------------------|-------|-------|-------|-------|-------|-------|
| - LIQUIDITY | | | | | | |
| Net Loans/Clients D | 208.7 | 200.0 | 195.0 | 190.0 | 185.0 | 180.0 |
| Net Banks/Clients D | 208.7 | 200.0 | 195.0 | 190.0 | 185.0 | 180.0 |
| Due fm Bks+Mkt.Sec/ | 208.7 | 200.0 | 195.0 | 190.0 | 185.0 | 180.0 |
| - ADEQUACY | | | | | | |
| Equity/Assets | 208.7 | 200.0 | 195.0 | 190.0 | 185.0 | 180.0 |
| Loans/Equity | 208.7 | 200.0 | 195.0 | 190.0 | 185.0 | 180.0 |
| - PROFITABILITY | | | | | | |
| Net Inc./T.Sharehol | 208.7 | 200.0 | 195.0 | 190.0 | 185.0 | 180.0 |
| Non Interest Income | 208.7 | 200.0 | 195.0 | 190.0 | 185.0 | 180.0 |
| - ASSET QUALITY | | | | | | |
| Loan Loss Prov/Tota | 208.7 | 200.0 | 195.0 | 190.0 | 185.0 | 180.0 |
| - MATCHING FUNDS | | | | | | |
| Due To Banks/Due fro | 208.7 | 200.0 | 195.0 | 190.0 | 185.0 | 180.0 |
| Due To Bks Dem/Due : | 208.7 | 200.0 | 195.0 | 190.0 | 185.0 | 180.0 |
| Due To Bks Tim/Due : | 208.7 | 200.0 | 195.0 | 190.0 | 185.0 | 180.0 |

N.A.: Not Available

Analysis of Financial Investigation Reports

This part analyses three investigation and audit reports conducted by the Hariri Group, the Banks Control Commission and Banque Indosuez. The studies are based on the Bank's financial statements as at March 31st 1986, December 31st 1987 and July 31st 1988 respectively.

The three studies followed distinct evaluation criteria regarding the Bank's portfolio of earning assets. Consequently, their estimates of required provisions showed some differences.

Hariri Group Financial Study

March 31, 1990

On January 29, 1986 Mr. Rafik Hariri acquired 435091 shares of Saudi Arabia Finance Corporation International, Luxembourg "SAFICO", representing 19.62% of the company's total outstanding share stock, comprised of 2,217,865 shares at a par value of Saudi Riyals 100 each, totalling SR 221,786,500. The shares were purchased by a Hariri Investment Company: RBH Holding S.A. Luxembourg.

The stake at SAFICO I was acquired from Prince Salman Bin Abdul Aziz for about US Dollars 22 million. SAFICO I owns, through its subsidiary, Al Saudi Bank Holding N.V. Rotterdam,

Al Saudi Banque S.A. France, which established branches in Cannes, London and Bahrain.

Following the acquisition, the Board of Directors of Al Saudi Bank Holding N.V. resolved to propose "that Mr. Hariri or the legal representative of RBH Holding S.A. be appointed member of the board of directors of the above mentioned companies."¹⁵

Mr. Hariri was informed of this proposition; however, he abstained and expressed his unwillingness to participate in the boards of directors of any of these companies before auditing the financial statements of the whole group by a team of experts selected from his own banking group: Mediterranee Investors Group (MIG) S.A., Luxembourg.

The audit work commenced on March 1st 1986 and was concluded by May 26, 1986. The on-the-spot audit was conducted on each of the Bank's branches separately. The report submitted to Mr. Hariri presented the weak financial position of the Bank and the need to book additional provisions for US Dollars 155 million regarding commercial and sovereign direct and contingent commitments, as well as the position of loans and diverse facilities granted to shareholders as at March

¹⁵Board of Directors Thirty-Fifth Meeting, Al Saudi Banque S.A., (Paris, April 24, 1986): 2.

31st, 1986. Based on this report, Mr. Hariri declined to accept participating in any of the companies' boards.

The evaluation of needed provisions was based upon "The Country Assets Swap Valuation Index."¹⁶

Paris Head Office

The thorough study of Al Saudi Banque S.A. Paris portfolio of outstanding loans as at March 31, 1986 exposed the commercial and the sovereign risks undertaken by the Paris Head Office.

The list of non - performing commercial loans included fifty two accounts for which Al Saudi booked provisions for US Dollars 2:118 million.

The report stated that the additional recommended needed provisions were FF 146,9 million (C/V \$US 20,6 million) for total outstanding risks of FF 344.28 million. (Ref. Appendix #8)

The Paris sovereign risks were distributed over eighteen countries mostly in Latin America, Africa and Eastern Europe

¹⁶ Mediterranee Group Services SARL. Annual Financial Study, (March 31, 1986).

block (Ref. Appendix #8). Recommended provisions for such countries' risks amounted to US Dollars 36,6 million.

The total risks of the Paris head office, commercial and sovereign, amounted to FF 1,259 million. Recommended provisions regarding such risks amounted to FF 408,147 million (C/V \$US 57,224 million).

Bahrein Branch
(Offshore Banking Unit)

The Bahrein office of Al Saudi Bank S.A. established on August 1978, operated as an offshore unit. The branch's operations were subject to the terms and conditions regulating the operations of such financial institutions issued by Bahrain Monetary Agency (BMA).

Despite previous assurances presented by Dr. Chafik Akhras regarding the sound position of Bahrain's O.B.U. portfolio of loans, reviewing that portfolio revealed the need to book a considerable amount of provisions for a variety of non-performing loans.

Checking commercial risks exposed the need to book recommended provisions for about US Dollars 80 million for a total outstanding risk of \$US 124,5 million (Ref. Appendix # 9).

As for sovereign risks, the study reflected the need to provide about US Dollars 2 million for total outstanding risks of US Dollars 12,175 million.

Provisions already booked by the Bahrain branch amounted to \$US 11,7 million. The branch's need was for total net provisions of \$US 70 million (Ref. Appendix # 9).

London Branch

Al Saudi Banque London was established in England as a licensed deposit taker according to English legislation and commenced operations late 1980.

The branch was engaged in finance operations, particularly in money market placements, borrowings, lending activities (including issuance of letters of guarantees and letters of credit) and F/X operations in addition to dealing with gold and silver transactions.

The study of the London branch portfolio of commercial loans included thirty four non-performing loans. Recommended provisions were estimated at STP 11,356 million (C/V \$US 16,851 million) for total outstanding risks of STP 34,978 million.

Loans with sovereign risks included countries in Latin America, Africa, and Eastern Europe block, (Ref. Appendix #10).

Recommended provisions amounted to STP 7,75 million (C/V \$US 11,5 million).

As no provisions were booked by the branch regarding these loans; total required provisions for the risks undertaken amounted to \$US 28,354 million.

Conclusions And Recommendations

Based on the above, the study conducted by the Hariri Group of financial analysts submitted many recommendations in the following respects:

1. Provisions

- a. Al Saudi Banque S.A. should book additional sufficient provisions for about US Dollars 155 million to cover potential losses with respect to non-performing loans, commercial and sovereign. This amount excludes any potential losses regarding facilities granted to shareholders in the SAFICO I different entities.
- b. The constitution of these provisions through an equal contribution by the shareholders is inevitable to assure the Bank's continuity and improve its liquidity and adequacy positions. This will have a positive impact on the Bank's future prospects.

2. Development of Financial Services

The Bank should add to its existing lines, some new services to secure new sources of income, thus contributing to the Bank's overall income and compensating the decline in returns due to the current stagnation in the financial markets.

3. Management

The Bank should improve and strengthen the quality of management at all levels, so as to face upcoming difficulties on the one hand and develop new banking services on the other.

4. Operating Systems

The management of the Bank should exert intensive efforts to develop a well coordinated computer system concomitant with the volume of operations, so as to supply management regularly with up-to-date reports regarding the Bank's financial position; this improves and facilitates the decision making process.

5. The Bank's Future Prospects

Taking into consideration the international economic conditions, and the intense competition in the worldwide banking sector as well as the scarcity of commercial and investment opportunities available in this sector, and in regard of the Bank's capabilities, we see that there are two choices facing the shareholders:

- a. To admit the Bank's weak position, and to take necessary measures to rectify this position by implementing the previously mentioned recommendations. The management of the Bank should exert efforts to define its identity by publicising the rationale for its existence in these countries' markets. Moreover, the Bank should define its clients and the markets it serves as well as the existing or potential services it renders.

- b. In case the Bank's management faced difficulties in defining its identity or in securing assistance, whether financial or managerial, we believe that the only position the shareholders should take is to divide the Bank into separate banking units that could be sold as operating units to potential investors in the banking sector.

Banks Control Commission Financial Study

December 31, 1987

Following the audit performed by the Hariri Group, officials in the Central Bank of France monitored closely, for about two years, the developments in Al Saudi Banque S.A. The shareholders were expected to take some remedial measures to rectify that position. However, the elapse of time proved that the shareholders were incapable of handling the variety of problems facing the Bank.

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The Banks Control Commission was asked by the Central Bank of France to conduct an audit on the consolidated financial position of Al Saudi Banque S.A. The mission started on December 1st 1987 and was concluded by March 31st 1988. A detailed report was submitted to French monetary authorities on April 14, 1988.

The Report spotted the variety of problems the Bank was facing from both a managerial and financial perspectives. It identified deficiencies in the following areas:

- 1- Sound organization administration.
- 2- Consistency in accounting practices.
- 3- Coordinated computer systems.
- 4- Qualified professional staff.
- 5- Efficient back office.

The Report presented a detailed study of the Bank's portfolio of earning assets per branch and the need to book total provisions for U.S. Dollars 177,5 million distributed over sovereign and private risks as well as risks on facilities granted to group sister companies and other diverse risks.

The financial study of AL SAUDI portfolio of loans and facilities, excluding off-balance-sheet engagements and acceptances, presented the geographical distribution of amounts granted per branch as at September 30, 1987. The study exposed

the concentration of credit facilities in the Paris head office for about FF 3,949 million distributed over 289 accounts, as Table 3 shows.

