

## *Mapping the Ailing (but resilient) Syrian Banking Sector*

**Rashad Kattan**

### **Executive Summary**

The decision to open the Syrian banking sector to private investments in 2001, as part of the government's policy to move to a social-market economy, was considered one of the major achievements of President Bashar al-Assad – after he had succeeded his father in 2000. This was a watershed moment for the Syrian economy, coming after decades of the nationalisation of private banks in Syria in the 1960s and the ensuing monopoly of state banks over the banking and financial sector. However, the decades-long rift between the Syrian regime – under both Assads – and Western countries, especially the US, has kept the country largely isolated diplomatically and economically. Accordingly, the continuing hostile anti-Western stance of the Syrian regime has stymied the regime's efforts to attract foreign direct investments into the Syrian economy and the banking sector. The increasing isolation of the Syrian regime by the US and European countries after its rejection of the US-led invasion of Iraq in 2003 and the Syrian interference in Lebanese domestic politics, made the economy highly dependent on investments from the Gulf region. Between the years 2005 and 2011, Syria witnessed a substantial inflow of foreign capital primarily from Gulf countries, who started investing billions of US dollars in mega-projects in the real estate and tourism sectors, alongside banking and insurance. Regional Arab banks that share similar cultural and business practices were eager to invest in a largely underdeveloped banking sector and an unbanked population of 21 million. The majority came from banks next door in Lebanon and Jordan, but others from GCC countries from Saudi Arabia, Qatar, Kuwait, UAE and Bahrain have also joined the fray.

The purpose of this research is to provide a broad overview of the banking sector in Syria with a focus on the ownership structure of banks operating in the country, and the impact of the conflict on the investments in this sector. Following the outset of protests in March 2011 in Syria, Western countries stepped up pressure on the Syrian government by imposing harsh sanctions against government officials and state-owned institutions including bans on state-owned banks. These measures have practically cut off the Syrian banking sector from international financial markets and transactions. By doing so, the US and the EU technically banned the supply of any type of financial services to the Syrian banking sector, forcing Syrian banks to turn to non-dollar transactions. As the Syrian conflict entered its fourth year in March 2014, studies and indicators point to a virtually complete collapse of economic output, domestic and external trade and finance in the country. The shrinking economy, international

sanctions compounded by the absence of public and private investments have drained banks' revenues, which are still somehow operational despite the escalating conflict. Similarly, dozens of security officials, politicians and businessmen were added to the US and EU sanction list in the hope of driving them away from the regime. Some of those sanctioned are investors in the banking sector who also have close ties to the Syrian regime. Syrian government officials and entities, and state-owned banks have also invested in private banks that wanted to take part in the erstwhile profitable sector. Because of the close linkages between business and political elite in the country, the sanctions aimed to disrupt this dynamic and drive a wedge between these closely-knit relationships. This policy has largely failed, since the majority remained highly invested in the survival of the regime and more than three years of biting sanctions against them did not result in any decision to abandon the regime.

As the conflict drags on in the absence of a viable political solution, the Syrian economy will continue to disintegrate and metastasise into a war economy. In the meantime, the impact of the civil war will continue to be manifested in the shrinking operations and ownership of the banking sector. In the past three years, the ownership map has changed after several local and foreign investors, both institutional and retail, have decided to divest from the banking sector for either economic or political reasons. At the same time, others have further invested in the ailing sector in spite of the severe operational, financial, political and security risks. The private banks, primarily subsidiaries of foreign regional banks and joint ventures with Syrian investors, have decided to maintain their presence until the resolution of the conflict, and will likely remain in the country for the long haul. Notwithstanding the raging civil war, almost all the foreign commercial entities either maintained their substantial shareholdings or, paradoxically, increased their ownership stake in these banks. The considerable investments they had made and the need for a nationwide reconstruction programme after the end of the conflict will outweigh the prospects for an exit from the country. Their decision to maintain their investments while scaling back their operations reflects the enormous opportunities after the ultimate resolution of the conflict. Eventually, it can be argued that banks will play an instrumental role in the reconstruction of the country, once this conflict comes to an end. It remains to be seen if continuing economic blockades and isolation of the Syrian regime will finally force foreign investors to divest from the financial system. For the time being, Arab investors in private banks have been biding their time while watching their annual negative return on investment by staying in the country. Their decision to remain in the country has made them one of the main beneficiaries of the ultimate resolution of the conflict.

## 1. Introduction: Battered economy and resilient banking sector

As the Syrian conflict entered its fourth year in March 2014, news coverage and research have either dwindled or shifted to cover a host of issues such as the fragmentation of the Syrian opposition, emergence of the Islamic State in Iraq and Levant (ISIL), and the spill over of the Syrian conflict on neighbouring countries.<sup>1</sup> However, little has been comparatively written about the detrimental impact of the war on the Syrian economy in general and the financial system in particular. The few reports and studies that actually tackled economic issues have attempted to speculate on the concealed figures of remaining foreign reserves at the reticent Syrian Central Bank, the depreciating exchange rate and the emergence of a new socio-economic class in the war economy<sup>2</sup>. The limited availability of data and the unreliability of official disclosures have also contributed to the difficulties in measuring economic indicators. Thus, international organisations and economists have struggled to learn about the precise conditions of the Syrian economy.

The World Bank and International Monetary Fund (IMF) were forced to stop collecting and publishing economic data on Syria since 2011 due to the ongoing conflict and the ‘uncertain political situation’<sup>3</sup>. However, independent studies and indicators published by Syrian-based organisations<sup>4</sup> point to a virtually complete collapse of economic output, domestic and external trade and finance in the country. According to one study, Syria’s GDP contracted by more than 40% since the start of the Syrian uprising in 2011 with losses estimated at \$144 billion by 2013 of only damaged state and residential buildings. Equally, public debt has climbed to 126% of GDP in 2013 and budget deficit reached 32% of GDP. Conservative estimates of unemployment put the rate at 50% of the country’s five million labour force, with the actual number to be substantially higher than that<sup>5</sup>. The country has also been suffering from hyperinflation, with areas outside government control bearing the brunt of prohibitive prices of increasingly unavailable staple items<sup>6</sup>. By the end of 2013, Syria’s largest city, Aleppo suffered the highest rate of hyperinflation with more than 300%, followed by the contested northeastern city of Deir Azzour. Government price increases of energy and basic consumption items in the face of shrinking supply and the collapse of the agricultural sector have been major factors in stoking hyperinflation rates. As a result, the Syrian currency has precipitously depreciated; reaching 325 Syrian pounds per US dollar in July 2013, substantially higher than the exchange rate of 45 pounds per dollar before March 2011<sup>7</sup>. In the past six months, however, the currency has relatively corrected its weak position and witnessed less volatility, hovering around 170 pounds per US dollar in late 2014<sup>8</sup>. The shortfalls have been primarily financed by Russian and Iranian credit facilities<sup>9</sup>, rising grants and aid inflows from international and non-governmental agencies along with increasing remittances from Syria’s growing diaspora<sup>10</sup>.

This paper aims to contribute to a better understanding of the role and status of the Syrian banking sector, which has played an important role in the past decade, and is still generally operational despite the conflict but on a minimal level<sup>11</sup>. This study shows that the banking sector has largely weathered the four-year-old storm, although the banks' bottom line figures have taken a hard beating from the shrinking economy and international sanctions amid the absence of public and private investments. None of the state-owned banks have suspended their operations entirely or closed their shutters, despite biting international sanctions and dried up public finances. Equally, the private banks, primarily subsidiaries of foreign regional banks, have decided to stay put until the resolution of the conflict, and will likely remain in the country for the long haul. These banks have endured physical destruction of their branches and offices in violent-ridden cities, robberies by emerging gangs and militias on both warring sides, tighter inspection of their foreign-currency operations, and even embezzlement by some of their own staff. Nonetheless, the considerable investments they had made and the need for a nationwide reconstruction programme after the end of the conflict will outweigh the prospects for an exit from the country.

It is worth mentioning from the outset that the purpose of this research is to provide a broad overview of the banking sector in Syria with a focus on the ownership structure of banks operating in the country, and the impact of the conflict on the investments in this sector. While the paper sheds some light on the operations of these banks during the conflict, the aim of the paper is not to provide a detailed financial analysis of the banks' performance and position since the start of the conflict.

Section two provides a brief historical background on the legacy of domination of government-owned banks in the Syrian economy and discusses the gradual approach by the Syrian government to introduce liberal market economic reforms. Section three discusses the sanctions imposed on state-owned banks before and during the 2011 Syrian uprising. Section four constitutes the main focus of the research by reviewing the inflow of Arab investments into the financial sector, analysing the ownership structure of the 14 Pan-Arab banks and the impact of the conflict on their operations and investments. Section five explores the desired and unintended impact of Western sanctions on investments in the banking sector. The final section provides concluding remarks on the future of the banking sector and the role of foreign investments in private banks.

## **2. Legacy of domination by government-owned banks and the gradual approach to liberal market economy**

Before the start of the Syrian uprising in 2011, the decision to liberalise the banking sector, as part of the government's publicised commitment to move to a social-market economy, was hailed by economic experts as one of the major achievements of President Bashar al-Assad. In April 2001, Syrian authorities officially issued decree No. 28, authorising the incorporation of private banks in Syria and technically ending the state monopoly over the banking sector<sup>12</sup>. This was a watershed moment for the country's economy, coming after decades of the nationalisation of private banks in Syria since the 1960s and the ensuing monopoly of state banks over the banking and financial sector. Likewise, the government passed decree No. 35 in 2005 permitting Islamic banks to operate in the country, leading to the establishment of three Islamic ones in the country (See section 5 for more details). Since late 2003, after the decision of the Syrian authorities to allow the establishment of private banks, 14 private banks started operating in Syria alongside state-owned banks in the country<sup>13</sup> (See section 3 for more details).

At the time when the state broke its monopoly over the banking sector, it only allowed foreign institutional and retail (also means individual and will be used interchangeably) investors to own up to 49% of these banks. Under law No. 28, subsidiaries of foreign private banks in Syria were required to have 51% Syrian ownership to be licensed in Syria. In January 2010, one year before the start of the uprising in 2011, the Syrian government issued law No. 3 amending some articles of law No. 28 of 2001. It increased the level of foreign ownership stake in private banks from 49% to 60% - in an effort to boost foreign investors' confidence and attract foreign direct investment in the erstwhile fledgling banking and financial sector. This was part of the government's five-year plan in 2010 to attract \$55 billion of foreign direct investments to the country in the forthcoming five years.

