Policy and Regulatory Framework

for Microfinance in Syria

January 2008

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Currency Equivalents

Exchange rates for the Syrian Pound (SYP) as of 7 September 2007:

Euro (€)	=	69.97 SYP
U.S. Dollar ($)	=	51.20 SYP

Acronyms

ACB	Agricultural Cooperative Bank
AKDN	Aga Khan Development Network
AKAM	Aga Khan Agency for Microfinance
ACU	Agency for Combating Unemployment
BIDAYA	Boosting and Inspiring Dynamic Youth Achievement
CB	Central Bank
CGAP	Consultative Group to Assist the Poor
CMC	Credit and Monetary Council
DEC	Development and Employment Commission
EIB	European Investment Bank
FIRDOS	Fund for Integrated Rural Development of Syria
FMFB	First Microfinance Bank
GDP	Gross Domestic Product
IFC	International Finance Corporation
IBTF	International Bank for Trade and Finance
KfW	Kreditanstalt für Wiederaufbau (German Development Bank, part of the KfW Bankengruppe)
MFI	Microfinance Institution
MFP	Microfinance Provider
MMD	Microenterprise and Microfinance Department
MOA	Ministry of Agriculture
MOF	Ministry of Finance
NGO	Non-governmental Organization

RCDP	Rural Community Development Project
SFBI	Social Financial Banking Institution
SME	Small and Medium-size Enterprise
SPC	State Planning Commission
SYP	Syrian Pound
UNCDF	United Nations Capital Development Fund
UNDP	United Nations Development Program
UNRWA	United Nations Relief and Works Agency
USD	United States Dollar
WB	World Bank
YBI	Youth Business International

Executive Summary[1]

Syria's momentum toward financial reform and liberalization, along with the commitment of key policy makers to expand microfinance, portend a positive future for the economy and the country's working poor.

Syria is in the wake of an economic and political upswing. After a decade of weak growth, economic recovery has gained steady momentum over the past several years, reaching a growth rate of 5.4 percent in 2006.[2] This growth has been driven primarily by the private sector and the non-oil sector of the economy, and has also benefited from the inflow of Iraqi refugees as well as abundant liquidity in the Gulf region. While accelerating inflation remains a concern, inflationary pressures appear to have subsided in recent months due to sustained fiscal efforts of the Syrian government. The investment climate is improving, with foreign direct investment (FDI) and gross domestic product (GDP) on a steady rise.[3] Overall, the government of Syria (GOS) has made consistent and sustained efforts to restructure and liberalize the economy, yielding positive results and an optimistic outlook, particularly with respect to near-term growth.

The private sector has become a major engine of economic growth, with private investment and the new private banking sector growing rapidly. The World Bank reports that between 2000 and 2005, public sector's GDP had negative average growth of 2 percent, while private sector GDP grew by 8 percent on average. According to the International Monetary Fund (IMF), overall investments in the financial sector grew by 200 percent in 2006, and are expected to remain strong in the coming years. Moreover, during the past two years there has been a surge in the volume of investment approvals across sectors, indicative of the government's efforts to catalyze growth of the economy and cultivate a more favorable business climate.[4] In 2004, Syria witnessed the opening of the first private banks, with six currently in operation. By 2006, the privately-owned banks captured 25 percent of private sector deposits and 14 percent of loans to the private sector. These banks have introduced a variety of new products contributing to an overall improvement in the quality of financial services and subsequently putting competitive pressure on the state banks.[5]

Financial sector reform continues to be at the forefront of the GOS agenda. GOS efforts toward reform have been slow but increasingly progressive since the start of the decade. Important budgetary and tax regulations have recently been enacted, and the monetary and financial sectors are opening up, highlighted by the increasingly important involvement of the private sector. The unification of exchange rates earlier this year signified a fundamental shift in the foreign exchange market. Noteworthy progress has also been achieved in the area of business

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1 The CGAP mission was part of the G8 BMENA initiative for the development of microfinance in the Arab world. The mission was carried out by: Rula Dababneh (CGAP); Dr. Mayada Baydas and Delila Khaled (Development Innovations Group); and CGAP consultants Alaa Abbassi, Ghada Armali, and Sahar Tieby. The mission visited Syria in June 2007.

2 *Syria: Economic Monitoring Note, Spring 2007*, World Bank, March 2007.

3 The World Bank reports that in 2006, FDI increased by 36 percent. FDI reached 2 percent of GDP in 2006, up from 1.8 percent in 2005, and an average 0.7 percent in the years 2001-2004. Source: *Syria: Economic Monitoring Note, Spring 2007*, World Bank, March 2007.

4 Under the most important investment law, Law No. 10 of 1991, investment approvals reached US$9.2 billion (26 percent of GDP in 2006), more than 2½ times the level of 2004. The share of FDI approvals in total approvals is estimated to have remained fairly stable at 20 percent. Source: IMF Country Report No. 07/288, IMF, August 2007.

5 *Ibid*.

and trade reforms, although several important laws remain under negotiation. To continue along this path of reform and ensure effective regulation and supervision of the financial sector, continued technical assistance to build local capacities remains imperative.

Recent legislation has generated significant opportunities for developing the microfinance sector in Syria. In February 2007, GOS issued the General Microfinance Decree (Syrian Legislative Decree no. 15), the first of its kind in the region. This new legislation reflects a significant opening of the financial markets; it is expected to catalyze greater access to affordable financial services for microfinance clients, who are typically lower-income and "unbanked" by traditional financial institutions. The Decree allows the Credit and Monetary Council (CMC) of the Central Bank of Syria to license Social Financial Banking Institutions (SFBIs) with the objective of providing microfinance services. These services include, "… lending and deposit taking in addition to insurance services… to help families create opportunities for owning and increasing the accumulation of assets as well as for smoothing consumption." While this dynamic reform presents a significant opportunity to expand and diversify the sector, much work remains to be done to further define and cultivate microfinance in Syria. Specifically, the microfinance landscape would benefit from a harmonized approach to microfinance policy that supports multiple providers (banks, SFBIs, NGOs) and models (charitable/relief-oriented, microfinance, and SME lending) to achieve maximum scale, outreach and sustainability of financial services for the unbanked population.

Numerous options exist to spur further improvements and development of the microfinance sector. A strategic mix of technical assistance, high-level consensus building, and training and education would help to improve performance within the sector; bolster the understanding and capacity of implementers, regulators, and policymakers; increase transparency among microfinance providers (MFPs); and integrate Syria's microfinance sector into the global microfinance industry. These efforts should include:

- Seeking technical assistance to resolve legal and policy issues pertaining to prudential regulations, reserve ratios, interest rate liberalization, NGO transformation, and internal audit controls.
- Building capacity of policymakers and regulators to create an enabling and effectively regulated environment for microfinance through roundtable discussions, study tours, and conferences engaging high-level GOS officials and showcasing regional successes in microfinance.
- Strengthening the sector through a variety of donor-supported training, networking and awareness building activities for the staff of MFPs, banks, and relevant government agencies, including alternative models for microfinance and technological innovations.

International donors and investors are interested in supporting Syria's ongoing economic reform process, including expansion of the microfinance sector. For the past several years, the European Investment Bank has been working with the Syrian Ministry of Finance on public sector restructuring and investment financing options. The IMF continues to provide regular consultations to GOS on the country's economic developments and policies. The Aga Khan Development Network and the World Bank, through the Consultative Group to Assist the Poor (CGAP) has been actively involved in bringing microfinance to the forefront of the GOS agenda. KfW has also been active within the microfinance sector, and plans to make a sizeable investment in what will soon be Syria’s first SFBI. Syria should continue to capitalize on the interests and efforts of these institutions to further bolster economic reforms and secure investments that will continue to catalyze growth.

Chapter One
Changes and Reform in Syria's Financial Sector

A THE GENERAL ECONOMY

Despite the unsettled regional environment, Syria's political regime appears to be in good standing and recovering strength regionally and internationally. Relations with other Arab countries in the region seem to have improved on the heels of the Riyadh Arab Summit in March 2007, exemplified by the acceptance of Syria's offer to host the next summit (the first time in Syria's history). The country's relations with the West also seem to be improving with numerous high-level European and American delegations heading to Damascus, after a period of Syria being shunned in the aftermath of the Hariri assassination in early 2005.

Against this backdrop, the Syrian economy recorded a total gross domestic product (GDP) growth of over 3 percent in 2006 (Table 1). This growth was led primarily by the petroleum and agricultural sectors, which together accounted for about one-half of GDP, coupled with a surge in investments. The Syrian economy also experienced a remarkable diversification of its economic activities that began in 2004.[6]

During the past few years, the Government of Syria (GOS) has rigorously implemented broad-based economic reforms, particularly in the financial sector, including gradual liberalization of interest rates, opening of private banks, and consolidation of exchange rates. The financial landscape significantly changed as a result of the new policies and legal reforms. In particular, the total foreign assets of the Central Bank (CB) and domestic banking system rose to approximately US$20 billion in 2006 as all restrictions on access to foreign exchange to finance imports were eliminated. The vibrant new private banking sector in conjunction with the new investment law place foreign and domestic investors on par, and are leading the growth of the financial sector while paving the way to a more enabling environment for the anticipated stock exchange set to open early next year. The positive strides in the financial sector reform, however, do not lessen the remaining challenges that the government should tackle to manage the projected fiscal growth and macroeconomic stability.

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6 IMF, Syrian Arab Republic, IMF Article IV Consultation, Mission Preliminary Conclusions, May 2007.

TABLE 1: SYRIAN ARAB REPUBLIC—SELECTED ECONOMIC INDICATORS, 2001–2006

	2001	2002	2003	2004	2005	2006
Nominal GDP ($billions)	21.2	23.0	22.9	24.9	27.3	29.3
Real GDP (percent change)	3.7	3.7	1.0	3.1	2.9	3.2
			(In percent of GDP)			
Government finances 1/						
Revenue	30.1	26.2	28.5	27.4	26.5	27.5
Oil-related revenue	17.9	12.5	14.6	11.2	8.8	10.0
Non-oil revenue	12.2	13.7	13.9	16.1	17.7	17.6
Expenditure	27.8	28.2	31.1	31.6	30.7	30.7
Overall balance	2.3	-2.0	-2.6	-4.2	-4.2	-3.2
Gross Debt 2/	22.3	24.2	25.5	29.2	38.2	37.9
Domestic	4.8	7.3	7.4	9.5	13.2	15.2
External 2/	17.4	16.9	18.1	19.7	25.0	22.6
			(Change in percent of beginning period money stock)			
Money and quasi-money	23.5	18.5	7.7	11.1	12.9	9.2
Net foreign assets	21.0	12.2	3.1	5.4	1.1	3.1
Net domestic assets	2.6	6.3	4.6	5.8	11.8	6.1
Credit to government	6.6	4.4	0.5	2.8	6.2	4.1
Credit to private sector	0.4	0.7	3.1	4.3	6.9	4.2
Credit to private sector (percent change)	4.5	6.6	30.3	35.0	45.9	21.9

Sources: IMF Staff Report for the 2006 Article IV Consultation, July 2006

1/ Including the Price Stabilization Fund and a broad coverage of public enterprises.
2/ Most of the increase in 2005 is due to the rcognition of the old Soviet era debt, which has been rescheduled in late 2004 to early 2005, and was not included in the historical data.
3/ Trade-weighted average exchange rate of official and parallel market rates.

B. FINANCIAL SECTOR OVERVIEW[7]

In 1986, the Central Bank, the Commercial Bank of Syria, and the specialized sector banks (the Agricultural Cooperative Bank, Industrial Bank, Real Estate Bank, and Popular Credit Bank) comprised the nation's entire banking system. In 2000, the Savings Bank transitioned from a strictly deposit-taking institution to a full-fledged bank that provides lending services. To date, while all of these banks are subject to the CB supervisory unit, they continue to act as agents for economic policy and are largely financial arms of the government. The Commercial Bank of Syria, being the largest commercial bank in the country, as well as the Agricultural and Cooperative Bank and the Savings Bank, having a certain linkage or interest in the microfinance sector, will be discussed in Section C in further detail.

[7] This section draws largely on the following report prepared for CGAP: "Syria Microfinance Environment and Savings Bank Assessment," by Dr. Mayada Baydas, Caroline Bright, and Delila Khaled, 2006.

Despite its long history of state dominated banking, Syria has taken a major step towards promoting a healthy banking sector through a series of private banking laws passed in 2000 and 2001 (outlined in text box on the right). These laws relaxed a number of controls that had previously constituted major barriers for the growth of the industry. The CB, in its efforts to improve the environment for private banks, instituted multiple regulations to improve their general internal operations. [8] In 2000, a new law allowed for the establishment of foreign private banks within Syria's Free Zones, with the condition of a maximum foreign ownership stake of 49 percent, based on approval from the Central Bank. In April 2001, Law no. 28 was passed allowing foreign banks to operate throughout Syria; this marked a major turning point in the liberalization of Syria's financial sector ending some four decades of state monopoly over banking services. (For highlights of the key elements of Law no. 28, see the following text box.) Immediately thereafter, Banking Secrecy Law no. 29 was passed in order to protect client confidentiality through the use of numbered deposits. The goal of this legislation was to attract increased foreign investment with the additional hope of competing with Lebanese banks to win over Syrian depositors who have turned to Lebanon for their financial services.

Banking Reform Timeline

June 2000:
Foreign banks allowed to establish operations in Syria's Free Zones.

April 2001:

Law No. 28 passed, ending the decades-old monopoly of banking services and allowing private banks to operate in Syria.

April 2001:

Law No. 29 passed, ensuring banking secrecy for clients.

March 2002:

Law No. 23 adopted, establishing Credit and Monetary Council.

Source: Syrian Official Gazette

THE CENTRAL BANK

As the main financial regulatory institution within the Government of Syria, the Central Bank serves as the primary regulatory body acting as an agent of the government's monetary and fiscal policy. The CB has the ability to issue notes, control the money supply, act as a fiscal agent for the government, control credit and supervise all banks. The capital of the CB is fully subscribed by the state and it is the sole body empowered to issue paper currency, according to national requirements. This power also makes it the sole financial institution capable of managing monetary circulation from a material point of view.[9]

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8 Bank Audi, Syria Economic Report. http://www.audi.com.lb/geteconomy/syria/SyriaEconomicReport.pdf (last accessed July 27, 2006).

