

## **LIQUIDITY MANAGEMENT PROCEDURE**

### **1. Introduction**

In accordance with the Terms of the Liquidity Policy approved by the Board of Directors, the Management Committee of BBE adopts, upon proposal from the ALCO, adequate limits pertaining to liquidity ratios. These limits must reflect the guidelines exposed in the Liquidity Policy, and must cover all pertinent maturities and currencies, as well as adequate stress scenarios, which encompasses the existence of a tailored contingency funding plan.

The present procedure sets out the decisions taken by the Management Committee in the context described above, and constitutes the comprehensive list of measures implemented at BBE in order to manage liquidity risks.

## **2. Liquidity gaps & ratios**

The liquidity positions of BBE are followed up by the Management (Operations Manager) and the Dealing Room on a daily basis. They are further discussed during the monthly meetings of the ALCO. They are derived from the official liquidity reporting produced for Belgian regulatory purpose (90.31 and 90.32 reports), and consist of a gap analysis as per the following features (content, time buckets and currency/frequency split):

- Inflows from/Outflows to:

1. Central governments institutions
2. Credit institutions
3. Private/corporate customers (overdrafts **not** included)
4. Securities issuers
5. Related parties

- Off-balance sheet items are almost exclusively deriving from BBE's main activity (Trade Finance), and the resulting outflows are generally offset by concomitant inflows, except in case of discounts of L/C's or forfeiting. Consequently, the gap analysis is exclusively focused on balance sheet captions. Off-balance sheet perspective is considered at stress scenarios level (except for the USD 25M money market line granted by BBSAL).

- Residual maturities, on both non-cumulative and cumulative basis, up to 1 week, between 1 week & 1 month, between 1 month and 3 months, between 3 months and 6 months, and between 6 months and 1 year.

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- BBE S.A. figures reported separately
  - (a) in EUR
  - (b) in the other main currencies (aggreg.) c/v in EUR
  - (c) for the total c/v in EUR of (a) and (b) → On a daily basis
  
- Figures reported by branch separately
  - (a) in EUR
  - (b) in the other main currencies (aggreg.) c/v in EUR
  - (c) for the total c/v in EUR of (a) and (b) → On a monthly basis

As expressly mentioned in the Liquidity Policy, the management of liquidity is centralized at Head Office. This is explained by the fact that all major decisions impacting the liquidity of any of the 3 units of BBE (pricing of deposits, tenor of loans, strategy in terms of correspondent banking...) are ultimately taken at Head Office. Hence, limits are expressed for BBE S.A. figures only, where:

- Gaps pertaining to liquidity flows with credit institutions up to 3 months may never be negative, save for negative gaps - on a non-cumulative basis – up to maximum 5% for either the EUR or the other main currencies (aggreg.). This limit has been set considering
  - a) the importance of bank deposits for BBE (as mentioned in section 5 below, they have become its main source of funding)
  - b) the matching principle (see section 3 below) applied on a consistent basis

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- c) the fact that profits reported from previous years have not been distributed, and have been maintained (for their main part) in the overnight liquidity of BBE.

Hence, BBE is expected to remain highly liquid in the short term, whatever the business circumstances are.

- Positive net cash flows pertaining to liquidity flows with credit institutions up to 1 month, must cover minimum 25% of the outflows to private sector for the same period. This limit has been set considering that, in normal business circumstances, the withdrawal of more than 25% of the deposits would be unlikely to occur. Up to this level, BBE should be able to rely on net inflows from banks, so as even not considering the inflows from customers.
- Total gaps must always be positive up to 12 months (on a cumulative basis). This limit has been set in order to comply with the main guideline included in the Liquidity Policy.

Additionally, the liquidity is also monitored through the loans to deposits ratios produced on a monthly basis for all main currencies and for each branch separately. These ratios are made available to Senior Management as frequently as necessary, and are discussed during the monthly ALCO meetings. As a general principle, they shouldn't exceed 80%.