TABLE 3
GEOGRAPHICAL DISTRIBUTION OF LOANS PER BRANCH

(In Millions of F.F.)

| <u>Geographical Zone</u> | <u>Paris</u> | <u>London</u> | <u>Bahrain</u> | <u>Total</u> | <u>Percentage</u> |
|--------------------------|--------------|---------------|----------------|--------------|-------------------|
| Middle East | 1,098.5 | 143.8 | 885.6 | 2,127.9 | 35.5 |
| North Africa | 798.6 | 52.5 | - | 851.1 | 14.2 |
| Central Africa | 541.7 | 73.8 | - | 615.5 | 10.3 |
| Eastern Europe | 535.0 | 238.8 | 33.5 | 807.3 | 13.5 |
| Western Europe | 419.0 | 119.9 | 94.7 | 633.6 | 10.6 |
| Latin America | 438.1 | 175.6 | 41.5 | 655.2 | 10.9 |
| Other Countries | <u>118.2</u> | <u>73.0</u> | <u>111.5</u> | <u>302.7</u> | <u>5.0</u> |
| Total | 3,949.1 | 877.4 | 1,166.8 | 5,993.3 | 100 % |
| | ===== | ===== | ===== | ===== | ===== |

SOURCE: Banks Control Commission Financial Study, Al Saudi Banque S.A., (March 31, 1988): 12.

This revealed that Al Saudi was heavily involved in loans to third world developing countries, which constituted about 85% of total outstandings thus exposing the Bank to a variety of sovereign and commercial private risks.

Risks calling for provisions were elaborated by the Commission as detailed in Table 4.

TABLE 4
 BREAKDOWN OF PROVISIONS AS REQUIRED BY BCC
 (In Millions of FF)

| | Amount | | Required Provisions | |
|----------------------------|--------------|----------|---------------------|--------------|
| | F.F. | C/V \$US | F.F. | C/V \$US |
| - Global Sovereign Risks | 1,716.68 | | 518.88 | 97.17 |
| - Private Commercial Risks | | | | |
| Paris | 153.10 | | | |
| Bahrain | 401.00 | | | |
| London | <u>6.50</u> | | | |
| | 560.60 | 560.60 | 248.60 | 46.60 |
| - Sister & Group Co.Risks | 114,39 | | 85.00 | 15.90 |
| - Diverse Risks | <u>75.99</u> | | <u>95.00</u> | <u>17.80</u> |
| TOTAL | 2,467.66 | 462.10 | 947.48 | 177.47 |
| | ===== | ===== | ===== | ===== |

SOURCE: Banks Control Commission Financial Study, Al Saudi Banque S.A., (March 31, 1988): 30-31, Annex 1.

Sovereign Risks

In evaluating the Bank's sovereign risks, the following factors were considered by the BCC:

.../51/...

1. Guarantees issued in favor of the Bank by the "Compagnie Francaise d'Assurance pour le Commerce Exterieur, COFACE", or other similar European agencies.
2. Syndicated or cofinanced loans granted in association with the "Banque Mondiale". Such loans were valued at 50% of their face value.
3. Short term commercial credits for which full settlement is possible upon maturity. Short term unsettled credits, subject to provisions, were not considered by the BCC.

Global sovereign risks undertaken by Al Saudi amounted to FF 1,716.68 million. The share percentage per branch could be detailed as follows (Ref. Appendix #11):

| <u>Branch</u> | <u>Amount</u> | <u>%</u> |
|---------------|---------------------|-------------|
| | <u>Million F.F.</u> | |
| Paris | 1,247.14 | 72.65 |
| London | 335.27 | 19.53 |
| Bahrain | <u>134.27</u> | <u>7.82</u> |
| | 1,716.68 | 100.00 |
| | ===== | ===== |

The rates of provisions on outstanding loans ranged from a minimum of 4.1% to a maximum of 77.7% (Ref. Appendix #11). Provisions requested by the BCC amounted to FF 518.88 million (C/V \$US 97.17 Million).

The distribution of risks and required provisions per geographical area were split as elaborated in Table 5:

TABLE 5
GEOGRAPHICAL DISTRIBUTION OF SOVEREIGN RISKS AND REQUIRED PROVISIONS

| <u>Geographical Area</u> | <u>No.of</u> | <u>Outstanding Loans</u> | <u>%</u> | <u>Required Provisions</u> | <u>%</u> |
|--------------------------|------------------|--------------------------|-------------|----------------------------|-------------|
| | <u>Countries</u> | <u>Million F.F</u> | | <u>Million F.F.</u> | |
| North & Central | | | | | |
| Africa | 14 | 662.53 | 38.59 | 173.50 | 33.40 |
| Eastern European | | | | | |
| Block | 3 | 396.93 | 23.12 | 171.61 | 33.07 |
| Latin America | 12 | 323.57 | 18.85 | 82.37 | 15.87 |
| Middle East | 3 | 301.39 | 17.56 | 82.27 | 15.86 |
| Other | <u>1</u> | <u>32.26</u> | <u>1.88</u> | <u>9.13</u> | <u>1.76</u> |
| TOTAL | 33 | 1,716.68 | 100.00 | 518.88 | 100.00 |
| | ===== | ===== | ===== | ===== | ===== |

Private Commercial Risks

Paris Head office

Total risks undertaken by the Paris head office amounted to FF 153.1 million (C/V \$US 28.7 million) distributed over twelve accounts, eight residing in France, three in Saudi Arabia and one in Tunisia.

The rates of provision on these loans ranged from 20% to 100%. Required provisions amounted to FF 132.2 million (C/V \$US 24.7 million). Provisions already booked amounted to FF 54 million (C/V \$US 10.1 million).

Provisions required by the BCC to cover potential losses amounted to FF 78.2 million (C/V \$US 14.6 million) estimated at an average rate of 52%.

Bahrain O.B.U.

The evaluation of Bahrain risks amounted to FF 401 million (C/V \$US 75 million) distributed over eighteen accounts.

Rates of provision ranged from a minimum of 7% to a maximum of 100%. Required provisions amounted to FF 219.7 million (C/V \$US 41.1 million) . Provisions already booked amounted to FF 57 million (C/V \$US 10.7 million).

Provisions required by the BCC amounted to FF 166,3 million (C/V \$US 31.1 million) estimated at an average rate of 41%.

London Branch

Only one account was considered doubtful in this branch. The account represented an agreement to finance the construction of a hotel in Srilanka. The total amount of the engagement was FF 8.1 million (off-balance-sheet FF 1.6 million). Provisions already booked amounted to FF 4 million.

The BCC required the Bank to constitute additional provisions for FF 4.1 million (C/V \$US 0.9 million) to cover the full engagement.

Total provisions required by the BCC to cover private and commercial risks amounted to FF 248.6 million (C/V \$US 46.6 million).

Group Companies' Risks

Arab Finance Corporation S.A.L (AFC) was established in Lebanon as a public limited company on January 19, 1974 and commenced operations in July 1974. The company was engaged in finance operations particularly in money market placements, lending activities and investment services.

AFC had transactions and relationships with members of the Group. Borrowings, the sole means of financing, were obtained from Group financial institutions. The company was subsidized by the Holding and sister companies as the weak financial position rendered repayment impossible.

The company's balance sheet as at December 31, 1986 could be summarized in Table 6:

TABLE 6
ARAB FINANCE CORPORATION SAL

In Millions of F.F.

| | <u>Assets</u> | | <u>Liabilities</u> |
|----------------|---------------|---------------------|--------------------|
| Banks | 29,3 | Group Companies | 137,2 |
| Advances/Loans | 137,6 | Diverse | 36,3 |
| Diverse | <u>7,8</u> | Shareholders Equity | <u>1,2</u> |
| | 174,7 | | 174,7 |
| | ===== | | ===== |

.../55/...

The loans advanced by Al Saudi and SAFICO as at September 30, 1987 amounted to FF 135,8 million:

| | <u>Millions of F.F.</u> |
|--------------------------|-------------------------|
| Al Saudi Banque, Paris | 49,8 |
| Al Saudi Banque, London | 46,2 |
| Al Saudi Banque, Bahrain | <u>18,4</u> |
| Total Al Saudi Loans | 114,4 |
| Holding Company | <u>21,4</u> |
| Total | 135,8 |
| | ===== |

The BCC required the Bank to constitute provisions amounting to 75% of total outstandings (FF 114.4 million) totalling FF 85 million (C/V \$US 15.9 million).

Other Diverse Risks

Al Saudi Banque was required by the BCC to book additional provisions for FF 95 million (C/V \$US 17.8 million) with regard to the following:

| | <u>Amount (Million)</u> | |
|--------------------------------------|-------------------------|-----------------|
| | <u>F.F.</u> | <u>C/V \$US</u> |
| - Decline in market value/securities | 82 | |
| - Diverse zero - valued assets | <u>13</u> | |
| | 95 | 17,8 |
| | === | ==== |

The BCC pointed out that the volume of investment securities held by the Bank witnessed a considerable evolution over the past four years (FF 43.9 million at 30/9/83, FF 770 million at 31/12/87). This was attributed to the Bank's aspiration to hold a huge portfolio of trading securities. However, this was not fit with the Bank's size and volume of operations.

The report noted also that interest rates matchings were not monitored regularly by the Bank's officials. The foreign exchange stop loss/stop profit ceilings were not stated clearly by management.

The concentration of deposits was among Al Saudi weaknesses noted by the BCC. One client's deposit for U.S. Dollar 120 million constituted about 50% of overall clients' deposits.

The report of the Banks Control Commission concluded that "Al Saudi Banque operating income is insufficient to cover the hidden losses discovered in its portfolio of earning assets."

