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BANQUE DU LIBAN: A FORENSIC ANALYSIS

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ANALYSIS

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OUTLINE

EXECUTIVE SUMMARY

Alvarez & Marsal's Audit Report (Report) on Banque du Liban (BDL), for the period 2015-2020, is the only official and externally audited report on BDL since its first operations in 1964.

By law and practice, BDL is an independent institution, with powers that are most extensive among central banks. Its policy-setting authority is the Central Council, constituted of independent members and headed by the Governor. The Report found that the BDL effectively was a one-man show by the Governor, adopting arbitrary accounting methods, hiding its mounting losses by deferred expenses and unjustified seigniorage income. None of these practices was questioned by any member of the Central Council or any government official.

The Report notes a payment of more than US Dollars ($) 111 million in "illegitimate commissions", with BDL refusing to identify ultimate beneficiaries or the nature of transactions. Several transactions, valued at hundreds of $ millions, include family members of the Governor.

While BDL consistently reported a positive financial condition, the Report identified significant losses, negative equity, and negative net foreign exchange (FX) reserves, the latter reaching a deficit of $60 billion by the end of 2019. The main culprit is BDL's costly "financial engineering", which consisted in attracting banks to shift their $ liquidity from foreign correspondent banks to BDL, against unusually high interest rates and bonuses. The result was a dramatic drop in banks' $ liquidity, to around 7%, which was the critical element leading to the banking collapse.

The banking collapse is the result of BDL's toxic "financial engineering" policy, willingly joined by banks that mismanaged their $ liquidity and credit policy. The Lebanese Government's responsibility stems from its systematic failure as a banking supervisory authority. The collapse of the Lebanese Lira is a separate event that resulted from Government's fiscal irresponsibility and corrupt practices.

During 2015-19, analysis of BDL's and the banks' sources and uses of $ funds reveal at BDL an unaccounted-for residual of at least $25 billion. These have most likely been purchased by banks and transferred abroad to their shareholders, as opposed to the banking institutions themselves.

Since late 2019 Lebanon has been witnessing a financial "year zero". Bank deposits are practically frozen, and bank depositors and the population at large continue to bear the full cost of the financial collapse. No official corrective action has been undertaken, no public or banking official has been brought to account, and bankrupt banks continue to operate as normal institutions, but effectively "zombie banks".

Financial recovery is feasible. Urgent legal and standard actions are proposed in order to have some recovery of depositors' money and a normally functioning banking sector, a necessary condition for economic growth. The key is to have an "honorable" political leadership to start executing known remedies. Recovery on all fronts then should naturally follow.

INTRODUCTION

“Something is rotten in the state of Denmark”
-*Shakespeare*

Following a commission by the Lebanese Government, Alvarez & Marsal (A&M), a financial services firm, has recently released its preliminary audit report (Report) on Lebanon’s central bank, Banque du Liban (BDL).[1] This is the only official and externally audited report on BDL that is publicly available since BDL first started operations in 1964.

An audit is a presentation of financial facts in accordance with generally accepted principles of accounting. A forensic audit does more; it “examines financial records to find any illegal financial activity that can be used as evidence in a court of law”, which the Report does, though incompletely, mainly owing to the withholding of data and other information by BDL.[2]

BDL’s refusal to provide requested information, although A&M’s work had been officially commissioned, was based on claims of “bank secrecy” despite the fact that the bank secrecy law was suspended by Parliament until A&M’s completed its forensic audit. Moreover, Lebanon’s bank secrecy law usually covers information relating to bank depositors and not to other banking information, such as expenditures or credit.

Examples of information that was denied by BDL to A&M include: descriptions of transactions and their purposes; beneficiaries of SWIFT bank transfers, originators and description fields; answers to written questions; and face-to-face interviews with BDL employees and leadership.

This study is divided as follows: The first section presents a review of the Report’s assessment of BDL’s management system, including its accounting practices. The second section selects from the Report illustrations of BDL’s improper transactions and provides the Report’s major findings with respect to the accurate status of BDL’s financial condition. The third section explains the genesis of the financial crisis and identifies its main culprits. The fourth section offers an updated cash flow analysis of the sources and destinations of BDL’s $ funds. The last section concludes with recommendations for specific urgent actions for financial recovery.