In tandem with the transformational plans to liberalise the imprint of the state-planned economy under the banner of *social-market economy*, the government announced the creation of Damascus Securities Exchange (DSE) in 2009<sup>14</sup>. For decades, the traditional vehicles of investment in Syria were primarily in real estate, precious metals and, in most cases, depositing cash for fixed-term interest in local and overseas banks, especially in Lebanon. By establishing the DSE, the authorities hoped it would create alternative investment outlets, shift cash away from the then overheating real estate market and attract capital back into the country. Since then, the DSE has witnessed a growth in the number of listed companies on the exchange, even after 2011. The DSE currently comprises 23 companies spanning various sectors, such as transport, media, industry, agriculture, banking and insurance. The stock exchange is

largely dominated by 19 capital-intensive banking and insurance companies. All the 14 banks are listed on the Exchange<sup>15</sup>, the latest of which is Al-Baraka Bank Syria whose shares were listed in September 2014, in the midst of the ongoing civil war.

However, the perceived reform of the financial and banking sector was not meant to eliminate the presence of public banks in the country<sup>16</sup>. The approach taken in the context of the newly found Syrian private banking system was to redistribute the monopolistic market share of public banks with private banks while maintaining a degree of protectionism of the public financial system. In other words, private banks' development could not take place at the expense of state-owned banks - perceived to be in dire need of structural and institutional reforms. By preserving their banking services monopoly over the public sector, state owned banks continued to dominate the country. Subsequently, private banks' capital remained limited and private banks followed a conservative operational and lending approach, with no significant expansion of their banking services and products.

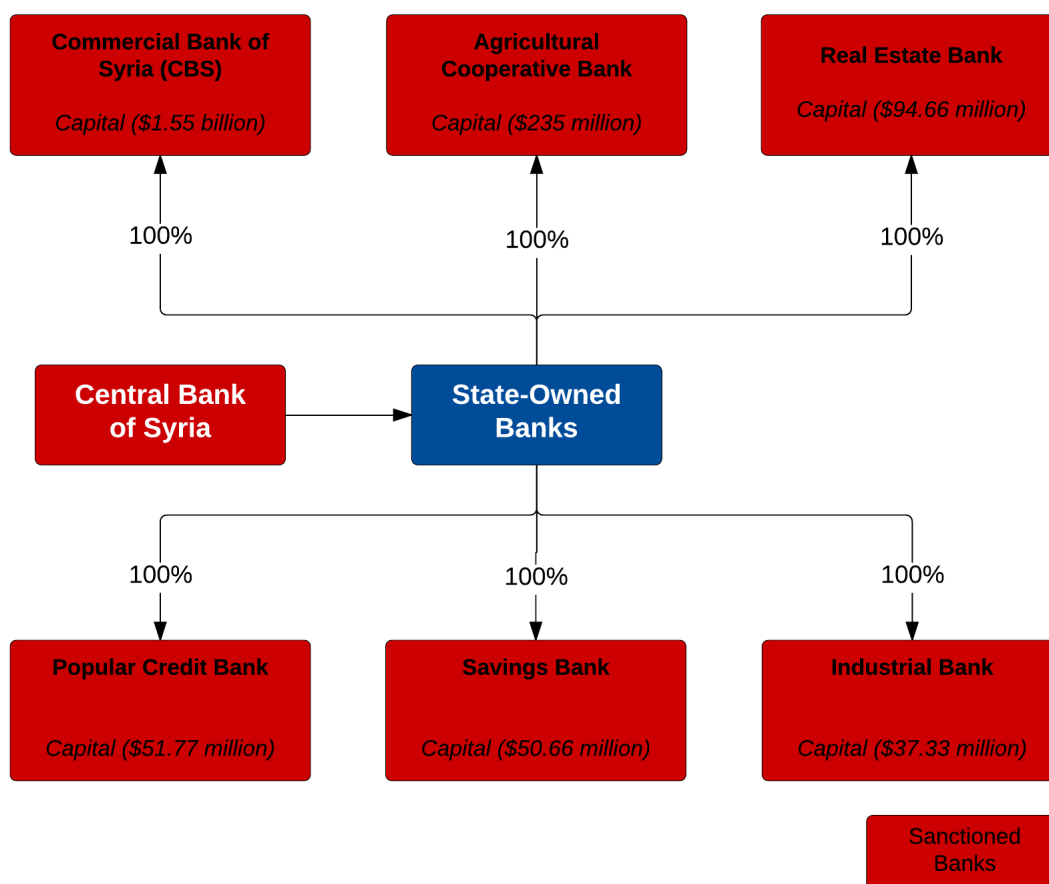
In Syria, there are 20 commercial banks divided broadly into two categories; six local state-owned banks and 14 subsidiaries of private regional banks<sup>17</sup> – which are largely joint ventures with Syrian investors (*See exhibits 1 and 2*). The largest of these state-owned banks is the Commercial Bank of Syria (CBS), which was founded in 1967 on the backdrop of nationalising private banks in the country. It has a total capital of SYP 70 billion (\$1.55 billion in pre-conflict value terms 45USD/SYP and \$463 million based on 2014 average official exchange rate of 151USD/SYP). CBS is also the largest bank not just amongst government-owned banks but also compared to private banks in terms of capitalisations, operations and services - with more than 72 branches in the country. This has been largely due to the centralisation of government financial transactions and deposits in the bank, providing it with a monopoly over the budget and revenue of the largest employer and investor, the Syrian state. To illustrate, the combined capital of the five other public banks currently at SYP 21 billion (\$466 million in pre-conflict value terms 45USD/SYP and \$139 million based on 2014 average official exchange rate of 151USD/SYP) make up less than 30% of CBS's capital. Also, CBS's capital nearly eclipses the combined capital of the 14 private banks, which currently stands at SYP 74 billion (\$1.645 billion in pre-conflict value terms 45USD/SYP and \$490 million based on 2014 average official exchange rate of 151USD/SYP).

The second largest government-owned bank in terms of capitalisation is the Agricultural Cooperative Bank with SYP 10.60 billion (\$235 million in pre-conflict value terms 45USD/SYP and \$70.1 million based on 2014 average official exchange rate of 151USD/SYP), which was established originally by the Turkish Ottomans

under the name of Bank of Mireh in 1880. Its stated mission is to provide banking facilities to the rural poor and facilitate the creation of a middle class in Syria's rural areas. The bank has the largest number of branches among both public and private banks and operates in the country through 106 branches, with a total workforce of around 3,200 employees before the conflict. The bank historically made loans to farmers at low and subsidised interest rates ranging between 4.5% and 6%<sup>18</sup>.

The four remaining state-owned banks have long provided more targeted banking services, but were less financed and with smaller balance sheets. Real Estate Bank, which has a paid-up capital of SYP 4.26 billion (\$94.66 million in pre-conflict value terms 45USD/SYP and \$28.2 million based on 2014 average official exchange rate of 151USD/SYP) was founded in 1966 and offers banking services exclusively in the real estate sector. These include financing construction projects, granting loans to co-operative housing associations and individuals for the building of houses, schools, hotels, restaurants, and commercial and industrial buildings. Popular Credit Bank was created in 1966 with a capital of SYP 2.33 billion (\$51.77 million in pre-conflict value terms 45USD/SYP and \$15.43 million based on 2014 average official exchange rate of 151USD/SYP) to grant easy loans to small traders, artisans, professionals and low-income people. The two smallest public banks are Savings Bank with a paid-up capital of SYP 2.28 billion (\$50.66 million in pre-conflict value terms 45USD/SYP and \$15.09 million based on 2014 average official exchange rate of 151USD/SYP) and Industrial Bank with only SYP 1.68 billion (\$37.33 million in pre-conflict value terms 45USD/SYP and \$11.25 million based on 2014 average official exchange rate of 151USD/SYP) capital.

The diagram below maps state-owned banks in Syria (Exhibit 1).



### 3. Sanctions against state-owned banks

The decades-long hostile anti-Western stance of the Syrian government has incurred the Syrian economy and state-owned banks several rounds of sanctions, mainly imposed by the US. In 2006, the US government imposed sanctions against the Commercial Bank of Syria (CBS) as a ‘financial institution of primary money laundering concern’ under the US Patriot Act. This action barred US banks and their overseas subsidiaries from maintaining a correspondent account with the CBS; it also required banks to conduct enhanced due diligence assessments to ensure that CBS is not circumventing the ban through its business dealings with them. Since the 2011 Syrian uprising, Western countries stepped up pressure on the Syrian government by imposing harsher sanctions against government officials and state-owned institutions including further bans on Syrian financial institutions. In August 2011, the US imposed harsher sanctions against CBS and its subsidiary, the Beirut-based Syrian Lebanese Commercial Bank, leading to their assets freeze. The US Treasury Department, explained its decision to be ‘taking aim at the financial infrastructure that is helping provide support to [Bashar] al-Assad and his regime's illicit activities’.



Following the US decision, the EU also imposed similar sanctions<sup>19</sup> on the bank in October 2011 and froze its assets ‘in protest against repression and human rights violations In Syria’. In late 2013, however, there has been a softening of EU sanctions in the face of deteriorating humanitarian conditions, with balance from accounts of CBS located in the EU now permitted to be used for the purchase of various humanitarian-related goods, such as basic food staples.

In the autumn of 2011, the US and EU slapped sanctions<sup>20</sup> against the Central Bank of Syria and three state-owned financial institutions; Real Estate Bank, Popular Credit Bank and Industrial Bank<sup>21</sup>. In October 2014, the US Treasury Department imposed further bans on four government-owned banks to further ‘increase pressure on the Syrian regime’ by blacklisting the Agricultural Cooperative Bank, Industrial Bank, Popular Credit Bank and Saving Bank for ‘acting for and providing support to the Syrian regime.’ The latest measures have practically cut off the official state-owned banks from international financial markets and transactions. These sanctions prohibit the opening of bank accounts with Syrian credit or financial institutions, or representative offices, branches or subsidiaries in Syria. By doing so, the US and the EU technically banned the supply of any type of financial services to the Syrian banking sector, forcing Syrian banks to turn to non-dollar transactions<sup>22</sup>. In response to these actions by Western countries, the staunchest supporter of Damascus, Moscow authorised Syria's central bank in December 2011 to open accounts in Russian roubles with several Russian banks. This announcement intended to show Russia's determination to stand behind its ally and its unequivocal stance to undercut and circumvent Western sanctions, after prohibiting Syrian banks from doing business in US dollars<sup>23</sup>.

Following its economic blockade against several Syrian banks, the EU went after the Governor of Central Bank of Syria, Adib Mayaleh, and added him to the sanctions list<sup>24</sup> on 15 May 2012. The EU's reason for including him in these sanctions as per its announcement is for his responsibility ‘for providing economic and financial support to the Syrian regime’ through his role as the governor of the bank.