Banque Indosuez Financial Study

July 31, 1988

Based on the conservative reaction of Al Saudi Banque shareholders with respect to the recommendations concluded by the Banks Control Commission, it was agreed with the Central Bank of France to conduct further investigations on the Bank's

portfolio of earning assets. The parties involved authorized Banque Indosuez, a giant in the sector, to verify the results concluded by the Banks Control Commission. The report was published on August 29, 1988.

For the estimation of sovereign risks, Indosuez Group placed their study with the perspective of the market value of the assets and took in consideration the following factors:

1. The rate of depreciation of outstanding loans certified by "Salomon Brothers" or whenever this was not possible, the market rates estimated by Indosuez.
2. The modifications of the outstandings in relation to the concerned countries between the date of the examination by the Banks Control Commission and the end of May, 1988.
3. The presence in the portfolio of a certain number of countries which the BCC had not taken in consideration.
4. The depreciation of FF/\$US exchange rate from FF 5,34/\$US as at December 31st, 1987 to FF 6,25/\$US as at July 31, 1988.
5. Short term loans which were not accounted for by the Banks Control Commission.

6. Syndicated loans granted in association with the World Bank, previously evaluated by the BCC at 50% of their face value.

Provisions for the sovereign risks estimated by Indosuez amounted to US Dollars 200 million; this represented an additional US Dollars 102.8 million from the figure required by the BCC: \$US 97.2 million.

In relation to private risks provisions, Indosuez calculations were based on:

1. Their knowledge of the French and Saudi markets.
2. The information received from their subsidiary company in Saudi Arabia.

The examination of Al Saudi loan portfolio indicated the need to book additional provisions for US Dollars 70 million with respect to commercial and private risks taking into account that an amount of US Dollars 46.6 million was passed in December 1987 upon BCC request:

| | <u>Million of \$US</u> |
|---------------------|------------------------|
| - Paris Head Office | 20 |
| - Bahrein O.B.U. | 35 |
| - London Branch | 15 |
| - Group Risks | <u>24</u> |
| | 94 |

The amount was rounded prudently to US Dollar 100 million.

The report revealed the heavy interbank borrowing position of the Paris head office. As at July 31, 1987, borrowings amounted to \$US 678,7 million split as follows:

| | <u>Million of \$US</u> | <u>No. Of Banks</u> |
|--|------------------------|---------------------|
| - French and Non-French banks based in France | 448.4 | 49 |
| - Other Banks, not based in France | <u>230.3</u> | <u>47</u> |
| | 678.7 | 96 |
| | ===== | === |

Sovereign Risks

Banque Indosuez used the risks concluded by the BCC as the basis to evaluate required provisions according to market prices of loans specified by the "Solomon Brothers". Recommended provisions amounted to FF 900.6 million (Ref. Appendix #12).

The depreciation in the FF/\$US exchange rate increased the amount of required provisions by FF 153.5 million to FF 1,054.1 million (Ref Appendix #13).

Country risks not accounted for by the Banks Control Commission amounted to \$US 81.7 million (Ref. Appendix #13); a 24.5% provision rate was applied on these loans: \$US 20 million, C/V FF 125 million.

.../60/...

The composition of sovereign risks provisions evaluated by Indosuez could be specified as follows:

| | <u>Million of FF</u> |
|--|----------------------|
| - Provisions based on BCC figures (evaluated at Solomon Brothers market prices) | 900.6 |
| - Exchange adjustment of FF/\$US as at 31/7/90 | 153.5 |
| - Provision on sovereign risks not accounted for by BCC | <u>125.0</u> |
| TOTAL | <u>1,179.1</u> |

The amount was rounded prudently to FF 1,250 million, C/V \$US 200 million.

Indosuez own evaluation of the sovereign risks concluded by the BCC stated that the total risks increased to U.S. Dollar 450.25 million, compared to the latter's U.S. Dollar 321.47 million. The difference was attributed partially to accounting for short term loans skipped by the BCC, as well as loans advanced in association with the World Bank evaluated previously at 50% of their face value.

Indosuez own evaluation of total engagements as at May 31st 1988, amounted to \$US 557.13 million, which included off balance sheet items for \$US 79.26 million.

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The variance in figures, Indosuez reported, were difficult to verify, as it was impossible to conduct a separate audit for each country's outstandings, the ideal approach to reach exact figures.

Indosuez concluded that "the amount of sovereign risks is not fit with the Bank's capabilities; the Bank, due to non - performing loans, is not generating enough income to cover its general expenses. This makes booking necessary provisions absolutely impossible."

Private Commercial Risks

Paris Head Office

Taking into account risks' provisions already booked during April 1988 upon BCC request, additional risks of the Paris head office were estimated at FF 348.7 million, C/V \$US 55.8 million distributed over eighteen accounts. The amount was rounded to FF 390 million, C/V \$US 62.4 million to account for risks not considered in the study.

The accounts were divided into French risks amounting to FF 307.3 million and non - French risks amounting to FF 41.398 million. The applied rates of provision were 25% and 40% respectively. Required provisions amounted to FF 106.5 million, C/V \$US 17 million. Diverse risks provisions were estimated at

FF 18.75 million, C/V \$US 3 million. Total required provisions amounted to \$US 20 million.

Bahrain O.B.U.

The additional risks of the Bahrain O.B.U. were divided into litigious, doubtful, problematic, follow up, substandard and diverse accounts. Total required additional provisions on these accounts were estimated at U.S. Dollar 35 million.

London Branch

Total additional risks of the London branch were estimated at STP 32,291 million, C/V \$US 55,024 million distributed over fifty nine accounts. The applied rate of provision was 25%. Required provisions amounted to STP 8.1 million, C/V \$US 13.8 million, rounded prudently to \$US 15 million.

Group Risks

Indosuez report exposed the risks undertaken by Al Saudi Banque S.A. with four sister entities owned fully or partially by SAFICO I : Arab Finance Corporation A.F.C. S.A.L. Beirut, Saudi Finance Corporation SAUDIFIN S.A., Geneve, Saudi Investment Group S.I.G and Al Saudi Bank Holding N.V. Rotterdam (Ref Appendix # 2).

Arab Finance Corporation S.A.L.

During April 1988, Al Saudi Banque passed provisions amounting to FF 85 million required by BCC to cover risks in A.F.C. As at July 27, 1988 Indosuez estimated the total exposure at FF 131,6 million, C/V \$US 21.05 million specified as follows:

| | <u>Million of \$US</u> |
|-------------------|------------------------|
| Paris Head Office | 10.00 |
| London Branch | 8.05 |
| Bahrain O.B.U | <u>3.00</u> |
| TOTAL | 21.05 |

Additional provisions for FF 46.6 million C/V \$US 7.6 million were required to cover the full risks in A.F.C. Beirut.

Saudi Finance Corporation SAUDIFIN S.A.

SAUDIFIN is a finance company based in Geneve with a paid in capital of SF 20 million. The company was fully owned by Al Saudi Bank Holding N.V Rotterdam.

The total exposure in SAUDIFIN was estimated as at July 27, 1988 at \$US 4.4 million:

| | <u>Million of \$US</u> |
|-------------------|------------------------|
| Paris Head Office | 3.7 |
| Bahreïn O.B.U | <u>0.7</u> |
| TOTAL | 4.4 |

Due to the weak financial and heavy borrowing position of the company, Indosuez recommended to provide fully for the amount in question.

Saudi Investment Group, S.I.G.

SAFICO I owned 50% of S.I.G. Al Saudi Banque S.A. Bahrain financed in 1984 the acquisition of two plots of land in Jeddah, Saudi Arabia, for SR 35.42 million, C/V \$US 9.4 million. The finance agreement was guaranteed by SAFICO I.

The weak liquidity position of both S.I.G. and SAFICO I, rendered repayment impossible. Indosuez requested a full provision amounting to \$US 9.4 million.

Al Saudi Bank Holding N.V., Rotterdam.

Al Saudi Bank Holding N.V., Rotterdam issued a guarantee in favor of Al Saudi Banque, London for STP 1.5 million to cover the branch's exposure towards a construction company. As ASB Holding was not in a position to honor its financial obligations, Indosuez requested to provide fully for the amount of STP 1.5 million, C/V \$US 2.6 million.

Total additional provisions required to cover risks in Group sister entities were estimated at \$US 24 million.

Compared to provisions requested by the Banks Control Commission, Indosuez additional provisions were estimated at \$US 202.8:

TABLE 7
COMPARATIVE ADDITIONAL REQUIRED PROVISIONS

| | Provision Required by BCC (Millions of \$US) | Provision Required by Banque Indosuez (Millions of \$US) | Additional Provisions (Millions of \$US) |
|----------------------------|--|--|--|
| Sovereign Risks | <u>97.20</u> | <u>200.00</u> | <u>102.80</u> |
| Private Risks: | | | |
| Paris | 14.60 | 34.60 | 20.00 |
| Bahrain | 31.10 | 66.10 | 35.00 |
| London | <u>0.80</u> | <u>15.80</u> | <u>15.00</u> |
| | <u>46.50</u> | <u>116.50</u> | <u>70.00</u> |
| Group Companies Risks | 15.90 | 39.90 | 24.00 |
| Diverse Risks | 2.40 | 8.40 | 6.00 |
| Depreciation of Securities | <u>15.40</u> | <u>15.40</u> | <u>-</u> |
| Total Required Provisions | 177.40 | 380.20 | 202.80 |
| | ===== | ===== | ===== |

CHAPTER IV

RESOLUTION OF THE CRISIS

Alternatives To Resolve The Crisis

Following the Banks Control Commission demands and the shareholders' failure to secure necessary funds to finance required provisions, Mr. Rafic Hariri, a shareholder of SAFICO I, offered his rescue plan proposal to the BCC:

- 1- To reconstitute the Bank's capital by issuing a new share stock. Mr. Hariri offered a contribution of \$US 50 million.
- 2- To book all shareholders equity funds amounting to FF 386 million and SAFICO I subordinated loan for \$US 10 million, C/V FF 53,4 million, as provisions against non-earning assets.
- 3- To delegate the Bank's management to a competent French banking group.
- 4- To resolve the dispute regarding the \$US 25 million syndicated loan advanced by SAFICO I and financed by four

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banks: Arab Banking Corporation-Bahrein, Gulf International Bank, Riyadh Bank and I.B. International - Luxembourg, as the financing banks declined to accept their loan as part of the Bank's equity to cover required provisions.