[1] Alvarez & Marsal Middle East Limited, *Preliminary Forensic Audit Report, Banque du Liban*, August 7, 2023. The Report was released following a Court ruling against the Ministry of Finance’s refusal to make the Report public.
[2] See Google definitions.

BANQUE DU LIBAN: POWERS AND PRACTICES

Powers: Independent and Strong

Lebanon's Code of Money and Credit (CMC), the 1963 law and subsequent additions and amendments, govern the objectives, functions, and policies of BDL. It notes two basic objectives: to safeguard a sound national currency, and to safeguard and develop the basic structure of the banking system, two objectives that are critical for financial and economic stability.

BDL, specifically its policy-setting and governing body, the Central Council (CC), which is headed by the Governor, has clearly and totally failed in its two essential tasks.[3] This failure is compounded by the fact that, compared to other central banks, BDL is independent of the Government and enjoys powers that are among the most extensive in the domains of money and banking. Thus, the Report states that, by law, BDL is "institutionally, functionally, personally, and financially autonomous" (p. 222).[4]

The CMC also includes the following built-in supervisory mechanisms by specific institutions or persons who can question BDL's policies: BDL's Central Council, which determines monetary policy; the Minister of Finance; Parliament; and the Government Commissioner.

In addition, the Banking Supervisory Commission separately examines the financial condition of individual banks and informs the Governor of its findings. It is an independent body and "can impose corrective and remedial measures on individual banks" (p. 296).

Practices: A One-Man Show

Despite all these legal firewalls and supervisory guardrails, the A&M Report states in this regard: "We have not identified any instances where challenges of BDL's decisions was triggered" by any of the above persons or institutions (p. 226). In particular, despite the formal independence of the Vice-Governors and the other CC members, the Report determined that "the Central Council was largely ineffective as a governing body with no challenge to the

> ***The Governor himself "has exercised largely un-scrutinized authority", making Lebanon's central bank practically a one-man show.***

[3] The Central Council consists of seven members: The Governor, four Vice-Governors and the two Directors General of the Ministry of Finance and the Ministry of National Economy.
[4] A&M Report, p. 222. Henceforth, the A&M Report's page references will be included in the body of the text, here as (p. 222).

Governor's exercise of decision-making power" (p. 27). [5] It added that the Governor himself "has exercised largely un-scrutinized authority" (p. 225), making Lebanon's central bank practically a one-man show.

Accounting: Misleading

A&M's audit of BDL covers only the period 2015-20. It is based on BDL's audited financial statements for 2015-18, by Deloitte & Touche and Ernst & Young, and on "Special Purpose" financial statements for 2019 by KPMG, in addition to BDL's statements for 2020. BDL's audited statements have never been made public.

The Report's conclusions in this regard are straightforward. "… BDL has adopted unconventional accounting policies …", and "In summary, the published financials do not provide an accurate picture of the financial position of BDL" (pp. 111, 133). This is a concise summary of the Report's evaluation of BDL's accounting methodology, which is not only out of line with international methodology but also arbitrary and inconsistent since BDL has applied auditing procedures, mainly on financial engineering operations, that are based on personal judgements (p. 15).

BDL has never shown any financial losses in its balance sheet, while losses have emerged probably since 2002 when it first stopped publishing its annual profit & loss statement (p. 134). To conceal its losses, which accumulated to about $50 billion by end 2019 (see Table 1 below), BDL introduced presumed seigniorage income, and deferred interest expense to the future, rather than recognizing it as it occurs, and other finance costs (p. 133). These practices all are contrary to standard accounting procedures.

A special accounting procedure by BDL was to create value through seigniorage income, which it used to offset deferred interest and other expenses. Seigniorage on currency, the most common form, is the difference between the face value of all Lebanese Lira (LL) money and the actual cost of producing the cash. BDL also added "Treasury-bill" seigniorage and "financial stability" seigniorage, with total seigniorage income reaching about $48 billion by end 2020, all with the approval of BDL's Central Council (pp. 44, 112-13).

