Bank Supervision and Surveillance: A Critical Case Study Analysis of the Bank of Commerce and Development (Libya)

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Abstract

This paper is based on desk research drawing on both theoretical and empirical literature on prudential regulation and supervision for the banking sector in Libya. The focus of the study is on the tools and techniques that the Central Bank of Libya uses to uncover and correct weaknesses in the banking system and to prevent bank failure from causing broader difficulties in the financial system.

In Libya, regulation of banking has come in the form of direct controls over items such as interest rates, volume of loans, allocation of loans to particular sectors and asset portfolios in addition to implementation of monetary policy.

Using a case study of Libya's only privately owned bank - the Bank of Commerce and Development, formal statutory controls have been examined. The study involved analysis of the regulatory framework set in place by the Libyan government and analysis of the Bank of Commerce and Development's annual reports from the bank's first annual report in 1997 to the latest report in 2002. The key prudential measures that were analysed include assets quality, liquidity, capital adequacy, earnings, and human resources management.

The main findings were that the Bank of Commerce and Development performed exceptionally well on all these measures, indicating that the Libyan's government's experiment on liberalising the banking sector appears to be working well. The main recommendations are that an insurance scheme (supervised by the Central bank of Libya) should be set up to protect investors in the case of bank overrun, the setting up of a legal framework to compel banks to publish more information on the results of inspections by the Central Bank and for the Central Bank to ensure that Libyan banks are prepared to work according to the Basel Accord by year 2007, both in terms of regulatory framework and technology.

1.0 Introduction

Bank regulation and supervision is an important aspect of the development of the financial sector. The soundness of banking systems in every country depends on the establishment of appropriate banking regulation and supervision. Banking regulations can be viewed as a set of incentives to shape the behaviour of bank's managers and the specific characteristics of the banking industry.

Although there exists an extensive literature on bank supervision and regulations, there is a very limited academic literature that discusses the implementation of bank supervision and regulations policies and procedures particularly in developing countries. Along these lines, the paper examines how the Libyan government regulates and supervises banks. An analyses of the performance of the Bank of Commerce and Development is carried out to find out how efficiently government regulates the private banks in Libya. Section 2 outlines the paper's research methods. Section 3 highlights the literature on bank regulation and supervision. The section 4 focuses on Libya's bank regulation and supervision policy and procedures. Section 5 considers the efficacy of bank regulation and supervision in Libya.

2.0 Research Methodology

Using a case study approach, this paper analyses and explores how the liberalisation of the Libyan banking sector affects the regulation of private banking by studying the regulation and performance of the Bank of Commerce and Development. The paper will focus on how the Libyan government is supervising and regulating the Bank of Commerce and Development in response to an already established theory which states that prudential regulation is often not accorded sufficient priority during economic liberalisation, with adverse consequences for financial fragility in the banking system, particularly when local private banks are established. This will be achieved by evaluating the effectiveness of prudential regulation and bank

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supervision in the Libya. The paper will specifically look at key bank performance measures used in supervising banks. These measures include capital adequacy, asset quality, management, earnings and liquidity ratios for the Bank of Commerce and Development.

3 Bank Regulation and Supervision

There are a number of reasons why banking regulation should be put in place. First, the customers need a degree of comfort and confidence that can be provided by regulation. Second, there is a possibility of the bank being tempted to adopt short-term strategies to maximise return. Third the failure of an individual bank may have contagious effects on other banks (Mishkin, 1996).

Regulatory agencies generally apply two types of regulation: prudential regulation and conduct of business regulation Llewellyn (1999).. Prudential regulation is applied to assist the customers when facing asymmetrical information problems where customers are not in a position to judge the safety and soundness of banks. The banks perform fiduciary roles for depositors.

Types of Regulation

The classic instruments for regulation are licensing, deposit insurance and prudential ratios. The prudential regulatory process commences with the screening of license applicants in order to prevent those with inappropriate professional qualifications, banking experience, financial capacity and ethical backgrounds from owning/managing banks (Maimbo ,2002). According to Polizatto (1990:176) at a minimum, prudential entry regulations should address the issues of capital, management qualifications, and the development of a reasonable business plan. He further suggested that independent supervisory authorities are responsible for bank licensing. The guidelines given by the Basel Committee on Banking Supervision (BCBS) issued in September 1997 states that: "The licensing authority must have the right to set criteria and reject applications for establishments that do not meet the standards set. The licensing process should consist of an assessment of the bank's ownership structure, directors and senior management, its operating plan and internal controls, and its projected financial condition, including its capital base.

Methods used to regulate and supervise banks

The technical methods used by regulators to supervise banks include off-site surveillance and on-site supervision. The main off-site supervision methods include estimation of ratios such as liquidity ratio, value of assets, capital adequacy, bank senior personnel and the bank's earnings. On site examinations includes the verification of the bank's books, with or without scheduled appointment.

The effectiveness of the prudential supervision is dependent on a number of variables such as enabling environment, effective of regulatory framework, the skills and competences of the regulators and banks management and the commitment of policy makers, depositors and investors towards the supervision process (Binhadi, 1994).

4 Prudential Regulation and Supervision in Libya

4.1 Regulatory structure

The agency responsible for regulating the banking sector is the Central Bank of Libya (CLB). The CBL falls under the Secretary for Finance for the government of Libya. The Libyan government wholly owns the CLB. However, the CBL enjoys the status of autonomous corporate body, operating under Libyan law. The day to day running of the CBL is entrusted to a board of directors, consisting of the Governor as chairman, Deputy Governor as Vice-Chairman, and six other members, who usually represent other financial and economic interests. The Governor is the chief executive officer responsible for the implementation of the policy of the CBL and the management of its affairs.