- 5- To insure the participation of existing shareholders in the rescue plan.

As the syndicated loan problem remained unresolved and the shareholders' participation was impossible, the governor of the Central Bank of France decided on May 26, 1988 to freeze all receivable accounts of the crediting banks estimated at FF 6 billion till September 30, 1988.

During this period, Indosuez report revealed the need to book provisions for \$US 380 million; consequently, the Hariri rescue plan proposal hit its dead end as it was based on the BCC estimates of \$US 179,2 million.

Adopted Resolution

The legal identity of Al Saudi Banque S.A. was among the complications facing any resolution for the crisis. The Bank, holding a Saudi name, with no legal ties with the Saudis, was a registered financial entity in France and subject to French legislations.

Given the interest in avoiding a default susceptible of harming the reputation of the Paris financial markets as well as the reputation of Arab banks in general, and Saudi banks in particular, a two-phase plan, backed by French and Saudi political support, was set up under the auspices of the French Monetary Authorities: Banque de France and the Banks Control Commission.

The participants in this rescue plan were:

1. Indosuez Group
2. Holding de la Mediterranee Holland B.V.: Mr. Hariri Group.
3. Al Bank Al Saudi Al Fransi: Mr. Al Omran Group (60%) and Banque Indosuez (40%).
4. The Thomson Group.

The total loss as at September 30, 1988 was estimated at FF 2,100 million. After deducting the holdings of the former shareholders amounting to FF 600 million and a contribution from the Thomson Group of FF 350 million, the estimated loss was reduced to FF 1,150 million.

In reference to article 52, paragraph 2, of the banking law which authorizes the French Monetary Authorities, in case of default by a bank, to call up capital from all credit

institutions,¹⁷ the Governor of the Bank of France insisted on paying in full the depositors and the non-resident creditor banks and to divide up the loss up to FF 950 million among the resident creditor banks and the remaining FF 200 million among the overall banks established in France.

The contribution towards covering the loss by the resident banks could be specified as follows:

| | <u>Million of FF</u> |
|---------------------------------------|----------------------|
| - Five Main Creditor Resident Banks | 695 |
| - Thirty Nine Creditor Resident Banks | 255 |
| - Other Non Creditor Resident Banks | <u>200</u> |
| Total | 1,150 |
| | ===== |

Phase I

Reconstitution of Al Saudi Banque S.A.

Acquisition of Al Saudi Banque by Thomson Group

The first phase of the rescue plan, implemented starting September 1988, was based upon a merger agreement between a subsidiary of the Thomson Group, after acquisition of Al Saudi shares, and a company established previously by Indosuez and endowed with a participants' capital of FF 100 million specified as follows:

¹⁷Banks Under Arab Control in France, BANKDATA, Vol.5, (1989): 11.

| | <u>%</u> | <u>Million of FF</u> |
|---|----------|----------------------|
| - Banque Indosuez | 35 | 35 |
| - Holding de la Mediterranee Holland B.V. (Mr. Hariri Group) | 30 | 30 |
| - Al Bank Al Saudi Al Fransi | 30 | 30 |
| - Thomson Group | <u>5</u> | <u>5</u> |
| | 100% | 100 |
| | ===== | === |

Formation of the New Al Saudi Banque S.A.

The plan's first phase included five steps:

1. Purchase of Al Saudi Banque S.A. shares by a subsidiary of Thomson Group, named afterwards "Societe de Banque Thomson."
2. Purchase of the \$US 25 million subordinated loan at 20% of its worth.
3. Payment of the resident bank's contributions to Banque Thomson. Payment by Thomson of FF 1.500 million to Al Saudi Banque S.A.
4. Reconstitution of Al Saudi Banque equity by carrying out an increase of capital of FF 25 million with a share premium of FF 2,100 million.
5. Absorption of Societe de Banque Thomson by an inactive subsidiary of Indosuez Group. The company's capital was increased to FF 100 million after opening the shareholdings proportionately to the parties involved in the rescue plan.

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The resulting company was publicly announced on December 30, 1988 as the new "Al Saudi Banque S.A.". The management of the new Bank was delegated to Banque Indosuez.

The reconstitution of the new Al Saudi Banque financial position is detailed in Appendix #14.

Phase II

Formation of Banque Francaise de L'Orient

Merging Al Saudi Banque with Banque Libano - Francaise (France)

The rescue operation, carried out during September 1988, was concluded in June 1989 by implementing the second phase of the plan.

Banque Indosuez, a holder of a 35% participation in Al Saudi, 40% in Al Bank Al Saudi Al Fransi, 90% in Banque Libano - Francaise - France and 57% in Banque Libano - Francaise - Beirut, was facing a conflict of interests between its fully and partially owned subsidiaries, which performed similar activities within the same financial markets.

Banque Indosuez offered to merge Banque Libano - Francaise - France with the new Al Saudi Banque S.A. The formers' participation was BLF itself, while other shareholders' participations would be paid in cash.

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Following a series of negotiations among major shareholders of the new Al Saudi: Indosuez, Hariri and Al Saudi Al Fransi, an agreement was concluded by mid March 1989 whereby BLF - France takes over Al Saudi and changes its title to "Banque Francaise de L'Orient". The transaction was based on the accounts closed on December 31, 1988 and was officially announced on July 28, 1989.

The merger agreement was based upon an evaluation criterion whereby BLF - France was evaluated at FF 215 million and the new Al Saudi Banque at FF 100 million. Consequently, the parties agreed to fix the exchange parity at 10 BLF shares for 21.5 Al Saudi shares.¹⁸

The agreement involved two major steps:¹⁹

1. Decrease the share participation of "Societe de Banque Thomson" from 5% to 2.1%. Banque Libano - Francaise S.A.L. - Beirut was assigned the 2.9%.
2. Increase the capital of Banque Libano - Francaise - France (before merger) to FF 263,762 million from FF 100 million.

The subscription in the newly issued capital was at a par value of FF 100/share and a share premium of FF 115/ share distributed proportionately to major shareholders.

¹⁸The Merger Agreement, June 22nd 1989, Paris: 3

¹⁹Ibid.

Consequently, the equity of Banque Francaise de L'Orient (B.F.O.) increased to FF 558 million:

| | <u>F.F.</u> |
|------------------------------------|--------------------|
| - B.L.F. France, Original Equity | 106,000,000 |
| - Al Saudi Banque, Original Equity | 100,000,000 |
| - Capital Increase of B.L.F. | 163,762,000 |
| - Capital Increase, Share Premium | <u>188,326,300</u> |
| | 558,088,300 |
| | ===== |

The shareholders of the newly established B.F.O. are:

| | |
|--|-------------|
| - Banque Indosuez | 35% |
| - Holding de la Mediterranee, Holland B.V. (Mr. Hariri Group) | 30% |
| - Al Bank Al Saudi Al Fransi (An affiliate of Indosuez:40%) | 30% |
| - Banque Libano-Francaise S.A.L, Beirut | 2.9% |
| - Societe de Banque Thomson | <u>2.1%</u> |
| | 100% |
| | ===== |

Purpose and Implications of the B.L.F. and A.S.B. Merger

The merger agreement signed between participating parties illustrated the transaction's objectives:

.../74/...

The purpose of A.S.B.'s merger and amalgamation with B.L.F. is to create a bank which is large enough to be adequately profitable by complementing the B.L.F. business aimed at the Lebanese community, with the A.S.B. business, which, because of its shareholders, is aimed at the Gulf countries, especially Saudi Arabia.

This bank will be a preferential correspondent of Indosuez's affiliated bank in Saudi Arabia, Al Bank Al Saudi Al Fransi, the fourth largest establishment in the country, operating a net work of 55 branch offices in the Kingdom and generating major business.

This transaction will provide the entity resulting from the merger with considerably increased net worth, making it one of the leading French banks specialized in the Middle East.²⁰

The mutual business interests shared by parties involved in the rescue operation, backed by French and Saudi political support were the core reasons for the successful rescue transaction.

The objectives from Indosuez participation in the new Banque Francaise de L'Orient were identified by Mr. Bernard Vernhes, Chairman - General Manager, formerly head of the Middle East section at Indosuez:

Our participation in the new Bank complements our Middle East active presence. A greater significance for European investments is currently being emphasized by Lebanese and Arab clientele; starting with real estate investments, investors are looking today for further opportunities in the industry and services sector.

²⁰ Ibid., p. 1.

Our mission, through the new Bank, is to facilitate and accomodate the growth of our Lebanese and Arab clientele in Europe. The new Bank represents the European extension of our activities in the Middle East. It is a Lebanese-Arab Bank in Europe complementing our network in this respect.²¹

For Banque Libano - Francaise - France, originally endowed with a capital ownership of FF 100 million shared by Banque Indosuez 90.45%, Mr. Farid Raphael (President) 1.87%, and Banque Libano - Francaise S.A.L. 7.68%, the rescue operation had positive impacts on the Bank's overall position, reflecting the development and the broader field of activity. In fact, B.L.F. - France witnessed with this operation the following:

- Its net work consisting of its head office in Paris and its branches in Nice and Monaco, spread in France to Cannes and to Great Britain with two branches in London and Berkley square and to Bahrain.
- Its balance sheet doubled considerably totalling FF 11.2 billion.
- Its shareholders equity rose from FF 106 million to FF 558 million.

The participation of Al Bank Al Saudi Al Fransi (BSF) in the new Bank opens and gives BSF new perspectives for its

²¹"The European Extension of Our Middle East Activities", Interview with Bernard Vernhes, Al Iktissad Wal Aamal, (April 1989): 26.

operations in Europe which were limited till then to the Saudi local markets with 55 branches operating all over the Kingdom.

