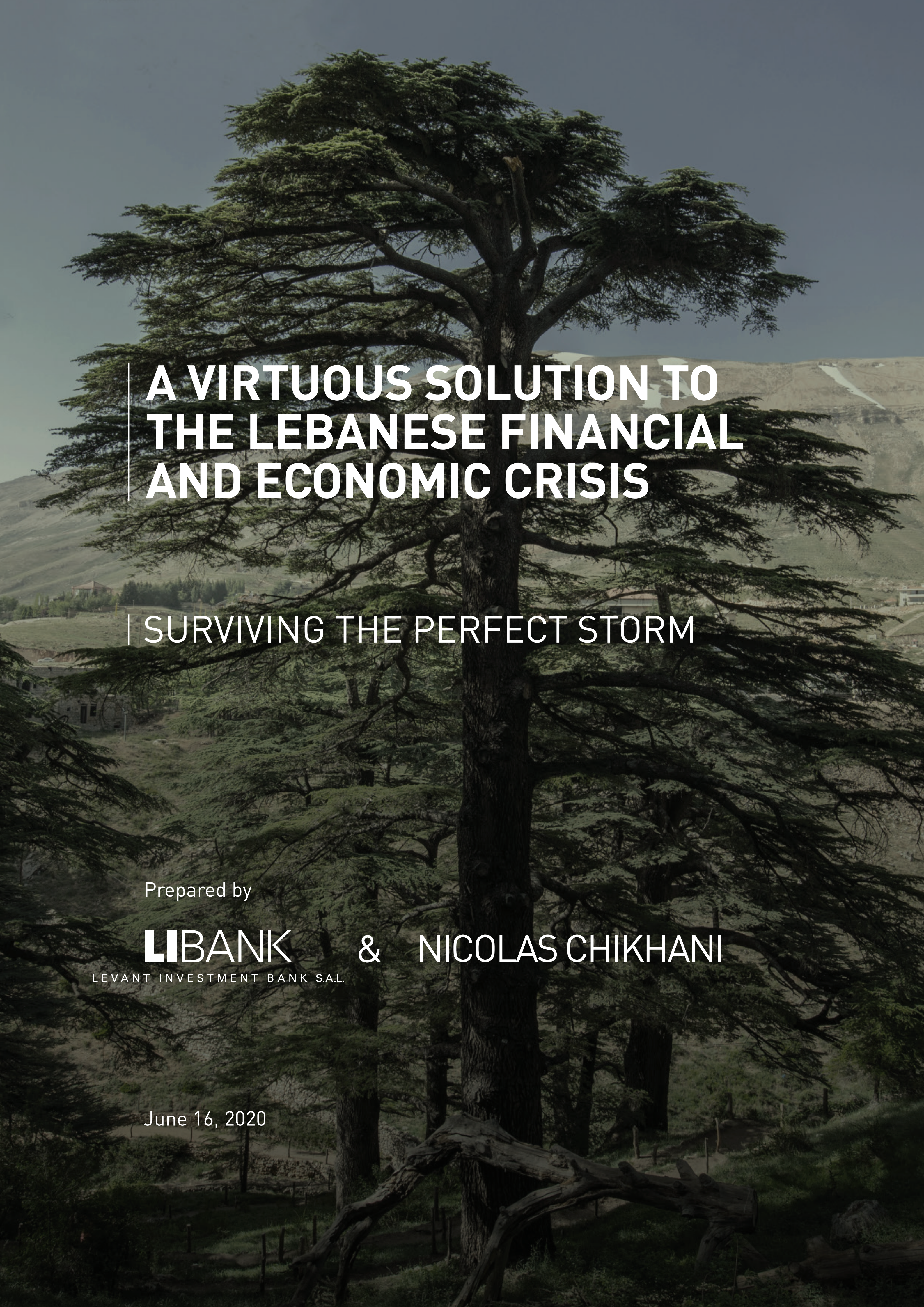

A VIRTUOUS SOLUTION TO THE LEBANESE FINANCIAL AND ECONOMIC CRISIS

SURVIVING THE PERFECT STORM

Prepared by

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&

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ASSUMPTIONS

1. This document is based on the assumptions and the numbers reflected in the English version of the Lebanese Government Financial Recovery Plan (LGP), and assumes that those assumptions and numbers are accurate and validated by the Lebanese Ministry of Finance, knowing that they were approved and signed by the Lebanese Government on 30 April 2020.

2. Government spending is accurately reflected in the LGP and includes spending from funds and semi-governmental bodies, considering no real and effective budgets were established.

3. To implement the solutions proposed in this document, a strong independent justice system is required and all the new laws and needed legislations should and would be approved and voted.

DISCLAIMERS

1. The figures used are sampled as-is from the LGP. Some of them may be outdated.

2. To the extent of the accuracy of the information available, the findings presented here are a reflection of the real financial situation of the Lebanon.

3. The LBP/USD exchange rates used throughout the document are consistent with those used in the LGP.

4. This document focuses solely on economic and financial factors. Political variables are beyond the scope of this document.

5. There are no official numbers provided by the Central Bank of Lebanon (BDL) besides a high level balance sheet with no details.

6. The reasoning used in this document remains applicable even if the government updates the numbers in the LGP. The audience's focus should be on the methodology and principle.

7. The document was drafted independently. The authors had no involvement in the preparation of the economic plan published by the Lebanese Association of Banks (ABL) or by the government.

DOCUMENT SNAPSHOT

This document details a step-by-step action plan to address the Lebanese financial and economic crisis, with the aim to minimize the financial losses in the system and avoid any haircut on depositors. All the actions proposed would need to be executed in harmonious collaboration between the government, the central bank, and the banking sector.

The government plan proposes to recognize a net loss of USD 44 billion across the financial system. The solution we propose contains sets of actions to reduce this loss to near 0.

In the first stage, the government must not default but reschedule its local debt in LBP to pay it back over a longer period of time and at a lower interest rate. Then, commercial banks must restructure their loans to minimize losses in this regard. The steps proposed will help avoid provisions for losses in the banking sector.

At the same time, the central bank and the government should enter in an agreement whereby the debt owed to the central bank will be paid back with the public assets owned by the government. The assets would be managed by an independent external firm to ensure neutrality and objectivity during the management process. To ensure that State assets remain in the hands of the Lebanese citizens, the agreement should include a possibility for the government to buy back the State assets when the financial situation of the country allows it. Additionally, central bank management techniques will increase the revenues of the central bank and the government, which would further decrease losses.

The above steps will automatically cut the losses by half, to USD 22 billion.

In the next stage, the government should take the necessary measures to recover unfair benefits and misappropriated earned funds that were paid across all sectors to depositors and shareholders. Also, those who abused the system should return the unfairly acquired funds. In that spirit, and to speed up the collection, it would be essential to create a voluntary settlement framework. **If well-managed, these actions would reduce the losses to almost 0, avoiding any haircut on depositors.**

The approach proposes a fair and shared contribution from the government, the central bank, and the commercial banks. It will be a first step in returning confidence and trust in the Lebanese system. It will also reduce the government deficit to below 5% of GDP, making the success of a future economic plan possible.

The solution also calls for actions that would halt future losses and cash leakage from the financial system. To do so, the government must re-negotiate new terms with its Eurobond lenders to enhance the time before repayment is due and reduce interest rates. The central bank must also restructure its commitments to the banking sector to stop paying large interest rates. This will make the economy healthier and reduce the cost of funding for companies, fast-tracking SME and GDP growth.

PROPOSED OBJECTIVES

Any structural, financial, and economic reforms should always be implemented with the following six core goals in mind:

1. Avoid any adverse impact on depositors.
2. Ensure continuity of the banking system.
3. Restore confidence in the State, the banking sector, and the economy.
4. Improve the GDP and reduce government debt and deficit.
5. Set a strategic economic plan for the future to create sustainable growth and long-term value for the country.
6. Increase purchasing power and GDP per capita.

Here, we propose several comprehensive sets of strategies to achieve these goals. The objective is to adequately restore systemic confidence in the Lebanese financial and governance system to create a new sustainable long-term economy.