9 Arab Decision, Syrian, Central Banks and Financial Regulatory Institutions. http://www.arabdecision.org/show_func_3_5_19_1_3_12566.htm (last accessed July 27, 2006).

Housed within the Central Bank, the Credit and Monetary Council (CMC) was established by the Government of Syria to regulate banking operations and financial markets. The CMC is a policy group of high-ranking officials headed by the CB governor, entrusted with the task of drawing up monetary policies and orienting them in accordance with the state's general strategy and the needs of the national economy.[10]

All banks, state-owned and privately-owned, have specific reporting requirements set by the Central Bank and are directly and solely supervised by the CB. Although the Central Bank has been successful as a regulator, and has a significant amount of discretionary power over the banks, it does not seem to have sufficient capacity to effectively serve as the sole governing body over all facets of the banking sector. This is especially true in the area of prudential regulation and supervision of microfinance.

The role of the CB needs to be expanded so that it serves as a catalyst, broadening and diversifying the market, particularly as a regulator of the microfinance industry. The primary resource constraint in this respect is human: given that the CB is only permitted to hire Syrians, it has been unable to leverage the skills and support of foreign financial experts. It is also constrained by a deficiency of skilled employees with the requisite technical knowledge in credit and monetary policies, largely due to the regressive public sector hiring policies.

Law No. 28

- Establishing Private and Joint Sector Banks
- Banks may be established in the form of private S.A. joint-stock companies or in the form of Syrian mixed S.A. joint-stock companies (Article 1).
- Applications for bank licenses shall be submitted to the Central Bank, referred to the Ministry of Economy and Trade and finally to the Prime Minister for a licensing decision (Article 4).
- Minimum capital requirement for banks is $30 million USD (Article 6).
- Maximum percentage ownership per natural person is five percent.
- Maximum percentage ownership by non-Syrian establishments is 49 percent.
- Banks are to deposit ten percent of the capital in an interest-free account at the Syrian Central Bank, only to be returned in the event of liquidation (Article 19).
- Income tax on net profits shall be levied at the rate of 25 percent (Article 3 25).

Source: Syrian Official Gazette

Interest Rates

In Syria, interest rates are set by the CMC. There is no explicit interest rate ceiling mandated by law that is imposed on the public and private banking sector; however, the CMC has been publishing a set range of interest rates that should be adopted by both the public and private sector banks. These rates are followed by the banks and any variations would have to be submitted for review to the CMC.

The interest rate is currently set at seven to ten percent for loans, one percent on current accounts, three to seven percent for short-term deposits, and up to nine percent for deposits over one year, per the CMC's latest directive.[11] These rates are not sufficient to cover the cost of

[10] http://www.innovations.harvard.edu/cache/documents/8992.pdf. The CMC is comprised of the Governor of the CB, the first and second deputy Governor of CB, the Assistant Minister of Economy and Foreign Trade, the Assistant Finance Minister, the Minister of Agriculture and Agrarian Reform Assistance, the Assistant Industry Minister, the Head of the State Planning Authority, and three experts in monetary, credit, and banking affairs.

[11] Directive Number 174, Interest Rates, Credit and Monetary Council, Syria, 2005.

funds, operational costs, and loan losses for many financial institutions, especially those that are interested in investing more of their assets in a loan portfolio.[12] On the other hand, prevailing deposit interest rates, which were negative in real terms during most of 2006, are now positive.[13] Banks have the authority to vary their pricing by up to one and a half percent at any given time depending on the loan terms and conditions, the sector to which they are lending and the savings instrument they are offering. In the case of credit interest on deposits, the banks have the authority to vary their pricing by two percent (up or down) at any given time.[14]

As banks develop new financial products, they apply to the CMC for approval of the interest rates they intend to charge, which are processed in a matter of days. Per the latest indications from the CB, interest rates will be totally liberalized in the near future for the banking sector although there is no indication of when this will actually happen or if it will include the microfinance sector.

Distribution of Credit

While on the one hand, growth in credit to the private sector in Syria reached 18.4 percent in 2006, it more than doubled as a percentage of GDP from 2002 through 2006. Net credit to public enterprises and the central government, on the other hand, remained the main contributor to the money growth (Table 2 below). Additionally, the recent IMF monetary study in Syria reflects that the absolute values of claims on the private as well as public sectors are increasing in parallel. This trend is also coupled with a deepened monetary circulation as the change in broad money (M2) continues to be positive to a large extent, especially given the growth in GDP in real terms. Currency to deposit ratio is also increasing steadily reaching about 55 percent for the past couple of years, similar to the slowly growing ratio of foreign exchange deposits to total deposits which was at 13 percent as of end of 2006.

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[12] Brandsma, Judith and Burjorjee, Deena. “Microfinance in the Arab States: Building Inclusive Financial Sectors,” UNCDF (2004).

[13] IMF study, August 2007.

[14] Directive Number 298, Interest Rates, Credit and Monetary Council, Syria, 2007.

TABLE 2: MONETARY SURVEY 2003-1007, SYRIAN ARAB REPUBLIC

	2001	2002	2003	2004	2005	2006
Nominal GDP ($billions)	21.2	23.0	22.9	24.9	27.3	29.3
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Sources: IMF Staff Report for the 2006 Article IV Consultation, July 2006

1/ Including the Price Stabilization Fund and a broad coverage of public enterprises.
2/ Most of the increase in 2005 is due to the rcognition of the old Soviet era debt, which has been rescheduled in late 2004 to early 2005, and was not included in the historical data.
3/ Trade-weighted average exchange rate of official and parallel market rates.

Investments in the financial sector grew by 200 percent in 2006 due to the establishment of a number of private banks and insurance companies. These investments are highly sought after as indicated by the huge oversubscription to the banks' IPOs. This trend is expected to remain strong in future years due to the improved financial legal framework and the increasing investment opportunities being pursued in the country. Additionally, in 2006, private banks contributed 45 percent to the growth of loans to the private sector and captured 70 percent of the increase in private sector deposits. As a result, private banks were able to capture 14 percent share of the private sector loan market and about 25 percent of the private sector deposit markets, both in Syrian Pounds and Foreign Exchange, by end of 2006. (See Figures 1 and 2, below)

FIGURE 1: CREDIT TO THE PRIVATE SECTOR, 2005–2006

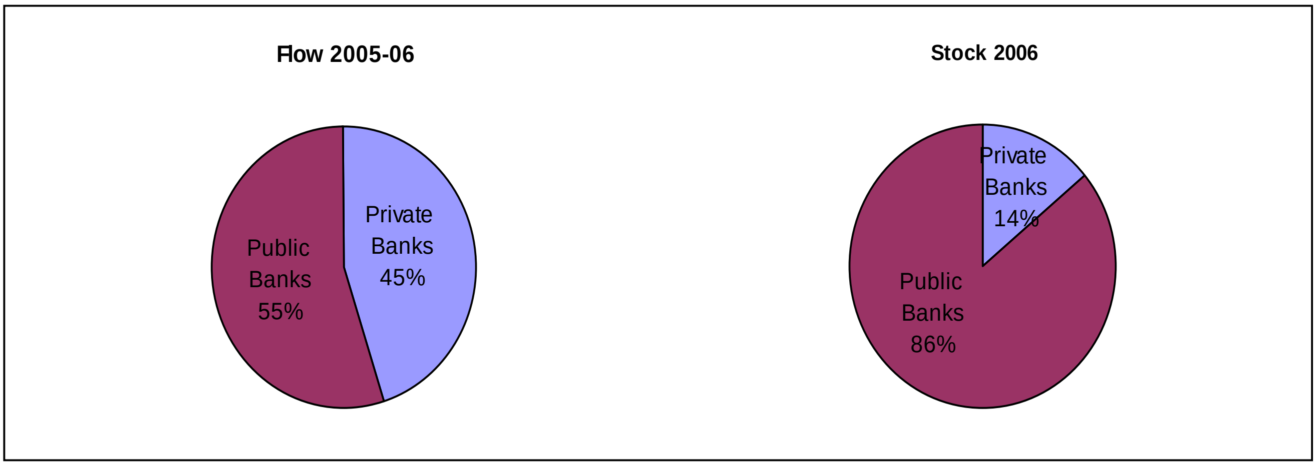
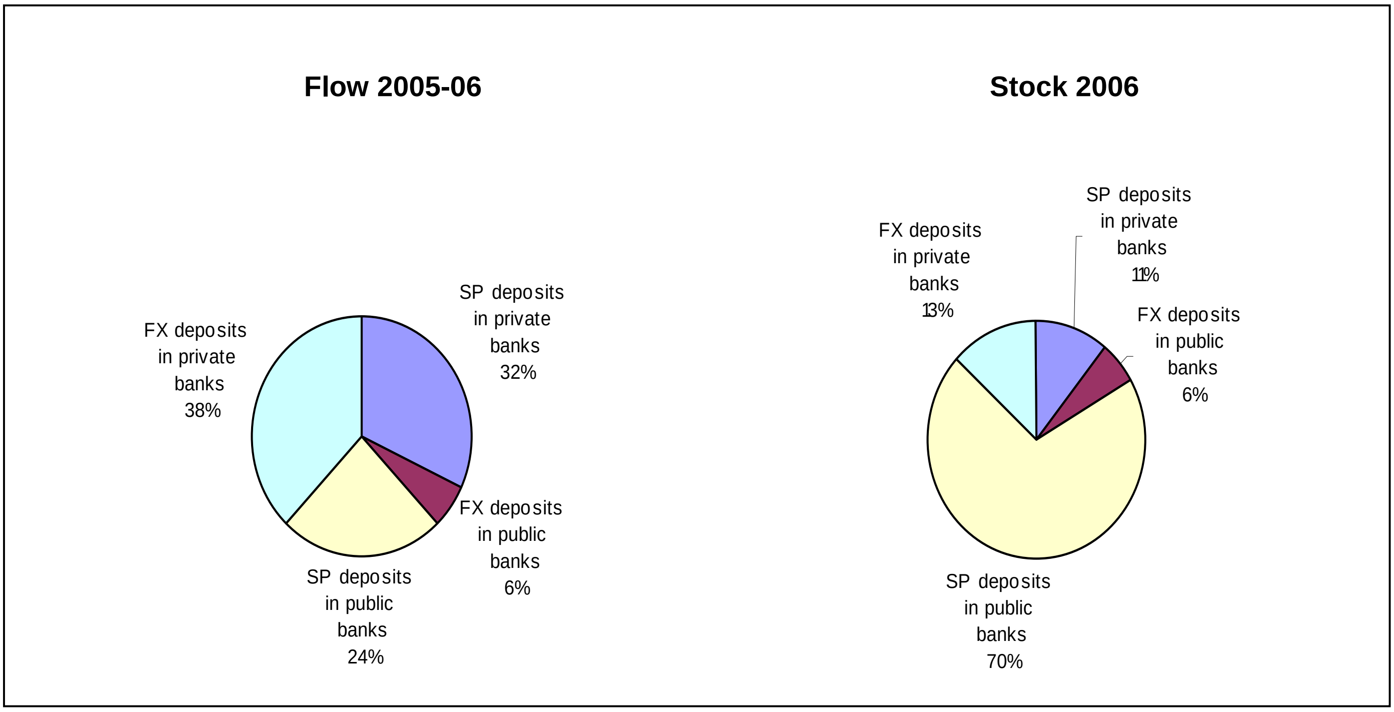


FIGURE 2: PRIVATE SECTOR DEPOSITS IN THE BANKING SYSTEM, 2005–2006



C. FINANCIAL SECTOR PROVIDERS

STATE-OWNED BANKS

State banks are technically owned by the Ministry of Finance (MOF) but are supervised by the Central Bank. The chairmen of the state banks report to the MOF, but the ministry does not directly involve itself with the affairs of the banks. The state banks are given the freedom to extend both short and long-term credit and to accept deposits, although direct controls such as credit limits are established for each bank in each sector. Public banks focus primarily on short-term commercial lending, as well as trade financing.

THE COMMERCIAL BANK OF SYRIA

In 1966, when the state gained control over all commercial banks, it merged every existing commercial bank into a single consolidated bank, the Commercial Bank of Syria. The role of the Commercial Bank of Syria was to serve Syrian economic and commercial activities, and control all foreign trade transactions. The Commercial Bank of Syria continues to be the largest state-owned bank in terms of assets and has a fairly large branch network, with 60 branches spread throughout the country. The bank is strongly backed by the government and was the first public bank licensed to engage in foreign exchange transactions. Today, all banks have the flexibility to deal in hard currencies.

The paid up capital of the Commercial Bank of Syria amounts to 70 billion Syrian pounds (SYP)[15] equivalent to US$139.45 million. Although the Bank is attempting to upgrade all technological infrastructures, it continues to be hampered by old practices. The management of the bank has been focusing on the retail market, as well as investment activities to diversify its portfolio, although public sector lending continues to consume 90 percent of its portfolio. Its deposit base, however, is about 40 percent public and 60 percent private. The Commercial Bank of Syria claims to possess about 50 percent[16] of the market share in terms of private and public sector lending and has plans to increase its branches in the coming year. The bank has a low minimum deposit balance requirement of SYP 10,000 (equivalent to US$190). While the bank does not deter small savers, it lacks the institutional capacity to engage in microfinance activities, particularly given its traditional lending methodology and use of conventional guarantees.

SPECIALIZED BANKS

The specialized banks (i.e., the Agricultural Cooperative Bank, Industrial Bank, Popular Credit Bank, Real Estate Bank, and Savings Bank), each extend funds to and take deposits from a particular sector. Each bank is authorized to make loans in its respective sector, with the exception of the Savings Bank, which commenced its lending operation over the past few years and lends across various sectors of the economy. The Industrial Bank is geared toward public sector enterprises and is undercapitalized.[17]

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[15] Commercial Bank of Syria, annual report, Syria 2006. http://www.cbs-bank.com/files/Report2006.pdf

[16] This figure includes public sector transactions and was provided by the Deputy General Manager of the Commercial Bank during an interview in June 2007 to reach up to 80 percent but was verified against Central Bank statistics to reach 50 percent in 2006.