Fully aware of the continuing international sanctions against public banks and the corroding impact this will have on these financial institutions, the government has been painstakingly trying to find alternatives to its conundrum<sup>25</sup>. In July 2014, the Directorate of Planning at the Ministry of Economy and Trade reviewed a set of proposals to revamp the banking sector in the country. The Committee for Financial and Banking Sector<sup>1</sup> has developed a set of proposals to restructure state-owned banks

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<sup>1</sup> The Committee for Financial and the Banking Sector is a unit at the Higher Commission for Scientific Research, which was established in 2005 to provide policy recommendations to the government.

and diversify their services and products. A part of this restructuring plan is the prospect of transforming state-owned banks into joint stock companies owned by the state, with their shares traded on the Damascus Stock Exchange. Amid the depleting investments in the country by both the public and private sectors, the government is keen on attracting local and foreign cash to be deposited and invested in local banks.

Meanwhile, Syrian businessmen have also been lobbying the government to attract Russian banks to establish subsidiaries and branches in the country to strengthen the financial relationship with these banks. The Chairman of the Syrian-Russian Business Council, Samer Othman, also suggested direct coordination between the central banks of the two countries to facilitate bilateral trade and currency transactions. Also, the Deputy Chairman of Damascus Chamber of Commerce, Bahaa al-Din Hasan, has been discussing the establishment of a joint Russian-Syrian bank by investors from both countries, and to open subsidiaries and branches in other countries to enable financial and currency transactions in the hope of circumventing Western sanctions.

Besides the rhetoric and statements coming from state officials and businessmen close to the regime, the possibility of implementing such projects are not just costly but the high operational risks will make such proposals hard to fathom at this stage of the conflict. On the other hand, trade between the two countries has been insignificant despite the substantial support Russia has provided to the Syrian regime, in its different forms. According to the pro-government al-Watan newspaper, trade between the two countries reached only \$2 billion, probably in the form of assistance from Russia.

#### **4. Investment opportunities attract Arab capital**

The increasing isolation of the Syrian regime by the US and European countries after the Syrian rejection of the US-led invasion of Iraq in 2003 and the Syrian interference in Lebanese domestic politics, made it highly dependent on investments from the Gulf region. Between the years 2005 and 2011, Syria witnessed a substantial inflow of foreign capital primarily from Gulf countries, that started investing billions of US dollars in mega-projects in the real estate and tourism sectors - aside from banking and insurance<sup>26</sup>. Various Gulf-based conglomerates, especially from the UAE, Qatar and Kuwait, flocked to Syria with tremendous amounts of cash to participate in the booming real estate development, tourism, banking and financial services with limited participation in infrastructure and light industrial projects.

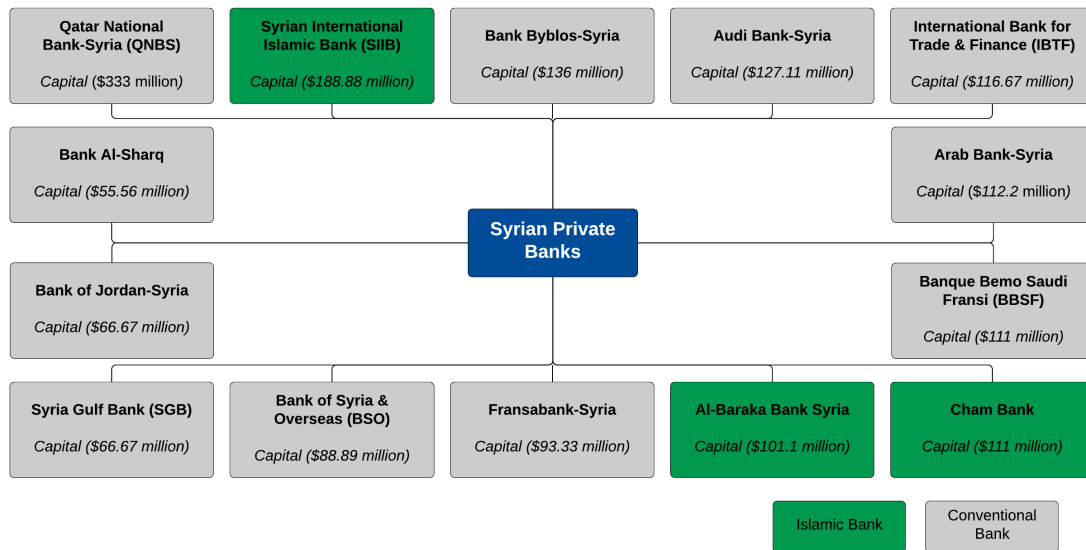
Prominent Gulf corporations and businessmen became partners in landmark hotels, resorts, and residential and commercial developments worth more than \$20 billion with Syrian businessmen, some of which were close to the Syrian regime<sup>27</sup>. Some of

these were the Saudi Arabian Prince Walid bin Talal, Bin Laden Group and Al-Oula Holding; the Emirati government-owned Emaar Properties, Majid Al-Futtaim, Belhasa International, Bonyan International for Investment and Emirates Investment & Development Company; the Kuwaiti Al-Kharafi Group, Al-Fayha Kuwait, Aref Group and Al-Madina for Finance & Investment; the Qatari Diar and Venicia Group. They invested in big-ticket projects such as Damascus Four Seasons Hotel, Damascus Eighth Gate, Five Chams in Yafour, Kiwan Tourism, Sheraton Hotel Aleppo, Damascus Financial City, Cordoba, Bonyan Syria, Rotana Gardenia Homs and Ibn Hani Resort Lattakia, among many others. Following the outset of protests in the country, several of these companies and investors suspended their operations. Others divested their investments following the decision of the majority of the Gulf Cooperation Council (GCC) countries to isolate the Syrian regime, cut their diplomatic ties and impose sanctions against it.

The decades-long rift between the Syrian regime – under both Assads – and Western countries, especially the United States, led to diplomatic and economic isolation of the country. The pariah status that was conferred on Syria increased the commercial risks to international investors to consider the country as part of their emerging or frontier market investment portfolio. Also, the uncertainty surrounding regulatory, institutional and policy frameworks in the financial system failed to instil sufficient investors' confidence to operate in such a highly statist environment. That said, regional Arab banks that share similar cultural and traditional backgrounds were more eager to take a leap of faith and invest in a largely underdeveloped banking sector and an unbanked population of 21 million. The majority came from banks next door in Lebanon and Jordan, but others from GCC countries from Saudi Arabia, Qatar, Kuwait, UAE and Bahrain have also joined the fray.

Also, the long decades of archaic and inefficient government-controlled banking sector accompanied with inadequate financial and business education system, underdeveloped human capital and risk-averse business class meant that help should come from outside. Regional financial institutions with international banking standards, foreign capital looking for overseas investment opportunities and seasoned bankers found a rare window following the opening of the financial system in Syria. Lebanese, Jordanian and Gulf banks from Saudi Arabia, Qatar, Kuwait, UAE and Bahrain started establishing their subsidiaries in the country to tap the largely cash economy and offer their retail and corporate banking services.

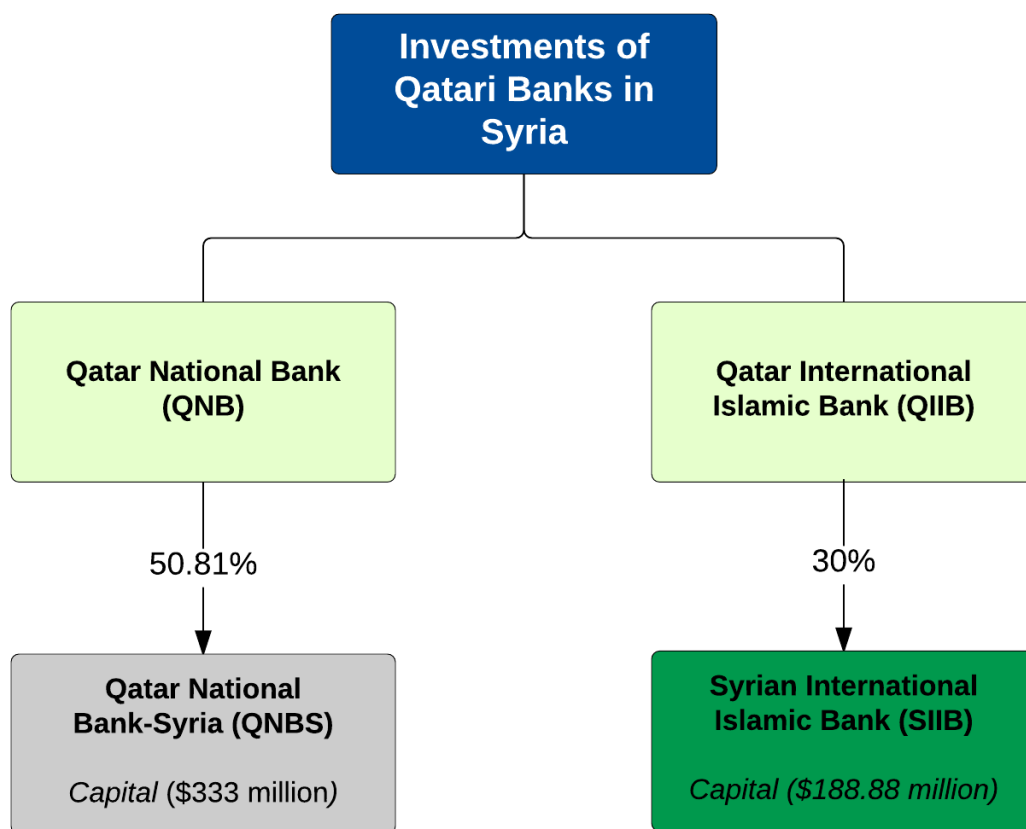
The diagram below maps private-owned banks in Syria, both conventional and Islamic (Exhibit 2).



4.1. Qatar

The Qatari government and investors have had the largest appetite to invest in the Syrian economy, including the banking sector, as part of their international investment portfolio. Notwithstanding their relatively late entry into the Syrian privatised financial system in 2007, they established two banks in Syria, one of which is the largest private banks in the country by market capitalisation.

Below is a diagram mapping the strategic investments by Qatari banks in Syria (Exhibit 3).