4.2 Supervision and regulation of banking activities by the CBL

The CBL examines and analyses the financial positions of Commercial banks thereby ensuring that that commercial banks keep within the main stipulated ratios such as the cash reserve, legal liquidity. The CBL Bank also issues directives to the commercial banks stipulating the volume and direction of credit extended by the banking sector. This is more so for credit for the more productive sectors of the economy. Officers from the CBL have the responsibility of carrying out inspections the commercial banks' books are examined and ensure the soundness of their financial positions and the accuracy of statistics, which these banks furnish, to the CBL. The CBL is also the lender of the last resort for the commercial banks.

4.3 Regulatory framework

The law governing the regulation of banks in Libya is the Law Number (1) of 1993

Concerning banking currency and credit. The relevant section of this law sates:

Regulate credit and banking policy and supervise the implementation thereof within the framework of the general policy of the state with a view to promote the national economy and achieve the development objectives. To accomplish these objectives the Bank may:

(a) Influence the direction of credit with regard to quantity, quality, duration and cost in such a manner as would ensure that the actual requirements of production and services in the economic activities are met.

(b) Take appropriate measures to deal with economic of financial disorders whether local or international.

(c) Supervise banking institutions to ensure their sound financial position, their good performance and safeguard the rights of their customers.

An interesting aspect of the above law is that the law makes it quite clear that the central banks will influence in activities such as determining the rates of interest (see paragraph *a*). This action is similar in some ways to what economies such as the UK and Germany the central banks do. Both the Bundesbank of Germany and the Central Bank of England, although independent, influence the quality, quality and duration of cost in a manner very closely similar to what the CBL does. This is because these central banks (Bank of England and Bundesbank) still determine the base rate and it is up to the individual bank to offer rates in a competitive way using the base rate as the guideline. The difference with the Libyan context is that the CBL is very much more involved in making decisions on interest rate and the amounts to be lent and to which sector the commercial banks must lend at stipulated rates.

4.3.1 Licensing of banks

One most popular way of regulating banks is by giving a bank the license to operate in a country. In Libya, for a bank to operate, it needs to be licensed by way of a permit. This permit is provided by the Secretary for Finance of the Libyan government whose decision is based on the recommendations of the Governor of the CBL.

However, for a bank to qualify for a permit, the bank must fulfil the following conditions: The existence of the new bank is not inconsistent with the exigencies of public interest. The name of the bank must not create ambiguity with already existing banks. Regarding ownership, the bank needs to have Libyan joint stock ownership within underwritten capital of at least Libyan Dinar (LD) of 3 million being distributed in nominal shares of less than 10 dinars each. This subscription should be allocated to Libyan members of the public of private entities of Libyan nationality. However, no individual should hold more than 1% of these allocated shares. Also, 'roots' and off springs cannot own more than 2% of total shares. Foreign banks are allowed to operate in Libya, but are subject to strict regulations. They need to approved by the CBL. Banks need approval before they can merge or acquire the other one or to cease trading.

4.3.2 Management

All commercial banks' chairmen and members of the board must be Libyan nationals and they cannot be board members of another bank. There are also stringent restrictions on the character of the members. Board members should within two weeks declare any share ownership in any company to the CBL. Foreign banks whose headquarters are outside Libya have to appoint local managers who are empowered to receive notices, including summons. The power given to this manager gives him the full responsibility before Libyan authorities. Any changes in the composition of the board should be reported to the CBL within 15 days.

Banks cannot lend to their employees anything in excess of the employee's one year salary and the terms of the loan must be the same as those of the public. This also applies to board members. For lending, banks cannot lend more than 20% of the capital, capital reserve and undistributed reserves to any one person.

4.3.3 Capital adequacy

Commercial banks must are required to maintain a reserve for the capital before prior to profit declaration. The banks must transfer no less than 50% of the profits into these reserves until the reserves are at least 50% of the paid up capital. Once this is reached, the banks must transfer 25% of the profits into the reserve until

the reserve equals the paid up capital. The law also stipulates that in addition to this sum equal to the paid up capital, banks must also keep in Libya funds equal to the total liabilities payable. For foreign banks, the funds kept abroad are regarded as part of available funds. Banks cannot pay dividends until its capital expenditure; administrative costs and any other expenditure items not covered by tangible assets have been written off.

Banks are also not allowed to offer mortgage loans, except for employees' housing. The only case banks can get involved in real estates is when they are settling debts on liquidation of a business. However, the bank must dispose of these real estates assets within five years. This practice contrasts with the UK, for example, where the liberalisation of the banking sector has resulted in commercial banks moving into the mortgages market.

Banks are also prohibited from owning more than 10% of paid up capital in other corporations. These shares must also not exceed 50% of the bank's paid up capital and reserve. However, the CBL has the freedom to increase these proportions. Banks cannot accept shares as security unless it is on liquidation or purchase stocks of other banks even if the other bank.

4.3.4 Quality of assets and audit

Banks have to two chartered accountants auditors to examine the annual accounts. These auditors cannot be related to board members, must not be employees and must not have borrowed from this bank. There are detailed instructions on what the auditors must do, including that the auditors must read their report to the shareholders at the annual general meeting. It is also the auditor's responsibility to file their report with the CBL. Banks should also display in a conspicuous position at all times a copy of the latest annual report showing the balance sheet.

The CBL requires the banks to submit monthly annual statements of the bank's financial position (on forms prescribed by the CBL) within 15 days of the end of the month. Some of the important information to be submitted on these reports include details on unsecured overdrafts, credit facilities made by the bank to companies in which the bank or its directors have interests. Annual reports should be submitted to the CBL within four months of the year-end.