[17] Library of Congress, Country Profile, Syria, http://lcweb2.loc.gov/frd/cs/profiles/Syria.pdf (last accessed July 27, 2006).

The Agricultural Cooperative Bank (ACB) and the Savings Bank (SB) are engaged in small and medium enterprise (SME) lending, and have an interest in expanding their outreach to the microfinance market. While the ACB is an old, large bureaucratic institution that may find it more challenging to transform its operations to microfinance lending, the management of the Savings Bank has already made a commitment to and is taking steps toward such a transition.

AGRICULTURAL COOPERATIVE BANK

With agriculture being one of the most important sectors of the Syrian economy, the ACB has played an important role in providing credit for a variety of agricultural activities. The general manager reported that the bank has even commenced lending to non-agricultural, rural enterprises (e.g., arts and crafts). The ACB is the only state bank that lends in rural areas, with 106 branches serving its rural clientele. The ACB provides in-kind assistance for agricultural inputs and other needs (e.g., local production and phosphates). The ACB also serves as a vehicle for government support, whereby the Government of Syria buys produce directly from farmers and pays them through the ACB.

As of 2006, the bank reported an outstanding loan portfolio of US$503 million. The ACB, however, continues to operate more as an input trading company than a bank. Operational inefficiency makes its financial services inadequate, and does not allow it to have a sufficient number of branches to adequately service the rural working poor. Moreover, despite the fact that ACB’s overall operational costs are extremely high, their interest rates remain low, in effect subsidizing the cost to the borrower at the expense of effectively recouping operational costs. Finally, the bank’s emphasis on in-kind credit to service input requirements crowds out servicing the small operators in rural areas.

THE SAVINGS BANK

In 1999, the Savings Bank, the smallest of the state banks, converted from a postal savings bank to a full-fledged bank, with lending operations starting in 2000. Prior to that, it was strictly a deposit-taking bank, with an average deposit of US$950. Currently, the bank has high liquidity and has gained significant outreach. Throughout the communities in which it operates the SB has built solid client trust as a result of a good track record when compared to other state banks. The SB began lending to small businesses in 2000 and to individuals in 2005. It has 57 branches with a total of 700 staff. Total loans reported by the SB in 2006 amount to US$976 million.

As Syria’s first major “bank downscaling” effort, the Savings Bank has made a commitment to incorporate microfinance services in its portfolio, but it has been slow in developing its products and services. The SB has faced two critical barriers to downscaling; namely, the interest rate restrictions, and hiring and remuneration policies imposed on state banks by the GOS, both of which would hinder scale and sustainability. The SB is considering several options including establishing a subsidiary commercial company through which it will offer microfinance services, leaving them free to operate without these constraints.

Through CGAP’s Retail Advisory Services (RAS) program, the SB is receiving technical assistance to offer microfinance services in three of its branches on a pilot basis, the proposed branches are Homs, Tartous and Latakia. This initiative is envisioned to expand to additional branches over the coming years as part of the overall program targets and outreach projections. It should be noted that the State Planning Commission has supported all external partnerships and activities relating to the SB's forays into microfinance.

The SB's technical assistance provider, Quality Finance International (QFI), is implementing the following scope of activities: conducting a market survey to confirm the viability of the selected pilot branches to deliver microfinance services; assessing the prevailing market conditions; measuring the demand gap; and identifying the main characteristics of the products to be provided by the bank. QFI will utilize the results of the market survey to help SB in designing the bank's credit products and developing its business plan. Once the business plan is approved by the bank's board, QFI will proceed with installing QFI's loan tracking system, El Mohassil, in addition to training the bank's MIS staff on how to use the system. QFI will also develop operational policies and procedures manuals to be used by the bank as guidelines for operations.

In addition to public sector hiring and remuneration policies, one of the major staffing challenges facing the SB is a lack of skilled professionals, which has made it difficult for the bank to enforce full compliance with state regulations. Inadequate staff capacity and limited lending experience, along with weak financial reporting and risk management systems, could lead to high delinquency rates if left unaddressed. To tackle this challenge, QFI will provide extensive classroom and field training to loan officers in a variety of areas including: loan disbursement; client assessment; portfolio and delinquency management; and communication skills. QFI will also provide ongoing support to the bank's management throughout the technical assistance period through continuous monitoring and evaluation of its operations.

To date, the Savings Bank has not yet initiated microfinance lending operations. QFI is currently finalizing the market survey and the business plan. Training will begin once the business plan has been approved. QFI expects the SB to begin loan disbursements in 2008, provided that the bank obtains all the necessary approvals and commits the required staff and resources. CGAP considers the SB's downscaling effort an important pilot that, if successful, would provide a model to encourage further such innovations within the public and private banking sectors.

Private Banks

The minimum capital required to start a private bank is the equivalent of US$30 million. Among the established private banks in the country, three private banks began operations in 2004, followed by another bank in 2005 and two more in 2006. Currently there are two Jordanian banks and four Lebanese banks among the private commercial banks. These include the International Bank for Trade and Finance (Jordanian), the Arab Bank (Jordanian), Banque Bemo (Lebanese), Bank Audi (Lebanese), Bank of Syria and Overseas (Lebanese) and Bank Byblos (Lebanese). Several more banks are expected to start operations in 2007, including some Islamic financial institutions. These banks are mainly subsidiaries of regional banks (typically Lebanese or Jordanian based), although majority ownership is held by Syrian investors, who have shown strong interest in the sector, as reflected in large oversubscription of the banks' IPOs.[18]

Private banks have enjoyed tremendous market opportunities and captured a good share of the savings over the past couple of years. These deposits amounted to a remarkable $2 billion in 2005 and today have exceeded $3 billion. Although these banks initially faced some challenge in

[18] International Monetary Fund, IMF Country Report No. 07/288, 2007, p. 9.

mobilizing deposits and making loans given the set interest rates on lending, which hovered at about nine percent, they are beginning to develop competitive products especially given the current trend towards liberalizing market rates. Additionally, private banks are faced with another challenge in searching for investment venues for their deposits, which forces the banks to continue to engage largely, albeit in a conservative fashion, in trade finance.[19] In addition, the Syrian government views the licensing of the new private banks as a process that will require more intensive efforts and measures to accelerate economic reforms, and modernize laws and regulations.[20]

Private banks, like their state-owned counterparts, report to the CB. Unlike the state-banks, however, private banks have successfully adhered to the prudential and non-prudential regulations governing their sector. The private banks have additionally contributed to an overall improvement in the quality of financial services by putting competitive pressure on state banks. Although the pace of increase in their loan portfolios slowed down in 2006, it was still above 100 percent. This development attests to the ability of Syria's restructured financial sector to meet the demands of a growing economy.[21]

A comparison of financial soundness indicators (Table 3) reflects high asset quality (measured by the ratio of the non-performing loans to loan portfolio and the loan loss provision to non-performing loans) in the private banks, and slowly improved performance in the public sector banks. A 60 percent liquid to total assets ratio indicates a highly liquid private banking sector. The public banking sector is decreasingly liquid, however, with a liquid to total assets ratio of 22 percent in 2006 compared to 38 percent in 2005. All banks, but especially the public banks, are moving towards increasing the borrower client base and their Syrian Pound loans. While the return on equity of 6 percent in 2006 is quite positive for the newly founded private banking sector, that of the public sector banks at 3.6 percent was affected by the increase in the capital requirement following the Central Bank's recapitalization of all banks in 2006.

ISLAMIC BANKING

The establishment of Islamic banks in Syria comes as a direct response to the needs of the community, an attempt to diversify the investment sector, and to conform to Sharia laws. In 2005, encouraged by the prime couple of years of success within Syria's nascent private banking sector, GOS issued Legislative Decree No. 35, allowing for the establishment of Islamic banks.

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[19] http://www.innovations.harvard.edu/cache/documents/8992.pdf

[20] *Ibid.*

[21] International Monetary Fund, IMF Country Report No. 07/288, 2007, p. 9.

TABLE 3: FINANCIAL SOUNDNESS INDICATORS, 2005-2006—SYRIAN ARAB REPUBLIC108

(Figures below are in percent unless otherwise indicated)

	Public Banks		Private Banks		All Banks	
	2005	2006	2005	2006	2005	2006
Asset quality						
Non-performing loans/loan portfolio	13.1	12.1	0.5	1.0	12.2	10.6
Loan loss provisions/non-performing loans	6.6	8.6	94.4	40.2	6.9	9.0
Liquidity 2/						
Liquid assets/total assets	38.4	22.3	64.0	62.9	40.1	27.5
Customer loans/total deposits	44.5	52.6	25.5	25.5	43.2	49.2
Syrian pound loans/total Syrian pound deposits	50.8	64.8	48.9	49.2	50.7	62.8
Profitability						
Return on Assers (RoA)	1.2	0.5	0.5	0.4	1.2	0.5
Return on Equity (RoE)	25.7	3.6	4.6	6.0	22.9	3.8
Solvency						
Capital adequacy ratio (BIS)	na	na	na	na	na	na
Leverage ratio (capital/assets)	4.7	14.6	10.0	7.1	5.1	13.7
Stability						
Growth in credit to private sector	38.7	10.9	281.7	106.9	45.9	18.4
Deposit Growth	1.9	-0.8	232.7	116.4	8.8	9.9
Deposit dollarization ratio	9.0	11.8	52.9	54.0	13.1	19.4

Sources: IMF Staff Report for the 2007 Acticle IV Consultation, August 07

1/ Data are preliminary and subject to change
2/ Weighted averages by asset size
3/ The decline in ROA and ROE ratios and the increase in leverage ratio in 2006 is due to the increase in CBoS's capital by SP 66 billion in 2006.

Prior to the issuance of this law, local Islamic financing options were entirely absent from the Syrian market. In a nationwide survey conducted by Bankakademie International, it was reported that some 34 percent of Syrian companies that had *not* requested a bank loan had done so for religious reasons. [22] Due to the Islamic dictates prohibiting the application of interest, these companies chose not to obtain credit from Syria's conventional banks. In effect, the creation of Syria's Islamic banking law was catalyzed by the GOS' recognition of the high demand for Islamic financing among Syrian companies given their long-time practice of acquiring such financing from abroad (namely the Gulf and neighboring countries).

The first Islamic bank to open in Syria under the new legislation was Al Sham Bank followed by Al Shall Kuwaiti, Dallah al-Baraka Group, and Syria International Islamic Bank (which is majority owned by Qatar International Islamic Bank). Permitting the creation of these Islamic banks in Syria not only demonstrates GOS' recognition of the local demand for such investment infrastructure, but also its desire to develop the country's financial sector to keep pace with the

[22] Karawani, Raed, *Syria Enters the Islamic Banking and Insurance Market*, Islamic Finance News, July 3, 2006.

growth and development of the global banking industry. The size of the Islamic banking market has been steadily increasing year after year. It is estimated that the assets of Islamic banks were worth over US$265 billion in 2006, with an annual growth rate of 20 percent.[23] GOS expects that the addition of Islamic banking to their on-going banking sector reform efforts will further boost the Syrian economy, and contribute to building trust in the Syrian banking system.

The structure of Syria's Islamic banking legislation is based on the experience of developing Islamic banking laws in other countries, and their related amendments.[24] The Syrian law aptly addresses important regulatory issues such as: compliance with the Accounting and Auditing Organization for Islamic Financial Institutions; compliance with the capital adequacy standards of the Islamic Financial Services Board; and compliance with all Sharia principles in providing Islamic services and products.[25] The minimum capital requirement stipulated by the law is US$96.31 million. Islamic banks are subject to the same 49 percent foreign ownership restriction applied to conventional banks. Under the law, Islamic banks are permitted to own, sell, invest and rent properties and lands, to establish companies, and to participate in projects under establishment, while adhering to Islamic rules and principles. While much progress has been made in developing the policies and regulations governing Islamic banking, some senior bank officials have expressed a need for continued reform measures—both in conventional and Islamic banking—particularly in the areas of liberalizing interest rates and hard currency operations.

Spotlight: Syria International Islamic Bank

Syria International Islamic Bank was established in 2006 as a private joint stock company. The principal activities of the bank are Islamic commercial banking services. The bank was capitalized at 100 million SYP, with 10,000 outstanding shares and Qatar International Islamic Bank as the major shareholder. The bank operates through 3 branches in Damascus, Allepo and Hama. With respect to microfinance, the bank has indicated interest in the sector, envisioning some level of engagement in microfinance lending (albeit undefined at this point) in the long-term.

Within Syria's microfinance industry, some effort has been made by MFPs to integrate Islamic lending principles. A notable example of this has been the *murabaha*[26] lending model employed by the Rural Community Development Program in Jabal Al Hoss (see section II D, below, for details). According to Islamic banking principles, *riba*, a term associated with usury and interest, is prohibited; within microfinance, therefore, this often leads to an emphasis on administrative fees rather than interest as a means to covering costs. Attempts to employ Islamic fundamentals by NGOs are still in their early stages and an issue of continued debate.

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23 *Ibid*.

24 Syria's Islamic banking legislation is available online at http://www.banquecentrale.gov.sy/main-ar.htm. At this time, only an Arabic version of the legislation has been published.

25 Karawani, R., *Great Demand Ahead for Syria*, Islamic Finance News Guide, February 1, 2007.

26 Definition: A cost-plus sale pricing strategy whereby the provider of funds actually purchases the commodity and resells it to the user (i.e., the "borrower") with a mark up against installments or delayed payment. Unlike conventional finance it links lending to the asset and involves ownership risk on the asset.

