

financial market briefing

Deconstructing the Syrian Banking System

Amid the daily turmoil in Syria, it comes as something of a surprise to see the financial statements of 12 of the country's banks posted, quarter by quarter, on the website of the Damascus Securities Exchange (DSE).

By the end of May, all 12 had published audited financial statements for 2012, complete with detailed accounting notes.

But despite the apparent normality projected by the DSE's website (daily changes in stock prices stream across the home page; weekly trading reports are easily available and up to date), echoes of the civil war can be detected.

In recent weeks, three banks have had trading in their shares suspended because they did not provide the Exchange with reports on their Annual General Assembly meetings – it is hardly surprising that convening an annual meeting, to be attended by numerous prominent directors and shareholders, is difficult to arrange when large gatherings present easy targets for bombs.

On 17 January Bank Bemo Saudi Fransi informed the Exchange that it had transferred all funds in its Deir al-Zour branch to its head office in Damascus. (A few days later, rebel forces captured strategic positions around the city.) On 5 March the bank informed the Exchange that a convoy taking money to the Central Bank had been attacked by an armed gang, resulting in lost funds of S£25mn.

Amid the acres of news that have been published about the conflict in Syria, little has been written about how the conflict has affected the financial system. Economic reporting tends to focus on the exchange rate (which has depreciated by more than 100% since the start of the conflict) and the level of the Central Bank's foreign exchange reserves (now probably around \$2bn-3bn).

Banking Activity Has Declined Dramatically

Cash, of course, is playing a much greater role in the economy than before. Banking activity is at a minimum as banks run down existing credit facilities while continuing to fund basic imports such as food and medicine. Banks say that they are able to get dollars as well as local currency to stock their ATMs (in areas under government control), although money exchangers are playing an increasingly important role in the distribution of cash.

Banks' financial statements should give a reasonable impression of the broad trends in a country's financial system. Those published in Syria – one of the least developed banking systems in the Middle East, even before the civil war – need to be treated with considerable care, although the figures published by subsidiaries of overseas banks are likely to be more reliable since overseas head offices are subject to supervision and auditing standards that are more robust than those applied in Syria.

With that *caveat* in mind, the financial statements of the 12 banks that report to the DSE show an aggregate 28% decline in loans extended in the two years to the end of 2012 and a 29% decline in customers' deposits. In both cases the figures under-state the effective shrinkage in the banking system. Syrian banks report their financial results in Syrian pounds but have, at least in the past, extended some loans and taken some deposits in foreign currency.



When the fighting is over

What will the Syrian banking system look like when the fighting stops? The obvious answer is that it will depend on how long the fighting continues and who emerges as the victor.

And to some extent, that obvious answer is the correct one.

If the rebels overthrow the Asad regime, fighting their way to Damascus, the destruction to the country's infrastructure will be huge. Regime figures who have been managing the financial system in recent years will either flee or be removed, and physical assets will be looted, either by the departing regime or by uncontrolled elements of the victorious forces.

In the final days of Saddam Husain's rule in Iraq, the Central Bank of Iraq was emptied of millions of dollars by regime figures preparing for a last stand or a future fight back.

If the Asad government prevails and regains control of its territory, then destruction in the regions outside Damascus will be considerable, but the Damascene key infrastructure, both physical and professional, will probably be in reasonable shape.

Yet whoever controls Damascus in the years ahead will inherit a banking system dominated by decrepit state-owned institutions that have been managed by public servants with little appreciation of modern banking.

Any country's banking system reflects the broader economy in which it operates, and there has been little real change in the structure of the Syrian economy and the relationships within it for decades. (The rise of private sector businessmen and industries is a chimera – their success has been reliant on regime patronage.)

The so-called "reform" of Syrian banking in recent years has combined the granting of new banking licenses to private sector interests and foreign banks with the acquisition of shares in many of those banks by cronies of the regime. The process has brought new skills and technology into the system.

Six of Syria's 20 banks now have Lebanese banks among their major shareholders. Jordanian banks are the largest shareholders in another three, and Qatari investors in another two.

Continued...