Under the framework explored throughout, a **"What's in it for me"** stakeholder analysis would yield a win-win outcome for the parties involved, as described below:

Depositors

- **Ensure no haircut** on deposits
- **Lift capital controls** to free depositors' money
- **Protect** future deposits and investments
- **Build a trustworthy** foundation in the banking sector
- **Facilitate banking transactions** for depositors and corporations

Government

- **Reduce** the **debt-to-GDP ratio** to the OECD acceptable level, starting year 1
- **Halt future losses** starting year 1
- **Reduce government deficit** to below 5%
- **Ensure** better international **credit ratings**
- **Implement** a **strong and smart fiscal policy** and a **robust governance** amongst public institutions
- **Increase** public sector **efficiency** and government **revenue**
- **Deliver** continuous higher **GDP per capita**

Central bank

- **Help** reduce **accumulated losses** to date starting year 1
- **Halt future losses** starting year 1
- **Optimize balance sheet** and **P&L**
- **Implement** strong **monetary policy** and ensure control over LBP/USD FX rate
- **Achieve** better oversight of the banking sector
- **Participate** in the economic reforms to create GDP growth

Commercial banks

- **Reduce banks' provisions for losses**, starting year 1
- **Up-lift** the banking sector to ensure its continuity (good bank/bad bank approach)
- **Solve** the balance sheet currency and tenor mismatch to provide, over time, **liquidity** in the banking sector
- **Propose** a way to recapitalize banks
- **Deliver** healthier ratios and a strong risk management framework with accountability
- **Ensure** better credit ratings and relationships with international institutions
- **Restore mutual trust** between banks and depositors

TABLE OF CONTENTS

EXECUTIVE SUMMARY

The virtuous solution aims to discuss and present solutions to resolve the current Lebanese economic and financial crisis, with the application of existing crisis management techniques and localized solutions. This document analyzes the Lebanese Government's Financial Reform Plan (LGP) released on 30 April 2020, proposes amendments to its basic assumptions, and provides cross-sectorial solutions and reforms.

To meet the International Monetary Fund's (IMF) reform requirements, the LGP's proposals included:

- Reduce debt-to-GDP ratio
- Increase taxes and fiscal reforms
- Devalue the LBP/USD rate to 3,500 (as a first step)
- Economic and social reforms
- Reduce corruption
- Reform the Electricity of Lebanon (public institution)

Improvements to the LGP are proposed that would meet and go beyond the IMF's reform requirements, while minimizing the financial burden incurred by Lebanon with the objective to avoid any impact and haircut on depositors.

Proposed solutions are based on the financial assumptions defined in the LGP and detail several comprehensive sets of strategies that, if properly executed, can jump-start a short-term recovery and push the economy into growth. For example, by adjusting the LGP's economic assumptions and restructuring the local currency debt through a rescheduling and a debt-to-equity swap, the systemic losses can go down from ~USD 44 billion in the LGP to ~USD 22 billion. Additional measures are described to **decrease losses to around USD 1 billion.**

Step-by-step solution summary	
Address the ~USD 44 billion financial gap representing losses across the financial system	
1.	Restructure T-bills with a longer tenor and lower interest rates.
2.	Use the net loss rate of 20% instead of the gross NPL ratio of 35%, considering part of the commercial loans are collateralized and some are held by foreigners; then amortize this loss.
3.	Compute seigniorage revenue for the central bank to partially reduce its intrinsic loss.
4.	Strategically swap at present value the BDL-held T-bills against State assets to reduce the intrinsic loss at BDL and reduce government debt servicing.
5.1.	Clawback on excessive interest payments to depositors.
5.2.	Agree with banks to reinvest dividends paid to bank shareholders in the capital.
5.3.	Recapitalize banks as required by the BDL.
5.4.	Recover misappropriated State funds over the last 30 years. Implement settlement process or use existent legislation such as Law 44 of 2015 on Combatting Money Laundering, within an international framework to combat money laundering.

Step-by-step solution summary

To stop future losses

6. Negotiate the restructure of the remainder of Eurobonds (25%) with bondholders at lower interest rates over 15 years, with a 5-year grace period. This reduces the debt's service cost and provides liquidity to fund economic reforms.

7. Discount and unwind banks' Certificates of Deposits (CD) in LBP and USD placed with BDL and place proceeds in the former's current accounts. This further reduces debt service costs.

8. Restructure Electricity of Lebanon (EDL) to reverse the USD 1.5 – 2.0 billion per year loss to the State.

Other core strategies

1. Restructure the banking sector through a good bank/bad bank strategy.

2. Improve the Balance of Payments (BOP) by generating short- and long-term liquidity in the economy and launching economic reforms to core sectors.

3. Adjust macroeconomic policies (Fiscal and Monetary) to provide stimulus in the economy.

4. Establish a National Investment Fund (NIF) to hold oil and gas assets and future exploitation benefits to be reinvested in the economy.

5. Launch efficient capital markets in Lebanon by optimizing the regulatory environment and redeveloping the Beirut Stock Exchange.

The six main goals that should drive the implementation of any reform program are:

1. Avoid any adverse impact on depositors.
2. Ensure continuity of the banking system.
3. Restore confidence in the State, the banking sector, and the economy.
4. Improve the GDP and reduce government debt and deficit.
5. Set a strategic economic plan for the future to create sustainable growth and long-term value for the country.
6. Increase purchasing power and GDP per capita.

Implementing the solutions presented below would be a first step towards securing an IMF investment, which is crucial to negotiate with foreign bondholders and to restore FDI confidence.

1. INTRODUCTION

Is this a sovereign debt crisis or a banking crisis?

The answer is both.

After 30 years of financing Lebanon's sovereign debt, the Lebanese banking sector is now going through a liquidity and solvency crisis. Any solution to this crisis must simultaneously address sovereign debt as well as commercial bank and central bank losses. Solutions should also seek to stop continuous leakages across the main public institutions, including the EDL's yearly deficit and continuous and cumulative yearly losses at BDL from CDs high-interest payments.

The ultimate goals of this document is to reduce the burden on the banking system and the economy, and to nullify the impact on depositors.

The solutions proposed here may take 6 to 18 months to be implemented, a period during which Lebanon must secure the needed liquidity to ensure the continuity of State institutions and the wellbeing of the Lebanese people in terms of necessary social needs, food, medicine, and energy.

The LGP released by the Lebanese government on 30 April 2020 confirms the severity of the economic disaster. It proposes a shy approach to solve parts of the problem, through economic structural reforms and combating corruption in the public sector. The LGP proposes to default on all of Lebanon's sovereign debt instruments (in USD and local currency) and an immediate devaluation of the currency from LBP/USD 1,507 to 3,500. These measures will have negative social outcomes as well as a heavy impact on the banking sector and the central bank's balance sheet with the immediate recognition of losses, putting at risk the solvency of many commercial banks. The LGP's economic reforms lack breadth and tangible timelines, KPIs, and commitments to create a culture of accountability. It also ignores solutions that can extensively improve the economic crisis at minimum cost.

The comprehensive solution presented draws from lessons learned in previous crises from around the globe. It aims to provide coherent and creative step-by-step data-driven solutions to minimize the financial burden across the entire spectrum of stakeholders: the State, BDL, banks, and most importantly depositors.

The proposed interlinked solution reduces the State deficit to below 5% of GDP, brings down the debt-to-GDP ratio to OECD required levels (i.e. circa 80%), and aims to remove all capital control measures, a requirement to build a robust and sustainable economy to secure long-term GDP growth.

Socio-economic snapshot *(May 2020 estimates)*	
Unemployment	40% (2019: 12.9%)
Inflation	~55%
Under Poverty Rate	~60% (2018: 33%)
Non-Performing Loans	25% to 35%
Debt-to-GDP	175%

World Bank, Johns Hopkins University, LGP

2. STATE OF AFFAIRS

In the early 2000s, the economic situation in Lebanon was grim. The Paris I and II loans injected the needed liquidity into the system to help rebuild the economy.

Efforts were reversed when, in 2006, Lebanon's war with Israel resulted in the near total destruction of Lebanon's infrastructure. Tourism and revenue from real estate growth vanished. Lebanon struggled to attract foreign currencies crucial to its imports.

At that time, financial support from the GCC and other countries helped sustain and rebuild the economy and country. The private sector led a new spurt of growth with no strategic and economic plan from the government.

Lebanon's woes were amplified in 2011 when the Syrian war erupted. About 1.5 million Syrian refugees settled in Lebanon (30% of the total Lebanese population) and remitted around USD 3-4 billion per year in cash back to their families. Consequently, the Balance of Service dropped by USD 5 billion between 2011 and 2018, which led to a current account deficit of ~USD 12 billion. This was further exacerbated by a slowdown in foreign currency inflows that led to a cumulative deficit of ~USD 18 billion in the Balance of Payments between 2011 and 2018.

From 2016 onwards, the central bank initiated several financial engineering programs to attract around USD 6 to 7 billion a year from foreign depositors through extremely high interest rates on deposits (reaching up to 20% in early 2019) to cover the country's increasing yearly foreign currency needs. This translated into high cost of debt, which impaired SMEs and corporate performance.