4.4 On-site examinations

Shareholders who control 25% or more of the total shares issues or depositors with more than 50% of total deposits can apply to the CBL asking the CBL to inspect the bank or examine certain aspects. However, reasons for this request have to be provided. This inspection will be done by at least two people commissioned by the CBL. The expenses are paid either by the person who asked for the inspection or by the bank at the discretion of the Governor of the CBL.

4.5 Punitive measures

There are laws that are in place to deal with those breaking the rules of trading as a bank. These vary from cancellations of the permit to fines and imprisonment. The licence to trade can be cancelled if the conditions are violated. The decision to cancel the permit rests with the Secretary for Finance, on the recommendations of the Governor. However, there is also scope for cancellation of the permit as a result of the General Popular Committee.

In some cases, those who violate the rules can be made to pay fines, be imprisoned or both depending with the seriousness of the crime. Directors or managers can be charged as individuals. Where the banks break the regulatory rules, the chief executive/branch manager will be held responsible. They have to pay their fines – the banks are prohibited from paying the fines on behalf of them. There are various levels of penalties that are actually stated in the Banking Act. These, hopefully, are designed to act as deterrents.

The next section will use the case of the Bank of Commerce and Development (BCD) to analyse how well the regulation and supervision is working by analysing the performance of the financial records of the BCD using ratio analysis and other qualitative measures.

5 Analysis of the Regulatory Conformance by the Bank of Commerce and Development

5.1 The BCD

The BCD, which was incepted in year 1996, is the only privately owned commercial bank operating in Libya. Despite its rapid growth, the bank has only 6% of the share of commercial banking assets (Rating Development Limited, 2002). The banking structure of Libya has the Central Bank of Libya as the overall supervisor of banks and below it are five commercial banks and eight other specialist bank.

5.1.1 BCD's objective

The objective of the Bank is to exercise all banking, financial and development financing operations including complementary related or otherwise normally required for banking, financial or development activities, particularly the following:

1. Acceptance of time deposits, opening of current accounts, contracting loans and granting other credit facilities for various periods.
2. Collection and payment of orders, bills and other documents of value.
3. Issue of bills, cheques, notes and other commercial papers as well as credit cards.
4. Discount, rediscount and otherwise handle commercial papers of any kind whatsoever.
5. Issue of bank letters of guarantee of any kind whatsoever.
6. Opening confirmation and financing of documentary credits.
7. Financing of foreign trade through credit facilities to importers or the grant of advance financing to exporters.
8. Exercise the business of investment trustees and participate in financing productive projects after ascertaining their soundness.
9. Granting of short term facilities and loans to persons, cooperatives, collective companies as well as public or private service share companies.
10. Granting of mid-term and long-term for construction, industrial, tourist or agricultural investment after approval of the appropriate authority.
11. Offering counsels in the field of investments and project financing.
12. Undertake banking and financial operations with commercial banks in the Jamahirya consistent with Law No 1 of 1993 and the Libyan Commercial Code.
13. Acts to achieve the objectives of development by endeavouring to adopt agricultural projects and services with a view to reduce dependence on imports from abroad (production to substitute imports system) or increase exports (exports oriented production system) to save foreign currency needed for development purposes.
14. Create and make available savings and investment channels appropriate to the development by employing the proceeds of such channels in mid-term and long term investments to satisfy the aspirations of depositors and within the safety and profitability considerations of both depositors and the bank.
15. Train and enhance capabilities of national staff in the banking sector in conjunction with the appreciate authorities.

5.2 Management of the Bank

The BCD has a 40-item 'Articles of Memoranda,' which states very clearly how the bank is expected to operate, including the appointment and role of the board and of senior managers. There is a powerful Supervisory Committee (appointed for a four year period), whose functions include the setting up of the remuneration of board members.

5.2.1 The board of directors

A board of directors consisting of a chairman and eight members including the vice-chairman conducts the management of the bank. The board members' appointment and their remunerations are determined by the General Assembly. The conditions provided in Law No 1 of 1993 in relation to the membership in the board of directors of commercial banks must be satisfied. The term of the board of directors is four years from its appointment and in the event of expiry of this term before the approval of the balance sheet for the preceding year, the board continues until the balance sheet is approved.

The Board of Directors shall be responsible for the management of the bank and shall to that end exercise all actions and activities it deems fit to attain its objectives, with the exception of the matters within the competence of the General Assembly, without limitation of its powers.

5.2.2 Auditors

It is the responsibility of the auditors to ensure in particular that the bank's accounting books are kept in accordance with the legal and orderly prescribed manner and ascertain that the balance sheet and the profit and loss account are consistent with the accounts books. Auditors must draw up a report on their findings stating the methods applied to verify the assets, how such assets were valued and the manner in which the outstanding obligations were assessed. Auditors have the responsibility of stating whether the banking operations they audited are not contrary to the law. They must send a copy of the report to the Central Bank.

5.3 Qualitative and ratio analysis of the BCD

This section describes the ratios used to analyse the asset quality, liquidity, earnings and capital adequacy, together with other qualitative variables such as management and ownership of the bank. Appendix 1 and 2 respectively shows that data on the Balance Sheet and the Income Statement compiled from annual reports produced by the BCD for the period 1997 to 2002, while Appendix 3 presents calculated ratios and other variables. Each of the ratios is interpreted individually, before collective opinion is formed on the overall condition of the BCD. No explicit mechanism exists to consolidate the ratios into a single measure of performance. The CAMEL model is clearly being used primarily as a ratio based financial analytical tool of univariate nature.