All this claimed seigniorage income was cancelled in A&M's adjusted audited statements. In view of the collapse of the banking sector and the strong depreciation of the Lira as of October 2019, it clearly was impertinent of BDL to continue, nonetheless, to register until end 2020 seigniorage income of more than $36 billion resulting from currency and financial stability!

[5] To emphasize the independence of BDL's Central Council, the CMC clearly states that the Directors General of the Ministry of Finance and of the Ministry of Economy and Trade are not to act in the Central Council as Government representatives (article 28).

Transparency: Absent

No important information on BDL's financial position was made public, in particular about its losses. More seriously, BDL had been declaring in the Official Gazette, where it is legally required to publish its annual summary balance sheet, that annual "results-profits" during 2002-21 were "zero" every single year of those twenty years.[6] In other words, remarkably, BDL was publicly declaring "substantial profits" while, simultaneously, reporting zero profits in the Official Gazette while, also simultaneously, it was in reality incurring substantial losses!
Thus, BDL intentionally has made false representations of material facts. It is then valid to say that BDL was publishing data, information, and making statements in order to deceive rather than to inform.

The Report also underlines the absence of "risk management arrangements … of internal audit … of scrutiny from external stakeholders and commissions" (pp. 225-26). In addition, it notes that A&M "has not been provided sufficient information or documentation that suggests that BDL is fully transparent in disclosing its governance arrangements … its policies and procedures in place … its operations … the outcome of its policies" (pp. 319-32).

BDL's lack of transparency is underlined by the absence, for example, of documents concerning rationale, analysis or reporting back on its notorious "financial engineering" policy that was instrumental in the ensuing banking collapse (p. 18).

BDL: IMPROPER TRANSACTIONS AND FINANCIAL CONDITION

Improper Transactions

The A&M Report includes a number of specific transactions by BDL that can charitably be described as improper, by normal banking or business standards. The following are illustrations of such transactions.

- Transfers from a "Consulting Account" amounted to more than $111 million during 2015-20. BDL refused to identify to A&M ultimate beneficiaries of transfers or the nature of transactions, based on a groundless reason of "bank secrecy"[7] (pp. 95-7). However, several names of beneficiaries from the "Consulting Account" are mentioned in the Report, including media people and institutions.

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[6] See various issues of the Official Gazette and BDL's Annual Report.
[7] Lebanon's Banking Secrecy Law was suspended by Parliament until A&M's completed of its forensic audit. Moreover, this law in Lebanon usually covers information relating to bank depositors and not to bank expenses.

A&M's comment: "There is evidence of the payment of illegitimate commissions during the period totaling USD 111m… Amounts and the destination of transfers were set by the Governor." (pp. 22, 24).

- In 2010, one bank was granted a LL loan, secured by LL-TBs, the equivalent to $200 million, at zero interest rate for 2 years, which was then raised to 2%. During 2014-16, two banks and one financial institution were also granted similarly secured loans in LL, the equivalent of more than $350 million, at an average rate of 2% when the 12-month LL-TB yield averaged 5.3% (and 6.7% for a term of 60 months) during the period in question (p. 137).
- BDL entered into "financial engineering operations via Optimum Invest SAL, a Lebanese financial firm, designed explicitly to create commissions to be paid to third parties" (p. 99).

  In this respect, BDL conducted in 2015-16 at least two operations that consisted in selling LL-Treasury Bills to Optimum Invest SAL then immediately buying back the same bills at a total premium of $36 million" (pp. 99-102).

- A&M's review of BDL's expenditures during 2015-20 "showed significant amounts paid towards items which may not be considered appropriate … The use of a miscellaneous supplier vendor name to record transactions of around LL 331 trillion", then equivalent to more than $150 million at market exchange rates (p. 187).
- For several property acquisitions by BDL, for a total equivalent of $48.5 million, "none of the documents provided in support of the acquisition included the reason behind … such a transaction", including a land deal with a professional syndicate for the equivalent sum of $10.5 million with a request not to invoice the amount, and the payment probably was "in cash" (pp. 194-5).
- BDL entered into a contract with Forry Associates Ltd, a brokerage firm for which the signatory is Raja Salameh, brother of Governor Riad Salameh, and registered in the British Virgin Islands. During 2002-15, Forry received from BDL during 2002-15, at HSBC Private Bank (Suisse), $333 million in commissions, allegedly as "agent for the introduction of BDL products". A French investigating judge noted in this regard that "Riad Salameh engaged the BdL with a company under the terms of a legally non-existent contract" (pp. 92-4).
- During 2015-20, accounts at BDL held by the Governor himself received cheque deposits of $99 million, while his salary receipts during the period were only $1.5 million. A total of $103 million were transferred out of the Governor's accounts, of which $75 million were traced to 23 banks in Switzerland, Germany, Luxembourg, UK, USA, France, and Lebanon. There are no details concerning "the source of the cheque deposits and … the ultimate beneficiaries of the outward transfers" (p. 110).

