



# FINANCIAL SECTOR RESTRUCTURING

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## STAKEHOLDER ANALYSIS

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# CONTEXT

Lebanon faces an unprecedented economic and financial crisis, rooted in decades of corruption, state capture, and flawed policymaking, which have in turn resulted in an accumulation of colossal liabilities. The settlement of aggregated losses in the financial sector, estimated at USD 72BN in September 2022, is a pre-requisite to reviving the banking sector and kickstarting growth. This should evidently go hand in hand with other key pillars for recovery, namely debt restructuring, a medium-term fiscal framework, exchange rate unification, governance reforms, and a growth inducing agenda.

Since the onset of the crisis in 2019, successive governments have sought to ensure political buy-in around a recovery plan that would form the basis of a program with the International Monetary Fund. A first plan was adopted by the Diab government in April 2020 and soon thereafter shot down by concerned stakeholders. A second plan was presented by the outgoing Mikati government in May 2022, this time based on a staff-level agreement with the IMF. An amended version, adopted in September 2022, integrates new elements that seek to further increase deposit recovery levels and thereby garner wider buy-in.

Both the May 2022 & September 2022 versions still require an accurate quantitative analysis. Their suggested treatment of losses would also greatly benefit from the input of delayed audits in the financial sector. What these propositions mostly lack however, is stakeholder alignment around them and political will for implementation - despite significant momentum for convergence over the past several months.

The paper below captures different stakeholder positions vis a vis the financial restructuring plan. It is the output of a stakeholder mapping and mediation exercise that Kulluna Irada has launched with the purpose of identifying areas of divergence -and convergence- across the different actors, and charting recommendations for the way forward. A summary of key findings is presented in what follows.

# MAIN STAKEHOLDERS

## ONE-ON-ONE MEETINGS WERE HELD WITH REPRESENTATIVES ACROSS THE FOLLOWING STAKEHOLDER GROUPS:

- Government of Lebanon
- Lebanese Economic Organizations
- Association of Banks of Lebanon
- Lebanese Private Sector Network
- Banks | BankMed, Bank Audi, Cedrus Bank, BLF, BLOM Bank
- Depositors' Associations

In addition, a discussion was organized between the Lebanese Economic Organizations and the BBA Committee for Depositors' Rights and Lebanese Observatory for the Protection of Depositors.

## DOCUMENTS

- Staff-level agreement with the IMF, April 2022 (official)  
– referred to below as: **IMF SLA**

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- Government Plan, Sept 2022 (official)  
– referred to below as: **Gvt Plan**

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- Draft Law on Restoring Financial Balance in the Banking System (Gap Resolution)  
– referred to below as: **Law 1**

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- Draft Law on Bank Resolution  
– referred to below as: **Law 2**

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- Financial Sector Recovery Plan (Issued by the Lebanese Economic Organizations, including ABL)  
– referred to below as: **LEO Plan**

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- Laws 2/67, 28/67, 110/1991, 192/1993

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# KEY FEATURES OF THE PROPOSED FRAMEWORK <sup>1/2</sup>

## I. TREATMENT OF DEPOSITS

**1 “FRESH” DOLLARS**  
POST 31 OCTOBER 2019 AND OTHER  
**“EXEMPTIONS”**  
REMAIN AS IS  
(Law 1, Article 12 – Law 2)

**2 DEPOSITS ARE CATEGORIZED AS “ELIGIBLE” AND “NON ELIGIBLE”**  
(Law 1, Article 6)

- “NON-ELIGIBLE DEPOSITS” ARE THOSE THAT HAVE BEEN CONVERTED INTO FOREIGN CURRENCIES AFTER OCTOBER 17, 2019 AT THE 1507.5 RATE OR ITS EQUIVALENT IN OTHER FOREIGN CURRENCIES. THESE INCLUDE BANK TRANSFERS, CHECKS, AND OTHER UNSPECIFIED OPERATIONS OR INSTRUMENTS.
- “NON-ELIGIBLE DEPOSITS” ARE LIRAFIED AT A YET UNDETERMINED RATE, PROVIDED IT IS LOWER THAN THE SAYRAFA RATE  
(Law 1 Article 7-5)