The financial engineering program paid high interest rates in USD to commercial banks to subsidize high deposit rates. This widened the existing gap between local/virtual dollars (representing currently more than 60% of USD deposits) and hard currency, further hindering the State's ability to meet its obligations.

At the onset of the Lebanese revolution in October 2019, banks closed for 2 weeks. This led to a deep loss of confidence and trust in the banking sector, further intensified when banks implemented discretionary capital control measures in deviation from the Code of Money and Credit (CMC) law of 1963. De facto capital controls were set to manage the banks' virtual dollar problem and to avoid real foreign currency outflows that could have led to an immediate banking sector collapse.

This uncovered a build-up of large mismatched positions across the banking system's balance sheets, leading to one of the most disastrous financial crises the country has ever faced.

Due to the huge net financial returns that were proposed by the financial engineering structures in 2016 (supported by the local currency peg to the USD), **banks placed customer deposits** (short term liquidity of around LBP 55 trillion and USD 80 billion) **against long-term maturities,** mainly at the central bank (in Certificates of Deposit). **These strategies led to a significant concentration risk for commercial banks, a maturity mismatch between bank assets and liabilities,** and a shortage of liquidity in the banking sector (e.g. limits on monthly USD cash withdrawals). The ensuing loss of confidence in the sector led to a cash-economy where withdrawals outweighed deposits within a capital control environment. Banks continued to bleed cash, draining liquidity further and creating a dramatic shortage of hard foreign currency.

Concurrently, the central bank had to service high interests on banks' CDs, while lending to the government at lower rates. This built a huge gross internal loss at the central bank, equivalent to USD 43 billion (at an LBP/USD rate of 1,507). This loss has built a large balance sheet foreign currency mismatch (from interest paid in USD, while USD capacities of the BDL are limited), that would generate FX losses after a devaluation of the official LBP/USD rate.

The legal framework supporting this system was continuously approved by successive governments and external auditors since 2003. It blurred the country's foreign currency shortage while keeping losses, mismanagement, and corruption unchecked.

Real economic data since the 1990s, however, indicates that today's crisis was inevitable. All players in the flawed system – successive governments, the central bank, commercial banks, the depositors, voters, and external auditors – participated in the systemic destruction of value in Lebanon.

Today, the country faces an ongoing deficit of~USD 6 billion a year in its Profit and Loss (P&L), with ~USD 90 billion of debt on its balance sheet (of which 60% in LBP).

The government's decision to default on its sovereign foreign currency debt (Eurobonds) early March 2020 also impeded its ability to bridge losses through raising funds in the capital markets.
In parallel, commercial banks and the central bank, the two largest holders of Eurobonds, recorded significant losses upon the default. The decision accelerated the unofficial devaluation of the LBP in the market.

As a result, the debt-to-GDP ratio crossed 175% in 2019 with a government deficit over 10% of GDP which makes an economic recovery very hard to achieve.

3. GOVERNMENT REFORM PLAN

A. LGP OVERVIEW

The LGP was prepared by the Ministries of Finance and Economy at the request of the Lebanese government to address the financial crisis and build a sustainable economic plan. The LGP presents a reform strategy that aims to tackle the main IMF targets (float the LBP, reduce debt-to-GDP ratio, reduce the government's yearly deficit, increase taxes, and implement structural reforms). Public discourse suggests little engagement with the central bank, commercial banks, and the private sector occurred in the preparation of the LGP.

The LGP assumes a default on all the sovereign debt and devalues the LBP/USD to 3,500 in a first stage. While this assumption frees the government from a large financial burden, it shifts losses to the BDL, banks, and depositors, while deteriorating purchasing power of the Lebanese population.

The final net losses assumed in the LGP are estimated at USD 44 billion (at LBP/USD 3,500). These are expected to be offset through a full write-off of banks' capital, bank and BDL recapitalization, clawback on bank dividends, and, as a last resort, the collection of stolen money.

LGP Goal Snapshot	
1.	Float the LBP
2.	Debt restructuring strategy
3.	Financial system restructuring
4.	Fiscal adjustment to improve tax compliance, streamline expenditure, and reform public sector
5.	Growth-enhancing reforms
6.	Social sector reform agenda
7.	National anti-corruption strategy
8.	Environmental reform and national sustainable development strategy to preserve national environmental identity
9.	International financial assistance at favorable terms to close the large financing gap and fund infrastructure (IMF and CEDRE)

The LGP also assumes that CEDRE and IMF external funding will be approved. These **external funds should be neither used to reduce the financial deficit nor the debt. These funds should rather be used exclusively to build up the needed liquidity to sustain the Lebanese economy and deliver on the LGP.**

B. LGP ASSUMPTIONS

Nominal GDP	2019: LBP 77.4 T 2020: LBP 90.9 T 2021E: LBP 111.4 T
Debt-to-GDP	2019: 175.6% 2020: 102.8% 2021: 97.7%
USD/LBP	2020: 3,500 2021: 3,684 2022: 3,878
NPL ratio	35%
Treasury bills haircut	40%
Eurobond haircut	75%
Clawback of bank dividends	> USD 6 B
Collection of stolen money fund	

GDP figures account for externally financed capital expenditures (CEDRE). Failure to approve CEDRE would drop the expected 2020 nominal GDP by ~25% (includes COVID-19 impact)

The total systemic loss, as estimated in the LGP, is as follows:

LGP Assumed Systemic Losses		
Loss analysis	LBP Tr.	USD Bn.
Government default	73	21
BDL intrinsic loss (net of cap. FX adjusted)	88	25
Banks' loss (net of cap. FX adjusted)	25	7
Sub-Total	186	53
Capital of banks	31	9
Total	154	44

** at LBP/USD 3,500*
*** all figures are rounded*

BDL's gross intrinsic losses are estimated at USD 43 billion (~30% of BDL's balance sheet assets). The table above assumes that central bank losses can be offset with its equity and other mark-to-market instruments, leading to a net loss of ~USD 25 billion. The LGP assumes that banks will use their entire capital to offset losses from non-performing assets. Finally, **these assumptions culminate in a net loss of USD 44 billion across the financial sector.**

The LGP does not account for additional losses and commitments, which include:

1. Non-bank T-bill holdings, with losses estimated at ~USD 1.5 billion after the default proposed in the LGP.
2. Commitments of ~USD 11 billion (post 75% default) on Eurobonds held by foreign investors.
3. Non-recognized net overdraft loan from the BDL to the State of ~USD 6.5 billion*.
4. Government payable due to social security and the private sector of ~USD 4 billion*.
5. Additional yearly intrinsic loss at the central bank of ~USD 5 to 7 billion from interest paid on Certificates of Deposit.
6. Underproductive State assets such as the EDL, Lebanon's electricity company with a yearly deficit of USD 1.5 – 2 billion.

** at LBP/USD 3,500*

4. AMENDMENTS TO THE LGP

A. PROPOSED SOLUTIONS

Most systemic losses can be addressed through an internal restructuring plan. LBP/USD rates in the following section are at 3,500, unless otherwise indicated.

An intervention by the IMF would provide part of the required liquidity to implement the necessary reforms and build a robust economy in the long-term.
It will build the needed trust for FDI inflows and other foreign aid packages.

The goals of this proposal are to reduce the burden on the banking system and the economy, and to nullify the impact on depositors.

To achieve its goal, the **below improvements to the LGP are suggested:**

1. Review the sovereign debt default and the NPL ratio to mitigate losses on the banking sector.
2. Use part of the State's assets to offset LBP loans between the central bank and the State.
3. Push for economic fiscal reforms to fast-track FDIs and reinitiate GDP growth.
4. Seek alternatives to create liquidity that will sustain the solution proposed.
5. Propose a credible program to ensure the return of stolen funds.

The above proposals are further elaborated in the step-by-step solution below.