BDL's Financial Condition

A lack of transparency usually occurs in order to hide disturbing, if not incriminating, evidence. The A&M audit has "adjusted" some of BDL's balance-sheet numbers for the period 2015-20 in accordance with generally accepted auditing principles. The result is a more accurate description of BDL's financial condition than that provided by its own accounts, with a significantly different picture of some of its major indicators.

Table 1: BDL's Financial Condition, Original and Adjusted

(In $ billions; end period)

	Data source	2015	2016	2017	2018	2019	2020
Cumulative profits	BDL	0.1	0.1	0.0	0.0	0.1	…
	A&M	-21.2	-31.0	-34.3	-41.7	-49.5	-64.6
Equity	BDL	1.1	1.1	1.1	1.1	1.2	0.9
	A&M	-15.0	-23.9	-25.9	-33.4	-39.0	-51.3
Net FX reserves	BDL	NA	NA	NA	NA	NA	NA
	A&M	-5.5	-14.7	-25.3	-35.0	-59.7	-71.8
"Financial engineering" cumulative costs	A&M	4.1	21.5	29.1	43.7	55.0	60.5
Memo							
BDL FX reserves	A&M	35.8	39.4	38.6	33.1	24.9	18.4
BDL FX liabilities	A&M	41.3	54.1	63.9	68.1	84.6	90.2
o/w Bank $ deposits at BDL	A&M	40.3	53.0	62.8	67.1	83.7	89.4

Sources: A&M Report. BDL data are from audited statements for 2015-19, of which none was published.

Notes: 1- "NA" is "Not Available". "FX" means "foreign exchange", usually the US Dollar ($). "FX reserves" denote universally accepted instruments of international payments, namely funds in dollars, euros, sterling, or internationally liquid financial instruments such as US Treasury Bills.

2- The exchange rate $=LL 1,507.5 is applied throughout, except for "financial engineering" costs for 2019 and 2020 where the average market rates are applied, respectively LL 1,625 and LL 5,673 to the $. This means that the numbers for losses and negative equity, practically only for the year 2020, are slightly inflated.

3- "Cumulative Profits", or retained earnings, is "Income after appropriations" in BDL's adjusted balance sheet.

The extent of BDL's losses and deterioration of its financial condition, at least since 2015, is illustrated by its basic indicators in Table 1 above, such as equity and net FX reserves. The contrast between the actual and published numbers is striking. BDL's actual financial condition also reveals the magnitude of BDL's mismanagement and responsibility in the collapse of the banking sector. The instrument used was its "financial engineering" operations.

BANKING COLLAPSE: HOW AND WHO?

A widely circulating belief, rather than explanation, regarding the financial collapse as a whole in Lebanon still is dominant among politicians and repeated in the media, without any reference to published official evidence. At heart, the story exonerates banks and BDL, and it runs as follows: People put their money in banks, banks put the money at BDL, then BDL lent the money to Government, which wasted it through corruption, which led to the collapse. Therefore, Government debt and corruption are the offenders. This story is fictional and is neither elaborated nor supported by facts.

The main cause of the banking collapse is monetary policy; the main cause of the Lebanese Lira's collapse is fiscal policy.

The two collapses are distinct in terms of their nature, causes and consequences. BDL's monetary policy of so-called "financial engineering", at least since 2015, is the critical policy that led to the total failure of Lebanon's banking sector, as detailed below. The collapse of the Lira is a different phenomenon. In fact, the Lira's similar downfall in the mid-1980s occurred while the banking sector then remained uncommonly strong, which underlines the distinction.