Qatar National Bank-Syria (QNBS) is the subsidiary of the Doha-based Qatar National Bank (QNB) that started its operations in November 2009. It is the largest private bank by market capitalisation with a total paid-up capital of SYP 15 billion (\$333 million in pre-conflict value terms 45USD/SYP and \$100 million based on 2014 average official exchange rate of 151USD/SYP) – which makes up a modest proportion of 20% of the largest state-owned bank CBS. The bank was listed on DSE in April 2010 and operates in the country through 15 branches. QNB is one of the major foreign institutional investors, which still plays an important role in the Syrian banking sector<sup>28</sup>. QNB is the majority shareholder of QNBS with 50.81%, according to the bank’s corporate filings with the Syrian Commission on Financial Markets & Securities (SCFMS)<sup>29</sup>. The remaining ownership stake is divided among several Syrian investors including the state-owned General Social Security Organisation (10.28%), Engineers’ Syndicate (5%), and the both Western-sanctioned state-owned Savings Bank (4.11%) and Popular Credit Bank (see section 3 for more details). The bank reported in November 2014 that the director Khalaf al-Abdullah, who represented the General Social Security Organisation on the board, had resigned from his position after he had been appointed the Minister of Labour in the new Syrian cabinet. On the security front, some of the bank’s branches sustained physical

damages, robberies and fraud due to the ongoing violence, especially in cities and regions outside government control.

The second Qatari bank is Syria International Islamic Bank (SIIB), the subsidiary of the Doha-based Qatar International Islamic Bank (QIIB), which owns 30% of the bank's shares, according to the bank's website<sup>30</sup>. SIIB started its operations in September 2007 with a total paid-up capital of SYP 8.5 billion (\$188.88 million in pre-conflict value terms 45USD/SYP and \$56.29 million based on 2014 average official exchange rate of 151USD/SYP). The bank was listed on DSE in May 2009 and operates in the country through 23 branches. Besides QIIB's 30% ownership stake, 12 Qatari institutional and individual investors collectively own 19% of the bank's shares. These are Burooq Trading Company (5%), Sheikh Thani Abdullah bin Thani al-Thani (5%), Islamic Insurance Company of Qatar (3%), Private Projects Company (2.5%), Yousuf Hussen Kamal (1%) and several members of al-Thani royal family. Several Syrian institutional and individual investors own the remaining 51%, according to the bank's corporate filings with SCFMS<sup>31</sup>, including Arab Union Reinsurance Company, Syrian Libyan Company for Industrial & Agricultural Investments, Ahmed Muhammed Nahhas and Mohammed Abdulraaouf Qudsi, among other prominent Syrian businessmen. The state-owned General Social Security Organisation also owns 0.23% stake in the bank with a representative member on the bank's board of directors.

Ihab Muhammed Makhoulf, Rami's brother and the maternal cousin of the Syrian president Bashar al-Assad, was a shareholder and member of the board of directors of the bank. Following the beginning of protests in March 2011, which largely denounced the concentration of economic power and overreach of Makhoulf's family in the Syrian economy, Ihab appears to have divested from the bank, announcing his resignation in May 2011<sup>32</sup>. Rami Makhoulf<sup>33</sup> is the 44-year-old first maternal cousin of the Syrian President Bashar al-Assad and the son of Mohammed, a former senior commander of the elite Syrian Republican Guard. Since the ascendance of Bashar al-Assad to power in 2000, Rami became the symbol of the emerging crony capitalism in the country and was widely known in Syria and among business circles of his deep involvement and control of the Syrian economy through a growing web of businesses and holding companies. His business empire spanned telecommunication, oil and gas, banking, airlines, construction and real estate, tourism and retail. One of his main investment vehicles that emerged in 2006 is Cham Holding<sup>2</sup>, one of the biggest

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<sup>2</sup> Cham Holding is one of the largest Syrian companies founded in 2006 by several prominent Syrian businessmen including Rami Makhoulf, who was one of its major shareholders. The conglomerate company was established with a \$365m capital during a time when the Syrian regime moved towards market liberalisation and increased participation of the private sector in major economic projects and activities. Cham Holding was added to the US sanction list in May 2011.

companies in Syria in terms of capitalisation. The holding company brought together many of the most affluent and influential businessmen in Syria, who had traditional business and family links with the country's political elite. Makhlouf was added to the US sanction list in February 2008<sup>34</sup> for amassing 'his commercial empire by exploiting his relationships with Syrian regime members...who benefits from and aids the public corruption', according to the US Department of the Treasury.

SIIB was subject to US and EU sanctions<sup>35</sup> on 26 June 2012 after being accused of acting as a 'front for the Commercial Bank of Syria', which was blacklisted in 2006 and again in 2011. According to the EU decision published on the case, this relationship 'has allowed the bank to circumvent sanctions imposed on it by the EU'. The Council's reason for adding the bank had been that the bank provided financial support to the Syrian regime and helped the Commercial Bank of Syria to circumvent the economic blockade on the Commercial Bank of Syria and Syrian Lebanese Commercial Bank. The statement goes on to say that 'from 2011 to 2012, SIIB surreptitiously facilitated financing worth almost \$150 million on behalf of the Commercial Bank of Syria'. However, in June 2014, the General Court of the European Union ruled in favour of SIIB, which was until then on the EU sanctions list<sup>36</sup>. The Court found that the Council of the EU had erred in deciding that SIIB should be added to the list of people and companies subject to restrictive measures in June 2012. The Court held that the Council did not have any evidence that the bank had assisted either of those commercial banks with transactions involving sanctioned people and entities, and the fact that the bank had been sanctioned by OFAC<sup>37</sup> (the US Office of Foreign Asset Control) was not relevant.

It is worth mentioning that the Qatari government owns 50% of the Doha-based QNB through the Qatar Investment Authority (QIA), in turn owned by the Qatari government, according to the bank's website<sup>38</sup>. Similar to QNB, the Qatari government is also one of the major shareholders and owns a significant percentage of the Doha-based QIIB with 17% through QIA, according to corporate databases. Therefore, the Qatari government has an indirect ownership stake in the two Syrian subsidiaries, QNBS and SIIB. Despite the raging civil war and the uncompromising hostile stance taken by the Qatari Al-Thani ruling family against the Syrian regime, the Qatari government and investors appear to have followed their economic interests by maintaining their investments in the banking sector<sup>39</sup>. It is also surprising that the Syrian regime did not take any adverse measures by expropriating the Qataris' shareholdings, despite the regime's aggressive campaign against the al-Thani family. Qatar is the opposition's biggest financial and military supporter, and was one of the first countries to recognise the Syrian opposition after it had cut its diplomatic ties with the regime. In a symbolic gesture in March 2013, it was the only country to allow

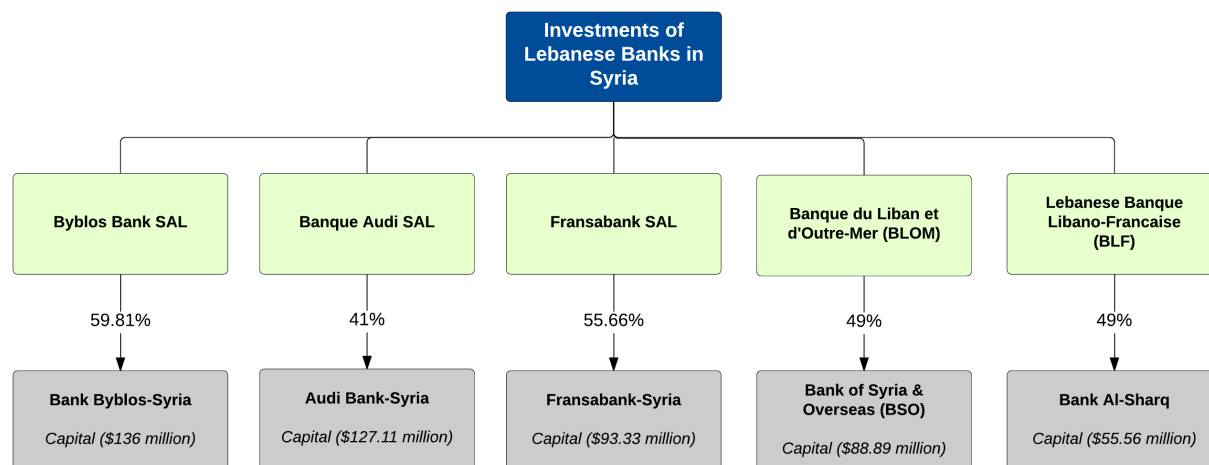
Assad's opponents to run the Syrian embassy in Doha after declaring the diplomats personae non gratae. Qatar's call for regime change in Syria and their leading assistance to Assad's enemies have been considered a personal insult to Bashar al-Assad, who wasn't long ago, a regular guest of the emir in Doha. This previous personal relationship between the ruling families in both countries translated in substantial investments of more than \$5 billion by Qatar in the Syrian economy, spanning tourism, real estate and energy projects.

#### *4.2. Lebanon*

Several Lebanese banks have also been predominant investors in the country, with some of their prominent financial institutions opening subsidiaries in Syria. The Lebanese financial sector has for decades benefited from Syrian businessmen who conducted their international business transactions and trade through Lebanese banks who were better integrated in the international financial markets. Also, the Syrian elite have long treated Lebanese banks as a safe haven by keeping their deposits there for fear of sudden expropriation or nationalisation by the Syrian government. Besides their reliance on its comparatively sophisticated banking system, Syrian businessmen long saw the Lebanese liberal economy as a future model for how Syria could become. After announcing the new changes in the Syrian financial system, the shortage of adequate local bankers have also opened a golden opportunity for Lebanese professionals to manage and train the new cohort of Syrian bankers in the newly-established banks with generous compensation packages and elevated social stature in Syria. Thus, Lebanon and Syria have always benefited from their special relations and the close links among their businessmen. On the backdrop of these competitive advantages, Lebanon has the biggest number of banks in Syria, with five subsidiaries operating in the country.

The diagram below maps the strategic investments by Lebanese banks in Syria (Exhibit 4).





The largest Lebanese bank operating in Syria is Bank Byblos-Syria, established in 2005 with a capital of SYP 6.12 billion (\$136 million in pre-conflict value terms 45USD/SYP and \$40.53 million based on 2014 average official exchange rate of 151USD/SYP) and is the subsidiary of the Lebanese Byblos Bank SAL. At the time of its establishment and until at least November 2011, it had 41.5% ownership stake<sup>40</sup>. During the third quarter of 2011, after more than six months into the Syrian uprising, the bank increased its ownership stake to 52.37%<sup>41</sup> to become the majority shareholder of its subsidiary. The OPEC Fund for International Development (OFID) – the multilateral development institution of Organisation of the Petroleum Exporting Countries (OPEC) – was also one of the major investors in the bank with a 7.5% stake ownership until July 2014. The majority shareholder Lebanese Byblos Bank SAL announced on 25 September 2014 in its filings to the stock exchange that it had acquired OPEC’s stake in the bank and that the Fund’s representative on the board of directors had resigned. This in turn has increased the bank’s parent shareholdings to 59.81%. Other noteworthy investors and board directors in the bank are the Syrians Nader Muhammed Qal’i, Muhammad Murtada al-Dandachi, Almo’taz Wasef Sawaf, Samir Anis Hasan and Andre Abou Hamad.