The objectives of BSF participation were identified by Mr. Omran Al Omran, Chairman - General Manager:

Our participation in the new Bank represents an important step at the appropriate timing. This step did not evolve as a result of a predetermined planning or among the bank's strategies. However, we had our part in the responsibility after the failure of Al Saudi Banque S.A. The situation, after establishing the new Bank is different, and is taken into consideration among our external strategies; trying to make use of the Bank as our window towards Europe after unifying the European markets starting 1993.²²

Mr. Hariri's strong financial ties with the Indosuez Group through his ownership of about 3% in Banque Indosuez; his personal political and financial links with the Saudis and his diverse interests and investments in different sectors of the French economy, through his own Banque de la Mediterranee - France S.A., were additional reasons for the inter-related interest and the subsequent success of the transaction.

The participation of Banque Libano - Francaise S.A.L. came in anticipation of any tangible recovery in the Lebanese

²²"The French are Determined to Invest in Saudi Arabia", Interview with Mr. Omran Al Omran, Al Iktissad Wal Aamal, (June 1990): 69.

economy so as to intervene with possible investments whenever the situation permits.²³

The five participating parties in the rescue operation possess essential capabilities and financial capacities as well as a traditional record of Banking skills. Moreover, their diverse investments in the different Saudi, Lebanese and French sectors provides a strong starting base for the new Bank.

²³Omran Al Omran, Press Conference, Okaz Newspaper, (June 1989).

CHAPTER V

FUTURE PROSPECTS OF BANQUE FRANCAISE DE L'ORIENT

Europe 1992 and Arab Banks

The Basle Agreement Challenge

The central banks of twelve developed industrial countries (U.S.A., Japan, U.K, France, Canada, Italy, Germany, Sweden, Switzerland, Belgium, Holland and Luxembourg) agreed on July 1988 on the standard upon which the ratio of capital adequacy will be measured as proposed by the Basle supervision committee. Based on this agreement, the international banks supervised by the central banks of the above mentioned countries must increase the ratio of their capital to a minimum of eight percent out of their total risk weighted assets by the end of 1992.²⁴ A transitional period of four years and six months was specified for the banks to rectify their positions.

In order to quantify the risks, the committee decided to classify the countries into two groups:

²⁴"The Capital Adequacy Ratio and the Banks Control and Supervision Committee", Arab Banks, (October 1988): 30.

1. Group one includes all member countries of the OECD countries in addition to Saudi Arabia.
2. Group two includes all non - OECD countries.

Based on these decisions, a hierarchy of risk weights was assigned based on the nature of the obliger. In both (Group One) and (Group Two) countries, loans to central governments and central banks were assigned a risk weight of zero percent.

Loans to public sector agencies in (Group One) countries were assigned a twenty percent risk weight. As for (Group Two) countries, it was concluded that it is difficult for the committee to assign specific risk weights; consequently, this issue was delegated to the respective supervising authorities. However, the ranges of risk weights were determined at zero percent, twenty percent, and fifty percent, etc. ...

Loans to banks for a term of less than one year were assigned a risk weight of twenty percent for both (Group One) and (Group Two) countries. As for loans granted for a term of more than one year, weights of twenty and hundred percent were assigned for (Group One) and (Group Two) respectively.

Loans guaranteed by the (Group One) banks were assigned a twenty percent risk weight regardless of the loans term. The same applies for loans guaranteed by the (Group Two) banks conditioned by a maturity term of less than one year.

Based on the above, differentiating between (Group One) and (Group Two) countries will have some negative implications on the competitive performance of the banks established in the (Group Two) countries, as well the banks with outstanding debts to central governments and public sector agencies in the (Group Two) countries.

During the eighties, the performance of Arab banks operating abroad was directly linked to their activity in the Arab countries' markets. The overall deterioration in the economies of Arab countries affected negatively the performance of these banks: the Gulf recession period, the reduction in oil returns and the provisions regarding bad debts to be named as the most urging.

The Basle agreement requirements are considered as an additional burden for about three hundred Arab banks operating all over Europe and endowed with an average capital adequacy ratio of 3.7 percent for 1988. The agreement is expected to have some negative implications on these banks:²⁵

1. The increase in the cost of necessary funding from International money markets.
2. The reduction in the credit facilities granted to

²⁵"Arab Banks in Regionalism Era: Vague Prospects", Al Iktissad Wal Aamal, (June 1990):71

(Group Two) countries, especially to Arab countries—a main source of activity—qualified by the agreement as highly risky.

3. The possibility that international banks might reduce the credit lines granted to Arab banks.

It is widely believed that many of these banks will be driven out of the European markets due to the intense competitive conditions, the increasing capital requirements and the lack of a widely structured base of clients matched by the limited variety of banking services. Arab banks are facing a series of challenges with limited opportunities.

Based on the above, the continuity of these banks seems impossible without their acquisition of some European banking units endowed with a well defined base of clients, and a network of operating units providing a variety of services to meet the markets' distinct emerging needs.

The acquisition strategy seems a suitable alternative; however, professional managerial skills and continuous follow up are required to keep up with the challenge.

Prospects of B.F.O. In Europe 1992

Out of Al Saudi crisis, Banque Francaise de l'Orient emerged as a Franch-Arab Bank endowed with many key success elements, capable of transforming this transaction into a model for other similar cases:

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1- The new shareholders of the Bank are well known for their strong financial position and their political links with the French and Saudi authorities. Such links gave the rescue operation a political dimension towards reinforcing the Saudi-French relations by establishing a common banking tool with a Lebanese-based participation in anticipation of any future economic recoveries. This tool shall be capable of carrying out the perspectives of both countries. The rescue operation, which was based upon a request from both Saudi and French monetary authorities in particular,²⁶ had a further perspective towards establishing an effective tool to be used in activating mutual economic interests.

2- Banque Francaise de l'Orient is the first French-Arab consortium bank with management and chairmanship assumed by a French banking group. Arab participation is limited to representatives in the board of directors. Therefore, the success of B.F.O. is a challenging objective for Banque Indosuez.

3- Banque Francaise de l'Orient operating strategies are an extension of Group Indosuez's overall strategy in the

²⁶"A New Consortium Bank", Antoine Jeancourt-Galigniani, Al Iktissad Wal Aamal, (April 1989): 24.

Middle East. The strategic development of the Bank is towards the Middle East with Lebanese and Arabs, especially in the Gulf area.²⁷

The development of the Bank's activities is specified within four strategic sectors:²⁸

- The banking operations, mainly trade financing.
- The private banking.
- The financial and real estate operations.
- the treasury and Forex operations.

Two main objectives were specified by the Bank's management for the first year of operations:²⁹

- To proceed with the merging of the two constituting banks of B.F.O., regarding the activities, the staff, the premises of these banks.

²⁷"The European Extension of Our Middle East Activities", Interview with Bernard Vernhes, Al Iktissad Wal Aamal, (April 1989): 26.

²⁸Banque Francaise de l'Orient, Annual Report 1989, Board of Directors' Report to the Ordinary General Assembly of 23rd May 1990: 5.

²⁹Ibid.

- To make the bank healthier, mainly through a reevaluation of its commitments, sovereign and clientele's risk. In this respect, the bank parted with its whole portfolio of buyer's credit and sold some of its country risks at market prices. Simultaneously, the Bank is doing its best to recover some bad debts; this effort, which already proved succesful, will be maintained in the coming months.

4- The new Bank possesses a widely structured base of clients; the absorption of Al Saudi Banque by Banque Libano - Francaise, France adds a portfolio of active Lebanese and Arab clients operating in France and Lebanon through Banque Libano - Francaise, S.A.L. with eighteen branches all over Lebanon. As at December 31st, 1988, Banque Libano - Francaise, France S.A. managed about seven thousand accounts representing deposits amounting to U.S. Dollars 375 million. Furthermore, Al Bank Al Saudi Al Fransi provides B.F.O. an opportunity to enter the Saudi markets with its diversified portfolio of banking services, especially in the sector of private banking.

The interaction of these factors, if properly managed, will carry B.F.O. to the highest ranks among banks operating in France with activity directed mainly towards the Middle East markets. This provides B.F.O. with a unique opportunity to

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continue to operate after Europe 1992. However, it should be noted that the Basle agreement requirements had negative impacts on the Bank's portfolio of assets as elaborated by Mr. Bernard Vernhes, Chairman:

When we acquired the Bank, we had a FF 2.1 billion discount from monetary authorities, reflecting our estimates then for the loss. Today, our estimates go above these estimates by 5-10 percent. This is mainly attributed to a variety of factors like the Cooke committee decisions issued last September, which limited the value of country loans, and the fluctuations in the U.S. Dollar and other exchange rates.³⁰

³⁰"A New Consortium Bank", Bernard Vernhes, Al Iktissad Wal Aamal, (April 1989): 24.

CHAPTER VI

EVALUATIONS AND CONCLUSIONS

The financial crisis which AL Saudi Banque - France S.A. faced was the outcome of unsound management practices, operating deficiencies and environmental difficulties.

The violation of sound banking practices could be elaborated by the policies adopted and practiced by management. These policies were beyond the Bank's size and capabilities; the involvement in long term loans to third world developing countries coupled by the declining level of customer deposits, rendered resorting to short term interbank borrowings to gap the net deficit position. This was reflected in the low profitability levels achieved due to differences' in interest rates attributed to distinct maturities between assets and liabilities. Moreover, the excessive loans to sister group companies facing chronical financial difficulties contributed significantly to the overall weak financial position of the Bank.

The concentration of deposits and the lack of a wide base of small depositors was an additional threat to the Bank's liquidity.

The Chairman, acting as the sole consolidator and coordinator of the Bank's operations and transactions with sister companies, followed an individualistic approach in

running the Bank's activities and solving its problems. Dr. Akhras failed to build the firm institutional infrastructure from an organizational, financial and administrative perspectives. Consequently, the Bank lost its first defensive lines required for its continuity. Moreover, the Bank was incapable of handling and adapting to the rapid economic changes taking place in its fields of activity.