Chapter Two
State of Development of the Microfinance Sector in Syria

While Syria's microfinance industry is relatively underdeveloped as compared with other countries in the region, the Government of Syria has made significant strides in the past year toward creating a more enabling environment to nurture the growth of microfinance. This is particularly evident in the passing of the Microfinance Decree in February 2007, the first of its kind in the MENA region. With the passing of this law, the government is eager to see rapid development of the sector while existing microfinance providers (MFPs) are quickly trying to assess how they can leverage the new law to assist their growth. Moreover, the donor community, primarily KfW and IFC, are eager to pursue opportunities to support the sector with investments and technical capacity building. The new law by no means guarantees the future success of microfinance in Syria; however, it should help in avoiding some of the obstacles faced in other countries where a lack of clarity regarding legal forms for microfinance has left many MFPs in a precarious situation, often hindering transformation, growth and investments. Additionally, the law provides for the first time a framework for taking deposits by other than commercial banks, which typically require relatively high sums of paid up capital.

A. THE DEMAND FOR MICROFINANCE IN SYRIA

The demand for microfinance products and services in Syria is far from being satisfied. In the absence of any formal market assessments, conservative estimates of current demand are upward of at least one million clients; meanwhile the total number of active clients being served has reached a meager 41,500. Moreover, the industry, still in a nascent developmental stage, has yet to diversify its products and services, with credit being the primary product offered by all providers, and business training the main ancillary service. To date, the industry remains dominated by one key provider, the Aga Khan Agency for Microfinance (AKAM),[27] currently serving some 11,000 clients. In short, there is significant room for growth within Syria's microfinance sector, both in terms of client numbers and product offerings. By allowing for the establishment of for-profit, deposit-taking microfinance institutions, the new Microfinance Decree is sure to have a significant impact in promoting sector expansion.

During in-country interviews, the main MFPs indicated that they were able to satisfy only 15 to 20 percent of the total demand for credit in their respective geographic areas of operations. In terms of savings, the MFPs did not have a clear perception of the volume of potential demand since heretofore it was not permissible for them to take deposits under their current legal status. However, they all concurred that the demand for saving would be high, with several MFPs estimating that approximately 50 percent of their client base would likely pursue savings if the service was readily available and market driven.

[27] AKAM falls under the umbrella of the Aga Khan Development Agency (AKDN) and oversees all of its microfinance operations.

B. OVERVIEW OF SYRIA'S MICROFINANCE PROVIDERS

To date, the key providers of microfinance services in Syria have been either state or NGO/donor sponsored programs. Currently, the main international donor programs are run by the United Nations Relief and Works Agency (UNRWA) and the United Nations Development Program (UNDP). The only two indigenous, non-profit, NGO providers are the Fund for Integrated Rural Development of Syria (FIRDOS) and Boosting and Inspiring Dynamic Youth Achievement (BIDAYA). The country's market leader, AKAM, is an independent international NGO. The primary state-owned and state-subsidized MFP has been the Agency for Combating Unemployment (ACU). However, under a recent restructuring mandated by the government, the ACU has been transformed to become the Development and Employment Commission (DEC) by the Legislative Decree No. 39 of 2006 and will no longer provide credit; it will service its outstanding loans, but moving forward it will return to its original mandate of providing job skills training and employment opportunities.

Among the public banks, the Savings Bank and Agricultural Cooperative Bank offer the smallest loans and deal most closely with potential microfinance clientele. While the ACB is interested in microfinance in the future, it must overcome the obstacles of high transaction costs of serving this market niche and the government mandated subsidization of loans. As a young institution with ample liquidity and a relatively clean track record, however, the Savings Bank could be an ideal candidate for microfinance lending. Finally, in terms of commercial sector involvement in microfinance, there are no such entities offering microfinance services in Syria today, most likely because the commercial financial sector itself is a relatively new development in the country.

With recent legislative changes (see Section III below) and investor interest, a broader spectrum of Syrian MFPs appears imminent. These new players may include commercially sustainable Greenfield MFPs as well as downscaling banks, indicating a need for the CB to clearly differentiate between subsidized, charitable efforts and commercially viable institutions serving micro, small and medium enterprises, applying appropriate regulation and supervision to each segment.

C. CHARACTERISTICS OF THE MICROFINANCE MARKET IN SYRIA

Geographic and Sectoral Focus

The geographic focus of MFPs currently operating in Syria is predominantly rural, where more than 40 percent of the Syrian population resides and where the highest concentration of poverty exists. (The one exception is UNRWA, which serves Palestinian refugees in the urban centers of Damascus and Aleppo.) It follows, therefore, that the majority of microfinance clientele use their loans for agricultural purposes, as this is the primary source of livelihoods in Syria's rural areas.

The geographic focus on rural areas coupled with the concentration in agriculture could present significant "systemic risk" to MFPs, according to UNCDF: Because microfinance in rural areas appears to be used mainly for cattle-breeding and crop-finance, the occurrence of drought or outbreak of disease among crops or cattle could jeopardize the sustainability of MFPs and place their entire microfinance portfolios at risk.[28] This highlights the importance of encouraging strong loan underwriting, risk management tools such as insurance, and portfolio diversification, to the extent possible, recognizing the need for rural providers to balance the credit needs of their communities with their own long-term viability.

Scope of Products and Services

The primary product offered by all MFPs is microenterprise credit. A few providers offer non-enterprise loans, including housing and rural development loans. In terms of enterprise loans the majority are used for agricultural purposes. While most providers offer non-financial services, such as business development services (BDS) and vocational training, their financial services are limited solely to lending because their current legal status restricts them from taking deposits. In terms of lending methodologies, most MFPs offer both group solidarity and individual loans. In addition, UNDP in Jabal AL Hoss follows the Islamic lending methodology of *murabaha*.

Industry Volume and Performance

The five main MFPs (excluding ACU) have a combined total outreach of approximately 16,500 active clients. Including the ACU's outstanding loans, this total reaches just over 41,500 clients. Despite the fact that ACU has historically served the majority of microfinance clients in Syria, given its level of loan subsidization and poor track record which led to the termination of its lending activities, it is clear that AKAM remains Syria's microfinance market leader. Table 3 below provides further detail regarding common characteristics and performance indicators for Syria's main microfinance providers.

Major Sources of Capital

In terms of sources of capital, the donor programs (UNDP and UNRWA) seem to have ample access to funding from their parent institutions. Thus far, AKAM has received all of its funding from the Aga Khan Development Network, although it anticipates significant international donor investments (namely, from KfW) in the future. FIRDOS receives 60 percent of its funding from the EU and UN, and the remaining 40 percent is raised through local corporate social responsibility efforts from Syrian institutions. RCDP received the majority of its funding from UNDP and the Japanese Government (via MOA), with additional funding from the Government of Syria.

Sustainability

While UNDP, UNRWA, AKAM and FIRDOS are generally best practice-oriented, several of them are still striving to make progress toward operational sustainability (see Table 3 below). Given their ample access to funds and the minimal level of competition faced within the market, however, the impetus to quickly achieve sustainability remains somewhat limited. Of the various MFPs, only AKAM and UNDP include financial sustainability indictors in their reporting.[29] It is unclear, therefore, whether the other MFPs factor in cost of funds. It was evident during interviews with these other MFPs that financial sustainability was not a major priority; in fact, it

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[28] Brandsma, J. and Burjorjee, D. "Microfinance in the Arab States," United Nations Capital Development Fund (UNCDF), (2004).

[29] While AKAM does track financial sustainability, its exact figures were not readily available.

appeared that their pricing strategies were not a function of costing, but rather based on symbolic fees which at best could work as a partial cost recovery mechanism for their operational expenditures.

Competitiveness of the Microfinance Sector

Competitiveness is almost entirely absent from Syria's current microfinance terrain. It was evident from interviews with UNDP, UNRWA, FIRDOS, AKAM and ACU that competition was not a major factor in their current strategic plans. This is likely due to their geographical segmentation, which allows each provider to operate unrivaled in any given location. Given the enormous size of unmet demand throughout the country, it is unlikely that this situation will change in the near future.

Due to the limited access to financial services for the working poor, informal money lenders are highly active in Syria and like the MFPs, operate relatively unrivalled. These lenders continue to offer credit at exorbitantly high interest rates. It is estimated that they provide up to 73 percent of credit to the poor at an average interest rate of 77 percent (annualized).[30] These numbers are indicative of the major unmet demand for microfinance in Syria and the enormous space that can be filled by microfinance providers.

D. PROFILES OF KEY MICROFINANCE PROVIDERS

The following section offers detailed profiles of Syria's primary microfinance providers. Table 3, below, summarizes the key indicators and characteristics of these MFPs based on the most current data available as of June 2007.

Aga Khan Agency for Microfinance (AKAM)

The Aga Khan Development Network (AKDN) has been operating in Syria since early 2002 under a framework of co-operation Agreement signed with the Syrian Government. AKDN's three-fold mission is promoting economic development, social development and culture.

The Aga Khan Agency for Microfinance (AKAM), the dedicated microfinance agency within the AKDN network, has been providing micro credit services since the second half of 2003 under this Agreement, as well as Memoranda of Understanding signed with provincial Governors and a specific Memorandum of Understanding signed with the Ministry of Health to deliver microcredit services through the Syrian government's Healthy Villages Program.

[30] International Center for Agricultural Research in Dry Areas, ICARDA-33/500/Dec. 2004 .

TABLE 4: CHARACTERISTICS AND INDICATORS FOR FIVE PRIMARY MICROFINANCE PROVIDERS IN SYRIA

Name	AKAM	FIRDOS	BIDAYA	UNDP	UNRWA	ACU (DEC)[31]
Type	NGO	NGO	NGO	Donor	Donor	Public Org.
Products	Individual (enterprise & consumption), Group, Housing, & Rural Dvlpt	Individual & Group	Individual	Housing & Sanduq Village Banking	Individual Microenterprise & Solidarity Group	Individual Small and Micro-enterprise
Active Clients	11,000	1,000	35	2,500	2,000	25,000
Outstanding Loan Portfolio	$11,000,000	$2,260,103	---	$1,750,000	$1,000,000	$37,500,000
Interest Rate	1% Monthly	4.5% Annual	---	5% Murabaha	2.2% Monthly	5% Annual
Repayment Rate	99.4%	99%	---	95%	98%	---
Demographic	Primarily Rural	Rural	---	Primarily Rural	Primarily Rural	Nationwide
OSS*	Almost 100%[32]	---	---	95%	119%	---
FSS**	---	---	---	83%	---	---

*OSS refers to Operational Self Sufficiency
** FSS refers to Financial Self Sufficiency. With the exception of UNDP, no other MFPs include financial self sufficiency indicators in their financial reporting.

During its five years of operation in Syria, AKAM's microcredit operation has achieved a significant level of growth, quickly becoming the country's market leader. It currently operates seven branches in Tartouz, Latakia, Hama, Aleppo, Damascus, Sweida and Masyaf. In terms of breadth of outreach, the Agency serves some 11,000 active clients (June 2007 data) and maintains a portfolio outstanding of US$11 million. Since inception, AKAM has served a total of 38,000 clients and lent US$50 million. While the majority of loans offered are individual, AKAM also works with groups through its Healthy Villages Program, which comprise approximately one-third of the Agency's loan portfolio. Some 15 percent of AKAM loans are for non-income generating activities. In terms of interest rates, the program charges a service fee of one percent flat per month.

According to recent analysis by KfW experts, in 2004, 2005, and 2006, AKAM would have been able to cover all costs if it were to have paid LIBOR plus on its sources of funds. Its current three-year business plan assumes market cost of funds, and starting in 2008 it will be seeking to

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[31] The numbers herein reflect the ACU's current outstanding loan portfolio; no new loans will be offered under the restructuring of the agency as the DEC.

[32] AKDN did not provide their actual operational self sufficiency, but indicated that while they were indeed close to reaching operational sustainability, they are currently in a rapid expansion phase that will prevent them reaching operational self sufficiency in the immediate term. However, under their new business plan, they do expect to reach FSS in three years, assuming normal market cost of funds.

secure credit lines from new investors, local banks and international lenders. In terms of growth plans, AKAM aims to increase its lending portfolio to a projected US$43 million by the end of 2010. This will coincide with plans to expand geographic coverage to Syria's 14 provinces within the next three years, and increase the number of branches in Damascus and Aleppo. In addition, AKAM plans to offer its clients the full range of microfinance products (with the exception of remittances which are not permitted under the new Microfinance Decree). AKAM will also seek to expand and develop its SME activities to provide existing clients with an opportunity to graduate to higher loan brackets.

These expansion goals are part of AKAM's immediate plans to transform its NGO lending operation under the new Microfinance Decree to establish the First Microfinance Bank (FMFB) of Syria. Similar plans were successfully undertaken by AKAM in Pakistan, Afghanistan and Tajikistan with a "First Microfinance Bank" now operating successfully in each of these countries. In preparation for the transition to the First Microfinance Bank, it has already begun addressing key institutional restructuring issues such as a) staffing, b) new policies and procedures, c) improved IT and MIS, d) expansion to new locations, and e) security and insurance policies. AKAM is in the final stages of obtaining this license; once issued, AKAM will integrate its current operations into a new microfinance bank.

Rural Community Development Project (RCDP)

RCDP in Jabal Al Hoss is a UNDP sponsored project with no legal status for its microfinance operation (it is neither an NGO nor a regulated financial institution). RCDP is currently operating under a general Memorandum of Understanding (MOU) between the Ministry of Agriculture and Agrarian Reform, the State Planning Commission and UNDP, which is set to expire in December 2007.[33]

The RCDP focuses on microfinance, income and employment generation, and is among Syria's most successful development projects. The project was carried out in two phases. During the first phase (1999 to 2002), the project was capitalized with an initial UNDP grant of US$1,420,930, out of which US$500,000 was dedicated to loan capital. Phase two (2003 to 2007) funding included: a US$50,000 grant from UDNP to support the project budget; US$1,500,000 from the Japanese Government through a grant to the MOA; and a contribution by the Syrian Government of US$760,138 for various administrative, operational and maintenance expenses.

The lending component of RCDP is a community-based, participatory rural finance scheme whereby a village fund, or *sanduq*, is created and owned cooperatively by village residents. The various village funds, or *sanadiq*,[34] together form a national cooperative. The program, however, is not required to abide by the cooperative law and is not registered as one. Since the start of the program in 2000, over 10,700 loans have been disbursed. By the end of 2006, the program had 32 *sanadiq* lending to 2,279 active borrowers. The total number of shareholders has reached 7,378 with a share capital of US$ 280,681. These shareholders enjoy an average return on equity of 24 percent. The portfolio outstanding is US$ 1,792,969, while portfolio at risk (greater than thirty days) is 5.5 percent. The program has maintained a repayment rate of 97 percent.