Rami Makhoul was also an investor in the bank before 2011<sup>42</sup> with 4.99%<sup>43</sup>, but it was not clear from the bank’s disclosures if he is still associated with the bank. Besides his blacklisting by the US in 2008, Rami – the cousin of President Bashar al-Assad – was added to the EU sanction list in May 2011 for ‘furnishing finance and support to the regime’<sup>44</sup>. In order for the bank to insulate itself from potential economic blockades, it removed the name of Rami from the published lists of its shareholders. According to Executive Magazine, the UK-based Bankers’ Almanac – which publishes the details of shareholders of banks globally – was asked in January 2012 by the Lebanese Byblos Bank to ‘change the ownership details to their current

listing'. The manager of Financial Markets Division at Byblos said 'the bank had recently tried to evict him [Rami] as a shareholder, but Makhoul had refused'<sup>45</sup>.

The second-largest Lebanese bank is Audi Bank-Syria with a paid-up capital of SYP 5.72 billion (\$127.11 million in pre-conflict value terms 45USD/SYP and \$37.88 million based on 2014 average official exchange rate of 151USD/SYP). It was established in 2005 and is the subsidiary of the leading financial institution in Lebanon, Banque Audi SAL. The parent bank owns 41% stake of its subsidiary<sup>46</sup>, and its shareholding did not change since its establishment nine years ago, contrary to its competitors. While the bank did not exit the country despite the deteriorating economic conditions, it did not alter its commercial interest either<sup>47</sup>. Other Lebanese financial institutions and companies have also invested in the bank since its inception. Both Audi Saradar Investment Bank and Lebanon Invest hold 3% each of the bank's shares. On the Syrian side, there are prominent businessmen who are both shareholders and members of the board of directors. Some of which are Ahmad al-Abboud, Adnan Takla, Rana al-Zein and George Jad'oun al-Achi. Bassel Hamwi was the bank's CEO until his resignation in December 2013, yet he remains a shareholder with 3.07% stake and a board director<sup>48</sup>. The London-based Syrian businessman Ayman Asfari was a shareholder with 2% stake, based on Syrian corporate databases published in December 2010<sup>49</sup>. Mr Asfari is the CEO of Petrofac, one of the global oil and gas services companies, listed on the FTSE-100. It is not clear if Mr Asfari is still associated with the bank after 2011, as the bank's disclosures only list the major shareholders who are also members of the board of directors.

Fransabank-Syria is the third largest Lebanese bank and the last one to enter the Syrian market in late 2008. It has a paid-up capital of SYP 4.2 billion (\$93.33 million in pre-conflict value terms 45USD/SYP and \$27.81 million based on 2014 average official exchange rate of 151USD/SYP) and is the subsidiary of Fransabank SAL, one of the largest banks in Lebanon, which is the strategic investor with 55.66% of its Syrian subsidiary<sup>50</sup>. The Lebanese banker Adel Wafic Kassar – the Deputy Chairman of the Lebanese parent bank – is a shareholder of the Syrian subsidiary, where he acts as the Chairman. The remaining major investors of the bank are mostly Syrian businessmen such as Ahmad Said Al-Shihabi, Eli Fath Allah al-Sioufi, Sami Youssef al-Rabbat, Ali Wahib Mer'ei and Thaer al-Lahham. In an unprecedented move among Syrian private banks, Banque Bemo Saudi Fransi (BBSF) purchased 4.23% of its Lebanese competitor Fransabank-Syria's shares on 19 August 2014<sup>51</sup>. In the bank's disclosures<sup>52</sup>, it pointed out that this is merely a financial investment in the bank and BBSF will not be involved in any strategy setting or decision making in its investee.

Banque du Liban et d'Outre-Mer (BLOM) was the first Lebanese bank to establish its

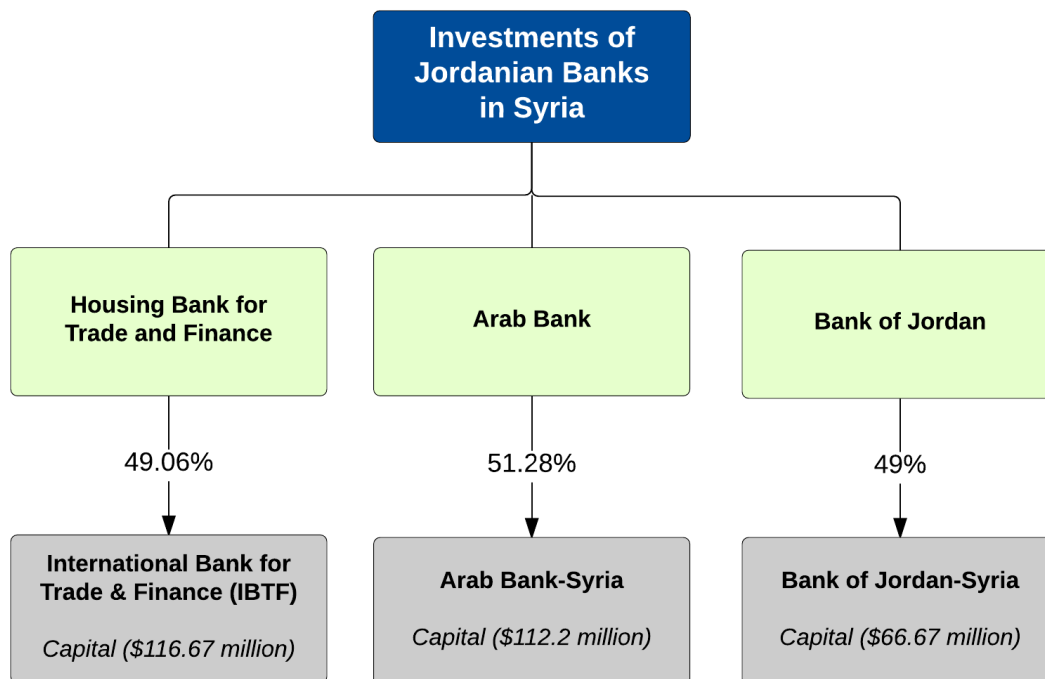
subsidiary in Syria, namely Bank of Syria & Overseas (BSO) in late 2003. Notwithstanding its early entry into the country, it is one of the smaller private banks with a paid-up capital of SYP 4 billion (\$88.89 million in pre-conflict value terms 45USD/SYP and \$26.49 million based on 2014 average official exchange rate of 151USD/SYP). BLOM is the major shareholder of the bank with 49% ownership stake. Several members of Azhari family – who are majority owners in BLOM – are also shareholders in BSO who sit on its board of directors<sup>53</sup>. Other Syrian investors who also sit on the board are the prominent businessman and Chairman of the bank Ratab al-Shallah (1.25%), Ihsan al-Baalbaki (5%), Nada Ibrahim Sheikh Dib (1.56%), Iyad Habib Beitinjaneh (0.62%) and Fahd Taher Tafnakji (0.49%). Several of the bank's branches in Homs and Hama were the target of armed robberies, costing the bank millions of Syrian pounds. It is worth pointing out that the International Finance Corporation (IFC) – the subsidiary of the World Bank focused on investing in private sector development in developing countries – owned 10% of the bank's equity<sup>54</sup>. The IFC's website mentions<sup>55</sup> that 'in light of the deteriorating security situation, IFC's operational activity in Syria was suspended in March 2011'. Therefore, it appears that it has subsequently divested from bank and explains that 'IFC has taken an equity position – now sold - in Bank of Syria and Overseas (BSO)'.

Bank Al-Sharq is the smallest bank, both compared to Lebanese and other private banks, and was established in 2008, with a paid-up capital of SYP 2.5 billion (\$55.56 million in pre-conflict value terms 45USD/SYP and \$16.55 million based on 2014 average official exchange rate of 151USD/SYP). It is the subsidiary of the Lebanese Banque Libano-Francaise (BLF), which owns 49% of the bank's shares, based on the bank's website and corporate filings<sup>56</sup>. A major Syrian investor in the bank is Khalil Boulos Georges Sara who owns 30.5% of the bank's shares. The bank has several other Syrian investors sitting on its board of directors such as Salim al-Challah, Najib al-Barazi and George Antaki. It also includes controversial Syrian businessmen, who are accused of enabling the regime's crackdown by financing some of its operations, such as Naji Chaoui<sup>57</sup>. The EU sanctioned<sup>58</sup> the son of Naji Chaoui, George, on 14 November 2011 for his membership of the Syrian Electronic Army – an outfit established to identify and disrupt anti-government activity and activists inside and outside the country. Another reason for the decision to blacklist him is his involvement 'in the violent crackdown and call for violence against the civilian population across Syria'. Following these sanctions, several members of the board of directors have resigned from the bank in the past three years, as per the bank's corporate filings<sup>59</sup>, including Nabil Sukkar in November 2012, a well-known Syrian businessman.

4.3. Jordan

The Jordanian financial sector is a long established one that boasts well-capitalised and managed financial institutions. Three Jordanian banks have set up shop since private banks were allowed to operate in Syria.

The diagram below maps the strategic investments of Jordanian banks in Syria (Exhibit 5).



The largest Jordanian bank in Syria is the International Bank for Trade & Finance (IBTF), and is one of the first private banks to be registered in the country in December 2003. It is an affiliate of the Jordanian Housing Bank for Trade and Finance, which is a major shareholder with 49.06% stake<sup>60</sup>. IBTF has a paid-up capital of SYP 5.25 billion (\$116.67 million in pre-conflict value terms 45USD/SYP and \$34.76 million based on 2014 average official exchange rate of 151USD/SYP) and operates in the country through 30 branches. The government-affiliated Engineers’ Syndicate and private Syrian Libyan Company for Industrial & Agricultural Investments each own 2.23% of total shares. Other Syrian investors are Nader Haddad, George Tafankji, Mustafa al-Kafri and Amer Hosni Lotfi, who is the Deputy Chairman of the board and has served as the head of the State Planning Commission. Since the start of the conflict, the bank suffered from several incidents of robbery and physical damage against its branches<sup>61</sup>.