**3 REMAINING LOANS**  
TO THE PRIVATE SECTOR ARE SETTLED  
AND NETTED ON THE LIABILITY SIDE  
(GVT PLAN)

**4 CLAW BACK ON EXCESS INTEREST**  
FROM THE POST 2015 “FINANCIAL  
ENGINEERING” OPERATIONS  
(Law 1, Articles 7-2&3)

**5 DEPOSITS UNDER USD 100,000** ARE PROTECTED  
(ONE ACCOUNT PER DEPOSITOR  
SECTOR-WIDE) (Law 1, Article 7-1)

**6 VOLUNTARY LIRAFICATION**  
AT LOWER THAN SAYRAFA RATE  
CAPPED AT A CERTAIN CONSOLIDATED  
AMOUNT (Law 1 Article 7-1)

**7 DEPOSITS ABOVE USD 100.000**  
ARE PARTIALLY BAILED-IN  
(Law 1, Article 7-4)  
THE REMAINING PART IS CONVERTED  
TO CAPITAL INSTRUMENTS AND/OR  
SECURITIES ISSUED BY THE  
**“DEPOSIT RECOVERY FUND”**

# KEY FEATURES OF THE PROPOSED FRAMEWORK <sup>2/2</sup>

## II. BDL RECAPITALISATION

- 1. Reduce the value of banks FX deposits at BDL** (Law 1, Article 2)
- 2. Reduce BDL net negative FX position** (Law 1, Article 3)
  - Government to recapitalize BDL with an injection of USD 2.5BN through financial bonds and/or other means to be determined by the Council of Ministers, based on a proposal by the minister of Finance.
  - Government to implement measures to recover funds related to ill-gotten assets in accordance with the UNCAC (Law No. 214 dated 8/4/2021)
- 3. Restore net positive position over 5 years** (Law 1, Article 4)

Remaining negative capital will be phased out gradually over a 5-year period. Deferred charges shall be written-off gradually as a result of Seigniorage.

### ASSUMPTIONS

- Total deposits are at USD 95BN, as of September 2022 compared to USD 123BN in September 2019
- Total losses in the financial sector (gap) are at USD 72BN. Gap is calculated net of gold assets held at the BDL.

# KEY ELEMENTS OF CONVERGENCE AND DIVERGENCE 1/2

## STAKEHOLDERS HAVE UNANIMOUSLY EXPRESSED AGREEMENT TO THE FOLLOWING PRINCIPLES:

- ✓ The need for an IMF program
- ✓ The need to recapitalize BDL
- ✓ The need for a bank resolution framework
- ✓ The recognition of the magnitude of losses
- ✓ The waterfall of losses starting with equity (In exception of certain banks who still refuse this)
- ✓ The need to protect depositors below a certain threshold (established at USD 100,000)
- ✓ Claw back on interests post-2015
- ✓ The principle of creating a fund to increase deposit recovery levels for deposits >USD 100,000
- ✓ The possibility for current shareholders to maintain control over their banks contingent to new capital injections
- ✓ Bail-in for part of deposits

## KEY ELEMENTS OF DIVERGENCE ARE:

### 1. ACCOUNTABILITY



For banks, the crisis is systemic and resolution should not follow the rules of a commercial default.

For the Bar Association, the systemic aspect of the crisis does not absolve banks of their responsibilities. Board members and top executives and auditors are liable on their personal assets that should be preventively seized pending investigation. They should be removed from office and replaced with new boards where depositors are represented.

The activation of laws on corruption, illicit enrichment, money laundering etc. is the entry point to hold every public officer, MP or minister accountable

### 2. ELIGIBILITY CRITERIA



Government and Lebanese Economic Associations agree on the principle that deposits converted to USD post October 2019 are ineligible.

The Bar Association considers that only a Forensic Audit on deposits can determine eligibility. An escrow account may be established to lodge questionable deposits until the completion of enquiries and audits.