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[33] The MOU was originally scheduled to expire in August 2007, but an extension was recently granted extending its validity until December 2007.

[34] The term *sanadiq* is the plural form of the Arabic work *sanduq* which, in this case, translates to a village or community fund.

The RCDP lending methodology adopted by the *sanadiq* is summarized briefly below:

1) Loan products are segmented based on the repayment method:
    a. Seasonal loans repaid in one lump sum upon maturity
    b. Loans repaid on a quarterly basis
    c. Loans repaid on a monthly basis
2) The pricing structure is based on the Islamic lending methodology of *murabaha*.[35]
3) Loan guarantees are based on debenture signed by the borrower, in addition to two guarantors, i.e. cosigners.
4) Compulsory savings of US$19 are required prior to loan disbursement with an option for the client to save an additional US$19 in voluntary savings. (This is a mechanism for both capitalizing the *sanduq* for on-lending, as well as to buy shares in the *sanduq*.)

The main challenge facing RCDP today is its legal structure. As mentioned above, RCDP is now operating under an MOU which is set to expire by the end of this year. When the MOU expires, RCDP will face the decision of transforming either into a financial institution (under Microfinance Legislative Decree Number 15) or to an NGO. While the option of transforming to a financial institution clearly offers RCDP the prospect of greater growth and expansion of services, the challenge therein will be to raise the minimum capital requirement (US$4,750,865) as stipulated by the decree. Alternatively, transforming to an NGO would not allow RCDP to accept compulsory savings as they would not have the legal authority to accept deposits.

Microenterprise and Microfinance Department (MMD)

The MMD is a United Nations Relief and Works Agency (UNRWA) program serving Palestinian refugees in the urban centers of Damascus and Aleppo. It currently operates under a general MOU between UNRWA and the Syrian Government under the auspices of the Ministry of Foreign Affairs. The MMD is part of UNRWA's regional initiative for Palestinian refugees in the West Bank, Gaza, Jordan, Lebanon,[36] and Syria.

Since the inception of the program in 2000, some 8,200 loans have been disbursed amounting to US$5,301,965. It maintains an outstanding portfolio of US$1 million and 2,000 active borrowers.[37] The program currently operates out of two branches—one in Yarmuk Camp and the other in old Damascus—with plans to expand operations to three additional branches in Damascus by the end of 2007, and two more branches in Aleppo in 2008.

The MMD currently offers two products: Microenterprise Credit (MEC) and Solidarity Group Loans (SGL). The MEC is an individual working capital loan for microentrepreneurs with loan amounts ranging from US$200 to $1,000 for first-time borrowers. Repeat borrowers that repay loans can secure loans ranging between US$200 and $6,000 for a term of six to nine months. The

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[35] Definition: A cost-plus sale pricing strategy whereby the provider of funds actually purchases the commodity and resells it to the user (i.e., the "borrower") with a mark up against installments or delayed payment. Unlike conventional finance it links lending to the asset and involves ownership risk on the asset.

[36] MDD not yet operational in Lebanon.

[37] The most recent data available from UNRWA and presented herein is approximately six months old, i.e., from January 2007.

interest rate charged is 2.2 percent flat per month for loans less than US$1,000, and two percent for loans greater than US$1,000. The form of guarantee used is promissory notes that are publicly notarized.

MMD began offering solidarity loans in April 2007. These loans are offered primarily to women for home-based enterprises. Successful borrowers can graduate to obtain individual microenterprise loans. Based on the two-month track record, at the time of the field mission, the repayment rate for the SGL product was at 90 percent for on-time repayments and 98 percent overall.

In terms of legal action taken against defaulted borrowers, 70 cases have been taken to court by MMD since the inception of the program. However, such legal action has not proven to be effective in securing repayment since the borrowers are confident that the courts will rarely pursue legal action against them, or at least will not execute court decisions such as jail sentencing (possibly because of their refugee status). The end result of such legal action is often times a monetary fine that can be paid over two years.

In addition to legal enforcement, MMD continues to face several institutional challenges that could inhibit growth. These include:

- The absence of a credit culture and a lack of understanding regarding the concept of credit and financial management among the camp populations.
- High turnover among loan officers (LOs) due to the absence of an incentive scheme. (LOs in the MMD program are salaried employees and do not receive additional financial incentives.)
- Bottlenecks due to the lack of an effective and comprehensive MIS hamper ability to grow and respond to the potential demand.

Perhaps the most significant challenge currently facing MMD is how to move forward in light of the new Microfinance Decree. It is unclear to UNRWA how the decree may affect MMD lending operation in light of the institution's special legal status. The three options being considered by UNRWA management are: 1) to convert to a commercial lending institution under the new decree; 2) to investigate the possibility of partnering with another institution; or 3) as a more distant option, to transform to a bank. While all three options are still being explored, at present, the first option seems to be the most likely one to be pursued. If indeed the decision is taken to transform to a lending institution, then MMD will have to separate from the UN and become an independent entity. MMD has indicated that in this case, it would have no problem meeting the minimum capital requirement stipulated by the decree. With regard to other future expansion plans, in 2008, MMD plans to increase its product offerings to include both housing and consumption loans. By 2009 MMD aims to introduce SME loans, as well as to expand to a total of nine branches serving some 30,000 clients.

The Agency for Combating Unemployment (ACU)

The ACU was established under Law 71 through the Prime Minister's Office with the initial objective of job creation and training for Syria's unemployed. Until recently, the ACU also provided subsidized microcredit through numerous state banks such as the Agricultural Cooperative Bank and the Savings Bank. Due to the poor performance of ACU's loan portfolio since inception, the Government of Syria mandated a restructuring of the institution and terminated ACU's lending operations upon expiration of its founding law in 2006 transforming ACU to become the Development and Employment Commission (DEC).

FUND FOR INTEGRATED RURAL DEVELOPMENT OF SYRIA (FIRDOS)

FIRDOS, a Syrian NGO, was established in 2001 with a mandate for rural development. The NGO is registered under a special law governed by the Ministry of Social Affairs, which allows it to provide financial services as a tool to enhance area development within the rural regions in which they operate. FIRDOS has been providing microcredit services in 60 villages across six governorates (Aleppo, Hama, Edleb, Latakia, Homs, and Qunaytra). The NGO reported having lent to 3,500 borrowers a loan portfolio of US$3.5 million since the inception of lending operations. Its total number of active clients is reported to be approximately 1,000.

As noted above, FIRDOS receives 60 percent of its funding from the EU and UN, and the remaining 40 percent is raised through local corporate social responsibility efforts from Syrian institutions. Up until 2004 the NGO had been lending at zero percent interest; thereafter it began charging an interest rate of 4.5 percent flat for a maximum term of 30 months, with monthly repayments. The average loan size offered by FIRDOS is US$2,850. Originally, its loans ranged in size from US$950 up to US$12,252; but its maximum loan amount was recently reduced to US$5,701. According to the Executive Director, the NGO has maintained a repayment rate of 99 percent, which is attributed to FIRDOS' solid standing in the communities in which it operates. FIRDOS recently stopped its lending operations in order to reevaluate its microcredit program.

BOOSTING AND INSPIRING DYNAMIC YOUTH ACHIEVEMENT (BIDAYA)

BIDAYA is perhaps Syria's most fledgling microfinance initiative. It is a Syrian NGO that was originally established as a pilot program in 2004 by FIRDOS, the Syrian Young Entrepreneurs Association, and MAWRED (Modernizing and Activating Women's Role in Economic Development). Youth Business International (YBI) also assisted with the development of the NGO, and today BIDAYA is an accredited Youth Business Program (YBP) and part of YBI's network of YBPs.

In June 2006, BIDAYA became licensed as an independent NGO with the mission of providing financial support to unemployed and underemployed young people (ages 18 to 35). BIDAYA serves those with a viable business proposition that are unable to access credit through conventional means. The NGO also provides borrowers with volunteer business mentors and full access to the organization's local and national business support network. BIDAYA's specific objectives are:[38]

- To create jobs by offering an outlet to young Syrians with potential business force.
- To contribute to the expansion of the private sector by deepening the pool of national entrepreneurs.
- To help fill the gap of Syria's lending system by meeting the financial needs of very small businesses: needs that can not be addressed by the conventional banking system.
- To give hope and provide role models to unemployed young people.

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[38] www.bidaya.org, last accessed on September 5, 2007.

- To provide support and encouragement through mentoring and where appropriate, to provide guidance and training.

BIDAYA reports that on average, 72 percent of beneficiary businesses are still trading in their third year. The NGO attributes this level of success largely to its business mentoring approach, whereby an experienced mentor guides the young entrepreneur during the first three years of business start-up.

Today, BIDAYA has 35 active borrowers (up from 15 borrowers last year). Loans are offered at four percent flat up to a maximum of US$3,800 over a three-year term. The repayment rate is estimated at 80 percent. In terms of loan guarantee, a promissory note is used, and in some cases a cosigner may be required. (It should be noted that since BIDAYA is a relatively young and underdeveloped organization, it could not provide further information regarding its loan portfolio.)

Chapter Three
Legal and Regulatory Framework for Microfinance in Syria

A. RECENT LEGAL AND REGULATORY CHANGES

The financial sector in Syria has seen a number of new laws, policies and regulations passed by the Government of Syria over the past few years. Notable laws and regulations governing the operations of financial institutions include:

- Private Banking Law no. 28 for the year 2001.
- Credit and Monetary Council Law no. 23 for the year 2002.
- Money Laundering Legislative Decree no. 33 for the year 2005.
- Banking Secrecy Legislative Decree no. 34 for the year 2005.
- Islamic Banking Law no. 35 for the year 2005.
- Insurance Legislative Decree no. 43 for the year 2005.
- General Microfinance Decree no. 15 for the year 2007.

B. GENERAL BANKING AND FINANCIAL SERVICES FRAMEWORK

Banks in Syria are permitted to carry out all banking services defined under Article 85 of Credit and Monetary Council Law no. 23, including microfinance activities. Additionally, as noted above, Private Banking Law no. 28 and Islamic Banking Law no. 35 also state that licensed private and Islamic banks may carry out all banking activities, which include microfinance activities.

The Private Banking Law no. 28 prohibits any natural and juridical persons from owning more than 5 percent and 49 percent, respectively, of the shares of a private bank. In addition, no foreigner (i.e., non-Syrian) may own more than 49 percent of the capital of a private bank. These rules apply to both private banks and Islamic banks.

The option of establishing a for-profit entity that provides microlending only is available due to the fact that there is no legal requirement that obliges a permission to lend. This entity can be registered as a company as stated in the Commerce Law and falls under the jurisdiction of the Ministry of Economy and Trade with minimal reporting requirements.

C. MICROFINANCE FRAMEWORK

Syria’s General Microfinance Decree no. 15 (Annex 1) was enacted by a presidential order in February 2007, giving permission to the CMC to license Social Financial Banking Institutions (SFBIs) that will provide various financial services, including microlending, deposit-taking and microinsurance to the poor. The executive instructions of the decree (Annex 2) define a Social Financial Banking Institution as “an institution that provides microfinance funding in addition to other financial and banking services in pursuance of the relevant laws.” Microfinance is defined by these executive instructions to include lending and deposit-taking in addition to the provision of other financial and banking services to the poor.

The social objectives of the institutions pertain to the overall aim of providing financial services to the low income population that microfinance institutions typically serve. It is essential to note that the word “social” in the term “Social Financial Banking Institutions” reflects only the social objectives of these institutions; it does not mean that these institutions must be non-profit or charitable entities. Neither the Decree nor its executive instructions stipulate a maximum amount in SYP or other currencies to qualify as a microfinance loan.

The General Microfinance Decree is Syria’s first and only law exclusively dedicated to microfinance. While laws and regulations enacted prior to 2007 do not focus specifically on microfinance, the Private Banking Law and the Islamic Banking Law do allow licensed private and Islamic banks to carry out the full range of banking activities (i.e., including microfinance).

The CMC is also responsible for establishing rules and prudential regulations necessary to ensure the continuity and soundness of the SFBIs’ operations. Reporting requirements set by the recently approved executive instructions are very much similar to those set for banks, where an audited balance sheet and a profit and loss statement should be submitted to the Central Bank according to the International Accounting Standards. Prudential regulations were not stated by the instructions, but it is important to note that the CMC adopts the Basel principles and standards that govern solvency ratio, liquidity ratios, required reserve, capital adequacy ratio, credit risk concentration ratios and corporate governance to all licensed banks in Syria. Given that the capital requirement for establishing a SFBI is markedly less than that of banks, the prudential regulation requirements will likely vary from those of banks, as well.

Social Financial Banking Institutions

As provided by Article 13 of the Microfinance Decree, all SFBIs shall be governed by the rules of the Commerce Law no. 149 for the year 1949. In the event of a conflict between the Commerce Law and the Microfinance Decree, the provisions of the Microfinance Decree shall take precedence. In effect, an SFBI must be registered as a commercial company.

The Commerce Law includes five types of commercial companies (general partnership, implied trust, limited partnership, limited liability company, and S.A. joint stock company), but only the S.A. joint stock company (JSC) would be an appropriate legal form for a deposit-taking microfinance institution (MFI).[39] Furthermore, the executive instructions specify that an SFBI must be formed as a S.A. JSC. (Note that one could form a limited liability company to engage in microlending only.)

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[39] The first three types of legal forms (general partnership, implied trust, limited partnership) are known as “natural persons companies” because shareholders in these types can only be natural persons. This would likely be inappropriate for most MFIs given that none of these legal forms could have a juridical person as a shareholder. Additionally, a deposit-taking MFI can not be registered as limited liability companies because Article 284 of the Commerce Law no. 149 for the year 1949 prohibits limited liability companies from performing insurance, economic and savings activities. Although there is no definition of the term “economic” in the law, the Ministry of Economy (as the relevant governing body) has indicated that the term “economic activities” refers to financial activities such as insurance, banking and savings. It would not include lending only.