Step-by-step solution summary	
Address the ~USD 44 billion financial gap	
1.	Restructure T-bills with a longer tenor and lower interest rates.
2.	Use the net loss rate of 20% instead of the gross NPL ratio of 35%, considering part of the commercial loans are collateralized and some are held by foreigners.
3.	Compute seigniorage revenue for the central bank to partially reduce its intrinsic loss.
4.	Strategically swap at present value the BDL-held T-bills against State assets to reduce the intrinsic loss at BDL and reduce government debt servicing.
5.1.	Clawback on excessive interest payments to depositors.
5.2.	Agree with banks to reinvest dividends paid to shareholders gained through BDL financial engineering funds as mandatory recapitalization of their banks.
5.3.	Recapitalize banks as required by the BDL.
5.4.	Recover misappropriated State funds over the last 30 years. Implement settlement process or use existent legislation such as Law 44 of 2015 on Combatting Money Laundering, within an international framework to combat money laundering.
To stop future losses	
6.	Negotiate the restructure of the remainder of Eurobonds (25%) with bondholders at lower interest rates over 15 years, with a 5-year grace period. This reduces the debt's service cost and provides liquidity to fund economic reforms.
7.	Discount and unwind banks' Certificates of Deposits ("CD") in LBP and USD placed with BDL and place proceeds in the former's current accounts. This further reduces debt service costs.
8.	Restructure Electricite Du Liban (EDL) to reverse the USD 1.5 – 2.0 billion per year loss to the State.

1. About T-bills (debt in local currency)

The Bank for International Settlements (BIS) research working paper 709 states that a sovereign nation is not likely to default on its local currency debt, as monetary and fiscal policy can bridge the gap in public finances. Greater exposure of the domestic banking sector to government bonds decreases sovereign creditworthiness because of the mutual reinforcement of sovereign and financial system risk **(the "doom loop")**. In this case the BIS suggests a higher likelihood of domestic default.

This document suggests NOT to fully default on these securities but rather to restructure them. A default on payment would generate unnecessary losses to the BDL and commercial banks, most of which may go bankrupt. **The government should instead reschedule its T-bills to an average maturity of 15 years and reduce the coupon rate to 1% or 2%.**

In years 1 to 5, only interest would be due. Principal repayment would occur between years 5 and 15. This would give the government additional flexibility on its liquidity to help fund economic reforms (Section 5.B.).

A restructure would **reduce assumed losses across the banking sector by ~USD 8 billion, thus the total loss decreases from ~USD 44 billion to ~USD 36 billion.**

LGP + T-bills Swap

Loss analysis	LBP Tr.	USD Bn.
Government default	44	13
BDL intrinsic loss (net of cap. FX adjusted)	88	25
Banks' loss (net of cap. FX adjusted)	25	7
Sub-Total	157	45
Capital of banks	31	9
Total	126	36

** at LBP/USD 3,500*
*** all figures are rounded*

The restructure removes the need for banks to record significant provisions from balance sheet write-offs and P&L losses. Instead, banks realize a future revenue loss from the discount that would be absorbed by new capital injections and future growth. Losses in annual income can be partially offset by a lower cost of funds across the sector.

2. Non-performing loans

Today, the trend indicates that borrowers are settling loans, either to benefit from the FX mismatch and/or to free up collateral. Many of the loans are assumed to be collateralized and some borrowers are non-residents, thus less likely to default. **A net loss from NPLs could be estimated at around 20%, or around USD 6 billion, thus a decrease in calculated losses from ~USD 36 billion to ~USD 31 billion,** post banks' foreign currency capital adjustment.

LGP + T-bills Swap + 20% Net NPL

Loss analysis	LBP Tr.	USD Bn.
Government default	44	13
BDL intrinsic loss (net of cap. FX adjusted)	88	25
Banks' loss (net of cap. FX adjusted)	8	2
Sub-Total	140	40
Capital of banks	31	9
Total	109	31

** at LBP/USD 3,500*
*** all figures are rounded*

Note: an amortization of net NPL losses could also be valued as per Basel III which would put even less burden on the banking system.

3. Central Bank (BDL) losses

As per the BDL Governor's statement, the central bank's losses could be offset with revenues from seigniorage and other avenues. Seigniorage in developing nations can generate revenues of up to 15% of expected GDP. In the BDL's case, new seigniorage revenues can average a maximum of USD 3 billion over the next few years, which would further reduce total losses from USD 31 billion to USD 28 billion, assuming an expansionary monetary policy going forward.

LGP + T-bills Swap + 20% Net NPL + Seigniorage

Loss analysis	LBP Tr.	USD Bn.
Government default	44	13
BDL intrinsic loss (net of cap. FX adjusted)	78	22
Banks' loss (net of cap. FX adjusted)	8	2
Sub-Total	130	37
Capital of banks	31	9
Total	99	28

** at LBP/USD 3,500*
*** all figures are rounded*

4. Debt-to-equity swap with State assets*

The re-organization of State assets could serve to offset dues between the BDL and the government, while generating significant recurring revenues for the State. Post-restructuring revenues from assets would be reinvested in the economy.

To further reduce the debt-to-GDP ratio, the government and the BDL can enter a swap transaction to exchange T-bills for an equivalent portfolio of State assets. This swap can be implemented as follows:

1. Create a contractual agreement between the State and the BDL to swap the present value of held T-bills (post-rescheduling) with an equivalent value in State assets. In view of the latitude given to the BDL by virtue of the Code of Money and Credit Articles 92-95, and since it is a public entity, the transfer of assets may be performed contractually.

2. Once the contract is ratified by parliament, State assets will be valued in LBP and transferred to the BDL's balance sheet (through a specific vehicle) to replace the T-bills position and partially offset losses. This cannot be applied to the Eurobonds as they are in USD and the state assets would be valued in LBP. It is best to avoid FX mismatch on the central bank's balance sheet and comply with the pari passu Eurobond rule that guarantees equal right to all bondholders.

3. The swap with assets valued at ~USD 20 billion **reduces the State's local currency debt towards the central bank by ~USD 14 billion. An additional ~USD 6 billion in value will be included to compensate for the present value of future T-bills interest.** This will immediately improve the country's debt-to-GDP ratio and reduce government expenditure.

4. The agreement must include a call option on the assets for the State to buy them back once the economic reforms are complete (Section 5.B.).

5. **Establish a Board of Trustees formed with independent and non-politically affiliated professionals** with local and international experience to manage and oversee State assets, and ensure optimal governance.

6. In the second phase, if required and feasible, the managers can issue senior secured bonds on up to 25% of the value of the portfolio of State assets. These funds would be used to fund public utilities and infrastructure while optimizing the State assets, based on stringent targets. This would serve as a first test of confidence in the Lebanese capital markets (Section 5.E.).

7. Net profits generated from the assets will be used to first recapitalize the Central Bank, provide liquidity to the government to reduce its deficit, and once the public assets are optimized, repay the bonds – if issued – with incremental revenues.

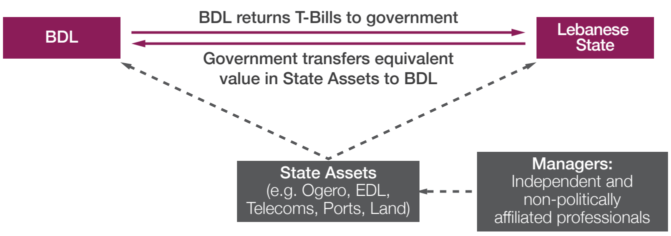
8. Later, minority shares of the State assets could be listed on the Beirut Stock Exchange to provide a continuous liquidity outlet for future growth.

LGP + T-bills Swap + 20% Net NPL + Seigniorage + Equity-Swap

Loss Analysis	LBP Tr.	USD Bn.
Government default	44	13
BDL intrinsic loss	78	22
Banks' loss (net of cap. FX adjusted)	8	2
Sub-Total	130	37
Capital of banks	31	9
Total	99	28
T-bills State Equity Swap	21	6
Net Losses	78	22

**at LBP/USD 3,500*
***all figures are rounded*

**See Appendix 5*



5. Clawback odious and illicit earnings and stolen money

Poor governance allowed several large depositors to earn inflated interest rates over the years. As per the LGP, part of those interest payments should be returned to banks to minimize losses. Using the interest rate on Eurobonds as the cutoff rate, all interest earned above that should be returned. Those should represent ~USD 7 billion since 2016.

In addition, an agreement should be reached with commercial banks for shareholders to reinvest USD 4 billion in dividends earned during a period of mismanagement and operational losses, as part of the BDL required cash contribution to capital.

The government must simultaneously implement a credible program to ensure the return of stolen funds, including an immediate anti-corruption strategy with quick wins. A voluntary settlement procedure could be established, such as anonymous settlement of illicit gains (e.g., Operation Lava Jato in Brazil). Several existing laws can be invoked to proceed (e.g., Law 44 on Combatting Financial Crime and Money Laundering and the Law of Illicit Enrichment). An initial estimate of **~USD 10 billion can be collected in stolen funds**.