# WHAT ARE THE MAIN POINTS OF AGREEMENT AND OF DIVERGENCE 2/2

## KEY ELEMENTS OF DIVERGENCE ARE:



### 3. EFFECTIVENESS OF PROTECTION OF DEPOSITS BELOW USD 100,000

Threshold is in line with international standards but the effective recovery rate remains unclear (no clarity over pay-back period and applicable exchange rate).

Treatment of protected deposits under a bank-by-bank approach raises the question of the fate of deposits in non-viable banks.



### 4. RECOURSE TO PUBLIC RESOURCES

Lebanese Economic Associations demand a state guarantee for deposits lodged in the DRF.

The Bar Association demands a forensic audit to distinguish between illicit and licit funds. The latter only being guaranteed by the State.

The IMF and to some extent the Government Plan insist on limiting public resource contribution to the recapitalization of the Central Bank.



### 5. BANK SECRECY

The IMF and Bar Association insist on the need to access names of account holders for the resolution process.



### 6. RESOLUTION PROCEDURE

The Draft Resolution Law gives all powers to the Higher Banking Commission which is chaired by the BDL governor.

The Bar Association requires an authority that is not conflicted.



### 7. GOVERNANCE

The Lebanese Economic Associations and Draft Bank Resolution Law do not mention the need for any changes to the governance of the financial sector.

The Bar Association highlights the importance of governance reforms, demanding the removal of the current BDL and SIC leadership as well as key amendments to the Code of Money & Credit.

# STAKEHOLDER POSITIONS RE. THE KEY FEATURES OF THE PROPOSED FRAMEWORK <sup>1/8</sup>

## 1. VALUE OF LOSSES IN THE FINANCIAL SECTOR

<b>AGREEMENT</b>	<p><b>Gvt and LEO</b></p> <p>Total size of the financial gap stands at USD 72BN.</p> <p>Magnitude of the increase since October 2019 and evolution of BDL and Banks' respective balance sheets</p>
<b>NEEDS CLARIFICATION</b>	<p><b>Bar Association</b></p> <p>Forensic Audit on deposit will determine the final size of the gap after deduction of illegitimate deposits.</p>
<b>DIVERGENCE</b>	<p>Forensic Audit on every transaction post-October 2019, including transfers abroad (including fiduciary accounts), loans repayment, credit facilities for imports, real estate transactions.</p>

## 2. WATERFALL OF LOSSES

<b>AGREEMENT</b>	<p><b>Everyone</b> Except for certain banks.</p> <p>Equity comes first in line.</p>
<b>NEEDS CLARIFICATION</b>	N/A
<b>DIVERGENCE</b>	<p><b>Bar Association</b></p> <p>Bankers' responsibility (board members and management) is, by law, not limited to equity but extended to their personal assets.</p> <p><b>Banks</b></p> <p>Stress the importance of a comprehensive approach focusing on value creation as a pre-condition for the application of the waterfall of losses and recapitalization.</p> <p><b>LEO</b></p> <p>The crisis is systemic, banks cannot be held responsible above their equity contribution.</p>



# STAKEHOLDER POSITIONS RE. THE KEY FEATURES OF THE PROPOSED FRAMEWORK 2/8

## 3. BDL RECAPITALIZATION

<b>AGREEMENT</b>	<p><b>Everyone</b></p> <p>The central bank must regain its function of lender of last resort to be able to restore confidence in the financial sector as a whole, protect the currency and curb inflation.</p> <p>The foreign-currency gap in the BdL's balance sheet estimated to exceed USD 50BN is too huge to be closed immediately.</p>
<b>NEEDS CLARIFICATION</b>	<p>Results of the BDL audit remain pending/undisclosed.</p> <p>Need to clarify BDL's interest rate management and how BDL will close, in due course, its negative net equity position post-restructuring.</p>
<b>DIVERGENCE</b>	<p><b>Bar Association</b></p> <p>Forensic Audit should be prioritized, including impact of financial engineering operations.</p> <p>New governor is needed at the head of the Central Bank.</p>

## 4. TREATMENT OF FRESH DOLLARS

<b>AGREEMENT</b>	<p><b>Everyone</b></p> <p>On the fact that they remain untouched</p>
<b>NEEDS CLARIFICATION</b>	<p>Some pre-Oct 2019 are also considered as fresh according to the bank resolution draft law.</p>
<b>DIVERGENCE</b>	<p><b>IMF</b></p> <p>Fresh money ought to be included in the Capital Controls law</p>