One complication for MFIs that might be considering transforming into an SBFI is that the law requires a minimum of five founding shareholders for a JSC (as per Article 103 of the Commerce Law no. 149 for the year 1949); shareholders in JSC can be either natural or juridical persons. This requirement, on the one hand, encourages more diverse governance; however, it would preclude the existence of one major international organization that typically establishes microfinance entities with 100 percent ownership. On the other hand, ownership diversification is less stringent than restrictions stipulated for private or Islamic banks.

Licensed SFBIs can be established by Syrian or foreign institutions (including an international NGO). Other than the requirement that foreign entities obtain the prior approval of the Ministers Cabinet before submitting a license application to the CMC, there are no limitations on foreign ownership in SFBIs. Public (i.e., state-owned) banks must also obtain the approval of the Ministers Cabinet (based on the recommendations of the Minister of Finance and the CMC) prior to acquiring ownership in an SFBI. Aside from these requirements for pre-approval and a minimum of five founding shareholders, there are no specific limitations imposed by the Microfinance Decree on the percentage of shares owned by any shareholder in SFBIs.

It is worthwhile noting that the JSC structure also applies to banks and clearly has not proven to be a deterrent in face of attracting investors into the banking sector in Syria. Large commercial banks from Lebanon and Jordan have been able to register in Syria as JSC, although their ownership is restricted to 49 percent so they were obliged to accept other shareholders.

The minimum capital for SFBIs is SYP 250 million (the equivalent of US$5 million). The institution must deposit an amount equal to five percent of the paid capital at the Central Bank in a frozen and interest free account; this deposit shall be paid back to the SFBI only in the case of liquidation. Profits and capital repatriation is allowed for non-Syrian shareholders. Non-Syrian experts and employees of SFBIs are allowed to transfer only 50 percent of their wages and bonuses and 100 percent of their remunerations at the end of employment.

SFBIs are allowed upon approval of the CMC to open branches and mobile services where needed. According to the executive instructions, an SFBI is not permitted to engage, directly or indirectly, in any of the following activities: commercial, industrial and agricultural works and activities, or any other activity not related to financial and banking activities and services. In addition, the executive instructions prohibit an SFBI from directly or indirectly investing in or partnering with any institution engaged in an industrial, commercial, agricultural servicing, or tourism business, nor can an SFBI invest in real estate, except for its own offices and in connection with its financial activities (e.g., mortgages, execution of pledges). The Insurance Supervisory Commission has the authority to supervise all microinsurance activities carried out by SFBIs (Article 10 of the Microfinance Decree).

It is important to note that the following laws also apply to SFBIs to the extent that they do not conflict with the Microfinance Decree:

- Commerce Law no. 149 for the year 1949.
- Private Banking Law no. 28 for the year 2001.
- Credit and Monetary Council Law no. 23 for the year 2002.

- Money Laundering Legislative Decree no. 33 for the year 2005.[40]
- Banking Secrecy Legislative Decree no. 34 for the year 2005.[41]
- Insurance Legislative Decree no. 43 for the year 2005.

NGOs

Microfinance in Syria, as described above, has largely been the domain of a few NGOs and UN related programs operating under special government decrees. NGOs, particularly the few that have provided microloans, have heretofore operated under the law known as the Associations and Private Institutions Law. The law identified an NGO as a group of persons, whether natural or juridical, with nonprofit objectives and gave the Ministry of Social Affairs and Labor jurisdiction over NGOs which can be registered after fulfilling the inception requirements stipulated by law. It is worth mentioning that the law does not state any restrictions with regards to foreign ownership. The law is also silent on the provision of credit implying that there is no permission to lend requirement.

No entity in Syria is allowed to mobilize savings outside of the purview and supervision of the Central Bank. This applies to NGOs, which are forbidden to accept deposits and provide any financial services besides microloans. The law also clearly stipulates that all NGOs require pre-approval for any funds transferred into or out of Syria. Moreover, Syrian law does not permit international NGOs to operate through a representative office, thus no international NGOs have been able to set up microfinance operations in the country without registering as a local NGO under the NGO law no. 42.[43] Reporting requirements set by the law are minimal; other than submitting their audited annual balance sheet, there are no other non prudential or prudential requirements for NGOs. In the case of liquidation the residual assets of NGOs may not be given back to the founders, they can only be distributed as stated in the bylaws and in case the bylaws are silent, the remaining assets shall be given to another NGO with similar objectives. Additionally, the NGO law gave the Ministry of Social Affairs and Labor, if found necessary, the authority to merge NGOs of similar activities and objectives. Finally, the Microfinance Decree in no way affects the operation of NGOs engaged in microfinance as they could still operate under their NGO charter in the same fashion they have in the past.

Interest Rates

NGOs who operate under the NGO law may not charge an interest rate above the maximum interest rate of 9 percent stipulated by Article 228 of Civil Code no. 84 for the year 1949. The 2002 Credit and Monetary Council Law, however, gave the CMC the authority to permit interest rates above the limit stipulated by the civil code.

Pursuant to the Microfinance Decree, the CMC has discretion regarding its approval of SFBIs' proposed interest rates, "*taking into consideration the special nature of the institution's*

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[40] This law applies to all banking and financial institutions, including SFBIs. The law requires all such institutions to keep records of all transactions above the limits specified by the authorities and check the identity of the clients.

[41] This law prohibits SFBIs (and all other institutions to which it applies) from divulging information about their clients unless required by the law.

[42] An international NGO may, however, establish a local NGO or set up a local commercial company.

[43] AKDN falls under the NGO law and was registered as a NGO by a presidential order.

objectives and activities" (quoting Article 9 of the Decree). This could be a barrier to the sustainability of SFBIs unless the CMC takes into consideration that microfinance costs cannot be compared to traditional banking costs or that of MFPs that have capital grants and thus enjoy cost-free funding in some cases.

Transformation Options

NGO Transformation. A local NGO is not permitted to set up and transfer its operations to a local commercial company because the Associations and Private Institutions Law treats NGOs as not-for-profit and charitable entities and prohibits profit distribution.[44] Setting up a commercial company would be considered a way to distribute profits to the members or founders of the NGO by transferring its "charitable assets" (its loans) to the commercial company, even if the NGO received shares or other compensation in exchange for the transfer of assets. However, a local NGO could transfer its operations to an *existing* commercial company. Because some existing MFPs (including AKAM) were established by special decree, it appears they may be able to "transform" their loan portfolios to newly established SFBIs under special circumstances.

Non-NGO Transformation. A local commercial company may "transform" into a licensed prudentially regulated legal form (i.e., SFBI) under the general rules of the Commerce Law.

Tax Rules for Different Legal Forms

As per common practice elsewhere, NGOs in Syria are exempt from taxes. SFBIs, however, are subject to a flat income tax rate of 25 percent of net profits, as are private banks (in accordance with Article 13 of the Microfinance Decree no. 15 and Article 25 of Private Banking Law no. 28).

Foreign Exchange Policies

SFBIs are allowed, when necessary (as determined by the CMC, and in its sole discretion), to deal in foreign currency through banks licensed to deal with foreign currencies. SFBIs are not allowed to deal in foreign exchange for retail customers directly, which may present a constraint on SFBIs' ability to meet the remittance and other foreign currency needs of their clients over the long term.

Deposit Insurance

Each bank must set aside ten percent annually of its net profits for allocation to a special reserve until the total reserve equals 100 percent of the bank's capital pursuant to Article 97 of the Credit and Monetary Council Law no. 23 for the year 2002. This reserve is treated as a guarantee for depositors to recover their deposits in case of liquidation, given a priority over other creditors. The "special reserve" is separate from and additional to the legal reserve required by the Commerce Law, which requires all Joint Stock Companies annually to set aside ten percent of net profits for a legal reserve until it reaches 50 percent of the total capital. Joint stock companies have the option to set aside a maximum of 25 percent (percentage decided by general assembly) of net profit annually as optional reserves until it reaches 100 percent of the total capital. Banks

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[44] In case of liquidation of an NGO, the law prohibits the return of the NGO's remaining assets to its members or founders.

and insurance companies are exceptions in the case of optional reserves where the percentage can be more than 25.

There is no requirement for deposit insurance under the laws and regulations that govern SFBIs. The executive instructions adopted pursuant to the Microfinance Decree also require each SFBI to set aside annually ten percent of net profits for reserves until the total reserve equals one half of the capital of institution. This reserve fund is also established to protect depositors.

Credit Reference

There is no credit reference system that provides credit history and information about potential clients in Syria. This leaves MFIs in need to adopt informal ways that are neither accurate nor sufficient. A reliable credit reference system would assist MFIs in assessing the credit worthiness of their potential clients and reduce lending risks. This system should also take into consideration that setting a minimum principal amount for reported loans should accommodate the average microloan as otherwise that may render the whole system cost prohibitive to MFIs. Additionally, there are no credit guarantee schemes focused on microfinance which could provide a track record for the industry and an option for mitigating the risk with new clients.

Collateral Registration and Requirements

Collateral and collateral substitutes in microfinance include movable and immovable assets. Vehicles in Syria enjoy the same collateral registration as property; however, the legal system does not have a clear policy in the event the collateral is a moveable asset. Typically collateral registration is made through an application to the relevant body where various documents are submitted with the application such as a pledge agreement and others.

D. SUMMARY OF KEY LEGAL AND REGULATORY ISSUES

The following section summarizes key issues regarding the legal and regulatory framework as well as the newly issued Microfinance Decree, as pertains to the operation of MFPs in Syria.

Social Financial Banking Institutions

- Limitations on the ability of SFBIs to establish market **interest rates** that allow them to serve their clients sustainably is a significant barrier to their viability, as well as the potential of the new Microfinance Decree to accomplish its goal of expanded access to poor and unbanked Syrians. Along with interest rate controls on NGOs and banks, this is a major policy issue to be resolved by the GOS if microfinance is to thrive. Also, the time needed for pre-approval of interest rates by the CMC may hinder the development of new products for the SFBIs.
- The CMC is encouraged to clearly define **prudential regulation**s suited to microfinance operations under the SFBI framework. As such, the solvency ratio, liquidity ratio, capital adequacy ratio, and credit risk concentration ratios, as well as non-prudential corporate governance standards, adopted by the CMC should differ for the SFBIs compared to those for banks. The GOS could benefit from the technical assistance offer by KfW in adjusting conventional prudential banking standards to fit the SFBI framework.

- The **range of the financial services** that can be offered by SFBIs should be reviewed on an ongoing basis to assess whether allowing new activities - such as foreign remittances and leasing – is feasible. Such efforts would increase the ability of SFBIs to respond to the changing needs of their clientele for various microfinancial services.
- Per the Microfinance Decree, the percentage of **reserves** that should be allocated annually by SFBIs is relatively high, totaling 30 percent of net profits. This 30 percent is reached as a result of three requirements. First, the CMC law requires the allocation of 10 percent of annual net profits as a special reserve until the total reserve equals 100 percent of capital. Second, the Commerce Law requires 10 percent of annual net profits to be allocated as a legal reserve until it reaches 50 percent of capital. Third, the executive instructions for the Microfinance Decree require 10 percent of annual net profits to be allocated for reserves until the total reserve equals 50 percent of capital.
- While the executive instructions for the Microfinance Decree specify setting a percentage of **reserves** based on net profits, no required reserves are specified based on deposits. This is a typical requirement for deposit-taking institutions in other countries as a tool to protect depositors and execute monetary policy.
- The role of the **internal auditor** appointed by the CMC as per article No. 10 of the decree needs to be defined and clarified.
- SFBIs must obtain approval from the Ministers Cabinet before accepting foreign aid and donations, which can be a time consuming process. It may be more appropriate to assign this duty to the Central Bank.
- SFBIs are prohibited from accepting deposits in **foreign currencies**. However, the executive regulations would permit an SFBI, for the purpose of performing its operations, to deal with foreign currency through commercial banks. This could limit development of SFBIs over the long term, as many low income households that represent the SFBIs' potential client base have demand for holding accounts in foreign currency stemming from the remittances sent by family members working abroad. The CMC may want to reconsider this prohibition at some point in the future, once SFBIs have demonstrated the capacity to manage the risks inherent in this type of activity.

NON-GOVERNMENTAL ORGANZATIONS

- Charitable NGOs fill an important grassroots niche in Syrian microfinance where commercial institutions may not be able or willing to participate. The legal **transformation** of such programs into SFBIs does not seem to be an issue in the current environment. Nonetheless, NGOs that desire to shift from a purely charitable to a commercial orientation in the future should have the legal flexibility to do so should they determine this to be the most appropriate way to serve their client base. The NGO laws should be amended to facilitate natural market evolution such as this.
- NGOs – including those engaged in microfinance – are overseen by the Ministry of Social Affairs and Labor, which is not the appropriate body to regulate a financial entity. In order to maintain a level playing field and better assess systemic risks and consumer protection issues, it would be prudent to shift **oversight responsibility** to the CMC and Central Bank.

Yet another concern is the weak reporting standards required of these institutions as set by the NGO law.

- NGOs are not allowed to charge an **interest rate** above the maximum of 9 percent stipulated by the Civil Code, which may prevent sustainability of their microlending programs.
- NGOs must obtain pre-approval to accept foreign aid and donations from the competent government authority, the identity of which would depend on the objectives of the NGO. While this is not necessarily an obstacle, it is a requirement that may be time consuming for both the government and the microfinance lenders.

STATE BANKS

- State banks face two critical barriers to downscaling their operations to serve microfinance clients **– interest rate controls** and **restrictions on public sector employee remuneration**. One emerging solution is for state banks to create a commercial subsidiary to conduct microfinance activities. However, over the long term it would be prudent to recognize the valuable role these banks could play in offering microfinance services given their existing branch networks and established reputations, and revise interest rate and public sector human resource policies accordingly.