Arab Bank-Syria is the second largest Jordanian bank in terms of capitalisation with SYP 5.05 billion (\$112.2 million in pre-conflict value terms 45USD/SYP and \$33.45 million based on 2014 average official exchange rate of 151USD/SYP), founded in 2005. It is the subsidiary of the Jordan-based Arab Bank, one of the oldest and largest financial institutions in the Arab World, which is a majority shareholder of the bank with 51.28%<sup>62</sup>. Several prominent Syrian businessmen are partners in the bank, where they also sit on the board of directors; Samer Salah Daniel, Ahmad Rahif al-Atassi, Hassan Ihsan al-Baalbaki, Muhammed Yassin Rabah and Mohammed Abdulsalam Haykal. The bank's disclosures identify several cases of reported theft against its branches in the embattled cities of Homs and Daraa where substantial sums of cash were stolen from the branches' treasury.

In September 2014, the Arab Bank has made international headlines<sup>63</sup> after it was found to be guilty for 'knowingly supporting terrorism efforts' in a high profile terrorism trial in the US Federal District Court in Brooklyn, simply referred to as 'Beirut Account' case. What is unique about this case is being the first civil lawsuit against a bank under the US Anti-Terrorism Act, spurring disagreements among different branches of the US government and the government of Jordan, where the bank is headquartered. Plaintiffs' lawyers, who represent 297 American and Israeli family members whose relatives were killed in 24 Hamas attacks in early 2000s – during the second Palestinian Intifada – accuse the bank of operating a 'shadowy network that finances terrorists', with reference to the Palestinian Hamas group. At the crux of this trial, is the account of Osama Hamdan, a spokesman for Hamas, at Arab Bank's branch in Beirut. This account is accused of acting as a social security system for relatives of Hamas' members who collected charitable funds after their relatives' deaths in security operations against Israel. In turn, the Arab Bank vehemently contended that it complied with anti-terrorism financing and money-laundering laws by screening for accounts against lists of individuals and organisations designated as terrorists. When Hamdan was added to one of the terrorist lists in 2003, the bank claims it closed the bank account. However, compliance with foreign bank secrecy laws has also prevented the bank from submitting critical documents to substantiate their claims. Considering the complicated and sensitive nature of the case, the US Supreme Court sought the guidance of several departments in the US administration, but that was not an easy accomplishment. The US State Department, aware of the importance of Jordan as a strategic ally in a turbulent Middle East, sided with the Arab Bank. The Justice Department's national security division did not want to intervene against American victims of terrorist attacks. Yet, officials at the Treasury Department took the side of the plaintiffs thanks to their efforts to clamp down on tax evasion through foreign accounts. The Jordanian government showed its displeasure at the course of events, saying that 'forcing the Arab Bank to stand trial under the sanctions

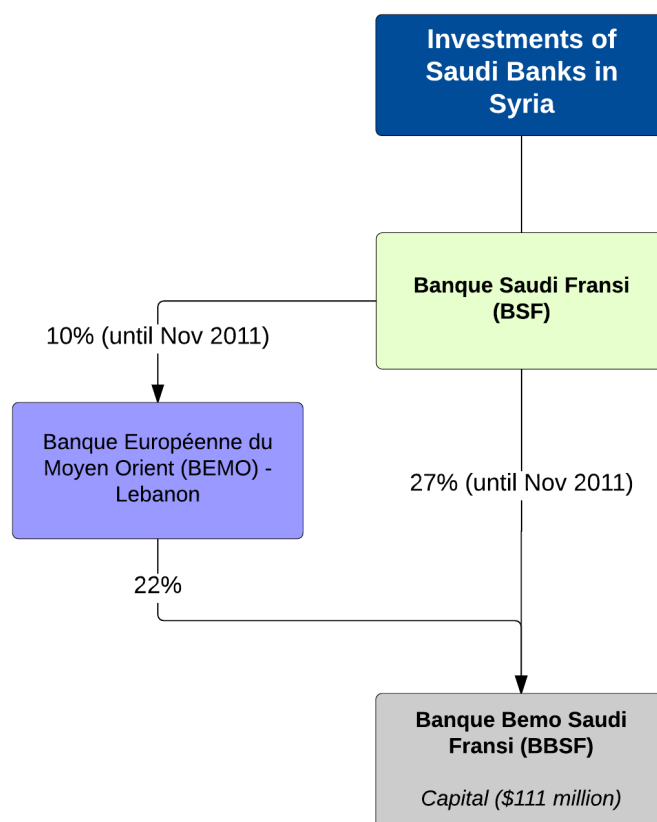
order could harm the bank's economic and reputational standing, and could lead to economic and political instability in a region that can ill afford any more of either'. Despite the political and legal sensitivities surrounding the case, the final verdict has put to rest these disagreements. The ruling against the bank will have a substantial impact on the bank's reputation and will further undercut its global operations in the US and Europe. Also, the verdict will serve as a benchmark on similar legal cases to hold banks and financial institutions responsible for wrongdoing by their clients, even if they had followed banking rules. This ruling can also be seen as a deterrent for banks that conduct business in high-risk countries, such as Syria, on issues related to sanctions, terrorism financing and bribery.

Less controversial is the Bank of Jordan-Syria, relatively one of the smaller financial institutions in the Syrian banking sector, with a paid-up capital of SYP 3 billion (\$66.67 million in pre-conflict value terms 45USD/SYP and \$19.87 million based on 2014 average official exchange rate of 151USD/SYP). It was established in 2008 and is the subsidiary of the eponymous Amman-based Bank of Jordan, which owns almost half of the bank's shares with 49% stake<sup>64</sup>. There are several Syrian investors who also serve on the board of directors, including Abdul Aziz Rashid al-Sukhni, Mohammad Nizar Haroun, Ibrahim Shehadeh Najmeh and Muhammed Maher Arabi Katbi. Several members of the Al-Akhras family, related to Asmaa al-Akhras the wife of President Bashar al-Assad, have also been prominent investors in the bank and members of the board of directors. The bank's corporate filings show that Diana Tarif al-Akhras was an investor and a board member until July 2012<sup>65</sup>. However, her brother Mohammad Murhaf al-Akhras remains a board member and an investor with a 5% ownership stake, according to the bank's corporate filings for the third quarter of 2014. The father of Nora al-Akhras, Tarif, who is the parental uncle of Asma al-Assad, was added to the EU sanction's list in September 2011<sup>66</sup>. The reasons included Tarif's 'close business relations with President al-Assad's family', which afforded him to 'benefit from the regime', according to the EU's published decision. Furthermore, he is accused by the same document of providing 'industrial and residential premises for improvised detention camps, as well as logistical support for the regime (buses and tank loaders)'.

#### 4.4. *Saudi Arabia*

Unlike banks from other countries, only one Saudi Arabia-based bank decided to enter the Syrian financial sector, but it was the first foreign private bank to be established in Syria in late 2003.

The diagram below maps the strategic investment made by the sole Saudi Arabian bank in Syria until late 2011(Exhibit 6).



At the time of its establishment in late 2003, Banque Bemo Saudi Fransi (BBSF) was the subsidiary of the Saudi Arabia-based Banque Saudi Fransi (BSF), which is partly owned by Crédit Agricole of France. It is the seventh largest private bank in Syria with a paid-up capital of SYP 5 billion (\$111 million in pre-conflict value terms 45USD/SYP and \$33.11 million based on 2014 average official exchange rate of 151USD/SYP), operating through 38 branches in the country. At the time it was set up and until late 2011<sup>67</sup>, BSF was the strategic investor and one of the major shareholders with 27% ownership stake, while Lebanon's Banque Européenne du Moyen Orient (BEMO) owns 22% of total shares. Several Syrian investors have major commercial interest in the bank who also serve on the board of directors, including Riyadh and Yordan Bshara Obegi, Mahran Hazar, Farid Talal al-Khoury, Noor Faisal al-Husseini, Bassam Mamdouh Mu'mari, Rana Hamdi al-Za'im and Riyadh Muhammed al-Basatneh. Similar to its competitors, the bank also incurred considerable losses due to a spate of robberies, heists, embezzlement, fraud and physical destruction sustained by some of its branches in hot zones in the country.

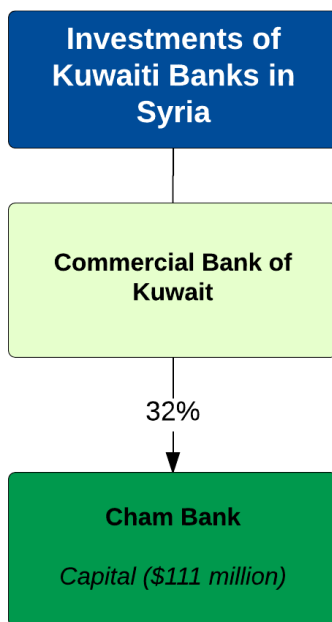
In November 2011<sup>68</sup>, BSF, the bank's strategic investor and one of the major bank's shareholders sold its 27% stake in Syria's BBSF, stating that 'the financial risks in Syria justify its decision to withdraw'. In addition, the bank sold its 10% holding in

BEMO, which owns 22% of the Syrian bank’s equity. The announcement came two days before the Arab League had approved sanctions, including a ban on financial dealings with the Central Bank of Syria and the state-owned CBS. The decision to divest from the bank made BSF the first and only foreign bank to exit the country due to the political upheaval. Similar to the decision of BSF to exit the country, it was expected that Qatari banks would follow suit given the prominent role that the Qatari government had played in cranking up political and economic pressure on the Syrian regime. Yet Qatari shareholders maintained their shareholdings in these banks in contrast to the Saudi decision to exit the country.

4.5. *Kuwait*

Similar to its larger neighbour, Saudi Arabia, only one Kuwaiti bank decided to enter the Syrian financial sector but it was the first Islamic bank to start its operations in the country in 2006.

The diagram below maps the strategic investments by the only Kuwaiti Islamic bank in Syria (Exhibit 7).