The Lira's collapse basically is the result of Government's fiscal mismanagement, with an emphasis on current expenditures rather than public investment. That responsibility falls, in particular, on the bloating of the public sector with tens of thousands of politically appointed personnel, and expenditures that were heavily loaded with corruption.[8]

BDL's Toxic "Financial Engineering"

The purpose of BDL's policy was to bring in additional FX reserves. This became necessary in order to support the fixed-exchange rate policy, especially as the balance of payments (BOP) had turned continuously into deficit since 2011.[9] The policy transactions were conducted with Lebanon's commercial banks, resulting in a significant shift of the banks' FX deposits from their foreign correspondent banks to FX deposits with BDL, which reached about $90 billion at end 2019 (pp. 65, 142).

Banks' voluntary response to BDL's generous offers was the companion cause of the collapse of banks. The transfer of most of the banks' own FX deposits from prime banks abroad to BDL ended with those $90 billion, or about 75% of all their customer FX deposits, being lent to BDL by the end of 2019. The result was the turning of the banks' previous high $ liquidity into $ illiquidity, a

[8] See Gaspard (2022) for details, particularly section 1.

[9] Except for a temporary surplus of $1.2 billion in 2016 following an escalation of "financial engineering" operations during the year. The continuous BOP deficit since 2011 is unusual because, since independence in 1943, the BOP usually has been in surplus and never more than two consecutive years in deficit.

deep low of only 7% at the end of September 2019. (Banks' $ liquidity is the ratio of their own $ deposits with correspondent banks to their customer $ deposits).
The policy of "financial engineering" was announced by BDL in early 2015. Essentially, it consisted of borrowing ever larger $ deposits from banks at ever higher and generous interest rates but without succeeding in reversing the trend of mounting losses and negative net reserves (see Table 1 above). Interest paid by BDL on the $ deposits by banks started with an average of around 5.5% reaching 13% in the summer of 2019, compared to an average of only 1.6% for the reference 6-month $ Libor during that period.

Importantly, in addition to those high interest rates, BDL discounted LL Treasury bills (TBs) held by banks "at a premium, equivalent to the value of the complete coupons to maturity" (p. 72). Moreover, since 2017, banks depositing $ at BDL received a net bonus in LL of at least 9% on notional loans in LL. The cost of BDL's "financial engineering" policy was enormous. As noted in Table 1 above, it has accumulated to more than $60 billion during 2015-20 (pp. 87-8).

BDL's "financial engineering" produced the bankruptcy of the banking sector. Had BDL's "financial engineering" not been devised and implemented, the banking sector would not have collapsed.

As the Report notes, BDL's "Central Council financial-engineering decisions appear not to have been properly reasoned, based on a clear articulation of the economic rationale … [and] allowed the Governor discretion that was unconstrained" (p. 18). BDL's "financial engineering" produced the bankruptcy of the banking sector. Had BDL's "financial engineering" not been devised and implemented, the banking sector would not have collapsed.

Banks' Mismanagement

The profits made by banks through that policy alone were substantial. In its 2016 annual report on the Lebanese economy, the International Monetary Fund (IMF) estimated that the "financial engineering" operations between BDL and the banks in the second half of 2016 have generated during that period profits to the banks of more than $5 billion, equivalent to "a money-financed capital injection (without any equity stake in return)".[10]

In addition, A&M estimates the profits made by banks, during 2017-20, to be $5.1 billion only on the notional LL-loans made by BDL to banks at a net margin in their favor of 9% (p. 156 and see above for details). In other words, during 2016-20, the banks made more than $10 billion in net profits from BDL's "financial engineering" transactions alone. These separate profits were equivalent to more than about 85% of the banks' reported total equity at the end of 2020.

[10] IMF (2017), p. 11.