### **3. Matching principle**

The Dealing Room is responsible for matching (regarding amount and maturity) each deposit (from customers or banks) greater than 10 % of equity (threshold currently set at KEUR 8000) and with a maturity greater than one month, with its asset equivalent.

The Dealing Room is responsible for ensuring that this rule is respected at any time (for the 3 units).

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The control of the correct implementation of this rule is executed by the Back Office (Head Office).

#### **4. Monitoring of interbank placements /deposits**

The placements with/deposits from financial institutions are closely monitored, on a daily basis, by the Dealing Room.

The latter communicates its daily deposits/placements report ('Bank\_Placements' spreadsheet) to the members of the Alco.

The information so communicated include:

- Limits allocated to financial institutions
- Placements done by BBE with financial institutions
- Deposits placed by financial institutions with BBE
- Current account balances maintained by financial institutions

This information is used on a dynamic basis by Senior Management, in order to identify unapproved excesses over limits, as well as placements with banks which are the subject of negative market news. Additionally, this information is also used in a group perspective, since BBE's mother company (Byblos Bank Beirut S.A.L. - BBSAL) is ultimately responsible for the risk assessment of all exposure on financial institutions.

The daily spreadsheet prepared by the Dealing Room is also communicated, once a week (together with the internal liquidity reporting), to the Belgian regulator (BNB).

## **5. Contingency funding plan**

The Management of BBE recognizes the importance of having a plan for addressing liquidity in times of crisis. Liquidity crises can occur both from internal as well as external events and our plan addresses both contingencies.

BBE has historically recognized the need for funding sources that go beyond retail deposit business – and has consequently built a funding program based on different sources. The choice of the sources is highly depending on their cost, given BBE's strict re-placement policy (according to which every deposit collected with a value greater than 10% of equity must be perfectly matched).

### **Funding Sources**

- a) Our primary source of funding is our retail deposit base. The particularity of this deposit base is that it has been developed despite the limited retail services offered by BBE. Deposits outflows are generally limited to deposits gained during periods of trouble in Lebanon (e.g. in 2006), and BBE has never considered these deposits as permanent. Therefore, its replacement strategy has been organized accordingly. In order to retain existing deposits, or to attract new ones, we are relying on marketing actions addressed mainly to the customers of our main business line, i.e. Trade Finance, through competitive pricing offers. The latter (premium over LIBID, extra premium for deposits above KUSD 500) are explained by BBE's strict re-placement policy. It can also be mentioned that BBE does make intensive recourse to pledge deposits, as credit risk mitigating measure, hence reducing the risk of anticipated withdrawal.

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- b) The main component of BBE's Trade Finance business line being Export Letters of Credit (L/C's), BBE has developed a broad network of correspondents in the countries targeted by its commercial strategy. Over the years, these relationships have been consolidated and the a/m correspondent banks have started to place deposits with BBE, not only for the provisioning of their L/C's transactions, but also for pure treasury purpose. This resulted in banks' deposits accounting currently for the major part of BBE funding, i.e. above the retail deposit base. Again, it can also be mentioned that BBE does make intensive recourse to pledge deposits, as credit risk mitigating measure, hence reducing the risk of anticipated withdrawal.
  
- c) The Investment portfolio of BBE could be used as additional source of funding, considering the strict criterion of BBE's Investment Policy (in terms of rating and of liquid markets). The Investment Policy allows BBE to invest up to 65% of its own funds, in order to make certain we have high quality collateral for pledging as well as for liquidity in times of need. The Management of BBE trusts that, given these circumstances, the realization of the portfolio could be processed without trouble and with minimum loss of value. On an average basis, the amount available through such realization exceeds EUR 20M (investments with a maturity date greater than 12 months, since the portion maturing up to one year is already included in the a/m gap analysis). Nevertheless, this amount must be reduced with the (by the ECB) eligible investments, which are already included in the gap analysis (inflows at < 1 week).
  