# STAKEHOLDER POSITIONS RE. THE KEY FEATURES OF THE PROPOSED FRAMEWORK 3/8

5.	ELIGIBILITY CRITERIA
AGREEMENT	<p><b>Gvt and LEO</b></p> <p>Agree on the same eligibility feature ie post-October conversions to USD are non-eligible.</p>
NEEDS CLARIFICATION	<p>Rate and impact of liraification of non-eligible deposits.</p>
DIVERGENCE	<p><b>IMF</b></p> <p>Liraification should be capped at a at a predetermined ceiling.</p> <p><b>Bar Association</b></p> <p>No justification for this feature.</p> <ul style="list-style-type: none"> <li>• Post-2019 conversions were allowed by banks.</li> <li>• Alternative dates are also possible: when BDL reserves turned negative, when Balance of payment turned negative, etc.</li> </ul> <p>It allows a huge reduction of liabilities without any accountability.</p> <p>The alternative, and only acceptable eligibility criteria, should be based on a forensic audit. Clean money is the only eligibility criteria.</p>

# STAKEHOLDER POSITIONS RE. THE KEY FEATURES OF THE PROPOSED FRAMEWORK 4/8

## 6. NETTING OF LOANS

<b>AGREEMENT</b>	<b>Gvt and LEO</b> Agree on netting loans to the private sector.
<b>NEEDS CLARIFICATION</b>	Applicable rate Netting modalities under a bank-by-bank treatment
<b>DIVERGENCE</b>	<p><b>Bar Association</b></p> <p>All transactions post October 17, 2019 should be investigated, including repayment of loans to the private sector, within a comprehensive forensic audit prior to any decision on eligible liabilities.</p> <p>It would be advisable to mention the latest BDL circular No 646 dated 12/10/2022 allowing prepayment of some loans despite contrary provisions.</p> <p>In addition, those who have benefited from the currency collapse and multiple rates to pay their dues and repay their loans should be taxed accordingly.</p> <p>كل شخص حقيقي أو معنوي حصل على ربح من عمل يدر ريعاً غير خاضع لضريبة أخرى على الدخل.</p>

## 7. CLAW-BACKS

<b>AGREEMENT</b>	<p><b>Everyone</b></p> <p>On claw-back on interests post-2015</p>
<b>NEEDS CLARIFICATION</b>	Valuation methodology
<b>DIVERGENCE</b>	<p><b>Bar Association</b></p> <p>Need to include claw-back on shareholders' paid dividends and management bonuses.</p> <p>Suggestion to start the claw-back as of 2011.</p>

# STAKEHOLDER POSITIONS RE. THE KEY FEATURES OF THE PROPOSED FRAMEWORK 5/8

## 7. PROTECTED DEPOSITS

<b>AGREEMENT</b>	<p><b>Everyone</b></p> <p>Agrees on the principle of a threshold. Protecting depositors whose accounts are less than USD 100,000 is consistent with international standards that provide for the protection of small depositors and the guarantee of their deposits.</p>
<b>NEEDS CLARIFICATION</b>	<p>The real recovery rate for this protection is still unclear in the absence of pay-back period and applicable rate.</p> <p>How many depositors with accounts &lt; USD 100,000 were there in 2019 against how many today? Those who exited the system incurred losses. Any compensation for that?</p>
<b>DIVERGENCE</b>	<p><b>Depositors Unions</b></p> <p>Treatment of protected deposits under a bank-by-bank approach: fate of deposits in non-viable banks.</p> <p><b>Bar Association</b></p> <p>Some categories of accounts should be treated as first-class creditors, such as the medical and pension funds of the various professional orders or the CNSS.</p> <p>Protected depositors should be paid upfront and not delayed for an undetermined period.</p>