LGP + T-bills Swap + 20% Net NPL + Seigniorage + Equity-Swap + Clawbacks		
Loss Analysis	LBP Tr.	USD Bn.
Government default	44	13
BDL intrinsic loss	78	22
Banks' loss (adjusted)	8	2
Sub-Total	130	37
Capital of banks	31	9
Total	99	28
T-bills State Equity Swap	21	6
Net Losses	78	22
Interest clawback	24	7
Dividend clawback and recapitalization	14	4
Collect stolen money	35	10
Final net losses	3.5	1

**at LBP/USD 3,500*
***all figures are rounded*

It is essential for the government to implement structural legal reforms to establish strong transparency and anti-corruption practices. Clear KPIs should be set on the clawback of interests, reinvestment of dividends and on the collection of stolen money. Only then should the banks' capital and State assets be used to cover the systemic losses. **Failure by the government to meet its KPIs will result in a direct haircut on depositors, which is a gross failure towards the Lebanese people and nation.**

6. Reschedule remaining Eurobonds

Reschedule the remaining balance (25%) for longer maturities at a significantly lower rate (as low as 1%). The Minister of Finance has the authority to perform swap operations that do not lead to further lending. Thus the swap does not require new specific legislation to pass.

7. Discount bank CDs with BDL

The central bank incurs interest expenses of ~USD 5 to 7 billion per year to banks on Certificates of Deposit. To minimize this cash outflow:

1. Create an agreement between all banks and the BDL to unwind and discount the latter's short- and medium-term liabilities (placements and CDs) and transfer proceeds into banks' current account at BDL. This procedure does not require new regulations or government action – it can be executed with Articles 98 of the Code of Money and Credit and by negotiations between the Associations of Banks in Lebanon and the BDL.

2. The discount will significantly reduce BDL's cost of funds and continuous losses. Additionally, it eliminates any potential provisions/losses that are required by the banking sector as per IFRS 9.

3. Lebanese banks can offset the annual interest income lost from the discounted BDL instruments through a lower cost of funds on deposits, as per BDL circulars that cap interest rates on deposits.

4. This also gives banks flexibility to fulfill customer transfer requests within Lebanon. With their CDs released to current accounts at the BDL, banks can move USD deposits from their current account at the BDL towards another bank's current account at the BDL hence addressing their customers' needs within the capital control framework while avoiding any provision under IFRS 9.

5. This step would succeed only if fair and proper capital controls are established, as per the LGP.

B. RESULTING SCENARIO

After the default on the Eurobonds and the State asset swap, the total government debt will reduce as below:

@ 3,500	Initial	EB 75% HC	BDL Swap
T-bills	24	24	10
Eurobonds	31	8	8
Other	2	2	2
Total	58	34	20
GDP *	26	-	-
Debt/GDP	223%	131%	77%

**based on the LGP data*
***all figures are rounded*

The **debt-to-GDP ratio will drop from over 200% to 77%**. Debt servicing costs would drop from around **USD 2 billion on Eurobonds and USD 3 billion on T-bills in 2019 to around USD 600 million and USD 500 million in 2020, respectively – both major milestones for Lebanon's credibility in international markets,** and a substantial positive signal to rating agencies and the global financial community.

The government deficit would decline to less than 5% of GDP. If the EDL is properly restructured in parallel, the State could become profitable and finance an economic plan that could lift capital controls, build GDP growth, and create value for FDIs.

Following steps 1 - 7, the contribution from each systemic party in the reduction of losses is as follows:

Total stakeholder contribution		
Party	**LBP Tr.**	**USD Bn.**
Government (T-bill restructure, D/E swap, and stolen money)	63	18
BDL (D/E swap, seigniorage revenues)	31.5	9
Commercial banks (T-bill restructure, NPLs, capital, and dividend clawback,)	31.5	9
Excess interest clawback	24.5	7
Total loss reduction	150.5	43

5. PROPOSED ECONOMIC REFORM PLAN

A. Banking Sector Restructure

The Lebanese banking sector is saturated with more than 50 banks that hold over USD 200 billion in assets (USD and LBP) while Lebanon's 2020 GDP is expected to be around USD 26 billion as per LGP.

Around USD 40 billion of those assets are in commercial and personal loans (with an assumed 20% net NPL loss ratio), ~USD 15 billion in Lebanese sovereign debt and ~USD 50 billion in BDL Certificates of Deposit *. (all figures above at LBP/USD 1,500 and based on the ABL Key Indicators from February 2020)

To address liquidity shortages due to the asset-liability mismatch created with the central bank, most commercial banks have significant leverage (up to 50% LTV) from foreign financial institutions, collateralized against Eurobond holdings.

The March 2020 Eurobond default triggered margin calls on banks' leveraged positions that they were unable to cover. It is assumed that commercial banks contracted large expensive loans from the central bank to cover margin calls and avoid insolvency. Those loans may be another burden on the Lebanese financial system and would require a deep review during a possible bank restructuring program.

Some banks, through desperation to generate further liquidity, pursued the dubious strategy of selling some of their Eurobonds to external funds (e.g. Ashmore and Fidelity). The result could prove catastrophic because external debtors hold close to 50% of the Eurobonds, making any negotiation between the government and debtors difficult, given that the Eurobond prospectus gives blocking power on restructuring decisions. It is relevant to note that those external funds knew about the Lebanese Government's high probability of default, yet bought these obligations expecting the government to eventually honor them at full face value. An ethical debt purchase could be questioned.

The Eurobond default combined with expected losses from NPLs would render some banks insolvent. New capital injections in the range of USD 5 to 7 billion would be required from current shareholders or new investors to adequately recapitalize the sector. Sector consolidation and M&A should also reduce the number banks.

Good Bank / Bad Bank approach

A **good bank / bad bank (GB/BB) strategy helps.** It cleans up the balance sheets of individual banks through a Qualitative Asset Review (QAR). A "bad bank" would be created to absorb all the non-performing or illiquid assets of weak banks and the "good banks" would assimilate strong and performing assets.

The GB/BB approach can address banks' balance sheet maturity and currency mismatch to solve liquidity issues and avoid bankruptcy. Because most banks have invested customers' short-term deposits in long-term Certificates of Deposit at the central bank, liquidity issues have surfaced and banks are unable to fulfill customer transfer requests.

Key components of the GB/BB approach:

- Allows well-performing banks to continue operations, without minimal impact on IFRS 9 and Basel III financial ratios. Banks will be smaller but healthier and with better credit ratings.
- Identifies risks and exposure to NPLs.
- Evaluates the needed capital to rebuild Tier 1 and Tier 2 ratio requirements and rebuild Liquidity Coverage Ratios (LCR).
- Optimizes maturity and currency mismatches between assets and liabilities through a deposit analysis.

- Reviews exposure or pledged off-balance sheet assets (AUMs) and associated risks, as well as commitments and global trading positions. Foreign branches and subsidiaries will be also reviewed.

The banking sector is of critical importance to build a sustainable economy, secure solid GDP growth, and improve international credit ratings. **A careful bank-by-bank restructuring process is crucial to understand industry risk and required actions using IFRS 9 and Basel III standards.**

Today, most banks have liquidity issues and several also have solvency issues in light of Eurobond and BDL exposure. The number of banks is expected to halve post-restructuring, and some may merge or get acquired.

Risk Management and Liquidity Framework

Going forward, the banking sector must implement a stronger risk management framework that would protect against future mismanagement. The external audit function will be crucial to this, where rotating external auditors would be engaged with clear accountability to be defined between auditors, banks and the regulator.

Within the new framework, banks would need to rely on traditional banking business lines, rather than investing deposits in risky assets. Risk Weighted Assets (RWA) would drop, leading to lower revenues and lower return on equity (ROE). **Banks' valuations would also deflate, attracting new external strategic investors (FDIs) to the Lebanese banking sector.**

Liquidity could be improved with several highly liquid traditional or specialized private/investment banks, to which illiquid banks would contractually transfer large deposits and a matching amount of CDs. Then, liquid banks would place new deposits received as long-term fiduciary deposits with the central bank, matching the CD maturities they have received, thus de-risking their balance sheet from any liquidity mismatch.

As a result, illiquid banks would become smaller but would have addressed liquidity issues and avoided bankruptcy. Depositors' would have deposits at the central bank — the ultimate banking authority in the country — in case of any risk on the banking sector.

Other Considerations

In the LGP, the government expects to issue five new banking licenses (typically, market forces and the central bank ought to dictate banking licenses). If Lebanon proceeds with the new licenses, it would be advisable to create one new bank per major sector of the economy: trade, industry, agriculture, technology, and energy. Sustainable funding for each sector can be channeled through these specialized banks, guaranteeing transparency, audit, and delivery.