OTHER KEY ISSUES

- A key issue for the entire sector is the need for the GOS to more clearly define the different aspects of the Syrian microfinance sector, recognizing the range of providers (banks, NGOs, SFBIs) and types of products and services (charitable/relief oriented, microfinance, and SME lending). There are valid reasons and strategies for each institution and market niche, and the GOS should provide a regulatory and supervisory framework that facilitates the sound growth and development of each.
- The absence of loan guarantee schemes and credit reference systems that typically help to mitigate credit risk could adversely affect loan portfolio quality in an expanding microfinance environment.
- As with the state banks, remuneration policies for employees of the Central Bank constitute a notable hurdle because they inhibit its ability to attract and retain qualified, professional personnel. A competitive working environment is necessary in order for the CB to attract a skilled staff that currently can otherwise find higher salaries in the private sector.

Chapter Four
Donors, Investors, and Practitioners Influencing Microfinance

The primary donors influencing microfinance in Syria today are KfW, UNDP, AKDN, and CGAP each to varying degrees and in differing ways. UNDP's influence has been limited primarily to that of an implementer (i.e., a microfinance provider), while KfW's influence is limited to that of a potential investor as it is expected to make a sizeable investment in AKDN's First Microfinance Bank of Syria. The IFC will likely play a future role in the microfinance sector in Syria as another potential investor in the First Microfinance Bank. CGAP's role has been to build awareness among policy-makers and key stakeholders in the GOS, as well as work with the SB on its downscaling efforts through its Retail Advisory Services unit.

AKDN, an international NGO and the market leader, has played a major role in the development and passing of the new Microfinance Decree, motivated by their desire to establish Syria's first SFBI. The organization worked very closely with the CMC throughout the process of developing the law, and was a major influence on the government's decision to pass it. It should be noted that throughout this process, AKDN strongly pushed for the adoption of best practice guiding principles for microfinance.

In terms of the availability of human resources for more intensive reform efforts, it is clear that Syria will require continued support from donors to build local capacity, particularly in terms of effective regulation and supervision of the microfinance sector. While passing the Microfinance Decree has been an achievement on the part of the government, it is now challenged with the task of becoming an effective regulator and one that cultivates an enabling environment for microfinance. To foster such an environment, widespread but targeted awareness and capacity building will be required among various government stakeholders.

Among the Syrian government bodies and policy makers with a solid understanding of the various needs and challenges facing the microfinance sector in Syria are the State Planning Commission, the Central Bank, and the CMC. Each of these bodies has played a critical role in supporting the microfinance sector and in passing the new decree. They all agree that additional capacity building within the various government institutions is required in order to provide a strong backbone for the relevant supervisory authorities.

Chapter Five
Recommendations for Developing Microfinance

In light of the recent financial sector reforms and newly issued laws, the groundwork for an enabling legal and regulatory environment conducive to the expansion of microfinance in Syria is now in place. The government has taken positive steps in establishing financial sector laws that are attractive to private sector investment, the results of which are evident in the relatively rapid development of the private banking sector in just a few short years. Furthermore, the Microfinance Decree, in addition to marking a milestone as the first such legislation in the region, presents an attractive framework for the creation of Social Financial Banking Institutions and the expansion of lending and deposit services to Syria's "unbanked" population.

While these changes are encouraging, Syria's microfinance sector remains in a nascent stage of development and much work remains to be done to meet the enormous unmet demand for financial services by Syria's poor and unbanked citizens. To that end, there are a variety of sector strengthening activities available from technical assistance providers that could help facilitate continued development and maturity of the sector. Such activities should focus on training and awareness building; networking; alternative models for microfinance; and technological innovations. Such activities will help to improve performance of the sector; bolster the understanding and capacity of implementers, regulators, and policy-makers; increase transparency among MFPs; and integrate Syria's microfinance sector into the global microfinance industry.

Training and Awareness Building

Training and awareness building among all key stakeholders is needed to: (1) demonstrate the commercial viability of microfinance as a legitimate and sustainable financial delivery system that can effectively benefit the working poor, and how this differs from public or charitable development tools that may be government-subsidized and/or interest-free; and (2) build local capacity to effectively regulate and implement microfinance activities in accordance with globally accepted good practice norms. Activities could include:

- A series of microfinance roundtables and/or conferences for high-level GOS decision-makers, with guest speakers (e.g., bankers, heads of successful MFIs in the region, local and foreign government officials, microfinance experts from the donor community) who can showcase microfinance success stories from other countries. Round table discussions could be hosted by the Central Bank, State Planning Commission and/or the Ministry of Finance.
- Targeted training and capacity building on microfinance best practices for MFP managers and loan officers, bank staff, regulators, and policy-makers. Activities could include:
  - Training for regulators and policy makers that focuses on issues such as interest rates, transparency, internal audit controls, reporting standards, etc.
  - Tailored training and technical assistance for MFPs and banks focusing on: product development, delivery schemes, operations, monetary incentives for staff, strategic planning, delinquency management, fraud control, training of trainers, MIS, etc.

- Study tours (south-south exchange) for both implementers and policy-makers to observe, firsthand, the operations and successes of MFPs in other countries.
- Donor-funded scholarships for promising MFP and regulatory staff to the Boulder Microfinance Training Program.
- Build a cadre of local BDS providers at the meso-level that can provide long-term support to the sector. For example, identify and sponsor a few local consultants, lawyers, etc. to attend the MicroSave Training.
- CGAP donor training.

Networking

Facilitate networking and create linkages with local, regional and international entities. This will help to facilitate transparency and knowledge sharing, increase exposure to good practices, and encourage innovations and the pursuit of alternative approaches to microfinance. Activities could include:

- Linking MFPs to the MIX Market.
- Establishing a national microfinance network for Syria.
- Linking Syrian MFPs to regional and/or global microfinance networks, such as Sanabel.

Alternative Models for Microfinance

Continue to explore and test new models for microfinance including (1) bank downscaling; (2) bank servicing model; and (3) Greenfield microfinance banks. It should be noted here that in order to help determine the viability of these and other approaches, a full microfinance ***market assessment*** is needed. To-date, a few studies of the microfinance sector have been conducted, but a formal and comprehensive market assessment has not. Such an assessment – including primary client-level research – is imperative to accurately gauge outreach and the effective and potential demand in the country, as well as to identify appropriate products and methodologies for lending in the Syrian context.

Greenfield Microfinance Banks. Given the potential size of the microfinance market in Syria, there is ample space and opportunity to grow the sector with Greenfield investments. The foundation laid by the Microfinance Decree and the initial licensing of AKDN's First Microfinance Bank (with investment from KfW and the IFC) have both contributed to attracting the attention of potential investors.

Bank Downscaling. The rationale for bank downscaling falls along the same lines noted above for start-up and Greenfield banks, with several additional factors worth considering. Banks may be the appropriate institutional mechanisms to reach scale in a more cost efficient and effective manner because they already have a branch infrastructure and require little additional investment. CGAP's work on a downscaling effort with the state-owned Savings Bank should be watched carefully to identify best practices and lessons learned. The constraints within the public sector context notwithstanding – notably interest rates, remuneration and capacity – state-owned banks have the advantage of established trust and links with potential microfinance clientele whom, in Syria, may be somewhat wary of working with the private sector banks.

The Bank Servicing Model. Among the advantages of the bank servicing model is that it allows for a private sector approach of managing microfinance portfolios while capitalizing on the main strengths of both the public and private sector banks. As with bank downscaling, the servicing model provides a more scalable and sustainable alternative to the NGO approach. Not only does it allow for reaching scale faster, it may encourage banks to engage in microfinance lending more quickly through an approach that mitigates risk and limits the amount of operational restructuring that may otherwise be required to explore this new market.

TECHNOLOGICAL INNOVATIONS

Encouraging technological innovations in the microfinance sector in Syria could help improve operational efficiencies and expand outreach to remote areas far more rapidly. Possible innovations that could be explored include "branchless" banking using mobile telephones. CGAP's Focus Note no. 38 "Use of Agents in Branchless Banking for the Poor: Rewards, Risks, and Regulation" (October 2006) may provide useful guidance in this area.

Annex 1
General Microfinance Decree of Syria

create mobile banking service units in the areas where such services are deemed to be needed.

Article 7- Institutions licensed pursuant to the provisions hereof undertake to:

a- Deposit, in a blocked (frozen) account without interest with the Central Bank of Syria, an amount equal to 5% of their paid capital. Such an amount shall be considered one of the elements of its fixed assets which is to be refunded at the liquidation of its activities.

b- Appoint immediately upon commencement of its activity one or more external commissioner to be nominated by the institution.

c- Abide by international accounting standards.

d- Use modern technologies in its operations.

Article 8- The statutes of the institution shall include all the provisions governing its activities and management. It shall be subject to the ratification of the Council of Currency and Crediting.

Article 9- The Council of Currency and Crediting shall set up the rules and precautious regulations needed for the continuity and safety of the operation of the institutions. It shall approve the proposed interest rates taking into account the special nature of their objectives and activities.

Article 10- Institutions created in pursuance of the provisions hereof shall be subject to control, supervision and follow-up of performance by the Council of Currency and Crediting through the relevant entities of Central Bank of Syria. Institutions are subject to the supervision of the General Authority for the Supervision of Insurance regarding their activities in micro-insurance. Institutions undertake to provide the periodic reports required by the Central Bank and undertake also to allow the inspectors of that bank to pay field visits entailed by its control. Institutions must also appoint internal bank auditors in accordance with the instructions of the Council of Currency and Crediting in this respect.

Article 11-

a - When necessary, institutions created in pursuance of the provisions hereof shall deal in foreign currency through commercial banks authorized to deal in foreign currency.

b - Institutions created in pursuance of the provisions hereof shall be allowed to transfer the following accruals abroad based on their duly legalized annual budgets and accounts:

- The interests, revenues and other costs incurred on the capital of the institution paid by non Syrian shareholders.
- Compensations and travel expenses of the non Syrian members of the boards of directors of the institutions and their directors general.
- 50% (fifty percent) of net wages, salaries and allowances, and 100% (one hundred percent) of the compensation of the end of employment receivable to non-Syrian experts, technicians and personnel operating for the institutions.

- Value of the sold/recovered shares of capital or the outcome of the liquidation of the institution capital related to non-Syrian shareholders.

Article 12- Institutions created in pursuance of the provisions hereof are prohibited to perform, whether directly or indirectly, the following activities:

a- practice of commercial, industrial and agricultural businesses and activities or any other activity which is not related to financial and banking services allowed by the foregoing Act or by the statutes of the institution that are issued in accordance with the provisions of this Act.

b- Participation or partnership in industrial, commercial, agricultural, services or tourism institutions.

c- Ownership of real estates except for the needs of the institution offices and practice of its activities.

Article 13- For all issues not contradictory to the provisions hereof, authorized institutions shall be subject to the laws, regulations and executive instructions in force and especially to the Law No /149/ of the year 1949 and its amendments, Law /28/ of 2001, and Law /23/ of 2003 as well as the Legislative decrees No /33, 34, 43/ of 2003 .

Article 14- Institutions to be created in pursuance of the provisions hereof shall be licensed pursuant to procedures set up by the Council of Currency and Crediting and validated by the Council of Ministers.

Article 15- This Act shall be published in the official gazette.

Damascus, / / 2/ 2007

Bashar Al Assad

President of the Republic

Annex 2
Executive Instructions for Microfinance Decree No. 15

EXECUTIVE INSTRUCTIONS FOR MICROFINANCE DECREE NO. 15

Syrian Arab Republic

Monetary and Crediting Council

RESOLUTION No. (306//mn/b1)

In pursuance of the provisions of the Act of Central Bank of Syria and the Basic Monetary Statute No./23/of 2002

In pursuance of the provisions of Legislative Decree No./15/ of 2007-08-21 and in pursuance of its consideration in its session held on 25/7/2007,The Monetary and Crediting Council hereby decides as follows:

Article 1- Accreditation of the Draft Executive List of Legislative Decree No/15/ of 2007 (enclosed herewith) which has permitted the Monetary and Crediting Council to license financial and social banking institutions named “Institutions” that aim at providing microfinance in addition to financial banking services.

Article 2- This resolution is to be notified to whom it may be necessary to put into force.

Damascus 25/07/2007

Governor of Central Bank of Syria — **Chairman of Monetary and Crediting Council**

/ Signed/ — **/Signed/**

Dr. Adib Mayaleh

Secretary of Monetary and Crediting Council

/Signed/

Hanaa Awadeh
Ratified

Eng. Mohammad Naji Otri
Prime Minister
/Signed/

5/8/2007

Syrian Arab Republic
Monetary and Crediting Council

Executive List of Legislative Decree No/15 of 2007

In pursuance of the provisions of Legislative Decree No./15/ dated 27/1/2007 which has permitted Monetary and crediting Council to license financial and social banking institutions to be named “Institutions” that aim at providing microfinance in addition to other financial and banking services, and in pursuance of the provisions of Article /14/of said Decree, Monetary and Crediting Council has approved the following executive list:

Article /1/:

1- The words and terms provided for in the foregoing list shall be intended to mean as it is matching thereto:

Microfinance: financial services such as lending, and depositing in addition to other financial and banking services for poor segments of populations in order to help families create opportunities for owning and increasing the accumulation of assets and control consumption.

Social banking financial institution: The institution that provides microfinance in addition to other financial and banking services in pursuance of the relevant legislations.

Microinsurance services: providing the insurance coverage against installments regularly paid so as to fit the probability of risks and their costs taking into account the needs of poor people for necessary protection against those risks and against an acceptable cost.

2- These institutions shall provide financial services such as:
a- Acceptance of deposits in Syrian currency for various terms.
b- Providing microcredits to the targeted segments of population.
c- Providing micro insurance services connected with their loans and re-insurance with one of the insurance companies licensed in the Syrian Arab Republic.

Article /2/:

1- These institutions may be created as joint stock companies by Syrian, Arab or foreign institutions or bodies recognized for their expertise and knowledge of such type of activity. The evaluation of availability of such expertise or not, however, shall be vested in Central Bank of Syria. It is conditional for the foreign body interested in being licensed to obtain a prior consent of the Council of Ministers to operate in Syria.
2- Subsequent to incorporation and commencement of their activities, these institutions are entitled to introduce other partners therewith to expand their operation, while it will be conditional to obtain a prior consent of the Council of Ministers on the partnerships of foreign bodies upon recommendation by Monetary and Crediting Council.