- d) Since September 2009, BBE benefits from a EUR 10M money market line (up to one week) available from KBC Bank S.A. This facility is tested twice a year.

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- e) The final source of funding is BBSAL, who - since the incorporation of BBE (1976) - has always proven its willingness to support its subsidiary.

During the last few years, this support has been materialized by BBSAL fully subscribing to the EUR 30 M subordinated bond issued by BBE in 2006 (tenor: 10 years), and by the frequent participation of BBSAL in the credit &/or liquidity risk of major documentary transactions booked by BBE, when they exceed its capital requirements ratios.

Considering also:

→ the highly liquid assets of BBSAL, as proven by:

- its international expansion

- the absence of any difficulty to raise funds or to attract new partners (Re the USD 100M equity investment made by the IFC)

→ the fact that – due to its location – BBSAL is not directly exposed to the same systemic risk as BBE (as indisputably demonstrated during the 2008-2009 financial crisis),

the Management of BBE strongly believes that BBSAL liquidity support could be received in any of the adverse situations BBE could possibly meet.

Since 2010, BBE benefits from a USD 25M money market facility granted by BBSAL. This amount is already included in the gap analysis (inflows at < 1 week).

## **Crisis Events**

Crisis events can be both short and long term and can be created by internal or external situations.

→ Short term scenarios could by example be triggered by events like Weather Related issues, Acts of War, and reputation/compliance situations that could reflect badly on BBE, leading to large deposit or funding sources withdrawal. Our plan in such situations would be to replenish - if necessary - our funding through the most likely sources of funding that could exist in this situation.

Based on our experience during the liquidity events of 2008 (March 2008 – the so-called Bear Stearns Week-end - and September 2008 – the so-called Fortis Week-end), BBE didn't suffer from any breach of liquidity, and each of the (at that time available) a/m sources remained viable.

→ Longer term events are events that severely impact our institution and could lead to severe liquidity problems (e.g. major losses on loans portfolio). This kind of events would likely cut us off from sources of funds a), b) & d) above. Sources of funds c) & e) would still remain available.

In order to keep BBE's stakeholders informed about BBE liquidity strategy, BBE publishes adequate information relating to its liquidity management on the BBSAL website (BBE partition). This information meets the Pillar 3 standards of the Capital Requirements Directive.

## **6. Stress scenarios**

Our stress testing methodology consists of three scenarios, tested on a quarterly basis. For each of these scenarios, we check if available net overnight liquidity (i.e. overnight balances/placements, nevertheless limited to the positive gaps with Credit Institutions at < 1 month) is sufficient to cover the additional liquidity outflows. If not, we check the 5 a/m sources of funds, and see if any of the 5 sources could be triggered in order to cover the additional outflows. The Management of BBE concludes about these tests, and takes corrective action when necessary.

The scenarios are as follows:

### *Scenario 1: Liquidity crisis relating to BBE*

Assumption → Withdrawal of 50% of the deposits placed by Lebanese customers. We believe that, in case of events affecting BBE reputation, the withdrawal of more than 50% of the deposits placed by Lebanese customers, would be unlikely to occur. The stress on Lebanese customers is explained by the fact that they can more easily & rapidly access market information pertaining to BBE.

### *Scenario 2 : General liquidity crisis*

Assumption → Utilization of 5% of the outstanding L/C's issued/confirmed by BBE, without the corresponding inflow. We believe that, in case of general liquidity crisis, we might face L/C's disbursements without the corresponding inflow (L/C's cash flows are normally perfectly matched, except in case of discount, but BBE has no obligation to execute discount instructions) up to maximum 5% of the outstanding L/C's issued/confirmed by BBE. Indeed, to call for payments under L/C's requires the production of documents (transport documents, invoices, insurance documents, several certificates, ...) complying with the Terms & Conditions of the L/C. As such, this is mitigating the risk of having presentation of documents triggered purely by liquidity shortage purpose.

### *Scenario 3 : Combination of scenarios 1 & 2*

Assumptions → See above.