Cham Bank is the eighth largest financial institution and the first Islamic bank in Syria, which was established in 2006 with a paid-up capital of SYP 5 billion (\$111 million in pre-conflict value terms 45USD/SYP and \$33.11 million based on 2014 average official exchange rate of 151USD/SYP). It has several Kuwaiti institutional investors with the Commercial Bank of Kuwait being the largest shareholder and strategic investor with 32%<sup>69</sup>. Other Kuwaiti investors include Securities Group

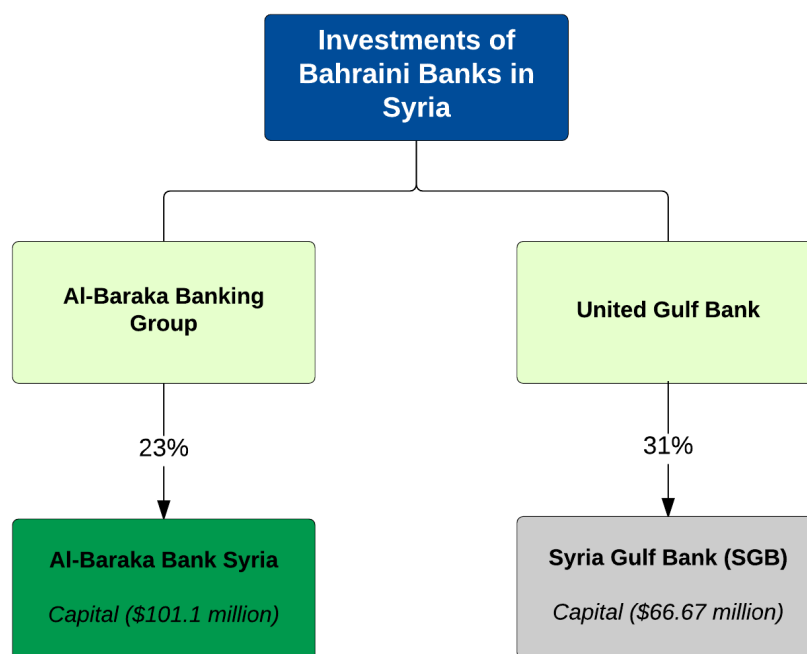


Company, Al-Shall Investment Company and Kuwait United Investment Company. Their exact ownership stake was not available in the bank's corporate filings because their representatives are not members of the board of directors. The Islamic Development Bank, affiliated with the Arab League, is also a significant shareholder in the Islamic bank with 9% stake, whose representative is a board director. Several Syrian organisations and individuals also own considerable percentage of the bank. To illustrate, the Syrian government-affiliated pension fund of Engineers' Syndicate holds 2% of the bank's shares. Meanwhile, several Syrian businessmen are also shareholders who sit on the board of directors such as Ali Mahran Khwanda (3%), Osama al-Taher (0.3%) and Ahmad Kuzbari (5%), the son of the Syrian-Austrian Nabil Rafik Kuzbari who was added to the US sanctions list in May 2011 for his ties to Rami Makhoul<sup>70</sup>, but was later delisted in April 2013 for severing these ties, according to official documents<sup>71</sup>. The listing was the result of Kuzbari's investment and chairmanship of Cham Holding, after which he severed his ties with it by leaving the company<sup>72</sup>. Separately, the bank's branch in Homs suffered a robbery and sustained physical damage in September 2012 after perpetrators tried to burn the branch<sup>73</sup>.

#### 4.6. Bahrain

Two important financial institutions from the tiny Gulf country Bahrain, were also the main founders of two Syrian banks, one is a traditional commercial bank and the other is Islamic.

The diagram below maps the strategic investments by the two Bahraini banks in Syria (Exhibit 8).



Al-Baraka Bank Syria is an Islamic bank that was the last to enter the Syrian financial sector in 2010 and to be listed on DSE in September 2014. It is the ninth largest private bank with a paid-up capital of SYP 4.55 billion (\$101.1 million in pre-conflict value terms 45USD/SYP and \$30.13 million based on 2014 average official exchange rate of 151USD/SYP) and is part of the Bahrain-based Islamic Al-Baraka Banking Group, which owns 23% of the bank's equity<sup>74</sup>. Other GCC-based financial institutions and corporations also have commercial interests in the Islamic bank. To illustrate, the UAE-based Emirates Islamic Bank is another investor with 10% shareholdings. The Kuwaiti-Syrian Holding Company owns 5% of the bank's stock while several well-established Syrian businessmen have invested in the relatively new bank. Some of these investors who also serve as board members are Mohammad Badr Eddin Al-Shaer, Ghassan Sukkar, Mohammed Imad Mawlawi, Basem Al-Taji and AbdulSalam al-Shawaf. Since early 2014, Al-Baraka Bank Syria had been making the necessary arrangements to list its shares on the DSE in September 2014, making it the last private bank to join the stock exchange<sup>75</sup>.

The second Bahrain-affiliated Syrian bank is Syria Gulf Bank (SGB) that is the subsidiary of the Bahraini United Gulf Bank (UGB). It was established in 2006 with a paid-up capital of SYP 3 billion (\$66.67 million in pre-conflict value terms 45USD/SYP and \$19.87 million based on 2014 average official exchange rate of 151USD/SYP). UGB is the major shareholder of the bank and strategic investor with 31% ownership stake<sup>76</sup>. The Kuwaiti Al-Fouttough Investment Company is also one of the major shareholders of the bank with 11% stake. Other noteworthy investors are

Syrian businessmen such as, Karim Mahran Khwanda, Muhammed Atman Orabi Kassab-Bashi, Nazriat Pouzant Yacoubian, Abdulwahab Zahed Sawwan and his son Muhammed Sawwan. Since the start of the conflict in 2011, several board members and investors resigned or divested from the bank<sup>77</sup> to preempt any potential economic blockade by Western countries. Also, SGB's branch in the northern-eastern city of Deir Azzour, which witnessed substantial clashes and is now largely under the control of ISIL, suffered an armed robbery of the cash deposited in the bank. To finance its operations, ISIL has been especially active in targeting banks and other financial institutions, which are usually in possession of large quantities of cash.

## **5. Impact of sanctions on investments in the banking sector**

### *5.1. The link between the political elite and regime businessmen*

The emergence of the private banking sector in Syria has attracted institutional and retail investors' as part of their diversification strategy. Investments in this sector proved a lucrative venture to many investors, which had the potential to grow at an exponential rate had it not been for the Syrian conflict. Currently, there are more than 23 individual investors whose shareholdings exceed the one million shares threshold, with a total stock ownership of 36.4 million shares. This constitutes more than 4.5% of overall shares of private banks and 11% of total retail investors' stock ownership in these banks. These investors are prominent members of the Syrian business community, some of which have close ties to the Syrian regime<sup>78</sup>.

Since the late 1980s, the links between the military, security and political elite on one hand and the business community in Damascus and Aleppo have strengthened thanks to joint business ventures and inter-family marriages. The end of the cold war and the declining strategic aid flow from regional and international allies prompted Hafez al-Assad to reverse some of the socialist redistributive policies enacted during the 1960s and 1970s. By the early 1980s, Syria's state building had reached a plateau, almost depleting the state treasury amid increasing external debt forcing the government to reconsider its populist policies. The growing pressure to keep the state-led economy afloat forced the country into a new phase of moderate opening of the economy towards the private sector and foreign capital, in what was widely dubbed *Infitah*<sup>79</sup>. New state bourgeoisies subsequently emerged, who benefitted from economic liberalisation and became heavily dependent on government contracts, establishing a clientelistic relationship with the state. The private sector also started gaining some of its lost ground by being allowed to take part in infrastructure projects and external trade, as the state rolled back its welfare measures and monopoly over the economy.

Since 2000, when Bashar al-Assad succeeded his father, Syria's oil revenue from local production had reached its apex at 600,000 barrels per day (bpd) in 1996, and starting

on a gradual course of decline hitting 500,000 bpd in 2001 and 400,000 in 2010. This oil production decline was taking place at a time when consumption was rising steadily on an annual basis from 100,000 bpd to 320,000 in 2010. The government had few options but to further liberalise the economy, on the back drop of the previous attempt in the 1990s, which gave the private sector more opportunities in the economy. In tandem, Bashar departed from his father's policy by forcing the Sunni old guard politicians from the inner circle out and curbing the role of members from the ruling Baath party, labour unions and farmers. Instead, Bashar embarked on a new mission by concentrating new powers within the extended Assad family and other trusted individuals. In order to compensate for the waning influence among the wider traditional base of the regime's support, Bashar forged new relations with the business elite. Bashar relied on co-opting the business elite and their relationship grew even closer in the last decade and transformed into a de facto alliance, to become the central backbone of the Syrian regime<sup>80</sup>. Before the 2011 Syrian uprising, this alliance became the new economic and business model in Syria, in what was described as 'crony capitalism', practically merging these two distinct socio-economic groups into a closely-knit but all-powerful ruling class<sup>81</sup>. This has driven the emergence of a new generation of 'regime businessmen', who are members of key families with a diverse range of investments in several sectors, including banking and finance, real estate development, tourism and entertainment.

### 5.2. *Private investors*

Because of the close linkages between business and politics in the country, the sanctions aimed at disrupting this dynamic and driving a wedge between these closely forged relationships. Dozens of security officials, politicians and businessmen were added to the US and EU sanction list in the hope of driving them away from the regime. This policy has largely failed, since most of these businessmen have substantial investments in the country, which outweighed their overseas assets and commercial interests. Hence, the majority remained highly invested in the survival of the regime and more than three years of biting sanctions against them did not result in any decision to abandon the regime. A case in point is Issam Anboubas, the president of Anboubas for Agricultural Industries Company, a major shareholder in several private banks in the country. He was added to the EU sanctions list on 2 September 2011 for 'providing financial support for the repressive apparatus and the paramilitary groups exerting violence against the civil population in Syria', according to the published EU decision document. Specifically, he is accused of 'providing property such as premises and warehouses for improvised detention centres'. Blacklisting him has demonstrably failed to change his stance towards the conflict and abandon the regime in its fight against its opponents.

One name stands out in the retail investor's category, Muhammad Suleiman Tlass Ferzat, who is the largest owner of shares in private banks, spread along three banks, QNBS, Cham Bank and Bank Al-Sharq. The second largest retail investor is Samer Salah Daniel, who is one of the principal shareholders at Arab Bank-Syria, with 5% stock ownership of the bank. In the third place is one of the most prominent Syrian businessmen, Nabil Kuzbari, who owns substantial shares in Cham Bank and Bank Al-Sharq, with 5% and 1.5%, respectively. Riad Bechara Obegi, a Syrian-Lebanese businessman, is the fourth largest investor with ownership stake of 2.33 million shares at Banque Bemo Saudi Fransi. In the fifth place is Nader Qal'i, a trusted associate of Rami Makhlouf, who owns 5% of Bank Byblos-Syria - in which the latter was one of its biggest investors.

Following him in the sixth place is Ihasan Baalbaki with 5% ownership stake at BSO. In the seventh place is Bassel Hamwi who is a major shareholder in Audi Bank-Syria with 3% stake. Hamwi had a long career at the World Bank and later became the General Manager of Audi Bank-Syria, until his resignation in early 2014, but still maintains his 3% shareholdings. Muhammad Murtada al-Dandachi is the eighth largest investor with 1.74 million shares at Bank Byblos-Syria. In the ninth place is Louay Abdel Hamid al-Assar who owns 3% in Cham Bank. The tenth largest investor in the private financial sector is Ahmad Said Al-Shihabi who owns 5% of Fransabank-Syria and 1% in Bank Al-Sharq. Other renowned Syrian businessmen with considerable investments in these private banks, whose shareholdings exceed the million shares threshold, are Mohammad Tarif Al-Akhras; Khwanda brothers - Karim and Ali; George Achi; Ahmad Abboud; Mahran Hazar; Bassam Maamari and Ahmad Rahif al-Atassi.