The banks' eager implementation of BDL's "financial engineering", driven by the extraordinary profits that that policy generated, resulted in the banks' depositing at BDL at end September 2019, just prior to the collapse, more than $90 billion, or more than $70 billion in excess of the legal reserve requirements of 15% imposed by BDL on $ deposits at banks. The $90 billion deposits by banks at BDL then represented about three quarters of the banks' customer $ deposits.[11]

A more systematic, or rules-based, method of assessing banks' management is to evaluate it according to bank prudential regulations, which usually set a ceiling of 25%, and often 15% of a bank's capital or equity as maximum exposure, or credit risk, towards one borrowing entity. Instead, at end September 2019, the consolidated balance sheet of commercial banks in Lebanon had reached a level of exposure to BDL, in $ only, of about 440% the banks' total equity, noting that the banks' equity is in $ and LL. If we consider the banks' total $ exposure to the Lebanese public sector, i.e. the Government and BDL, the risk level increases to more than 5 times, or 500%, the banks' total equity.

Such a dangerous behavior by banks should have been strikingly clear to the Banking Supervisory Commission, especially since that mismanagement was making the banks' $-liquidity ratio continuously drop from 23% at end 2010 to only 7% at end September 2019. In contrast, that banks' $-liquidity ratio during the war years 1975-90 was a remarkable average of more than 99%!

BDL's "financial engineering" produced BDL's significant losses and significant negative net FX reserves. It also produced, in association with banks' mismanagement, a very low $ liquidity at banks. The banking sector's collapse became inevitable.

WHERE DID BANQUE DU LIBAN'S $ BILLIONS GO?

While the sources and amounts of $ funds going to BDL overall are clear, their utilization is not. Identifying the destinations of the funds is important in order to close the circle of the argument regarding BDL's and banks' behavior.

During the five years, between the end of 2014 and end 2019, BDL received a total $ inflow of $72.5 billion, the largest part of more than $45 billion borrowed from banks. Where did these $ go? An answer is provided in Table 2 below.

[11] The $90 billion deposit by banks at BDL at its height at end September 2019 is a conservative estimate, noting that it was about $84 billion at end 2019 (see Table 1 above), following 3 months of crisis and some $ reimbursement by BDL to banks.

Table 2: BDL's Sources & Uses of $ Funds, 2015-2019
(Flows in $ billions; all items originally in $)

$ Sources		Data source
Bank deposits	45.4	A&M, p. 142
Eurobond issues	12.6	MOF, unpublished
Interest	3.0	At 6-month LIBOR, and US 10-year TBs for securities
FX assets	11.5	A&M, pp. 57. Sale of FX assets
Total	**72.5**	
$ Uses		
Interest	18.8	A&M, p. 156 (at 6% annual average)
O/D to Government	5.0	A&M, p. 65
O/D to banks	4.6	A&M, p.136
Eurobond holding	4.9	A&M, p. 57
Loan reimbursement	1.7	BDL balance sheet
Total	**35.0**	
Residual	**37.5**	Positive residual means unaccounted-for $ outflows from BDL
Memo (2015-19)		
Balance of payments	-12.9	
Transfers to EDL	6.7	

Sources: A&M Report, BDL, Ministry of Finance (MOF).
Notes: 1- The Eurobonds were issued by the MOF at the request of, and strictly for, BDL in exchange for LL-TBs held by BDL.
2- FX assets include, in addition to FX reserves, all other assets in foreign currencies, e.g. Government-issued Eurobonds.
3- O/D is overdraft.
Some numbers in Table 2 are different, and more accurate, than previous estimates (in Gaspard, 2022, 2020) because the recent A&M Report includes first-time published audited data.

Estimating the Destination of the $ Residual

Popular explanations of the various uses of BDL's FX reserves during 2015-19 usually center on two destinations: mainly financing the Government's fiscal deficit, including transfers to Électricité du Liban (EDL), and financing the BOP deficit.

Major financing by BDL of the $ fiscal deficit is inaccurate, as detailed in the next section (b) below. On transfers to EDL, these are already included in the $ overdraft to Government, and the amount was relatively small, only $6.7 billion during the period, as noted in the Table above. However, the picture after 2019 becomes different. Subsidies of fuel and other commodities, e.g. wheat and medicine, have continued with increasing transfers from BDL, including a significant funding of smuggled basic commodities to Syria.