Article/3/ Capital of the Institution to be created:

1- The minimum capital of these institutions is determined to be /250/ million Syrian pounds, which is to be paid in cash to the treasure of Central Bank of Syria.
2- Non Syrian shareholders shall pay the value of their shares of the capital in foreign currency based on the exchange rate of foreign currency issued by Central Bank of Syria at the date of payment. The total shares of non Syrian shareholders, whether natural

persons or corporate bodies, may exceed the maximum limits of the ownership of non Syrians provided for in the laws governing these institutions.

3- Syrian persons' shareholdings shall be paid in Syrian pounds.
4- Shareholding by whoever is interested in partnership subsequent to incorporation shall be paid in foreign currency by a foreigner or a Syrian residing abroad.
5- Existing institutions may consider a portion of its portfolio existing in Syria as a part of its capital by virtue of a resolution to be issued by Monetary and Crediting Council subsequent to evaluation of those assts by a charter accountant auditor accredited by the Council.
6- Institutions shall produce a detailed statement of the subsidies and donations provided by foreign bodies. Central bank shall study those applications and raise a proposal to the Prime Ministry for obtaining consent.
7- The capital of these institutions may be increased upon an entrustment by Monetary and Crediting Council based on the rate of the growth of their activity and effectiveness and in fulfillment of the international criteria accredited for adequacy of capital.
8- Founders may assign the ownership of their shares of the capital of institution to third party only after issuance of three profitable balance sheets. Moreover, assignment of stocks or shares of the capital of institution may be made only for Syrian persons or to a non Syrian body by a prior consent of Central Bank of Syria and by the resolution of the Council of Ministers.

Article /4/ Licensing Procedures:

Bodies interested in founding social financial institutions shall submit a detailed application to Central Bank of Syria (Directorate of government Commission at Banks) in accordance with the accredited application form.

Article /5/:

The licensing application shall include the data provided for below:

1- Name of the institution to be licensed and its legal status.
2- Proposed capital of institution, provided that it would not be less than /250/ million Syrian pounds.
3- The institution main office and the main offices of branches, if any.
4- Name of applicant founders, their nationalities, type of their activities, their main offices, their detailed addresses and their shares of the institution to be licensed.
5- Detailed statement of the expertise and knowledge owned by the founders in the field of microfinance as well as other financial and banking services that are provided for certain segments of populations.
6- Names and addresses of those who are authorized to follow up the licensing application and the official authorization documents.
7- Any information or documents required by Central Bank of Syria for completion of the study of application.

Article/6/:

The following shall be attached to the licensing application within the data file and the application supporting documents which are considered to be an integral part thereof:

1- Act of Association of institution and draft by-laws (3) copies.
2- Proposed organizational chart of institution.
3- Serious and detailed feasibility of the institution in addition to the estimated budgets of the first three years of the life of the institution to be created.
4- Resolution of the Council of ministers of approval of the participation of non Syrian persons and the Syrian public banking sector in the founding of institution.

Article /7/ Study of Licensing Application:

1- Subsequent to the completion of information and documents, Central Bank of Syria shall study the application and review the information provided therein to ensure their veracity, according to enforceable laws and regulations taking into account the need of the country for incorporation of such type of institutions in view of economic situations and banking services available in Syria in general as well as in the area in which the institution is to be created in particular. The central Bank of Syria shall comment on it, evaluate it and refer it together with its final opinion to the Monetary and Crediting Council which will finally decide on it and take the appropriate decision.
2- The Monetary and Crediting Council shall take its positive or negative decision within three months as of the date of notification with the completion of all documents needed for licensing by Central Bank of Syria. However, if the decision is not issued within that period the application shall be deemed to be rejected.
3- In both cases of implicit and express rejection, the applicant may contact Central Bank of Syria to peruse the reasons of rejection.
4- In the event of rejection of application, founders may not submit the same application before the lapse of six months as of the rejection of application.

Article /8/ Resolution of Licensing:

The licensing resolution issued by Monetary and Crediting Council shall comprise the information provided for in Article /5/ (clauses 1-4) and clause (4) of Article/6/.

Article /9/ Special Register of Financial Institutions:

A special register of financial and social banking institutions shall be set up and accredited by Central Bank of Syria.

Article /10/ Registration Procedures:

Subsequent to the issuance of the resolution stipulating the licensing, founders shall apply to Central Bank of Syria for filing the institution at the special register. The application should be attached to the following documents and data:

1- Address of main office in details, E-mail, telephone, fax.
2- Capital of institution, names, nationalities and addresses of partners as well as the percentage of the share of each of them with respect to the capital and the value of said share.
3- Date of commencement of operation.
4- Slip notice of the receipt of depositing 5 percent of the capital of institution with Central Bank of Syria.
5- Slip notice of receipt of payment of the registration expenses by the institution to the treasury of Central Bank of Syria.
6- Certificate of registration of institution at Commercial Registry.
7- A copy of the resolution of licensing **published in the official Gazette** and issued by Monetary and Crediting Council
8- Institution by-laws and a legalized copy of the institution statute.
9- Names of the members of the board of directors of institution and the name of its director general.
10- Undertaking by institution:

- To notify Central Bank of Syria with the amendments that may occur to the items written down in the special register of financial institutions.
- To provide all the regulations set up by the institution (personnel policy subsequent to being ratified by Ministry of Social Affairs and Labor, system of transactions operated thereby) in order to be duly accredited.

Article /11/ Branches and Offices:

Upon a prior consent by Monetary and Crediting Council, these institutions may create a network of branches and offices and may create mobile banking services in the areas where they see a need for such services, provided that they would submit an application to Central Bank of Syria comprising the following:

1- Address of the proposed branch or office.
2- Feasibility of the branch or office to be established.
3- The institution shall subsequently provide Central Bank of Syria with the telephone number and fax of the branch or office to be established in addition to the name of the general manager of that branch or office.
4- However, as to the mobile banking service units, they shall be affiliated to one of the existing branches and Central Bank of Syria shall be provided with the kind of the transactions that they will undertake provided that the institution would provide Central Bank of Syria with the name of the supervisor of such unit and the way to communicate therewith.

Article /12/ Registration Expenses:

The registration expenses of the social banking financial institutions shall be determined by virtue of the resolution of Monetary and Crediting Council.

Article /13/ Obligations of Institution:

1- The statute of institution shall comprise all the provisions governing its activities and it shall be ratified by Monetary and Crediting Council.
2- All regulations of transactions and interest rates that will be applicable by the licensed institutions shall be subject to the ratification of Monetary and Crediting Council and any future amendment of the regulations of the applied transactions and interest rates shall also be subject to a prior consent by Monetary and Crediting Council, taking into account the special nature of the objectives and activities of licensed institutions.
3- Institution shall develop its personnel policy as well as all the affairs related thereto in compliance with the enforceable Labor Law. This personnel policy shall be subject to the ratification of Ministry of Social Affairs and Labor. The institution shall deposit a ratified copy thereof with Central Bank of Syria.
4- The institution shall appoint a certified auditor out of the list of auditors (charter accountants) accredited by Monetary and Crediting Council.
5- Every licensed institution must nominate a number of persons of appropriate qualifications for practice of the tasks of internal controller. The Committee of Management of Central Bank of Syria shall select one controller or, depending on the volume of transactions of institution, out of the candidate nominees for occupation of the function of internal controller while it is to be understood that a controller may practice activities only after being sworn in before the Civil Court of First Instance.
6- Two brief semi-annual reports shall be provided to Central Bank of Syria (Government Commission at Banks) about its operation and results of its activities for the first half before 31st July of the same year and for the second half before 31st January of the following year, in addition to the statements and data which shall be decided by Monetary and Crediting Council for this purpose.
7- It shall develop and publish, within the first three months of every fiscal year, its general budgets, inventory lists, profit and loss account and all reports that explain the status of the institution and its development subsequent to ratification thereon by the external auditor.
8- The institution shall deduct annually an obligatory reserve at the rate of 10 percent of net profits until it amounts to one half of the capital of institution. Furthermore, a portion of net profits may be deducted in the name of optional reserve to be determined by the institution general assembly and upon the approval of Monetary and crediting Council.
9- Regulatory accounting records shall be kept in pursuance of the provisions of Commercial Law and amendments as well as in pursuance of the requirements of Central Bank of Syria in compliance with the international accounting standards.
10- An amount equal to 5 percent of its paid capital shall be deposited in a non interest bearing frozen account with Central Bank of Syria. This amount shall be considered as one of the elements of its assets fixed assets to be refunded thereto upon liquidation of its activities.

11- Institution shall use modern technologies in its activities.

Article /14/ Precautious Guidelines:

Monetary and Crediting Council shall set up the precautious rules and guidelines necessary for continuity and safety of the operation of these institutions such as the percentages of liquidity, obligatory reserve. Percentage of adequacy of capital and the percentages of concentrations of risks and it shall also set forth the instructions necessary for good governance management of the institution.

Article /15/ Monitoring:

1- These institutions shall be subject to monitoring, supervision and follow up of performance by Monetary and Crediting Council through the relevant bodies of Central Bank of Syria. These institutions undertake to provide periodic statements that are required by Central Bank of Syria; they also undertake to allow the controllers of Central Bank of Syria to pay the visits that are required for its monitoring.
2- They will be subject to supervision by the Insurance Supervision Commission as regards their activities in the field of micro insurance and they shall comply with the regulations and instructions issued thereby.

Article /16/ Dealing with Foreign Currency:

When necessary, Licensed institutions, and for the purpose of fulfillment of their activities and realization of their objectives may deal with foreign currency through licensed banks and authorized to deal with foreign currency in pursuance of the enforceable legislations, under the supervision and monitoring of Monetary and Crediting Council.

Article /17/ Receivables Allowed to Be Transferred Abroad:

The institutions created in pursuance of the provisions of Legislative Decree No./15/ of 2007 shall be allowed to transfer abroad the receivables set forth hereunder based on their duly ratified annual accounts and balance sheets:

1- Interests, returns and other costs incurred by the capital of institution paid by non Syrian shareholders.
2- Remunerations and travel expenses of the members of the boards of directors of institutions and their non Syrian general managers within the guidelines and limitations set up by Monetary and Crediting Council for this purpose.
3- (50 percent) of net wages, salaries, and allowances and (10 percent) of the compensations of the end of service due to the non Syrian experts and technicians working for institution.
4- Value of the shares of capital sold or recovered by non Syria shareholders.
5- Outcome of the liquidation of the capital of institution pertaining to non Syrian shareholders.

Article /18/ Prohibitions:

The institutions created in pursuance of the provisions of Legislative Decree No./15/ of 2007 are prohibited to practice directly or indirectly the activities set forth hereunder:

1- Practice of commercial, industrial and agricultural works and activities or any other activity not related to the financial and banking activities and services allowed as per Legislative Decree No./15/ of 2007 or the statute (by laws) of the institution set up in pursuance of the provisions of the Legislative Decree governing the operation of those institutions.
2- Participation or partnership in industrial, commercial, agricultural servicing or tourism institutions.
3- Appropriation of real estates except for meeting the needs of offices pertaining to the institution and practice of its activities.

Article /19/ Laws Governing These Institutions:

The financial and banking institutions licensed in pursuance of the provisions of Legislative Decree No./15/ of 2007 shall be subject to the relevant enforceable laws and regulations particularly for all not otherwise contradictory to the provisions of Legislative Decree governing the operation of these institutions.

Annex 3
List of Meetings with Persons and Institutions

LIST OF MEETINGS WITH PERSONS AND INSTITUTIONS

Name	Position/Title	Institutions
Dr. Tayseer Al Raddawi Mrs. Amal Dalati	Head of SPC SPC	State Planning Commission
Round–table meeting for microfinance practitioners and SPC representatives		
Mr. Abdallah Dardari	Deputy Prime Minister	
Ms. Fabienne Bessonne	Representative	European Union
Mr. Radwan Shaaban	Lead Economist	World Bank
Eng. Ali Kayyali	RCDP Project Manager	UNDP
Mrs. Basma Al Hafez	Manager, Banks and Insurance Office	Ministry of Finance
Dr. Erfan Al Azmeh	Member of Council of Money & Credit	Council of Money & Credit
Mr. Jean-Lorenz Ehrentrant Mr. Ali Ismail	Chief Executive Officer	Agha Khan Agency for Microfinance
Mr. Bassel Hamwi	Deputy Chairman and General Manager	Bank Audi
Ms. Noha Al Sayed	Project Manager	QFI
Ms. Nawwar Al Sharaa’	Executive Director	FIRDOS
Dr. Mohamad Kayyal	Senior Program Officer	KfW
Dr. Ahmad Hamandoush	Minister of Finance	Ministry of Finance
Mr. Ahmad Diab	Assistant General Manager	Commercial Bank of Syria
Mr. Mohamad Al Khatib	Senior Manager	UNRWA
Dr. Bian Harb	General Manager	Development and Employment Commission
Mrs. Rima Kadri	Director of International Relations	Ministry of Economy & Trade
Dr. Diala Al Haj Aref	Minister of Social Affairs and Labor	Ministry of Social Affairs and Labor
Mrs. Haifa Younis	General Manager	Savings Bank
Mr. Adeeb Mayaleh	Governor	Central Bank of Syria
Dr. Alfred Kraft	Project Director	GtZ
Mr. Nabil Mahaini	Country Representative	IFAD
Mr. Abdel Qader Dweik	General Manager	Syria International Islamic Bank
Mr. Yassine Talas Mr. Imad Simsmieh	Credit Manager Audit Manager	Real Estate Bank
Mrs. Nuha Chuck	Program Director	Syrian Enterprise Business Center
Mr. Faisal Kasem	Chairman, General Manager	Agricultural Cooperative Bank
Ms. Rana Shanawani	Chief Executive Officer	BIDAYA
Dr. Anis Maarawi	Chairman, General Manager	Industrial Bank
Dr. Tayseer Al Raddawi Mrs. Amal Dalati	Head of SPC SPC	State Planning Commission