### 5.3. *Public investors*

Investment in the banking sector has also included Syrian government officials and entities that also wanted to take part in the erstwhile profitable sector. As demonstrated before, state-owned entities also have commercial interests in these private banks, where they invested their cash surplus. To illustrate, the General Social Security Organisation owns approximately 18.14 million shares, the equivalent of 2.31% of overall private banks' stocks. These shareholdings are divided between two Qatari banks: 10.25% of QNBS with 15.42 million shares and 0.32% of Syria International Islamic Bank with 2.7 million shares. Furthermore, several government-affiliated unions and syndicates have invested in several private banks to tap into the former booming banking sector, reaching 4.21% or 33 million of their total shares. The pension fund of Engineers' Syndicate owns more than 8.87 million shares, equalling 1.11% of private banks' total stocks. These are divided among 5% QNBS, 2.23% of IBTF and 2% of Cham Bank.

An interesting phenomenon is also evident in the Syrian banking sector, with state-owned banks owning stocks in other private competitors. For instance, the sanctioned public Savings Bank owns 4% of QNBS with 6.16 million shares, making 0.79% of total private banks' shares. Equally, current and former government officials are also major investors in the banking sector, but which has not attracted much public scrutiny of this controversial involvement. Amer Hosni Lotfi, the head of State Planning commission and the former Minister of Economy and Trade between 2004 and 2010, is one of the largest individual investors in the IBTF with more than 152,200 shares. He was also appointed to the board of directors as the Deputy Chairman in October 2013, according to the bank's disclosures.

## **6. Conclusion**

As the conflict drags on in the absence of a viable political solution, the Syrian economy will continue to disintegrate and metastasise into a war economy. While the government will try to display an air of normalcy in its held territory by announcing new development and reconstruction projects, substantial financial support will prove harder to attain. However, modest cash inflows from its allies and aid agencies will help it finance its operational expenses. The emerging asymmetry between the relatively safe government-held areas and the conflict-ridden territories outside regime control will allow the resumption of basic business activities in the former while hampering any form of sustainable recovery in the latter. Meanwhile, the role of the Central Bank of Syria will be mainly focused on maintaining the stability of the foreign exchange rate, while avoiding any major runs on the Syrian pound, witnessed in the summer of 2013. The depleting foreign cash reserves, collapse of export revenue and increasing sanctions amid the increased costs of the raging war will make this task harder to achieve, without ongoing financial and economic commitment from its allies.

In the meantime, the impact of the civil war will continue to be manifested in the shrinking operations and ownership of the banking sector. State-owned and private banks have equally struggled to recover the loans extended to companies and individuals, with increasing provisions for non-performing loans and defaults. Notwithstanding the setbacks, these banks' mission seems to have shifted to 'wait the conflict out', in anticipation of its eventual resolution – which looks increasingly implausible any time soon. The latest estimates and figures released in September 2014, paint a clearer picture of private banks' shareholding structure since the start of the conflict in 2011. In the past three years, the ownership map has changed after several local and foreign investors, both institutional and retail, have decided to divest from the banking sector for either economic or political reasons. At the same time,

others have further invested in the ailing sector in spite of the severe operational, financial, political and security risks. Reports based on banks' third-quarter filings for 2014 indicate that institutional investors represent the highest owners in private banks with 29 local and foreign commercial entities owning approximately 58%, and the remaining 42% owned by more than 34,600 individual investors. Considering that almost all private banks are listed on the DSE, which surprisingly still comply<sup>82</sup> with the Exchange's disclosure regulations during the raging civil war, access to updated corporate and ownership information on the Syrian Commission on Financial Markets & Securities (SCFMS) is still possible, although incomplete and at times contradictory. As it stands, the total number of private banks' shares is 783.9 million; institutional investors own 452.7 million and the remainder 331.3 million shares are owned by individuals.

Syrian investors and commercial entities have sizable shareholdings that gave them seats at the board of directors. Among the notable Syrian companies with stakes owned in these banks are Syrian Libyan Company for Industrial & Agricultural Investments, Kuwaiti-Syrian Holding Company and Arab Union Reinsurance Company. Foreign companies and financial institutions constitute strategic and principal investors in the Syrian banking sector, which did not only bring their decades-long of institutional experience in banking but also substantial capital to support their operations in the country. Since these private banks are subsidiaries of foreign financial institutions, they have primarily constituted the principal, if not the majority, shareholders in these banks. This has given them the advantage to participate and influence strategic decisions of these banks, benefiting from their local knowledge of the market. Notwithstanding the raging civil war<sup>83</sup>, which entered its fourth year in March 2014, almost all the foreign commercial entities either maintained their substantial shareholdings or, paradoxically, increased their ownership stake in these banks. Although not conclusive, the plausible rationale behind their decision to maintain their investments while scaling back their operations, is the enormous opportunities after the eventual resolution of the conflict. Otherwise, it would not be prudent to maintain such an extremely high-risk investment on their balance sheets and justify it to their shareholders, regardless of the size of their footprint. More than three years of a destructive civil war, Syria still appears to these institutions to be a potential lucrative source of income, even if they have to swallow the bitter pill of losses incurred in the country for the time being. Eventually, it can be argued that banks will play an instrumental role in the reconstruction of the country, once this conflict comes to an end.

In contrast to the decision of foreign investors to suspend their real estate and tourism projects in the country, foreign shareholders of private banks have maintained their

stake in these businesses. Some of these real estate projects were still under construction or located in conflict zones, justifying an immediate decision to suspend them. However, when the conflict broke out in 2011 several private banks were newcomers and also operated in areas where the fault lines between urban and rural areas were pronounced. In spite of that, these banks have largely maintained their presence in the country and as this research showed some of them even increased their investments in these subsidiaries. Three years after the start of the Syrian conflict, all 14 private banks are still operating in the country, albeit on a minimal basis. Their banking activities have been severely scaled back and they have shifted their operations to recovering retail and corporate loans for the past three years<sup>84</sup>. Counter to their earlier expanding retail and corporate lending portfolio, these banks have been at pains to reduce the soaring rate of defaults on non-performing loans by both individuals and companies.

Gulf banks are still very much present in the country by either maintaining their stake in their investees or increasing their shareholdings in those banks. The Commercial Bank of Kuwait grew its ownership by more than three folds from 10% in Cham Bank to a whopping 32%, transforming it into one of the bank's major shareholders. Another Gulf-based bank United Gulf Bank of Bahrain amplified its shareholdings of its subsidiary SGB from 24% to 31%. While the Kuwaiti Al-Fouttuh Investment Company did not follow the footsteps of its other fellow companies, it did not divest its shareholdings of SGB either, by maintaining its 11% ownership stake at the bank. Similarly, the Bahrain-based Al-Baraka Banking Group is still very much present in the country through its 23% ownership of its subsidiary Al-Baraka Bank-Syria. The Emirates Islamic Bank also maintained its 10% shareholding stake in the same bank since its initial investment in it.

The traditionally conservative banking sector in Lebanon does not seem to have flinched by the extremely high commercial and operational risks in Syria. As of the first-half of 2014, not a single Lebanese bank has liquidated its investments in the country, although it has been hit hard and its banking activities have come to a standstill in Syria<sup>85</sup>. This decision is highly informed by these banks' own experience in their country's 15-year-old civil war between 1975 and 1990, where banks held their ground in anticipation of the eventual conclusion of the conflict. The Lebanon-based Byblos Bank increased its shareholdings in its subsidiary Byblos Bank-Syria by 44% from an initial share of 41.5% of the bank's equity to become the majority shareholder with 59.81% over the past three years. The Lebanese Blom Bank, which owned 39% of its subsidiary BSO, amplified its shareholdings by 10% to almost own half of the bank's equity to 49%. Equally, its fellow Fransabank, which was one of the last Lebanese banks to enter the Syrian market in 2009, increased its ownership in its



eponymous subsidiary Fransabank-Syria from 48% to become the majority shareholder with almost 56% of the bank's shares. Audi Bank-Syria serves as an exception to this rule, where its three main Lebanese investors, namely Banque Audi Lebanon, Audi Saradar Investment Bank and Lebanon Invest, chose to hold their investments at 41%, 3% and another 3%, respectively. The experienced and sophisticated Jordanian banks did not seem to disagree with the strategy of rival banks from other Arab competitors in their gambit to participate in the waiting game and expand their possessions. The Jordan-based Arab Bank Group also increased its imprint in its identically named Arab Bank-Syria marginally from 49% to 51.28%. However, the Jordanian Housing Bank for Trade and Finance – one of the first institutional investors in private banks in Syria – maintained its substantial investment level in the IBTF at 49%. Considering the already significant investment of Bank of Jordan in its eponymous subsidiary Bank of Jordan-Syria with 49%, the bank chose not to increase its investment to the allowed threshold of foreign investors to 60%.

As illustrated above, the preservation and expansion of Qataris' investments in the Syrian banking sector after 2011 presents a noteworthy phenomenon to be explored further. This is especially important considering the hostile stance of the Qatari government towards the Syrian regime. The relations between the two governments did not only break down by suspending all diplomatic activities between the countries, but also the Syrian regime accuses the Qatari Al-Thani ruling family of funding the Syrian opposition to topple the regime in Damascus. Hence, these existing links openly contradict the political stance of Qatar with its economic interests in the country especially since several government-owned and affiliated institutions are also shareholders of the same bank, such as the Syrian General Social Security Organisation and the Engineers' Syndicate that hold considerable shares in the two Qatari banks. What is more problematic is the existing shareholdings of the two blacklisted state-owned Savings Bank and Popular Credit Bank in QNBS. This adds another layer of not just policy inconsistency, but also a legal liability, as a Qatari government-owned bank is in a commercial partnership with an internationally sanctioned bank. Banks that carry out operations in the US and EU are required to comply with these sanctions, even if they are not domiciled in any of these countries. In the last few years, we have seen a flurry of cases with hefty fines imposed on banks for breaking these sanctions<sup>86</sup>. It remains to be seen if continuing economic blockades and isolation of the Syrian regime will finally force foreign investors to divest from the financial system. For the time being, Arab investors in private banks have been biding their time and watched their annual negative return on investment by staying in the country. Their decision to remain in the country has made them one of the main beneficiaries of the ultimate resolution of the conflict.

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