5.3.1 Asset quality

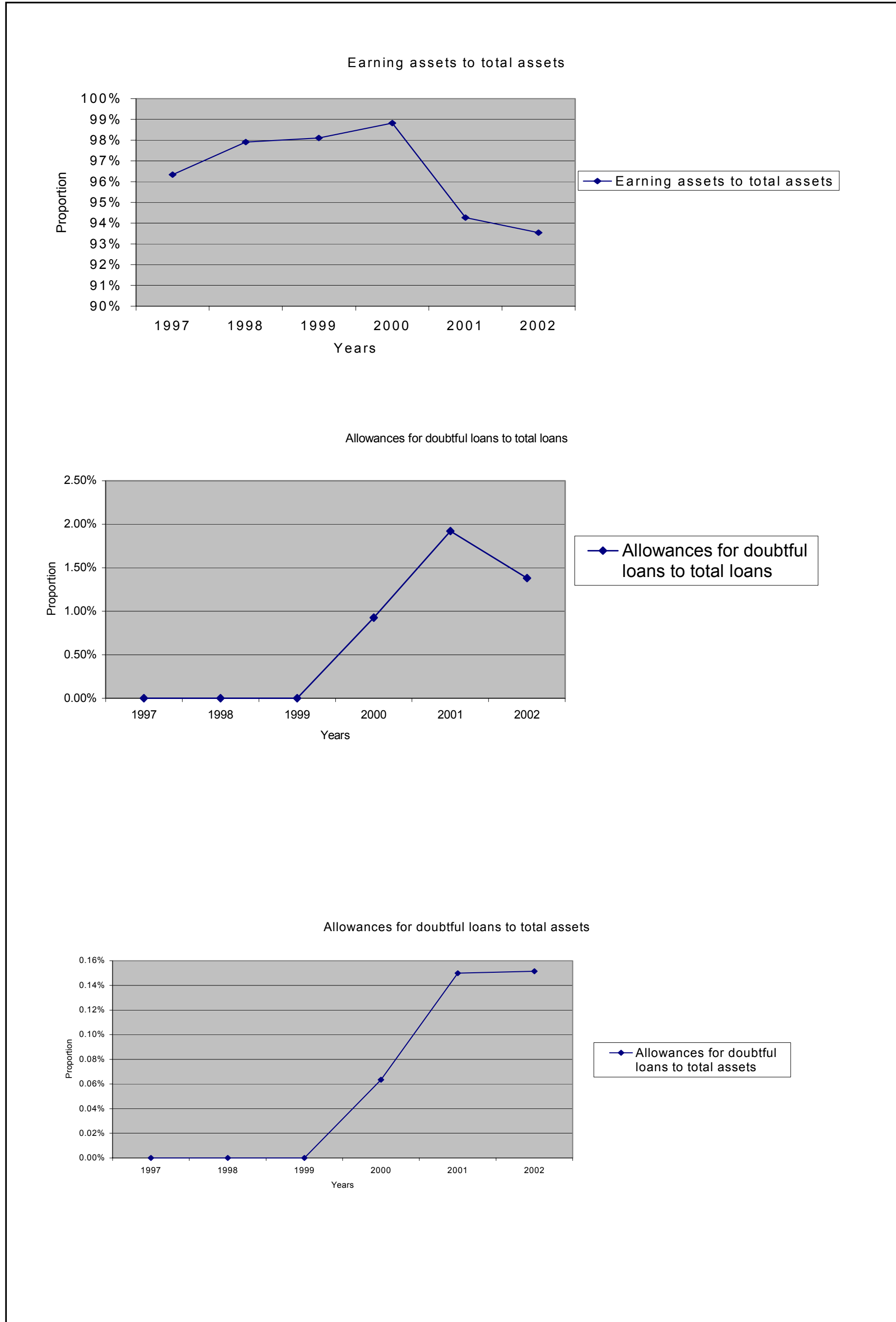
The assessment of a bank's asset quality is a good area to begin any analysis of a bank's overall financial condition. This is because conclusions regarding the financial condition of the bank and the quality of management are weighted heavily by the asset quality component. It is always an important consideration in determining capital adequacy. Asset quality also tends to affect the evaluation of other components such as the validity of earnings and the adequacy of capital and liquidity.

The primary measure of asset quality is the quality and level of earning assets of the bank as a proportion of total assets. In analysing the BCD, the following rations were used - earnings assets to total assets, allowance for doubtful loans to total loan, and allowance for doubtful loans to total assets. One other commonly used ratio is the ration of non-performing loans to performing loans or total assets. It was not possible to use this ratio because the CBD does not provide figures on non-performing loans. However, the figures for the bank's provision of doubtful debt are a very close proxy of non-performing loans.

Figure 5.1 shows the pattern of trend of the quality measures for time period years 1997 to 2002. The earnings to asset ratio increased during the first few years since the bank was started, with a value of 96% and peaking at 99% in the year 2000. Since then there has been a declining trend and the latest rate in the year 2002 was 94%. The important point is that the higher this ratio, the better it is because it means more of the assets owned by the bank are there to directly generate cash (not items like buildings and vehicles). These are real cash generating assets, which implies that most of these are in monetary value. Although there was a decline to 94%, it is still a good performance for a bank.

The ratio of allowance for doubtful loans to total loans rose in the years 2000 and 2001 and declined in 2002. No provision for bad debt was made during the first three years. The peak was in year 2001, where this ratio was 2%, declining to 1.5% in 2002. Again, this is a very good performance by the bank as provision for bad loans is below 2%. A similar pattern emerges for the ratio - allowance for doubtful loans to total assets. This started to increase from the year 1999 to the year 2001 before stabilising and levelling of in the year 2002.

Figure 5.1 Asset quality – BCD



5.3.2 Earnings

A bank enjoying a good favourable position in the industry tends to have solid sustainable earnings generated from normal banking activity, generally referred to as the core earnings to differentiate them from the one-off non-sustainable types of bank income. If a bank has poor earnings, it is bound to be vulnerable to many adverse situations that can be weathered by a bank with good earnings.