## 8. BAIL-IN

<b>AGREEMENT</b>	<p><b>Everyone</b> agrees on the principle of a bail-in of part of deposits.</p>
<b>NEEDS CLARIFICATION</b>	<p>Nature of rights that are swapped against deposits: convertible bonds, shares, etc.</p> <p>Voting rights</p>
<b>DIVERGENCE</b>	N/A



# STAKEHOLDER POSITIONS RE. THE KEY FEATURES OF THE PROPOSED FRAMEWORK 6/8

10.	DEPOSIT RECOVERY FUN
<b>AGREEMENT</b>	<p><b>Everyone</b></p> <p>On the principle of such a special vehicle that allows to enhance recovery rates over time – marginally.</p> <p>On linking its assets to the recovery of stolen, smuggled and illegal funds.</p>
<b>NEEDS CLARIFICATION</b>	<p>Legal Structure of the DRF: it should be a non-recourse vehicle.</p> <p>Modalities of illicit funds recovery.</p> <p>DRF Management: how to guarantee the independence of “experts” from the current political class.</p>
<b>DIVERGENCE</b>	<p><b>IMF</b></p> <p>Public resources should not be used to protect deposits. Fiscal margins are very low and priority goes to reboot the economy.</p> <p><b>State contribution is already important:</b></p> <ul style="list-style-type: none"> <li>• Gold assets at BDL to protect part of remaining deposits</li> <li>• 2.5 BN recapitalization of the BDL + FX negative position over five years</li> </ul> <p><b>Bar Association</b></p> <p>Action plan on accountability first based on activation of:</p> <ul style="list-style-type: none"> <li>• Law No 175/2020 – corruption</li> <li>• Law No 189/2021 – illicit enrichment</li> <li>• Law No 44/2015 - anti-money laundering</li> </ul> <p>The establishment of a fiduciary fund is recommended instead of a DRF. The DRF should include inter alia the portion of Oil and Gas revenues dedicated to debt reimbursement as per laws 132/2010 and 57/2017 as well as a portion of revenues allocated from the management of selected state-owned enterprises/assets. It may also include some ear-marked taxes qualified as solidarity tax and wealth tax.</p>

# STAKEHOLDER POSITIONS RE. THE KEY FEATURES OF THE PROPOSED FRAMEWORK 7/8

11.	BANK RESOLUTION PROCESS
AGREEMENT	<p><b>Gvt and LEO</b> agree on giving full powers of a Resolution Authority to the Higher Banking Commission chaired by the governor of the Central Bank.</p> <p><b>Gvt and LEO</b> on a bank-by-bank approach of the resolution and liquidation and recapitalization processes.</p>
NEEDS CLARIFICATION	<p>Compatibility of a bank-by-bank approach with key features of the plan, notably protection of deposits in non-viable banks.</p> <p>Treatment of bank assets, including real estate and foreign subsidiaries.</p>
DIVERGENCE	<p><b>Bar Association</b></p> <p>Make sure the Higher Banking Commission established under law 28/67 has full power and independence to conduct a fair resolution process. Otherwise, appoint an ad hoc Bank Resolution Authority.</p> <p>Shareholders retaining control of their banks must be contingent to a prior forensic audit.</p>

# STAKEHOLDER POSITIONS RE. THE KEY FEATURES OF THE PROPOSED FRAMEWORK 7/8

## 12. SECTOR GOVERNANCE

<b>AGREEMENT</b>	<b>Gvt and LEO</b> do not propose any governance reforms in their respective plans.
<b>NEEDS CLARIFICATION</b>	N/A
<b>DIVERGENCE</b>	<p><b>IMF</b></p> <p><b>Governance reforms are needed:</b></p> <ul style="list-style-type: none"> <li>• Modernizing the central bank legal framework and governance and accountability arrangements;</li> <li>• Establishing a credible and transparent monetary and exchange rate system.</li> </ul> <p><b>Bar Association</b></p> <ul style="list-style-type: none"> <li>• Amend The Code of Money and Credit to resolve conflicts of interest between monetary policy and prudential rules.</li> <li>• Develop new governance structure for the BDL and the Higher Banking Commission.</li> <li>• Ensure the independence and effectiveness of the Special Investigation Commission, Banking Control Commission and Capital Markets Authority.</li> </ul>