The International Finance Corporation's (IFC) Distressed Assets Recovery program (DARP) could also support the banking sector restructure through the IFC's acquisition of non-performing assets. In collaboration with the World Bank, DARP offers the ability to systematically intervene in financial markets to address the problem of rising levels of distressed assets.

B. THE BALANCE OF PAYMENTS

The Balance of Payments deficit will remain an ongoing concern but can be addressed with a proactive economic plan.

In 2020, the trade balance deficit should reduce to ~USD 5 to 6 billion, mainly due to capital controls, limited imports, and decline in domestic consumption from unemployment and an increased poverty rate.

In USD billions	2012	2016	2018	2020 E
Balance of Payment Surplus/(Deficit)	(1,537)	1,238	(4,823)	(11,500)
Trade Balance Surplus/(Deficit)-Current Account	(10,317)	(10,474)	(12,445)	(5,500)
Goods Balance	(15,412)	(13,997)	(15,146)	(8,000)
Services Balance	3,505	1,890	1,438	500
Income Balance	(204)	(818)	(314)	0
Current Transfer Balance	1,794	2,451	1,578	1,000

An immediate and long-term foreign currency liquidity strategy to support economic reforms is key. After solving the financial gap described in Sections 3 and 4, the debt-to-GDP ratio should meet international thresholds for new funding outlets, allowing the government to build liquidity.

- Short-term liquidity should be sourced through remittances, international organizations (IMF, CEDRE), and from gold leasing (Appendix 4).

- Long-term liquidity can be built by a new trustworthy and well-governed banking system through increased diaspora remittances, inbound FDIs, capital markets, and a full restructuring of private and public sectors.

IMF and CEDRE are additional loans, they are not required to solve the country losses rather they will be used to provide the needed liquidity to deliver a restructure plan and will bring the needed trust to FDIs to invest in the country.

After the government commits to deep structural and anti-corruption reforms, it may be approved to receive IMF funding in the amount of ~USD 867 million per year with a maximum of USD 4 billion over the next five years. Such a liquidity inflow can immediately minimize the Balance of Payments deficit.

According to the report from the CEDRE Local Group Meeting on 18 May 2020, Lebanon expects to receive USD 8.2 billion from CEDRE over 10 years, less than half the amount from the original plan.

The CEDRE deployment parameters were also modified. Initially, most of the funds were directed towards first on building roads, then transport and infrastructure, whereas the new capital deployment proposed is as follows:

Electricity	USD 1.946 billion
Water and irrigation	USD 1.559 billion
Wastewater	USD 1.074 billion
Roads & Transport	USD 1.615 billion
Telecom	USD 0.72 billion
Culture and industry	USD 0.144 billion
Environment	USD 1.4 billion

Investment in these sectors creates national benefits such as long-term job creation, improved productivity, ecology, health, reduced energy costs, FDIs, and boosted exports. All of the above reduces the trade deficit. **Appendix 2 details the key sectors that would benefit from CEDRE capital injections, and each one's favorable socio-economic and financial impact.**

While CEDRE funds would provide economic stimulus, Lebanon can further develop crucial projects without reliance on additional debt. A build-operate-transfer (BOT) model can provide project finance to non-CEDRE projects. BOT is a path to upgrade infrastructure and establish a strong corporate governance culture.

Fixing the EDL will also be crucial to improve the Balance of Payments. EDL contributed to around 5% of GDP value destruction in 2019 (10% in 2020 due to the intrinsic drop in GDP and devaluation). EDL losses are heavily linked to corruption and mismanagement, leading to heavy costs of unnecessary oil imports. Losses hover around USD 1.5 to 2 billion a year, while only serving 50% of the needs of the population. The other 50% is served by local generators, costing as much in oil consumption, and polluting the environment.

Optimizing EDL would close certain consistent cash leakages across the public sector and would send a very positive message to the IMF, CEDRE or any other foreign investor.

There are several additional sectors that should be reformed in order to sustainably improve the Balance of Payments. The Ministry of Economy mandated McKinsey & Co in 2018 to provide a solid roadmap for cross-sector redevelopment, which can serve as a blueprint. In all cases, value creation must be at the heart of economic reforms. Some of these reforms can include:

Specialized Business Zones

- Establish business-friendly zones, Technological Zones (TZ), Industrial Zone (IZ), Agriculture Zones (AZ) and other value-added services to boost the service line in the balance of payment.

- Invest in infrastructure development (e.g., telecoms, manufacturing, irrigation, Agriculture mechanization) which creates new jobs, retention of skilled labor/graduates, up-lift production and improve exports.

- Mandate the five new banks to provide direct support (Section 5.A.).

Agriculture

- Build a strategy to develop raw material for the food/fodder and cattle industries, diversify crops to include nutritive produce and high yield cultivation (e.g., hemp, cannabis) that generate direct FX liquid.

- Enter international agricultural cooperatives. Through these structures, rural areas can benefit from a global network and know-how.

- Ensure product standardization and conformity (ISO norms).

- Develop a comparative advantage strategy.

- Revisit bilateral and multilateral treaties to protect Lebanese production from unfair subsidized agro-production in neighboring countries (especially under Tayssir Accords).

- Implement the Euromed Partnership (provides Lebanese produce with access to the EU).

Education

- Implement internationally accredited continuous training programs across agriculture, technology, production, logistics, service, etc.

- Modernize and diversify education programs to include vocational training programs and higher education programs.

- Re-establish technical schools. Many were previously converted to universities, which led to disequilibrium in the market and decrease in workforce qualifications. Criteria for university licenses must be revised and reinforced. Non-compliant universities should be converted to technical schools.

- Improve teacher-to-student ratio and teaching quality in public schools (currently, there is 1 teacher for 7 students as opposed to 1 for 20 in the private sector) and subsidize universities.

- Develop and provide free and rigorous continuous training programs for the blue-collar workforce to further enhance value. It would increase the quality of output to close the gap with international standards and create additional jobs. Redundant public sector staff can find meaningful employment in productive roles.

Manufacturing and Production

- Ensure product standardization and conformity in-line with global standards.

- Optimize current and establish new industrial zones.

- Develop new industries and sub-sectors that provide economic value added (EVA).

- Invest in factories to promote output diversification.

- Subsidize high EVA sectors.

Technology Infrastructure

- Within the TZs, develop technological hubs across the country that include call-centers, R&D centers, and IT co-working spaces.

- Modernize communications infrastructure to sustain the TZs.

- Integrate financial technologies, including digital money and mobile payment services.

Legal and Regulatory Environment

- Ensure the independence of the Justice System.

- Overhaul and modernize legal system with the immediate implementation of the following initiatives:

i. Launch e-courts by issuing the required implementing decrees.

ii. Fundamentally reform the judiciary system with the introduction of specializations to match the current need, while in the meantime requesting technical assistance from advanced countries (UK and France mainly).

iii. Introduce fast track and other measures for arbitrage and alternative dispute resolutions to speed up court proceedings.

- Review, unify, and improve bilateral agreements (chiefly to boost exports).

- Reorganize and give independence to the Investment Development Authority of Lebanon (IDAL).

- Remove the FDI exemption from the approval of the council of Ministers and empower IDAL to execute the exemption packages as determined in the incentive law number 240/2000.

- Liberate and modernize labor laws.

- Update of the fundamental laws to match the needs of the current century.

- World Trade Organization accession by revoking the laws consecrating monopolistic positions.

C. MACROECONOMIC POLICIES

Monetary and fiscal policy should support the above reforms and improve the Balance of Payments.

In a high inflation, high unemployment, low capital mobility, and general stagflation environment, anything short of a strong expansionary monetary and fiscal policy deepens economic woes.

Macroeconomic policies must restore stability, increase expenditures, reduce interest rates, reduce virtual dollars, and create essential stability for economic growth and FDIs.

Monetary Policy

Monetary policy should officially be set by the BDL through a reduction in its policy interest rate. From there interest rates across the ecosystem would adjust downwards. Future State interest related costs would reduce, borrowing activities would increase, and savings would shift to investments and local spending, driving-up the economy.

The drop in the private sector's cost of funds would also drive employment and economic growth.

To reach the expected rate of LBP/USD 3,500 in 2020 to 4,297 in 2024, the BDL can, as permitted by the CMC, gradually print up to USD 20 to 40 billion equivalent in LBP as a stimulus over 3 to 5 years. This increases the money supply in LBP by the equivalent of USD 6 to 7 billion per year.

The overall result is a depreciation of the LBP in line with the LGP projections.

With the LBP hovering towards fair value, GDP growth and foreign currency inflows would help control inflation and reduce virtual dollars, in a first step towards lifting capital controls.