TABLE 1: SYRIAN BANKS LISTED ON THE DAMASCUS STOCK EXCHANGE: SUMMARY OF FINANCIAL POSITION

Millions of Syrian Pounds, except where stated

	Year end	Assets (\$mn)*	BALANCE SHEET					INCOME STATEMENT			
			Assets	Cash & Placements with Central Bank	Placements with Banks	Net loans	Customers' Deposits	Equity	Operating income	General & Admin. Expenses	Net Profit
Syrian International Islamic Bank	2012	1,243	88,042	15,978	45,432	22,500	13,481	9,478	2,919	1,154	600
	2011		63,322	13,614	20,621	24,970	8,722	8,859	2,555	909	873
	2010		77,485	25,513	16,407	32,177	12,678	5,966	1,711	676	746
Banque BEMO Saudi Fransi	2012	1,184	83,892	29,276	16,700	26,421	70,068	7,060	3,469	1,852	41
	2011		75,642	13,640	23,047	32,935	61,729	7,021	3,723	1,964	660
	2010		114,761	36,189	36,475	36,854	103,560	4,993	2,880	1,613	668
International Bank for Trade & Finance	2012	808	57,219	12,139	19,094	22,963	38,708	8,489	2,786	881	662
	2011		61,467	12,230	16,863	29,008	41,156	7,828	2,617	885	1,009
	2010		78,294	15,549	26,071	33,078	59,281	7,319	1,989	721	914
Bank of Syria & Overseas	2012	801	56,754	12,276	18,168	13,778	48,516	5,733	2,516	973	61
	2011		69,494	11,318	18,428	21,231	58,653	5,646	2,586	1,058	570
	2010		92,141	16,240	29,122	30,353	83,483	5,116	2,004	989	713
Bank Audi Syria	2012	701	49,675	14,062	6,574	20,753	38,674	7,040	2,966	880	6
	2011		63,432	12,796	11,564	29,141	49,971	6,968	2,930	1,003	114
	2010		93,789	26,906	18,135	39,444	82,139	6,864	2,251	1,147	682
Byblos Bank Syria	2012	614	43,529	15,398	5,739	17,049	25,785	6,460	2,790	796	-157
	2011		46,454	6,046	7,919	23,750	35,636	6,559	1,737	704	169
	2010		42,577	7,536	8,078	22,390	33,612	4,389	1,070	722	231
Arab Bank Syria	2012	528	37,387	9,047	6,998	17,372	28,777	5,899	2,213	727	-44
	2011		37,320	6,147	5,260	22,430	27,409	5,943	1,976	739	460
	2010		41,178	10,206	5,117	23,123	35,303	3,635	1,366	721	402
Fransabank Syria	2012	477	33,799	5,659	13,611	10,738	16,318	4,135	2,002	675	57
	2011		31,113	3,204	13,467	11,531	13,153	4,037	1,001	430	150
	2010		23,690	2,424	10,098	8,739	13,087	1,528	288	283	5
Syria Gulf Bank	2012	368	26,083	4,475	5,439	13,127	16,329	2,543	1,183	511	-185
	2011		22,356	3,149	4,011	12,709	13,845	2,727	757	431	258
	2010		15,759	2,834	3,041	7,460	11,850	2,470	250	419	-203
Qatar National Bank Syria	2012	341	24,131	4,824	10,025	2,465	4,940	18,454	3,939	631	2,750
	2011		21,836	3,330	9,642	3,078	5,276	15,704	1,715	565	1,178
	2010		23,456	4,840	7,743	6,091	4,363	14,525	218	391	-93
Bank of Jordan-Syria	2012	241	17,109	3,384	3,454	7,831	11,198	2,582	1,004	512	-360
	2011		17,729	3,124	2,019	10,622	10,890	2,964	659	421	104
	2010		16,171	3,862	1,740	8,804	8,935	2,860	382	339	18
Al-sharq Bank	2012	231	16,353	5,157	1,870	6,814	11,117	2,503	904	297	215
	2011		15,813	3,652	3,812	6,188	9,680	2,280	433	316	49
	2010		9,185	1,569	1,927	3,662	5,718	2,235	86	241	-113

* Asset figures in \$ use an exchange rate of \$1=SE70.85, the rate cited on oanda.com for 31 December 2012. Source for all data, except asset figures in U.S. Dollars: Damascus Securities Exchange.

TABLE 2: OVERVIEW OF SYRIAN COMMERCIAL BANKS

	SHARE CAPITAL (\$MN)*	BRANCHES*	SHAREHOLDER NOTES	SANCTIONED BY U.K. GOVERNMENT?*
Commercial Bank of Syria	70,000	69	State owned	Yes
Qatar National Bank Syria	15,000	15	QNB, 51%	No
Agricultural Cooperative Bank	10,593	106	State owned	Yes
Syria International Islamic Bank	8,499	23	Qatar International Islamic Bank, 30%; other Qatari investors, 19%	Yes
Byblos Bank Syria	6,120	11	Byblos Bank, 52%	No
Bank Audi Syria	5,725	23	Bank Audi, 41%	No
International Bank for Trade & Finance	5,250	30	Housing Bank for Trade and Finance (Jordan), 49%	No
Arab Bank Syria	5,050	19	Arab Bank, 51%	No
Bank BEMO Saudi Fransi	5,000	39	BEMO, 22%; Banque Saudi Fransi 27%.***	No
Cham Bank	5,000	8	Commercial Bank of Kuwait 32%; Islamic Development Bank 9%	No
al-Baraka Bank Syria	4,541	9	Al-Baraka, 23%; Emirates Islamic Bank, 10%	No
Fransabank Syria	4,122	8	Fransabank (Lebanon), 56%	No
Real Estate Bank	4,062	23	State owned	Yes
Bank of Syria & Overseas	4,000	27	Blom Bank 49%	No
Bank of Jordan Syria	3,000	13	Bank of Jordan, 49%	No
Syria Gulf Bank	3,000	12	United Gulf Bank (Bahrain, Kuwaiti owned), 31%; First National Bank (Lebanon), 7%	No
al-Sharq Bank	2,500	6	Banque Libanon-Française, 49%	No
Popular Credit Bank	2,335	65	State owned	Yes
Savings Bank	2,249	13	State owned	Yes
Industrial Bank	1,278	17	State owned	Yes