For the BCD, three key ratios were calculated to measure the earnings, together with the trends in profitability and dividend payment. These ratios were: return on assets (income before tax/assets at year end); return on equity (income before tax/shareholders equity); and net interest margin ((interest income – interest expense)/interest income).

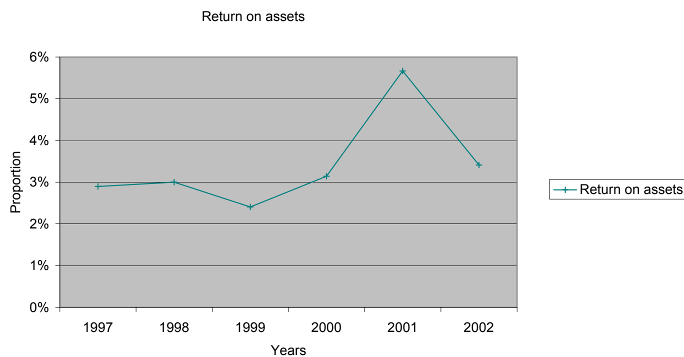
The results of the above ratios are shown on Figure 5.2. The return on assets measures the net income generated from the employment of all assets. From Figure 5.2 it can be seen that the return on total assets has been averaging around 3%. Compared to Western banks'standards, this is an acceptable return on total assets, particularly as the BCD is a new bank, which is still accruing assets such as buildings, which get depreciated over many years.

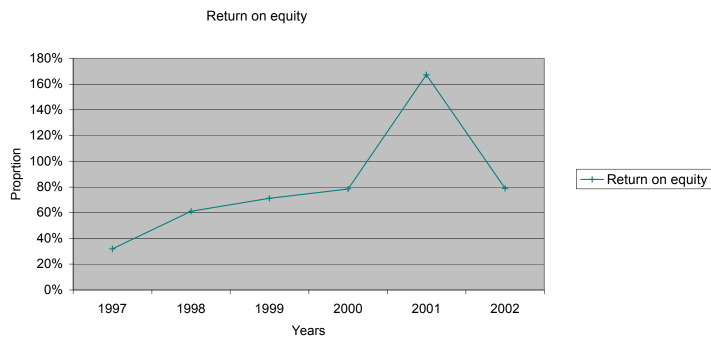
The return on equity measures the rate of return on the shareholders equity investment. For BCD the return on equity has risen sharply, from 30% in year 1997 to over 167% in year 2001, declining to 80% in year 2002. Given the very low rate of inflation in Libya (averaging less than 5%), the performance of this measure is excellent.

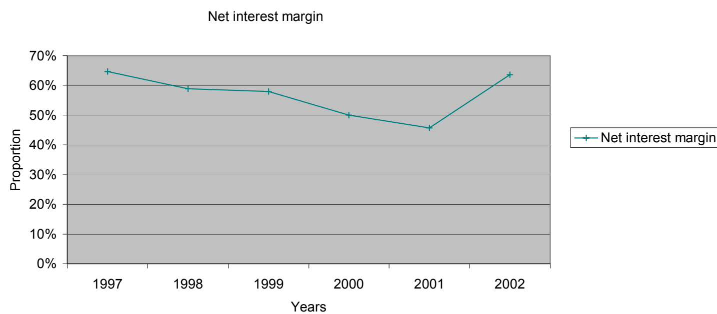
The net interest margin identifies and evaluates the core earning capacity of the bank. The BCD's interest rate margin consistently declined from 65% in year 1997 to 55% in year 2001, but rose again to just less than 65% in the year 2002. Only when the decline is sharp and consistent or when the ratio is negative can a bank be considered to be doing badly.

In monetary terms, the earning per share increased from 0.92 Dinar Dirhams in the year 1997 to 16.15 Dinar Dirhams in year 2001. Based on these results, when measured on the earnings variable, the BCD is doing very well.

Figure 5.2 Earnings- BCD







5.3.3 Liquidity

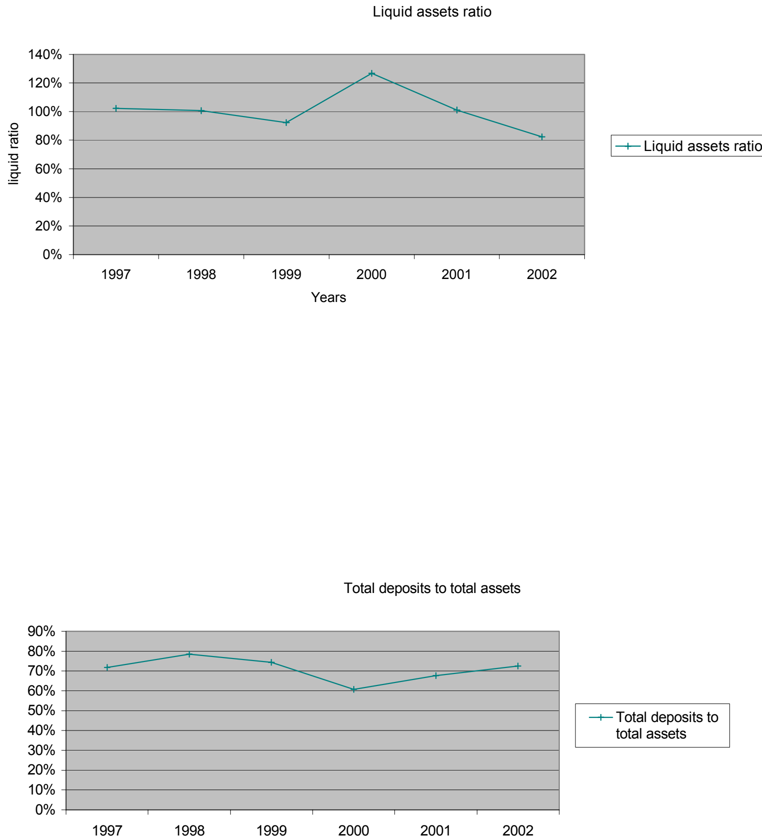
Liquidity represents the ability of the bank to efficiently and economically accommodate decreases in deposits and other liabilities. Measurement of liquidity is complex but a combination of liquidity ratios such as liquid ratio (that measures the bank's ability to meet short term liabilities) and other factors such as the nature of the bank's deposits (eg the proportion of demand deposits) and whether the bank is a net borrower or lender in the inter bank market. Figure 5.3 shows the results of the liquidity ratios.