The continuous changes in Al Saudi shareholders was an indicator of the Bank's poor performance and the lack of a proper delegation of responsibilities and weak internal organization and administration. Furthermore, The Bank was not capable of keeping top caliber staff; the impacts were evident on the Bank's deficient back office and quality of operations.

The operating procedures were not consistent for the head office and branches. Many non-performing loans were not classified as problematic or doubtful. Consequently, the Bank continued to account for interest in its profit/loss statement; such practices are not in conformity with generally accepted accounting principles.

The general deterioration in Gulf economies was an additional and final hit for the Bank's portfolio of earning assets. the recession period witnessed during the eighties paralysed the Bank's shareholders and rendered further contributions of capital impossible.

.../88/...

By using a Saudi name and capital, the individual Saudi shareholders, lead by Dr. Akhras, were successful in giving the Saudi - indentity dimension for Al Saudi Banque. However, these investors failed to transform the Bank into a Saudi banking tool in Europe. Consequently, using a Saudi name turned to be a burden for both political and monetary Saudi authorities, which faced an embarrassing position to save their financial credibility and goodwill in France.

The experience encountered by the short lived Al Saudi Banque throughout its twelve years of operations, represents a model for the upcoming difficulties threatening about three hundred Arab banks operating in Europe. The "Europe 1992" restrictions will burden heavily these banks and limit their activities. Their continuity; therefore, is a function of a direct financial support from Arab monetary authorities and a well coordinated plan to merge the small banks, endowed with minimal chances for continuity.

The defensive step undertaken to save Al Saudi Banque had one positive impact; it brought up the need for establishing a French - Saudi consortium bank with financial capabilities and skillful management. Banque Francaise de L'Orient was the outcome.

The growth of Al Saudi Banque S.A. was unsound; its failure was inevitable.

APPENDIX # 1

Development of Market Shares of
Banks Under Arab Control
(in percentage)

| | <u>Loans &</u> | <u>Customers'</u> | <u>Balance Sheet</u> | <u>Shareholders' Equity</u> |
|---------------------|--------------------|-------------------|----------------------|-----------------------------|
| | <u>Discounts</u> | <u>Deposits</u> | | |
| | 1987 1988 | VAR. 1987 1988 | VAR. 1987 1988 | VAR. 1987 1988 |
| Share in Overall | | | | |
| Banks Under Foreign | | | | |
| Control | 28.4 24.4 - 4.0 | 31.0 29.7 - 1.3 | 19.3 16.1 - 3.2 | 22.8 22.6 - 0.2 |
| Share in Overall | | | | |
| French Banks | 2.6 2.4 - 0.2 | 2.4 2.3 - 0.1 | 2.8 2.5 - 0.3 | 4.2 4.2 - |

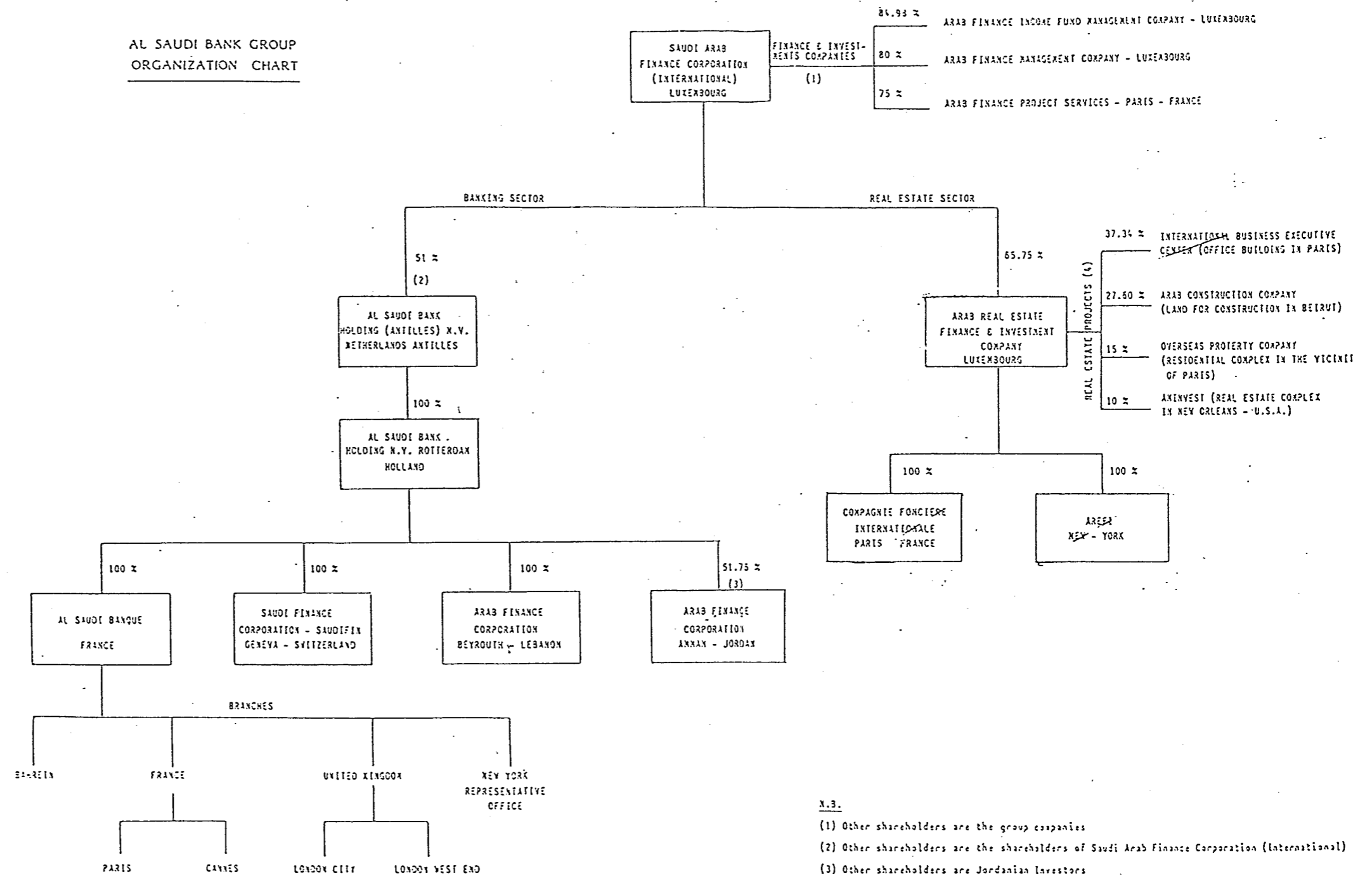
VAR. : Variations.

SOURCE: BANKDATA, Banks Under Arab Control in France, Vol. 5, 1989.

APPENDIX # 2

AL SAUDI BANK GROUP ORGANIZATION CHART

AL SAUDI BANK GROUP ORGANIZATION CHART



N.B.

- (1) Other shareholders are the group companies
- (2) Other shareholders are the shareholders of Saudi Arab Finance Corporation (International)
- (3) Other shareholders are Jordanian Investors
- (4) Other shareholders are Arab Investors

APPENDIX # 3

Board of Directors of AL SAUDI BANQUE S.A.

| | |
|------------------------------------|----------------|
| . Dr. Chafik Akhras | Chairman |
| . Sheikh Abdullah Kanoo | Vice President |
| . Sheikh Salah Ibrahim Al Hejeilan | Member |
| . Sheikh Muhamad Bin Laden | Member |
| . Mr. Sami Alami | Member |
| . Sheikh Hussein Abdullatif | Member |
| . Sheikh Khalid Al Seif | Member |
| . Sheikh Jamal Hassan Jawa | Member |
| . Mr. G. William Miller | Member |
| . Mr. Eyad Kayali | Member |

APPENDIX # 4

Evolution of AL SAUDI BANQUE S.A. Capital Ownership

| | <u>1976 - 1981</u> | <u>1982</u> | <u>1983 - 1988</u> |
|---|--------------------|-------------|--------------------|
| SAFICO INTL.S.A. LUXEMBOURG | 75% | - | - |
| BANQUE DE L'UNION EUROPEENE S.A. PARIS | 10% | 10% | - |
| ARAB FINANCE CORPORATION INT.S.A. LUXEMBOURG | 7,5% | - | - |
| MANUFACTURERS HANOVER HOLDING (DELAWARE) INC. | 7,5% | 7,5% | - |
| AL SAUDI BANK HOLDING N.V. (ROTTERDAM) | - | 82,5% | 99,95% |
| DIRECTORS | - | - | 0,05% |
| | <u>100%</u> | <u>100%</u> | <u>100%</u> |
| | ===== | ===== | ===== |

APPENDIX # 5

AL SAUDI BANQUE S.A.