* Dated 30/09/12, downloaded from Central Bank of Syria website.

** Downloaded from UK Government website, updated to 5 June 2013

*** In 2011, Banque Saudi Fransi announced its intention to sell its stake but at the end of 2012, no sale had taken place. Banque Saudi Fransi is 31% owned by Credit Agricole.

A 50% devaluation in the Syrian pound will increase the reported value of a foreign currency loan by 50% on a bank's local currency-denominated balance sheet. Without that effect, the banks' loan portfolios would have shown a much greater decline.

As the crisis has deepened, banks have been converting foreign currency loans into local currency loans in the hope of improving their borrowers' ability to repay. Again, the accounting treatment around such transactions has a big effect on the banks' balance sheets, inflating the apparent size of a their loan portfolios.

Well-placed observers comment that the assets and liabilities of the banking system have fallen dramatically since the end of 2012.

Syrian Banks' Exposure to Banks in Major Economies is Now Minimal

The decline of international lending and borrowing by Syrian banks can be seen in figures published by the Bank for International Settlements (BIS), an institution that tracks overseas exposures of banks in the major world economies. According to the BIS, banks in major economies had placed \$264mn with banks in Syria (including the Central Bank) at



Lebanese banks in particular stand to gain once the fighting stops and business resumes (and assuming sanctions are lifted). With their strong personal connections to the Syrian business community, geographical proximity, and entrepreneurial acumen, they were already building strong franchises when the Syrian civil war began in 2011.

But the experience of Iraq since the overthrow of Saddam provides a cautionary tale to any who think that a change of regime will lead to quick and dramatic change in an antiquated banking system.

In Iraq, state owned banks continue to dominate the banking scene, with Rafidain and Rashid accounting for about 90% of banking assets. Reform programmes implemented by foreign advisors backed by millions of dollars achieved little over many years. The Central Bank of Iraq, focussed on upgrading its own operations and on winning the political knife fights that threatened its independence, was unable to force the two big banks to make meaningful changes to the way they conducted business.

So what are the realistic priorities for the reconstruction and development of the Syrian banking system once the conflict ends?

Assuming that head offices and branch buildings are physically in tact, the first task will be to restore the provision of reliable electrical power and internet connections through bank networks. Without these, the process of reconciling branch accounts into a consolidated ledger – and managing the bank's liquidity position – is delayed and dependent on couriers.

Then the focus should move to the Central Bank. An authoritative and competent Central Bank is the key to upgrading a banking system because only the Central Bank can force commercial banks to take the difficult decisions that are needed to modernise their operations.

Thirdly, the loan portfolios of state-owned banks will have to be realistically re-valued and restructured, and then the banks re-capitalised.

Alongside these moves, a modern electronic payments system needs to be introduced.

But most important of all, and most difficult, will be the need to bring competent and motivated senior staff into the state-owned banks, and to modernise and enforce the laws and regulations that underpin financial activity. The timetable for doing that kind of change is more likely to be measured in decades than in years. ■

the end of 2009. This figure halved by the end of 2010 and at the end of 2012 was down to \$42mn. Placements by Syrian banks (including the Central Bank) with banks in the major economies stood at \$16,310mn at the end of 2009, remained steady through 2010 before falling to \$2,328mn at the end of 2012. The fall in placements by Syrian banks reflects both the repatriation and spending of much-needed foreign currency, as well as the redeployment of funds out of the major international banking systems and into others where the reach of international sanctions is less keenly felt.

The Syrian banking system was one of the smallest in the Middle East even before the civil war. Assets of \$47.7bn at the end of 2010 represented 2.1% of the assets of commercial banks in the Arab Middle East. Private sector deposits of \$23.5bn represented about 2.2%. This was a little more than Oman and Tunisia. Private sector credit was equivalent to 23% of Gross Domestic Product – a very low figure in a region where banks dominate financial intermediation.