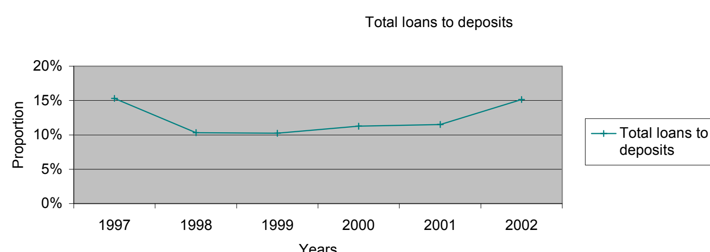
The liquid assets ratio – short term assets (including cash from the CBL and deposits with other banks) to short term liabilities – has been hovering around the 100% mark, indicating that the bank can meet its short term commitments. This ratio declined to 80% in the year 2002. However, this decline should not be a cause for major concern because the other two measures of liquidity show a robust performance.

The ratio of total deposits (core deposits) to total assets has consistently ranged around 70%. This ratio measures the extent to which the BCD's assets are financed by the deposits of its customers. The greater the ratio the greater the bank's vulnerability to liquidity in the event of a run on the bank. However, if the ratio is also too low, it means the bank is not doing enough core activity – that of borrowing and lending money. Hence this ratio of 70% appears to be reasonable.

The gross loans to total deposits ratio is ranging between 10% and 15%. This ratio measures the extent to which a bank is able to mobilise deposits from the public to support its operations and the extent to which it is able to lend these deposits. A higher ratio is traditionally associated with a greater element of risk, since this indicates lower liquidity vulnerability to institutional lenders, adverse economic conditions and or the consequence of a deposit run. The literature suggests that a ratio of 50% is adequate. This means that the BCD is very risk averse as this ratio is only 15% at the most. It implies that the bank is very safe against the likely problem sources mentioned here, but is also implies that the bank may be under utilising the deposits. Depositors may therefore not be making as much return on their banks compared to banks whose ratios are nearer the 50% benchmark. However, from a regulator's perspective, this low ratio shows that the bank is very safe.

Figure 5.3 Liquidity - BCD





5.3.4 Capital

The main reason for analysing capital is to check if the bank has enough equity to support the risk on its balance sheet, whether the asset growth is being supported by proportionate equity growth and whether capital is being eroded by excessive dividends. The factors include the bank's regulatory capital position, and a discussion of the capital adequacy ratios is also included.

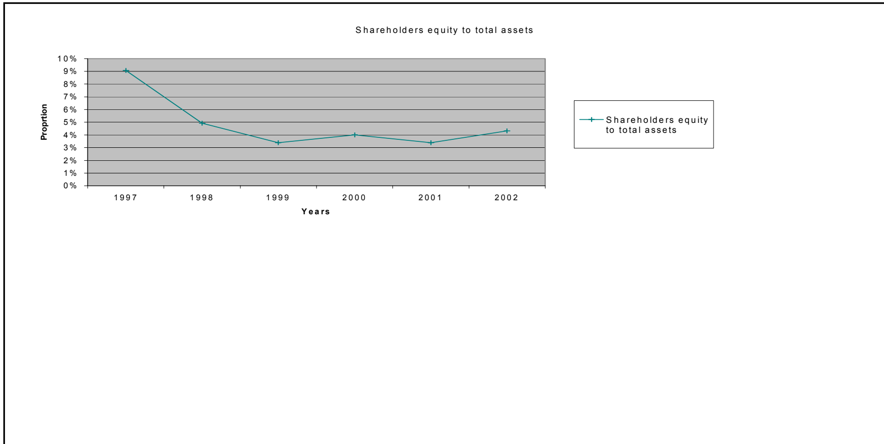
The most commonly used measures of capital are the ratios on shareholders' equity to total assets; debt to shareholders' equity and net non-performing loans to shareholders equity. The results of these ratios are shown on Figure 5.4.

The ratio of the shareholders equity to total assets was 9% when the bank started operating in 1997. This declined to around 5% in year 1999 and it has kept around this range up to date. This ratio is a crude measure of the extent to which the bank's assets are financed by the shareholder's equity. This ratio means that the shareholders' risk is only 5% of the total assets. Hence, in the event of a collapse, it is the depositors that are more likely to lose out. Hence a bank with such a low ratio needs to be supervised carefully since the owners have less to lose compared to depositors.

The debt to shareholders' equity ratio (also known as leverage ration) started off at 200% rising to above 600% in the year 1999 but has since stabilised at around 400%. This means that the basic net worth at this point in time is four times the value of the equity.

The ratio of non-performing loans to shareholders equity was measured using the provision of bad debt as a proxy for non-performing loans because no data was available on the value of non performing loans. This ratio measures the severity of non-performing loans to shareholders equity. For the BCD, this ratio was zero for the first three years, rising to 4% in year 2000, then to 9% in year 2001 and to 11% in year 2002. This implies that the shareholders' equity has now been eroded by 10%. The importance of this erosion depends on how much profit the bank is making. As mentioned earlier, the bank's profit has been rising sharply, indicating that the 10% erosion may not have much of a significant effect.