Changes in the Board of Directors

(Subsequent to Changes in Ownership)

| <u>NAME</u> | <u>REPRESENTING</u> | <u>1976 - 1982</u> | <u>POST</u> | <u>1983</u> | <u>POST</u> |
|-----------------------------------|---------------------------------|--------------------|-------------------|-------------|---------------------|
| HRH Mhd. Bin Fahd Bin Abdul Aziz* | | X | Honorary Chairman | - | - |
| Dr. Chafic Akhras* | | X | Chairman | X | Chairman |
| Sheikh Abdallah Taha Bakhsh* | SAFICO(Chairman) | X | Director | - | - |
| Mr. Jean Rosillion* | BUE/- | X | Director | X | Advisor to Chairman |
| Mr. Bruce Hunderson* | Manuf. Hanover | X | Director | - | - |
| Dr. Chafic Akhras | AFC | X | Director | - | - |
| H.E. Hussein Mansour* | - | X | Director | - | - |
| Sheikh Salem Bin Laden* | Bin Laden Org. | X | Director | X | Director |
| Sheikh A.R. Sharbatly* | | X | Director | - | - |
| Sheikh Mhd Al Fraih* | | X | Director | - | - |
| Mr. Omar Ba Jamal | | X | Director | | - |
| Dr. Nasser Al Rashid | SAFICO(Chairman) | | | X | Director |
| Sheikh Khaled Ibraheem | SAFICO (Vice Chairman) | | | X | Director |
| Sheikh Saleh Al Hejeilan | Al Hejeilan Law Firm (Chairman) | | | X | Director |
| Mr Eyad Kayali | Shaf Corp. (Managing Director) | | | X | Director |

* Original Shareholders in the Bank

APPENDIX # 8

AL SAUDI BANQUE S.A. PARIS
Hariri Group Financial Study

Recommended Additional Provisions On Outstanding Direct And Contingent Commitments

As At March 31, 1986

All Figures Are In Thousands, FF 7,1325/\$US

| Country Client | Total Outstandings | Total Needed Provisions | % | Booked Provision |
|--|--------------------|-------------------------|---------|------------------|
| | Original Currency | C/V in FF | Minimum | Recommended |
| | | | P.F. | |
| 1- Commercial Risks | 344,280 | 96,578 | 28-43% | FF 15,104 |
| C/V in \$US of Additional Needed Provisions | \$ 13,540 | \$ 20,594 | | \$ 2,118 |
| 2- Sovereign Risks | | | | |
| - ARGENTINA: | | | | |
| Loans to Banks | 35,508 | 11,717 | 33-40% | |
| - BRAZIL: | | | | |
| Loans To Corp. | 22,993 | | | |
| Loans To Banks | 56,079 | | | |
| TOTAL BRAZILIAN RISKS | 79,072 | 13,442 | 17-26% | |
| - COLOMBIA: | | | | |
| Loans To Corp. | 6,858 | | | |
| Loans To Banks | 7,781 | | | |
| TOTAL COLOMBIAN RISKS | 14,639 | 2,050 | 14-18% | |
| - CONGO: | | | | |
| Loans To Corp. | 11,227 | | | |
| Loans To Banks | 6,763 | | | |
| TOTAL CONGO RISKS | 17,990 | 5,397 | 30-35% | |
| - COTE D'IVOIRE: | | | | |
| Loans To Corp. | 15,008 | | | |
| Loans To Banks | 32,904 | | | |
| TOTAL RISKS | 47,912 | 9,582 | 20-23% | |
| - CUBA: | | | | |
| Loans To Banks | 27,740 | 9,987 | 36-38% | |
| - EGYPT: | | | | |
| Loans To Banks | 30,549 | 3,055 | 10-15% | |
| - EQUADOR: | | | | |
| Loans To Banks | 13,228 | 3,836 | 29-32% | |
| - SPAIN: | | | | |
| Loans To Corp. | 3,856 | 3,856 | 100% | |
| - IRAQ: | | | | |
| Loans | 37,000 | 3,700 | 10-15% | |
| - MOROCCO: | | | | |
| Loans To State/Corps. | 163,935 | | | |
| Loans To Banks | 8,658 | | | |
| TOTAL MOROCCAN RISKS | 172,593 | 34,519 | 20-23% | |
| - MEXICO: | | | | |
| Loans To State | 12,712 | 3,050 | 24-45% | |
| - NIGERIA: | | | | |
| Loans To State/Corps. | 36,335 | | | |
| Loans To Banks | 8,547 | | | |
| TOTAL NIGERIA RISKS | 44,882 | 11,221 | 25-30% | |
| - POLAND: | | | | |
| Loans To State/Banks | 126,327 | 55,584 | 44-45% | |
| - SUDAN: | | | | |
| Loans To The State | 20,524 | 19,498 | 95-97% | |
| - SYRIA: | | | | |
| Loans To Banks | 93,210 | 9,321 | 10-15% | |
| - VENZUELA: | | | | |
| Loans To Banks | 108,307 | 19,495 | 18-20% | |
| - YUGOSLAVIA: | | | | |
| Loans To Banks | 28,294 | 6,508 | 23% | |
| TOTAL OUTSTANDING SOVEREIGN RISKS | 914,343 | | | |
| Additional Needed Provisions, ASB-Paris | FF 255,818 | | | 261,263 |
| (Sovereign Risks) | | | | |
| C/V in \$US OF Additional Needed Provisions, ASB-Paris (Sovereign Risks) | \$ 31,660 | | | 36,630 |
| Add: C/V in \$US OF Additional Needed Provisions, ASB-Paris (Commercial Risks) | \$ 13,540 | | | 20,594 |
| TOTAL ADDITIONAL NEEDED PROVISIONS (SOVEREIGN AND COMMERCIAL RISKS) | \$ 45,200 | | | \$ 57,224 |

APPENDIX # 9

AL SAUDI BANQUE S.A. BAHRAIN

Hariri Group Financial Study

Recommended Additional Provisions On Outstanding Direct And Contingent Commitments

As At March 31, 1986

(All Figures Are In Thousands of Currency Units)

| Country/Client | Total Outstandings Total Needed Provisions | | % |
|--|--|---------------------|--------|
| | C/V in \$US | Minimum Recommended | |
| 1- <u>Commercial Risks</u> | 124548 | 59429 | 48-64% |
| | ===== | ===== | ===== |
| 2- <u>Sovereign Risks</u> | | | |
| - ARGENTINA | | | |
| Cash at Banks | 450 | 148 | 33-40% |
| - BRAZIL | | | |
| Loans to Banks | 5,000 | 850 | 17-26% |
| - PERU | | | |
| Cash at Banks | 625 | 200 | 32-36% |
| - OTHER BANKS | | | |
| Arab African Int.Bank | 2,000 | - | |
| Al Baab | 3,000 | - | |
| Romanian B.for Foreign Trade | 1,200 | - | |
| Yepi Ve Kredi Bankasi | <u>440</u> | <u>-</u> | |
| TOTAL | \$ 12,175 | 1,198 | |
| Add: Additional Need Provisions, ASB - Bahrain | | | |
| (Commercial Risks) | | 59,429 | |
| Less: Booked Provisions as at 31.3.86 | | <u>(11,722)</u> | |
| Total Additional Needed Provisions, ASB-Bahrain \$ | | 48,905 | |
| | | ===== | ===== |

APPENDIX # 10
AL SAUDI BANQUE S.A. LONDON
Hariri Group Financial Study

Recommended Additional Provisions on Outstanding Direct and Contingent Commitments

As At March 31st, 1986
All Figures are in Thousands, \$US 1.4839/STP

| Country/Client | Total Outstandings | | Total Needed Provisions | | % |
|--|--------------------|------------|-------------------------|-------------|--------|
| | FC | C/V in STP | Minimum | Recommended | |
| 1- Commercial Risks | | 34,978 | 8,959 | 11,356 | 26-32% |
| - ARGENTINA | | ===== | ===== | ===== | |
| Cash at Banks | \$ 3,000 | 2,022 | 667 | 809 | |
| | ===== | ===== | | | |
| C/V in \$US of Additional Needed Provision, ASB-London | \$ | 7,685 | 1,306 | 1,998 | |
| | ===== | ===== | | | |
| 2- Sovereign Risks | | | | | |
| - BRAZIL | | | | | |
| Cash at Banks | \$ 11,403 | | | | |
| | ===== | | | | |
| - EGYPT | | | | | |
| Loans to Banks/Corps | | 5,614 | | 842 | 10-15% |
| Cash at Banks | \$ 18,150 | 12,231 | 561 | 842 | 10-15% |
| Total Egyptian Risk | | 17,845 | 1,223 | 1,835 | |
| | ===== | ===== | | | |
| - IRAQ | | | | | |
| Loans to Banks | | 4,696 | 470 | 704 | 10-15% |
| | ===== | ===== | | | |
| - MEXICO | | | | | |
| Cash at Banks | \$ 3,000 | 2,022 | 485 | 910 | 24-45% |
| | ===== | ===== | | | |
| - MALAYSIA | | | | | |
| Cash at Banks | \$ 2,671 | 1,800 | - | - | - |
| | ===== | ===== | | | |
| - PORTUGAL | | | | | |
| Banco Totta | \$ 2,000 | 1,348 | - | - | - |
| | ===== | ===== | | | |
| - POLAND | | | | | |
| Bank Handlowy | \$ 2,157 | 1,454 | 640 | 654 | 44-45% |
| | ===== | ===== | | | |
| Total Outstanding Sovereign Risks | | 42,051 | 5,352 | 7,752 | |
| Additional Needed Provisions, ASB-London | | | ===== | ===== | |
| C/V in \$US of Add. Needed Provisions, ASB-London | \$ | 7,942 | \$ 7,942 | \$ 11,503 | |
| | ===== | ===== | | | |
| Add: C/V in \$US of Add. Needed Provisions, ASB-London | \$ | 13,294 | \$ 13,294 | \$ 16,851 | |
| | ===== | ===== | | | |
| C/V in \$US of Total Needed Provisions, ASB-London | \$ | 21,236 | \$ 21,236 | \$ 28,354 | |
| | ===== | ===== | | | |

APPENDIX # 11
AL SAUDI BANQUE S.A.