Fiscal Policy

The government should implement an expansionary fiscal policy through increased spending and overall tax reduction.

A hybrid fiscal approach would be optimal:

- Reduce fraud, increase income taxes and optimize tax collection. For this, an E-government infrastructure is essential.

- Semi-float the LBP to ensure control over the black market and support exports.

- Product-adjusted VAT and import tax framework (e.g. high tax on non-essential products and tobacco, low tax on staples).

- Subsidize exportable products and services, tourism, and FDIs. Encourage sectors that bring in foreign currency.

- Create international business zones, like a Lebanese Offshore Financial Centre or tax free zones to encourage and facilitate foreign investment.

Liquidity

Monetary and fiscal policies should prioritize liquidity, as the Marshall Plan did to quickly rebuild and modernize European nations post-WW2.

Liquidity is needed in foreign and local currency.

- **Local currency liquidity:** the BDL can set monetary policy as described above. Other sources include savings from the public sector restructure (public staff recruitment should be frozen for 5 years at least, with early retirement measures and the discontinuation of non-productive staff or non-existent positions). This will reduce government deficit and revert to a surplus through time.

- **Foreign currency liquidity:** the need must be met through IMF and CEDRE borrowings. Other sources can be evaluated to provide small-scale liquidity, such as gold leasing which could generate up to USD 78 million a year (Appendix 4), a stolen funds collection program, capital markets (Section 5.E.), and revenues from oil exploitation (Section 5.D.).

Any liquidity strategy should also address foreign currency leakages such as the outflow of foreign workers' remittances (~USD 4 billion each year), exchange houses "pump and dump" strategy, smuggling, and rebuild diaspora trust to encourage the return of remittances to Lebanon.

D. NATIONAL INVESTMENT FUND*

The government should also prepare the legislation to create or activate a **National Investment Fund (NIF) that would own USD 50 billion of future benefits from oil and gas exploitation**.

To regain investor confidence, the fund would be managed by a highly-experienced specialized international fund manager and operate as an independent organization free of political collusion. A consortium of Lebanese private sector asset managers could co-manage or advise.

Such fund managers would provide the needed credibility and trust for investors, and increase productivity to secure healthy returns to stakeholders while improving public utilities for taxpayers.

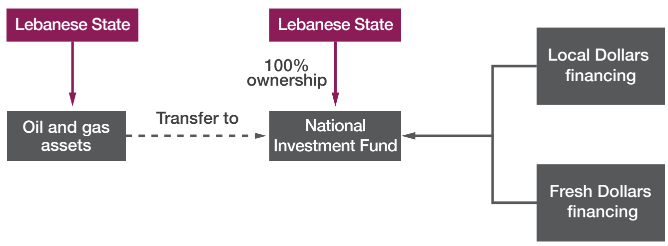
Local or international investors could participate in the NIF through secured bonds; equity ownership would remain with the State.

- Local bonds can be issued at a rate of around 2% in the amount of USD 25 billion that can be purchased with depositors' virtual dollars. This can shift deposits into investments, giving depositors the option to reinvest in the economy or subscribe to coupon-paying instruments on the NIF, which would pay interest in fresh dollars.

- International bonds also worth USD 25 billion could be issued at a higher interest rate (up to 5%) to compensate international investors for the additional risk. Funds raised here would be used both for oil and gas exploitation and to re-invest in the economy.

- The fund would be established with a strong corporate governance framework with specific binding rules to guarantee transparency and ethics (e.g. no conflict of interest at any level, cap on debt issuance and dividends).

*See Appendix 6



E. CAPITAL MARKETS

i. The Capital Markets Authority (CMA)

To access capital markets and attract foreign investors, an inherent conflict of interest in the reporting structure between the CMA and the BDL needs to be resolved. To minimize the conflict:

1. The relationship between the BDL and the CMA should be severed. Today, the CMA Board of Directors reports to the Governor of the BDL while international standards require Chinese Walls between both regulators.

2. The CMA Board of Directors should be composed of fully-independent members, with extensive experience in the financial sector.

3. Board members cannot be assigned consecutive mandates (this should also apply to BCC and SIC).

Other key steps to enhance the CMA's role and optimize its oversight process include:

1. Finalize implementation of *Capital Market Court of Law.*

2. Establish CMA Portal to enhance communication with financial community.

3. Consider the development of the Beirut Stock Exchange, a re-evaluation of the sovereign debt issuance process, and a full reform of the regulator.

The CMA must also adopt a governance model that ensures financing from transaction fees. This will encourage the CMA to take the proper actions to facilitate access to the capital markets and remove existing administrative obstacles. This will require an amendment to Law 161.

Other changes might be required to meet the critical need for foreign investment in the Lebanese capital markets.

ii. The Beirut Stock Exchange (BSE)

The redevelopment of the BSE can also attract foreign investments. Today, the BSE only has a handful of listed securities and a total market capitalization of around USD 6 billion. Today, the BSE is the MENA's smallest and least liquid exchange.

The successful floating of up to 49% of State assets (Section 4.A.4.6)—akin to France Telecom in the French CAC 40—can bring foreign liquidity to the BSE. Similarly, listing large Lebanese corporations on the BSE would provide liquidity to develop local and international business.

Once the BSE is adequately restructured, listed entities could explore the introduction of Global Depository Receipts (GDR) in international markets to increase confidence and secure foreign funding sources.

Also, many Lebanese private companies are family owned SMEs. To support these companies' cash flow needs, the BSE could open the door for local IPOs and/or develop a crowd-funding platform for SME capitalization needs and share trading.

iii. Sovereign Debt Issuance

To issue further foreign currency debt, a fundamental requirement would be to reach an appropriate understanding with foreign Eurobond holders to ensure access to the capital market and raise new debt.

Currently, the process to issue and approve sovereign debt in Lebanon is not aligned with international capital markets standards.

The government can implement four simple steps to address these shortcomings:

1. Establish a strong legal and regulatory framework where issuance of government bonds and T-bills would be attractive to foreign and local investors.

2. Establish a Debt Management Office that would report to the Council of Ministers, which would include economists, members of the Ministry of Economy, Ministry of Finance, and the central bank. By separating the functions of issuance and debt management, the committee's goal is to set short, medium, and long-term debt objectives according to State guidelines.

3. Establish a debt ceiling and legal framework under which the debt ceiling can be increased.

4. List all government bonds and T-bills on the BSE and other foreign exchanges to increase liquidity and transparency.

6. CONCLUSION

By implementing this comprehensive solution, the Lebanese debt would be reduced to an acceptable OECD level with almost no impact on the vast majority of Lebanese depositors. Debt-to-GDP would drop below 80%, opening the avenues for the country to further leverage and cover its liquidity needs for its economic plan.

The government deficit would be fully cleared, banks' capitalization requirements would be significantly reduced, and the virtual dollar issue solved as a prerequisite to lift the capital controls, all with no impact on depositors.

Such a solution would give a positive signal to the international financial community about the commitment and seriousness of the government to rebuild the economy, in the hope of restoring local and international trust in the Lebanese financial sector and to prepare the country for future growth.

Only then will Lebanon be able to implement a strategic vision with a solid economic plan to create value for the future.

APPENDIX 1 – CRISIS COMPARATIVE TABLE

	Lebanon	Argentina	Cyprus	Greece	Iceland	Venezuela	Turkey
	2019	1998	2012	2009	2008	2017	2005
Peg	Fixed	Extreme	Float	Float	Float	Fixed	Float
Foreign currency debt	✔	✔	X	X	✔	✔	✔
Fiscal expansion	✔	✔	✔	✔	✔	✔	✔
Corruption Perception Index	2.8	3	6.6	3.8	8.9	2	4.1
Holdouts (vulture funds)	✔	✔	✔	✔	✔	✔	X
Collective Action Clause	X	X	✔	✔	✔	✔	X
Budget deficits/GDP	-11.0%	-1.9%	-5.6%	-15.1%	-12.9%	-16.6%	-4.20%
Current account deficit/GDP	-27.0%	-4.8%	-3.9%	-12.3%	-22.4%	2%	0.90%
Domestic tax avoidance	High	High	High	High	High	High	N/A
Default(s)	1	9	1	1	0	1	6
Depositor bail-in	-	X	✔	✔	X	X	X
Free flow of capital	✔	✔	✔	✔	✔	X	✔
Independent monetary policy	✔	X	X	X	✔	✔	✔
Dollarization	✔	✔	-	-	-	✔	X
Peg authority	Executive	Legislative	-	-	-	Executive	Legislative
Main source of currency	Banking	Trade	Banking	Banking	Banking	Banking	Banking/ Trade
Economic block	X	MERCOSUL	EU	EU	EEA	Suspended from Mercosul in 2106	X
Central lender of last resort	Central bank	None	Eurosystem	Eurosystem	Ambiguous	Ambiguous	Central bank
Privatization	Low	High	Low	Low	High	Low	Low
Customs tariffs	High	Low			Medium	Medium/ High	
Antitrust legislation	Weak	Weak	EU	EU	EC	Weak	TCA
Fractional reserve	✔	✔	✔	✔	✔	✔	✔
Debt/GDP	151%	38%	80%	127%	66%	72%	70.60%
Bank deposits/GDP	240%	20%	210%	98%	86%	38%	73%
Labor laws	Rigid	Rigid	Semi-rigid	Semi-rigid	Flexible	Rigid	Rigid
Interest rates	High	High	High	High	High	High	High