Figure 5.3 Capital – BCD



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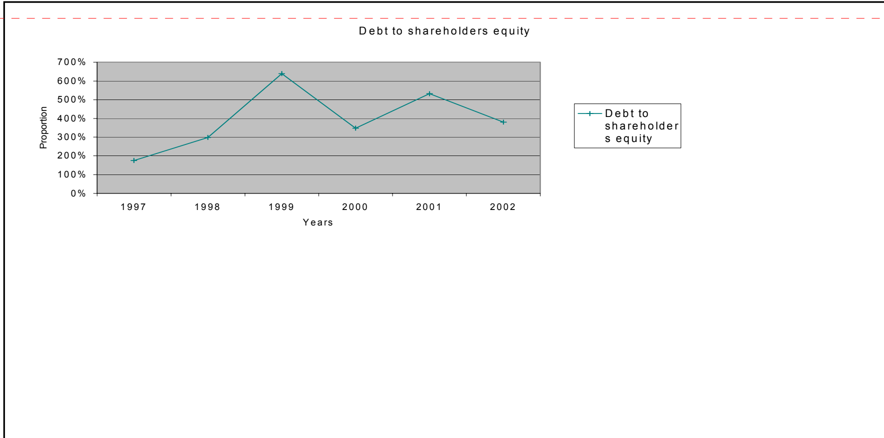

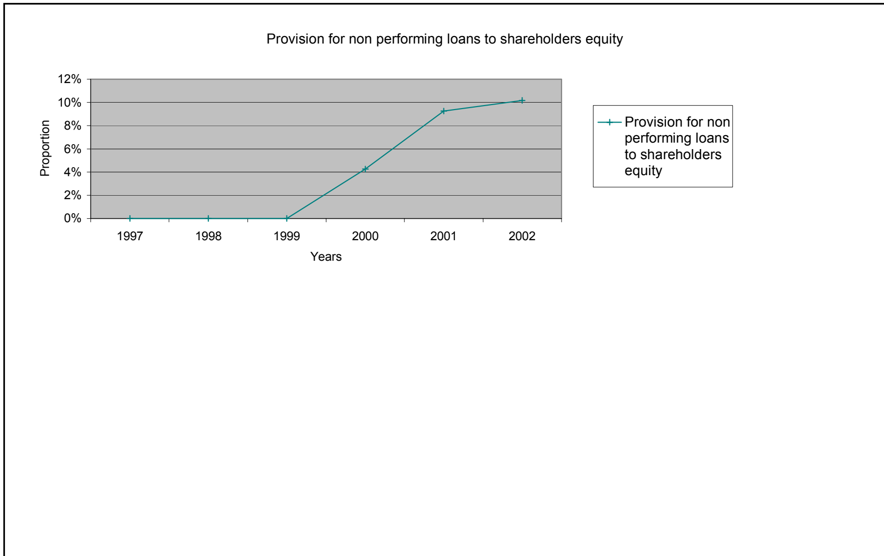

5.3.5 Management

The BCD has a strong management team. The management structures shows a bank that has checks and balances, although the only weakness is that the Chairman of the board is also the General Manager – he may be too powerful. According to the Rating Development Agency (2002), the Chairman/General Manager, is "…*widely respected within and outside the bank and has attracted a highly qualified and management team. Under the Chairman, managers appear to be well motivated and efficient, and many capable officers in state banks have applied to join the BCD*."

The bank has adequate internal controls with one or two internal control staff in each branch. While the Chairman has full authority, there are 50 other managers out of a total of 186 employees, who are signatories. The bank's annual reports lists all the senior managers and their qualifications, indicating how confident the bank is on the quality of its managers. Among the senior managers is the Manager of Internal Audit and Inspection. The fact that a senior manager occupies internal audit and inspection is clear indication of the bank's perception that this is a very important function.

5.3.6 Profitability and dividends

The bank's profitability is strong and well managed, with the net income rising steadily from LD 0.2 million to LD 5 million in 2002. The underlying profits on average assets are averaging around 3%, which is more than twice the industry average of 1.3%. The return on average core capital is also for the years 2000 to 2002 averages to over 30%, against an industry average of 20%. Expenses are growing at a rate lower than revenue, particularly revenue generated form foreign currency sales. For example, in 2001, operating revenue as a percentage of assets were 5.6% for BCD as opposed to 2.5% for the market, while that for expenses were -1.3 compared with the industry average of –1.0%.

The risk with the bank is that it is still small and in case the bank fails, the government may decide to rescue it. However, if the current performance is sustained, the bank will soon be 'too big to fail.' The dividends paid to shareholders translate to 15% return on capital. This very high return is bound to keep the shareholders happy and they are more likely to invest in the bank's expansion programmes.

5.3.7 Ownership

As required by the regulators, there is a widely dispersed ownership pattern of the BCD. According to Libyan laws, the maximum share ownership of one enterprise is 5% of a bank and the maximum for individuals is 1%. As shown on Table 5.1, the bank is complying with this law. It is also interesting to note that even the largest five shareholders have in total only 26% of the bank's total shares. The major investors are also from different industry types. The bank has a total of 1697 individual shareholders and 38 enterprise shareholders. These 38 include the 50 founding investors.