As for the BOP deficit, a part usually is financed by the private sector through direct imports. Even allowing for the full financing of the BOP deficit by BDL, the $37.5 billion residual then is reduced to a final $24.6 billion as an unaccounted-for outflow from BDL.[12] This amount has most likely been purchased by banks in the open market and transferred in favor of bank shareholders rather than the banks as institutions, which show a decline, not an increase, in their $ deposits with correspondent banks.[13]

The sources of these bank transfers include the large profits in $ and LL that were made through BDL's "financial engineering" generous interests and commissions. Bank profits and other liquid assets in LL were then exchanged for $ at BDL's open market.[14] To a large extent, the corresponding image of banks' profits is BDL's losses or the reduction in its equity, which fell by at least $30 billion during the period (see Table 1 above).

On BDL's $ Overdraft to Government

Still focusing only on $ funds, the $ overdraft (O/D) by BDL to Government/Ministry of Finance (MOF), is worth clarifying. By the end of 2019, BDL had a net outstanding $ overdraft (O/D) on MOF of only $5 billion. However, all such $ advances by BDL had then been offset/paid by equivalent LL funds held by MOF at BDL. Strictly speaking, the credit by BDL to Government, outside BDL's portfolio of LL-TBs or Eurobonds, was zero.

Concerning Eurobonds, in the past BDL has frequently initiated exchange operations with MOF whereby the MOF was asked to issue new Eurobonds, without a government need for these $ funds. The exchange operation was solely for the sake of BDL and at its request, against holdings by BDL of LL-TBs. BDL's objective was to sell these Eurobonds in the market to augment its FX reserves.

During 2009-19, these exchange operations amounted to $17.5 billion in Eurobonds issued in favor of BDL against equivalent amounts in LL-TBs held by BDL. During the same period, BDL separately had transferred $13 billion (funded in LL) to Government for various operations.[15]The net effect of all these $ operations was $4.5 billion extended by the Government to BDL. In other words, the Lebanese Government was the net-supplier of $ funds to BDL and not the other way round!

Significantly, had BDL not subjected the MOF to exchange operations of LL-TBs for those $17.5 billion Eurobonds, the Government's $ debt would have amounted, after accounting for interest,

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[12] Methodologically, Table 2 already includes elements from the BOP, such as interest receipts or payments and Eurobond transactions from/to non-residents, which may involve some minor double counting concerning the financed amount in the BOP deficit.

[13] The estimate of about $25 billion final residual as outflow to bank shareholders reconciles well with an analysis of banks' sources and uses of $ funds during the period. A cash-flow analysis of banks' balance sheets shows a net cash inflow of about $66 billion, of which about $45 billion were deposited at BDL. The residual of about $21 billion can be estimated as transfers by the banks, as shareholders, to personal accounts outside Lebanon.

[14] Banks performed the same operation in the late 1980s during the strong depreciation of the Lira (see Gaspard, 2004, Chap. 6, for details).

[15] Sources are unpublished documents by the MOF. See Gaspard (2020) for more details on these operations.

to only about $5-$6 billion instead of $31 billion prior to the collapse in September 2019. And Lebanon then would have been able to avoid its bankruptcy in international markets.

LEBANON, YEAR ZERO

Suddenly, by the end of October 2019, bank depositors were no longer allowed access to their bank deposits. Total private deposits of about $169 billion (of which 73% in foreign currencies, mostly in $) then were the equivalent of more than three times Lebanon's GDP of $55 billion in the previous year. It was the beginning of a financial year zero.

Lebanese law gave BDL extraordinary independent powers, unhindered by political or other influences, in order to secure exchange rate and banking stability. BDL completely failed to achieve either of these fundamental objectives. The failure is of historical proportions, with an almost complete bankruptcy of the banking sector and a depreciation of up to 98% of the Lebanese Lira.

More than four years after the unfolding of the crisis, bank depositors, representing most of Lebanon's population and commercial institutions, continue on a daily basis to pay for the joint faults, if not crimes, of BDL, of Lebanese bankers, and of the Lebanese authorities.

> *"The crime continues. The authorities still have not provided any formal explanation for that historical financial and economic meltdown, nor have they undertaken any measure to redress it. Nothing. Worse, not one banking or political official has been questioned or brought to account. Nobody."*

The crime continues. The authorities still have not provided any formal explanation for that historical financial and economic meltdown, nor have they undertaken any measure to redress it. Nothing. Worse, not one banking or political official has been questioned or brought to account. Nobody. On the contrary, the same financial and other officials since before the collapse are still in power and, with the consent of the authorities, bankrupt banks continue to function "normally", mostly in cash, effectively "zombie" banks.[16]

In the meantime, political and banking officials, supported by most of the media, have been busy destroying reality and replacing it with a simple but fictional story of what happened.