Banks Control Commission Financial Study
Country Risks Provisions As Requested By Banks Control Commission

December 31, 1987
(All Figures in Million of FF; FF 5.34 \$US)

| Country | Basis Amount for Provision | | | | C/V \$US | Rate of Provision* | Amount of Provision | |
|-----------------|----------------------------|--------|---------|----------|----------|--------------------|---------------------|----------|
| | Paris | London | Bahrain | Total | | | F.F. | C/V \$US |
| 1 - ANGOLA | 10.94 | - | - | 10.94 | | 25.1% | 2.75 | |
| 2 - ARGENTINA | 24.30 | 12.42 | 3.85 | 40.57 | | 29.3% | 11.89 | |
| 3 - BOLIVIA | 0.14 | - | - | 0.14 | | 65.3% | 0.09 | |
| 4 - BRAZIL | 34.08 | 75.02 | 7.14 | 116.24 | | 31.1% | 36.15 | |
| 5 - CONGO | 51.39 | 10.68 | - | 62.07 | | 27.3% | 16.95 | |
| 6 - IVORY COAST | 126.77 | - | - | 126.77 | | 19.3% | 24.47 | |
| 7 - CHILE | 10.30 | 15.00 | - | 25.30 | | 23.7% | 6.00 | |
| 8 - COLOMBIA | 18.37 | 8.00 | - | 26.37 | | 18.7% | 4.93 | |
| 9 - CUBA | 30.44 | 7.89 | - | 38.33 | | 26.3% | 10.08 | |
| 10- EGYPT | 91.56 | 14.86 | - | 106.42 | | 20.4% | 21.71 | |
| 11- ECUADOR | 12.82 | 1.05 | - | 13.87 | | 22.4% | 3.11 | |
| 12- GABON | 23.15 | - | - | 23.15 | | 59.8% | 13.84 | |
| 13- GUINEA | 5.34 | - | - | 5.34 | | 23.6% | 1.26 | |
| 14- IRAQ | 75.20 | - | - | 75.20 | | 35.0% | 26.32 | |
| 15- LIBERIA | 0.19 | - | - | 0.19 | | 77.7% | 0.15 | |
| 16- MADAGASCAR | 7.29 | - | - | 7.29 | | 50.0% | 3.65 | |
| 17- MOROCCO | 151.01 | 0.36 | - | 151.37 | | 25.2% | 38.15 | |
| 18- MAURITANIA | 22.97 | - | - | 22.97 | | 68.0% | 15.62 | |
| 19- MEXICO | 0.87 | - | - | 0.87 | | 39.1% | 0.31 | |
| 20- NIGER | 30.73 | - | - | 30.73 | | 24.4% | 7.50 | |
| 21- NIGERIA | 85.24 | 19.45 | - | 104.69 | | 24.1% | 25.23 | |
| 22- PANAMA | 25.70 | - | - | 25.70 | | 4.6% | 1.18 | |
| 23- PHILLIPINE | - | - | 32.26 | 32.26 | | 28.3% | 9.13 | |
| 24- PERU | 6.28 | - | - | 6.28 | | 60.4% | 3.79 | |
| 25- POLAND | 117.64 | 53.73 | 27.64 | 199.01 | | 66.5% | 132.34 | |
| 26- PARAGUAY | 1.88 | - | - | 1.88 | | 20.0% | 0.38 | |
| 27- ROUMANIA | 32.38 | 16.59 | - | 48.97 | | 14.5% | 7.10 | |
| 28- SENEGAL | 5.60 | - | - | 5.60 | | 20.9% | 1.17 | |
| 29- SYRIA | 132.57 | 39.30 | - | 171.60 | | 31.3% | 53.71 | |
| 30- TURKEY | 23.34 | 29.50 | 1.75 | 54.59 | | 4.1% | 2.24 | |
| 31- TOGO | 5.00 | - | - | 5.00 | | 21.0% | 1.05 | |
| 32- VENZUELA | 7.25 | - | 20.77 | 28.02 | | 15.9% | 4.46 | |
| 33- YOGOSLAVIA | 76.40 | 31.69 | 40.86 | 148.95 | | 21.7% | 32.17 | |
| TOTAL | 1,247.14 | 335.27 | 134.27 | 1,716.68 | 321.48 | | 518.88 | 97.17 |
| | ===== | ===== | ===== | ===== | ===== | | ===== | ===== |

*Represents the average rate of provisions constituted by French Banks as at December 31 1986.

APPENDIX # 12
AL SAUDI BANQUE S.A.
Banque Indosuez Financial Study

Country Risks Provisions As Requested by Banque Indosuez

July 31, 1988

(All Figures in Million of FF, FF 6.25/\$US)

| Country | Banks Control Commission | | | Indosuez Group | | |
|----------------|----------------------------|-------------------|---------------------|----------------|---------------------|--|
| | Basis Amount for Provision | Rate of Provision | Amount of Provision | Market Price | Amount of Provision | |
| | 31.12.1987 | | | 31.7.1988 | | |
| 1 -ANGOLA | 10.94 | 25.1% | 2.75 | - | 6.2* | |
| 2 -ARGENTINA | 40.57 | 29.3% | 11.89 | 25 | 30.4 | |
| 3 -BOLIVIA | 0.14 | 65.3% | 0.09 | 11 | 0.1 | |
| 4 -BRAZIL | 116.24 | 31.1% | 36.15 | 51 | 57.0 | |
| 5 -CONGO | 62.07 | 27.3% | 16.95 | 28 | 14.7 | |
| 6 -IVORY COAST | 126.77 | 19.3% | 24.47 | 29 | 90.1 | |
| 7 -CHILI | 25.30 | 23.7% | 6.00 | 61 | 12.4 | |
| 8 -COLOMBIA | 26.37 | 18.7% | 4.93 | 66 | 9.0 | |
| 9 -CUBA | 38.33 | 26.3% | 10.06 | 5 | 36.4 | |
| 10-EGYPT | 106.42 | 20.4% | 21.71 | 40 | 63.9 | |
| 11-ECUADOR | 13.87 | 22.4% | 3.11 | 26 | 10.3 | |
| 12-GABON | 23.15 | 59.8% | 13.84 | 65 | 8.1 | |
| 13-GUINEA | 5.34 | 23.6% | 1.26 | - | 1.3* | |
| 14-IRAQ | 75.20 | 35.0% | 26.32 | - | 26.3* | |
| 15-LIBERIA | 0.19 | 77.7% | 0.15 | 5 | 0.2 | |
| 16-MADAGASCAR | 7.29 | 50.0% | 3.65 | 45 | 4.0 | |
| 17-MOROCCO | 151.37 | 25.2% | 38.15 | 50 | 75.7 | |
| 18-MAURITANIA | 22.97 | 68.0% | 15.62 | - | 23.0* | |
| 19-MEXICO | 0.87 | 39.1% | 0.31 | 51 | 0.4 | |
| 20-NIGER | 30.73 | 24.4% | 7.50 | 60 | 12.3 | |
| 21-NIGERIA | 104.69 | 24.1% | 25.23 | 70 | 73.3 | |
| 22-PANAMA | 25.70 | 4.6% | 1.18 | 25 | 19.3 | |
| 23-PHILLIPINES | 32.26 | 28.3% | 9.13 | 54 | 14.8 | |
| 24-PERU | 6.28 | 60.4% | 3.79 | 7 | 5.8 | |
| 25-POLAND | 199.01 | 66.5% | 132.34 | 42 | 115.4 | |
| 26-PARAGUAY | 1.88 | 20.0% | 0.38 | - | 0.2 | |
| 27-ROMANIA | 48.97 | 14.5% | 7.10 | 85 | 7.4 | |
| 28-SENEGAL | 5.60 | 20.9% | 1.17 | 50 | 2.8 | |
| 29-SYRIA | 171.60 | 31.3% | 53.71 | - | 53.7* | |
| 30-TURKEY | 54.59 | 4.1% | 2.24 | 98 | 1.1 | |
| 31-TOGO | 5.00 | 21.0% | 1.05 | 60 | 2.0 | |
| 32-VENEZUELA | 28.02 | 15.9% | 4.46 | 55 | 12.6 | |
| 33-YOGOSLAVIA | 148.95 | 21.7% | 32.17 | 46 | 80.4 | |
| TOTAL | 1,716.68 | | 518.88 | | 900.6 | |

Exchange Adjustment of FF/\$US
FF 900.6/5.34-FF 900.6/6.25

200.0
25.7

153.5

1,054.1

=====

*Estimated Provisions By Banque Indosuez

APPENDIX # 13

AL SAUDI BANQUE S.A.

Banque Insosuez Financial Study

Country Risks Not Listed By Banks Control Commission

As Of May 31st, 1988

(All Figures In Millions Of U.S. Dollars)

| <u>Country</u> | <u>Basis Amount Of Provision</u> | <u>Rate Of Provision</u> | <u>Amount Of Provision</u> | |
|-----------------------|----------------------------------|--------------------------|----------------------------|------------------|
| | | | <u>\$US</u> | <u>C/V F .F.</u> |
| 1 - CAMEROUN | 10.34 | | | |
| 2 - KENYA | 8.81 | | | |
| 3 - TANZANIA | 0.60 | | | |
| 4 - ZAMBIA | 0.02 | | | |
| 5 - ZIMBABWE | 7.32 | | | |
| 6 - ANTILLES | 13.48 | | | |
| 7 - GUATEMALA | 0.02 | | | |
| 8 - TRINIDAD & TOBAGO | 3.90 | | | |
| 9 - URUGUAY | 0.50 | | | |
| 10- INDONESIA | 1.52 | | | |
| 11- PAKISTAN | 5.80 | | | |
| 12- SRI LANKA | 1.31 | | | |
| 13- GERMANY - EAST | 8.27 | | | |
| 14- BULGARY | 14.87 | | | |
| 15- HUNGARY | 4.30 | | | |
| 16- ZCHEZOLOVAKIA | <u>0.64</u> | | | |
| TOTAL | 81.7 | 24.5% | 20.0 | 125.0 |
| | ===== | | ===== | ===== |

APPENDIX #14

Reconstitution of Al Saudi Banque S.A.
Financial Position, September 30, 1988

| | <u>Million F.F.</u> |
|--------------------------|---------------------|
| - CAPITAL | 350 |
| - RESERVES | <u>37</u> |
| NET POSITION ON 31/12/87 | 387 |
| - SUBORDINATED LOANS | <u>213</u> |
| NET WORTH | 600 |
| - LATENT LOSS | <u>(2,100)</u> |
| NEGATIVE NET POSITION | (1,500) |
| - RECONSTITUTED BY: | |
| .INCREASE OF CAPITAL | 25 |
| .SHARE PREMIUM | 2,100 |

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