Libyan Bank of Commerce Case Study

Background

The Libyan Bank of Commerce (LBC) was established in 1902 as a private commercial and trade bank. As part of the 1970 bank reforms, LBC was taken over by the Libyan government and became one of the biggest providers of finance to the hydrocarbon industry. Recently, the bank was permitted to sell a 17% ownership stake to a large Italian bank, which is expected to help LBC modernize and participate in global finance through trade finance and foreign exchange.

The management of this bank includes the following people:

Habib S. – Chief Executive Officer (CEO)
Naser M. – Executive Vice President, Head of Corporate Lending
Abdul-Hakim R. – Vice President, Head of Operations Department
Maurizio C. – Executive Vice President, Chief Risk Officer

For purposes of this case study, you are Mustafa L., Senior Vice President and Deputy Head of Risk Management. You report to Maurizio C. in the Risk Management Department. This department was formed nine months ago, and before that you were Vice President in charge of the Operations Department. You received a promotion to come to the new Risk Management Department, and at the time you were told you were going to manage the department, but when the Italian bank took an ownership position, they demanded that one of their managers, Maurizio C., become head of Risk Management. Maurizio's family has a background in Libya but left the country many years ago. Maurizio was born in Italy and knows some basic Arabic from his family, but you have found that he has difficulty understanding and communicating with LBC management and staff. While he has experience in modern risk management techniques, you feel you have to be his translator much of the time, and you resent having to do part of his job as well as your own. The only other employee in the Risk Management Department is an administrative assistant.

For the moment, Maurizio wants you to help him establish modern risk management practices at LBC, and therefore he has instructed you to work on new risk management analysis and reporting. To begin this work, you have begun meeting with Naser in Corporate Lending, and Abdul in Operations.

Corporate Lending

Naser has agreed to send to you every month the loan balances for all corporate clients. He also has a report that shows the limits for credit exposure to each client. These limits are set by CEO Habib, and you have noticed that each client receives one limit, expressed in dinars, that covers the sum of all loans and trade finance to the customer. You wonder whether this limit is effective. Should there be separate limits, one for credit and one for trade finance? Also, you notice that the credit limit covers all maturities of credit.

Should there be separate limits for short term loans and long term loans? At the moment, there is no calculation of potential credit loss on any of these exposures. You wonder how you should go about that type of analysis.

When you ask Naser who is monitoring situations where a customer's total exposure exceeds the limit, he said that he does that personally. He keeps notes on his desk about overages, and makes sure someone calls the customer to fix any problems. If the problem can't be fixed right away, he tells CEO Habib.

When you first review the report, you see that some of the bank's biggest customers are not included, such as Libyan Petrochemicals Ltd. It is well known throughout the bank that this company is close to CEO Habib – his brother-in-law is the chairman of Libyan Petrochemicals, and his nephew heads the finance department of this company. Naser tells you that because of the high level attention this company receives from CEO Habib, there is no need to include it on the reports. He says CEO Habib would never let LBC lose money on this account, because he and his family have a large personal ownership stake in LBC. Also, CEO Habib is close to the Libyan Government and knows people who can help with problems if they come up.

Operations Department

Abdul-Hakim R. is an old friend of yours who used to work for you when you were head of Operations Department. You recommended him to take over the department after you left. Your second choice was Yasmin Z., but she did not have as much experience as Abdul, even though she was a more organized person. Also, Abdul has a friendly personality and is well-liked in the bank, whereas Yasmin is a quieter person who does not know as many people.

You have set up a reporting system with Abdul that allows Risk Management to receive weekly reports on all payments and settlements for credit or operational risk. These reports include the total of all payments and settlements processed, and they identify any late payments either by the bank itself or by customers. You notice on these reports that there has been a 15% increase in late payments by the bank, and when you ask Abdul about this he says a systems conversion to automated payments has had some difficulties but the problems are being worked out.

Later on, though, you meet in the hall someone who works in the Operations Department whom you have known for a long time. This person tells you confidentially that Abdul had insisted on doing the system conversion without a thorough testing period, whereas Yasmin had insisted that there be a manual check to be sure all names and account numbers matched before the new system was put in use. Abdul ignored Yasmin's recommendation, and now that payments are going wrong, Yasmin and her staff are going through each account and finding many errors that could have been prevented through a manual check. This person also told you that Abdul has lost the respect of the department because of this, but you are aware that this person has never liked Abdul and tends to overstate problems.

When you look at a separate report that lists customer payment failures, you notice that Libyan Petrochemicals is 24 days past due on its largest loan from the bank. The Tripoli newspapers are reporting that Libyan Petrochemicals is having problems with its cash flow, because it has very large debts taken on when oil was over $100/bbl. The company's revenues have collapsed now that oil is under $50/bbl.

In talking about this late payment with Maurizio, you were hoping he would bring the matter immediately to the attention of CEO Habib, but he will not do so. He recommends you call your friends at other banks to see if they too are having problems with payments from Libyan Petrochemicals. You suspect Maurizio's relationship with CEO Habib is not very close, especially since CEO Habib speaks no Italian and Maurizio's Arabic is very limited.

You then decide to discuss the matter with Naser in Corporate Lending. He says it is "not yet time" to bring this matter to the attention of CEO Habib. Naser has heard of the problems with missed payments in the Operations Department, and he thinks Libyan Petrochemicals probably made the payment, but it has been lost within the bank. He instructs you to work with Abdul in finding this missed payment. He says one of the reasons the Risk Management department was set up was to fix problems like this, and he says your pay and your promotion are dependent on the success of the lines of business. Therefore it is in your interest to help fix this problem and prevent any potential losses for Corporate Lending.

Your experience in the bank tells you that CEO Habib is very friendly with customers and government officials, but inside the bank he is known to get very angry if things go wrong. People are afraid to bring problems to him. You wonder, therefore, how he should be informed about the Libyan Petrochemicals problem if in fact they have missed their payment. Should you bring the problem to him personally, or should you wait to see if the problem gets worse so that the executives are forced to get involved?

In the meantime, you have on your calendar a meeting next week with Maurizio plus officials from the Libyan Central Bank. The meeting is to discuss compliance with a new anti-money laundering report that all banks will have to file with the central bank. To meet the requirements of this report, Risk Management is going to need to identify large cash payments made for customers. You wonder how you will comply with this report, since currently the bank has no easy way to isolate cash settlements from electronic settlements. Secondly, the central bank wants LBC to start filing market risk reports. You think this will be much easier because the bank has no trading and therefore no direct or indirect market risk.

Your assignment: Working with your group, list the risk management problems Mustafa must deal with. What should Mustafa recommend about each of these problems? Identify which problems are the most urgent, and which can be solved later.