Table 5.1 Proportion of major shareholders for BCD

Company	Share (%)
Libya Insurance Company	5
Islamic Call Society	5
Al-Tahaddi Construction Company	5
General Pipes Company	4
Libya Auto Club	2
Safaa Construction Company	1

5.4 Conclusion

This section has presented a detailed analysis of the BCD with the view of establishing how the bank is performing in relation to regulatory requirements. The main tool for analysis was the calculation of ratios of key CAMEL variables to determine the trend for the six-year period – 1997 to 2002. The major findings are that the bank is performing exceptionally well on all measures, which include asset quality, capital adequacy, earnings, liquidity, profitability, management (personnel) and other qualitative factors. The bank is also not violating the share ownership regulation, with no individual company or individual owning more than 5% or 1% respectively of the total shares of the bank. The only potential weakness is that the Chairman is also the General Manager (he may be too influential), although there is a strong board and senior management with significant levels of responsibility and accountability.

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Appendices

Appendix 1 BCD Balance Sheets 1997-2002

	A	B	C	D	E	F	G
2	**BCD Balance Sheets 1997-2002**						
3	(Monetary values are in million Dinars)						
4		**1997**	**1998**	**1999**	**2000**	**2001**	**2002**
5	**ASSETS**						
6	Cash and balance with the Central Bank of	11.2	25.2	36.4	57	90.5	73.5
7	Deposts and other balances with banks	30.8	70.9	112.2	192	191.9	199
8	Investments	0.6	0.6	5.6	5.8	5.9	51.3
9	Loans and advances	5.7	8.9	13.3	21.6	26	43.5
10	Accounts receivable and other debtor	1.6	2	3.6	35.1	0	3.2
11	Buildings under construction					13.9	4.3
12	Other assets						17.6
13	Fixed assets	1.8	2.4	3.3	3.6	5.2	6.7
14	**Total assets**	**51.8**	**109.9**	**174.4**	**315.2**	**333.4**	**396.1**
15							
16	**Liabilities and owner's equity**						
17	**Liabilities**						
18	Customer deposits - Current a/c	31.9	76.3	116.2	167.8	202.5	246.8
19	Customer time deposits	2.8	4.9	2.7	11.2	6.1	17.2
20	Savings deposits	2.5	5	11	12.6	17	23.2
21	Cash securities	1.8	2.2	0.8	66	24.9	13.9
22	Certfied cheques margin			0.8	66.9	24.5	35.5
23	Various provisions					4.5	0.6
24	Accounts receivable and other liabilities	8.2	16.1	37.7	43.8	60.1	65
25	**Total liabilities**	**47.1**	**104.5**	**168.5**	**315.2**	**322.1**	**379.2**
26							
27	**Owners' equity**						
28	Capital	4.5	4.5	4.5	9	9	9
29	Legal Reserve	0.1	0.5	0.9	2.3	2.3	6
30	General Reserve	0.02	0.02	0.02	0.04	0.2	0.7
31	Various Provisions			0.4	1.2	0.2	2.2
32	**Total owners' liabilities**	**4.7**	**5.4**	**5.9**	**12.6**	**11.3**	**17.1**
33	**Total liabilities and owners' equity**	**51.8**	**110**	**174.4**	**315.2**	**333.4**	**396.1**
34							

Appendix 2 BCD Income Statements 1997-2002

	A	B	C	D	E	F	G
2	**BCD Income Statements 1997-2002**						
3	(Monetary values are in million Dinars)						
4		**1997**	**1998**	**1999**	**2000**	**2001**	**2002**
37	**Revenue**						
38	Interest income	1.7	3.4	5.7	6.8	9.2	11
39	Interest expense	0.6	1.4	2.4	3.4	5	4
40	Net Interest income	1.1	2	3.3	3.4	4.2	7
41	Commission and other revenue	0.5	1.3	0.9	6.5	14.7	6.5
42	**Gross income**	1.5	3.3	4.2	9.9	18.9	13.5
43	**Total expenses before tax**	**1.1**	**1.4**	1.8	2.8	4.4	3.5
44							
45	total net profits	0.2	0.7	0.9	2.7	6	5.4
46							
47	**Appropriations**						
48	legal reserve to 50% capital	0.1	0.4	0.5	1.4	2.2	1.4
49	general reserve	0.02	0	0.02	0.02	0.02	0.57
50	provision for reserves					1.3	0.9
51	dividends		0.4	0.5	1.1	1.8	1.8
52	remuneration - board of directors (5%)		0.02	0.02	0.07	0.2	0.2
53	provision for doubtful debts			-	0	1	1
54	retained earnings	0	0	0	0	0	0
55							
56	**EARNINGS**						
57							
58	Eaning per share before tax (in Dinar	0.92	4.2	5.36	7.84	16.15	
59							

Appendix 3 BCD Ratio Analysis 1997-2002

	A	B	C	D	E	F	G
2	**BCD Ratio Analysis 1997-2002**						
4		**1997**	**1998**	**1999**	**2000**	**2001**	**2002**
59	**RATIOS**						
60	**Capital**						
61	Shareholders equity to total assets	9%	5%	3%	4%	3%	4%
62	Debt to shareholders equity	174%	298%	639%	348%	532%	380%
63	Provision for non performing loans to	0%	0%	0%	4%	9%	10%
64							
65	**Asset quality**						
66	Earning assets to total assets	96%	98%	98%	99%	94%	94%
67	Allowances for doubtful loans to total loans	0.00%	0.00%	0.00%	0.93%	1.92%	1.38%
68	Allowances for doubtful loans to total	0.00%	0.00%	0.00%	0.06%	0.15%	0.15%
69							
70	**Earnings**						
71	Return on assets	3%	3%	2%	3%	6%	3%
72	Return on equity	32%	61%	71%	79%	167%	79%
73	Net interest margin	65%	59%	58%	50%	46%	64%
74							
75	**Liquidity**						
76	Liquid assets ratio	102%	101%	92%	127%	101%	82%
77	Total deposits to total assets	72%	78%	74%	61%	68%	73%
78	Total loans to deposits	15%	10%	10%	11%	12%	15%
79							