APPENDIX 2 – KEY INVESTMENT SECTORS WITH SOCIO-ECONOMIC IMPACT

Type	Sector	Social impact	Job impact	Economic impact	Financial
Technology	Internet	Technological hubs, skilled labour, R&D	Creates long term jobs	Incentivise Foreign direct investments	Fx revenue Generator
	Telecom				Fx revenue Generator
Companies	SMEs	Increase GDP per capita and productivity		Incentivise Foreign direct investments/ Export service	Fx revenue Generator/Reduce trade balance deficit
	Tax free Zones				Fx revenue Generator/Reduce trade balance deficit
Public Utilities	Electricity	Increase productivity, reduce energy costs			Fx revenue Generator
	Waste management	Improve health and reduce cost of healthcare		Ecological impact	
	Public Transport	Improve productivity, reduce energy costs		Economical development of regions	
	E-goverment	Improve public service, tax collection, and reduce corruption and fraud		Productivity and Quality of service impact	
	Public hospitals	Improve healthcare and reduce costs		Reducer NSSS Cost	
Agriculture	Mecanisation of the Agriculture	Improve yield and quality		Economical development of regions/Export	Fx revenue Generator/Reduce trade balance deficit
	Subsudise/Training /Crops				Fx revenue Generator/Reduce trade balance deficit
	Irrigation				Fx revenue Generator/Reduce trade balance deficit
	Clean Qaroun Lake				Fx revenue Generator
Industry	Automate/subsidise	Improve and increases local production			Fx revenue Generator/Reduce trade balance deficit
	Traning/Iso certifications				Fx revenue Generator/Reduce trade balance deficit
Tourism	Hotel/Ports/Natural reserves/Historical and Religious sites			Economical development of regions	Fx revenue Generator

APPENDIX 3 – MONEY SUPPLY ANALYSIS

M1 includes all cash and short-term deposits. M2 includes M1 plus savings and long term deposits, money market funds, and certificates of deposits. Today, M2 stands at around USD 40 billion (at LBP/USD 1,507).

The total liquid assets in the BDL should always represent at least 30% of the M2 money supply.

BDL total liquid assets = USD 35 - 45 billion (in cash, liquid foreign assets, and gold). A conservative estimate would be the lower end of the range, i.e. USD 35 billion.

Currency allowed to be printed = 35/30% = USD 117 billion

So, the BDL can print up to:
USD 117 billion – USD 40 billion = USD 77 billion (LBP equivalent at an LBP/USD rate of 1,507)

APPENDIX 4 – GOLD LEASING SIMULATION

Gold reserves can be leased to banks or other commodity firms to raise funds for liquidity. The interest earned would be the gold lease rate (GLR).

The GLR varies based on economic conditions. It is typically calculated as LIBOR minus the gold forward offered rate (GOFO) - rate at which dealers will lend gold on a swap basis for USD.

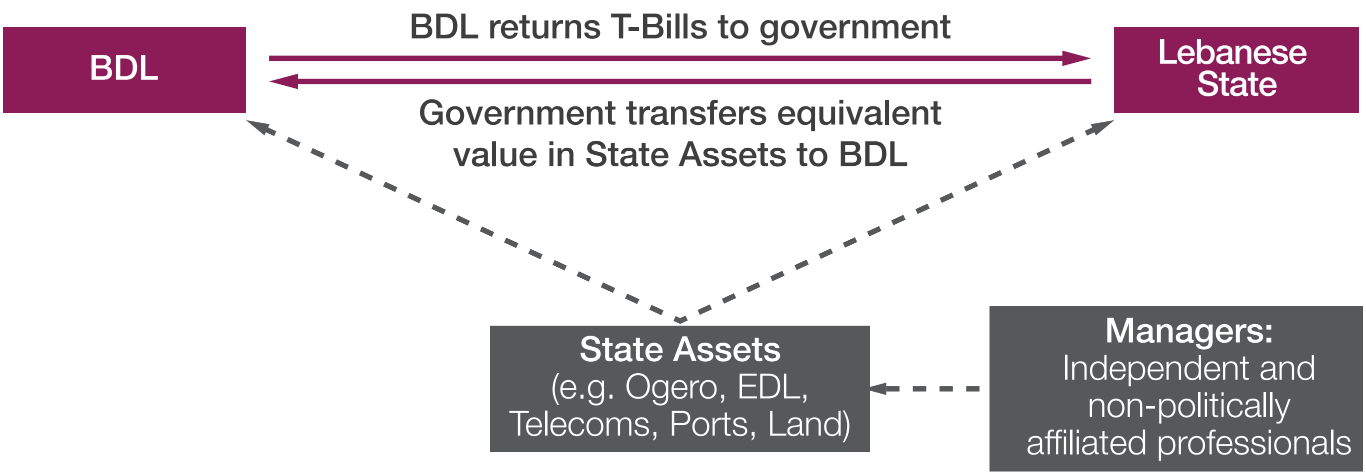
Today, the BDL has 9.2 million ounces (260 T) of gold, with a market value around USD 15.6 billion.

Assuming an average GLR of 1% and a lending rate of 50% of reserves under today's gold prices, the BDL could generate:

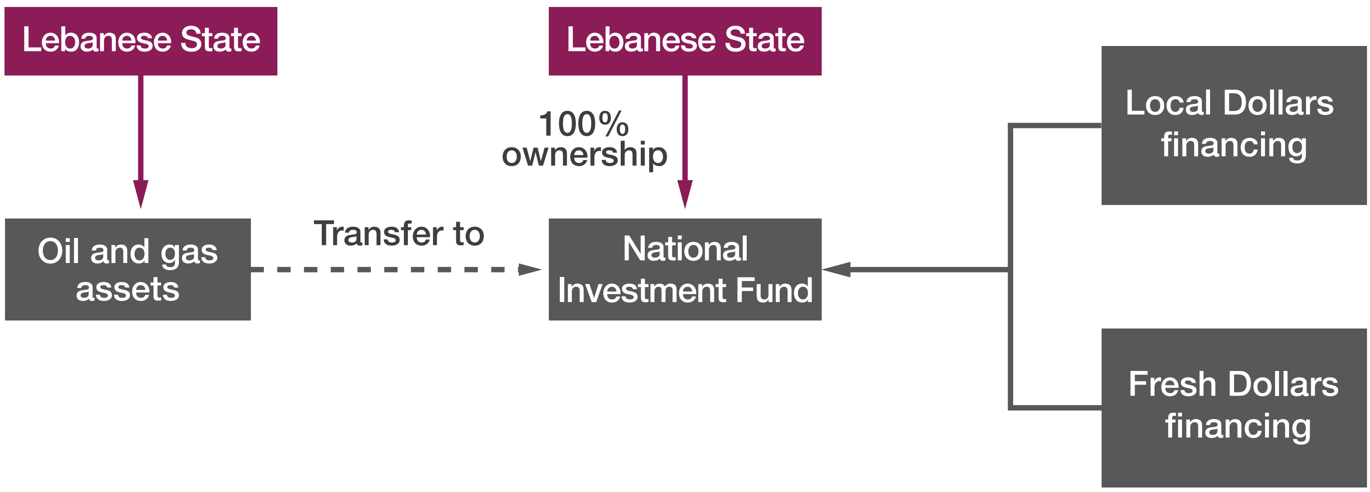
9.2 million Oz x USD 1,700 per OZ x 50% x 1.0% = **USD 78.2 million per year in foreign currency.**

The price of gold is expected to further increase in the coming years, which could further increase the leasing revenues.

APPENDIX 5 – DEBT-TO-EQUITY SWAP WITH STATE ASSETS



APPENDIX 6 – NATIONAL INVESTMENT FUND



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