[16] At end July 2023, BDL's now ex-Governor, Riad Salameh, ended 30 years in power after five consecutive six-year terms that were endorsed by Government, the banks, and praising media. He is, however, being prosecuted in Lebanon and several European countries, and is subject since May 2023 to two Interpol arrest warrants. These have not then been considered, by the authorities or himself, sufficient for his resignation! Since leaving office, his whereabouts remain unknown.

Responsibility for the Banking Collapse

This is an unprecedented man-made financial and economic collapse, engineered by men with faces, names and addresses.

A specific policy by specific people has led to a specific collapse. BDL's policy of "financial engineering", approved by its Central Council and willingly implemented by most of the commercial banks, led to a historical bankruptcy of the banking sector, including BDL. The A&M Report substantiates this assessment.

Effectively, bank depositors are bearing the full cost of the banking collapse, with severe limits on deposit withdrawals and a deep haircut (up to 80%) on the conversion of $ deposits into Liras. Understandably, the issue of recovering bank deposits is a very live issue at the popular level in Lebanon. However, before proposing any workable solution, one should logically start with the distribution of responsibilities for the banking collapse. Three parties bear these responsibilities: Government, banks, and depositors.

The Lira's exchange rate downfall is due to the Government's fiscal irresponsibility, as noted above. The collapse of the banking sector is a completely separate affair.

On the banking collapse, Government's responsibility stems from its systematic failure as a supervisory authority, noting that, by law, any BDL losses must be covered by the Treasury. The banks' responsibility is the direct outcome of their mismanagement, by any banking or prudential standard, of their $ liquidity and in relation to their extending very high-risk $ credit to one entity, the central bank. The depositors' responsibility is the result of their failure to evaluate, as they should have done, the high risks carried by the banks where they put their money.

Based on the analysis above, the responsibility for the banking losses is here proposed to be distributed, roughly, at the following rates: 40-40-20 percent among Government-banks-depositors.

Urgent Actions

It is unrealistic to ask the current authorities to implement any significant reform, despite frequent related calls by numerous foreign governments and international institutions, and the public at large. To date, no major reform has been implemented, and no public or banking official has been brought to account. The political authorities themselves, past and present, are concerned that effective reforms could unveil facts about corrupt practices and their responsibility in the collapse. Meanwhile, no official financial aid is being directly given to official institutions, justifiably fearing it would mostly serve the political and personal agendas of corrupt officials.

Setting as primary objectives the re-establishment of a normally functioning banking sector, which is necessary for a normally functioning economy, and the recovery of some of depositors' money, the following are necessary actions that should have been implemented weeks, rather than years, after the collapse.

These actions are minimal and in line with Lebanese laws and standard international practice in similar circumstances. They should be immediately implemented.

- Put a lien, in Lebanon and abroad, on the assets of the board members of banks that are effectively bankrupt, with negative equity, and refuse to recapitalize.
- Identify the beneficiaries and $ amounts transferred by banks abroad since October 17, 2019, when transfers for ordinary depositors were no longer authorized.
- Invite foreign banks to open branches in Lebanon, with the offer of a 10-year tax holiday. Similar conditions would apply to new Lebanese banks.
- Implement reforms listed in the April 2022 Staff-level Agreement with the IMF.
- Externally audit, as legally required, the public enterprises BDL, EDL and Middle East Airlines (MEA), a private company but 99% owned by BDL. Publish the audit reports.

No financial situation is impossible to redress. Above all, in Lebanon, the key is to have “honorable” politicians at the helm to start executing known remedies. Recovery would then naturally follow.

AFTERWORD

Not long ago, as the price of bread was fast rising, I came across an angry elderly man at the entrance of a supermarket. Clenching a pack of bread to his chest, he was shouting to nobody something like: How can one live with [so many] Liras to pay for just a pack of bread! This paper was written thinking of that man's rebellious cry in the air.

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