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Reading List

"Libya beyond the Revolution: Challenges and Opportunities (IMF)

Qatar's Masraf al Rayan seeks nod for Libyan bank stake buy (Reuters)

Libya says pushing forward with Islamic finance plans (Reuters)

Libya approves Islamic banking law – official (Reuters)

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Challenges & Opportunities for Islamic banking in Libya

In the wake of the Arab Spring, the Libyan banking system faced a crisis of confidence amidst a shortage of currency, despite the government monetizing its deficit by issuing bonds to the Central Bank and withdrawing the proceeds to finance the budget deficit. To stem the flow of cash out of the country's banks, the central bank placed caps on the amount of currency depositors could withdraw. In June 2012, the central bank lifted these limitations.

Prior to the lifting of the limitations on withdrawals, the government approved an Islamic banking law, which was expected to go into effect by the end of 2012 (it is not clear whether it has yet). Even with the Islamic banking law still being implemented, Qatari Islamic bank Masraf al-Rayan said it is seeking approval from its shareholders to acquire an unnamed Libyan commercial bank.

Since there are currently no Islamic banks to speak of in Libya, any acquisition by Masraf al-Rayan, which is a wholly Islamic bank, would have to be converted from conventional to Shari'ah-compliant following an acquisition. In most cases, the process is difficult because banks hold most of their assets in conventional loans that have to either mature or be converted from interest-based to Shari'ah-compliant. As a result, most Islamic bank conversions are done over a multi-year period.

Within Libya, the process of converting the bank's assets might be easier due to the high levels of liquid assets held in the banking system. A 2012 IMF report (PDF), Libyan banks held 74.3% of their total assets in the form of liquid assets (mostly deposits with the country's central bank) as of 2010. The remaining assets that were loans had a high level of non-performing loans, 17.2% in 2010, but the banks were well capitalized with regulatory capital as a share of risk-weighted assets of 17.3% and the ratio of provisions to non-performing loans was 85%.

Of course, these figures were from 2010 before the revolution toppled Muammar Qaddafi. As a result, the NPL has likely risen substantially, particularly since many loans were likely made to those connected with the former regime. In addition, the assets put up as collateral for these loans is likely to be confiscated by the government, so the recovery rate on the regime-connected NPLs will be high.

An Islamic bank entering the market through an acquisition (perhaps of one of the central bank-owned commercial banks) will have to likely write-off many of the existing assets, while also stemming the tide of withdrawals by depositors. The links to the reports on the Central Bank website on more recent statistics on the banking sector are broken, so it is hard to tell whether there are publicly available data on the deposits held today by Libya's banks.

That being said, however, there will be an easier process of shifting borrowers and depositors into Shari'ah-compliant products since many of the few loans made are likely to be in default and need to be written off. On the liability side, the bank can provide depositors with confidence in their deposits through the bank's link with its new parent bank, as well as holding up its status as one of the country's few Islamic banks (assuming other Islamic banks open once the Islamic banking law takes effect). Even if depositors do withdraw their deposits, the banks' high levels of liquid assets should make a bank run that threatens the bank's solvency a relatively remote risk.

Once the bank's balance sheet is stabilized and the loans written off that need to be written off, what can a foreign-owned Islamic bank offer to the country? One of the main things that a foreign owned bank of any kind—conventional or Islamic—can offer is management expertise.

With a mostly state-owned banking system formerly directed by the former regime, there are likely to be few skilled people working in the top levels of these banks with the necessary experience to run a private sector bank particularly for an Islamic bank, since they have been absent from the market. There will—and should—be an effort by a new Islamic bank to attract Libyans who have been living outside Libya with experience in Islamic banking to return while training programs are established to provide the necessary training of Libyans to work in the bank.

There should be a focus also within the bank on providing financing for the non-oil sector which was growing prior to the Arab Spring which represents a small part of the economy (less than 30% according to the IMF) and a negligible part of the country's exports. These are areas that would benefit the country the most, although that is not necessarily the grounds by which an Islamic bank will prioritize its activities. But, this type of business would likely provide the greatest return to the country in terms of employment increases. With a small private sector there should be opportunities that other commercial banks have not yet targeted that can be profitable for the bank while also facilitating the development of the 'real economy'.

It is not likely to be an easy path for a bank like Masraf al Rayan to acquire a Libyan commercial bank and convert its operations to become Shari'ah-compliant, let alone then go and make it profitable. However, there is likely to be a source of stable depositors in the country for a bank that can offer Islamic banking and also leverage its management's experience to project a level of security that the bank will remain solvent and its depositors' money will be protected. That will provide it with the resources it needs to make a contribution to the economic growth of the country's 'real economy', hopefully including the non-oil private sector.

Until next week,
Blake Goud

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