Non-Performing Loans Double or Treble

Income and net profit figures of the 12 listed banks have been fluctuating wildly as a result of revaluations of assets and as a result of loan loss provisioning. All 12 of the listed banks reported a doubling of non-performing loans (NPLs) in 2012 and in some cases a trebling or even quadrupling. Eight banks showed NPLs as more than 20% of their total loan portfolio.

Three of the 12 listed banks declared net losses for 2012 but income statements carry little meaning in the current Syrian environment. Quite apart from the exchange rate, which can turn revenue streams into losses, or vice versa, from one reporting period to another, the physical destruction of a client's businesses can render loans which were performing yesterday uncollectable today.

(Although the exchange rate has depreciated considerably during the last two years, it is interesting to note that the unofficial rate shows big fluctuations and at times can show significant appreciation as well as depreciation. The collapse of a country's exchange rate during a time of civil war cannot be assumed. For example, the Lebanese pound remained around \$1=LL3 for the first seven years of the Lebanese civil war and only started to slide after the Israeli invasion of 1982, with the really big devaluations happening in the late 1980s and early 1990s. As any seasoned Lebanese banker will tell you, militias expect to be paid in cash, and usually in dollars, so civil wars bring a lot of foreign currency into a country, regardless of whether the official sector is running low on its own foreign reserves.)

The State-Owned Banks Dominate the Banking System

The 12 listed banks account for about a quarter of banking assets and liabilities in Syria. The state-owned banks dominate the system but their financial statements for recent years are not available.

The Central Bank of Syria's public disclosure of aggregate banking statistics peters out in early 2011. Statistics for year-end 2010 show aggregated assets for the 20 banks at \$47.7bn (converting the Central Bank's Syrian pound figures into dollars at a rate of \$1=£45.79). State banks account for 71% of this. Note that not all private sector banks are listed on the DSE - Cham Bank and al-Baraka Syria are not.

Physical Safety and Hard Cash Are Crucial for Banking Activity to Continue

Looking ahead, the most obvious threats to the continuation of banking services in Syria are physical – the destruction of bank branches or security threats that prevent banks restocking their ATMs or prevent their staff from going to work. (In mid-June, the website of Arab Bank Syria announced that banking services had been discontinued at eight of its branches (out of 19), most of them in the south western corner of Syria, near the Lebanese border.)

The availability of physical cash in government-controlled areas will be another challenge for the banks. Much will depend on the willingness of the regime's foreign backers to facilitate the printing of local-currency bank notes and the provision of foreign currency notes. (It is assumed that rebel-held areas will continue to receive cash dollars from their foreign benefactors).

The state-owned banks will continue to support local industries, providing loans and not calling-in bad debts. They will be able to do this because the Central Bank of Syria will not enforce its own regulations. And because state-owned banks account for such a large part of the banking system, a significant part of the economy will be able to continue to operate as if all is well and everyone is paying everyone else on time. Again, it is when banking gets "physical" – for example, when wages have to be paid in cash, or foreigners paid in Dollars or Euros – that problems arise. If confidence in the regime declines, then, in regime-controlled areas, cash will become even more important than it is now. ■

The Lebanese Example

Lebanon provides a case study of a banking system which was able to quickly regain its footing and then move forward after a devastating civil war. In Lebanon's case, the war lasted fifteen years, entailed considerable physical destruction (though not on the scale being seen in Syria) and saw large-scale displacement of population.

Yet when rating Lebanese banks for Moody's just a few years after the war had ended and stable government established, I saw institutions that were well managed, entrepreneurial, profitable and solvent.

Before the war, Lebanese banks had been privately owned and they were managed by businessmen and financiers determined to make money. True, regulation was light, scandals occurred, and corruption widespread in the economy, but it was a dynamic environment always with an eye on the future.

Bank shareholders worked hard to protect their banks during the war, and when peace returned, the system benefitted from the return of thousands of young Lebanese who had spent the war years in London, Paris or the U.S. earning university degrees and developing a taste for high standards and good living.

Then there is the Central Bank. Supposedly the only institution not to be targeted during 15 years of war, but certainly one that retained its reputation and integrity, Lebanon's Central Bank has been a robust regulator, requiring its banks to comply with international norms. ■



Andrew Cunningham has spent more than 25 years writing, training and consulting on banking and finance, both in the Middle East and in Europe and the U.S.

Darien Middle East advises clients on international financial regulation and best practices in risk management and corporate governance. The firm was founded in 2010 by Andrew Cunningham and is based in London. The firm publishes regular briefings on financial markets under the title, Darien Analytics.

darien analytics
FINANCIAL MARKET ANALYSIS

Phone +44 (0)755 75 27 243
Email andrew@darienmiddleeast.com
Website www.darienmiddleeast.com