

FIVE QUESTIONS TO GUIDE THE ASSESSMENT OF THE ANTICIPATED "GAP LAW"

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QUESTION 1

DOES IT PRIORITIZE DEPOSITORS BY RESPECTING THE HIERARCHY OF CLAIMS?

- International Standards stipulate that financial losses should first be absorbed by bank shareholders' equity, before deposits are affected.
- This principle, known as the « Hierarchy of Claims » assures a fair allocation of losses and guarantees that depositors are prioritized in any proposed solution.
- *It has not been confirmed yet whether the latest version of the draft bill respects the hierarchy of claims. Any bill that fails to adhere to this core principle will not be endorsed by the IMF.*



QUESTION 2

ARE DEPOSIT RECOVERY MECHANISMS CREDIBLE?

- A transparent and credible repayment mechanism is required to define a clear level of deposit protection, specifying how repayment will be guaranteed.
- Statements from government officials have indicated that the treatment of deposits will be as such:
 - The first 100,000 USD for each depositor shall be repaid in yearly installments over a period of 4 years. Banks and the BDL* will contribute equally to this repayment.
 - For amounts above 100,000 USD, Asset Backed Securities (ABS) will be issued by the BDL with maturities varying between 10 to 20 years depending on deposit brackets. These Securities shall be backed by the income and revenues from BDL assets.
- *Until present, questions remain around the liquidity and repayment capacity of both the Banks and BDL. These should be addressed to guarantee that commitments to depositors are respected and to avert against any future default. In addition, more clarity should be provided around the use of BDL assets, particularly gold, in the plan.*

*Banque du Liban

QUESTION 3

IS THE STATE'S CONTRIBUTION SUSTAINABLE?

- The state's commitment to bridging part of the financial losses should be consistent with debt sustainability targets, and based on a macro-fiscal analysis. This is key to minimize the risk of another default, which would negatively impact depositor recovery levels.
- It has been publicly confirmed, as has always been the case, that the state shall contribute to bridging part of the financial losses by a contribution to the recapitalization of the BDL. However, in the absence of a macro-fiscal analysis to date, and clear audits of BDL and banks, the level of state contribution remains unspecified, and moreover, a subject of dispute, particularly given that the debate over the validity of presumed BDL claims on the treasury of 16.5 BN USD has not been officially resolved to date.
- *A macro-fiscal framework and debt sustainability analysis are needed, in addition to the draft bill, to be able to specify state contribution levels, among other variables.*



QUESTION 4

DOES IT REFLECT A COMMITMENT TO ACCOUNTABILITY AND FAIRNESS?

- Elements of accountability should be reflected in the bill. These should be anchored in a forensic audit of the BDL and Banks, and should include tools that address illicit funds, and seek to redeem profits from financial engineering operations, and transactions post October 2019.
- Public statements about the plan indicate that some elements of accountability have been incorporated.
 - Transactions deemed irregular on legal grounds shall be addressed.
 - Profits from financial engineering operations shall be redeemed, as shall excessive interests.
 - Fees shall be imposed on those who leveraged influence to transfer their money abroad.
- *The tools above could be significantly expanded: a full-fledged forensic audit is needed, a clear definition of irregular transactions is required, and additional fees could be imposed particularly on Politically Exposed Persons and individuals who had insider information and breached their fiduciary obligations.*



QUESTION 5

WILL IT GET IMF ENDORSEMENT AND UNLOCK INTERNATIONAL SUPPORT?

- This Gap Law is a significant piece of reform. If applied in line with international standards, it will be instrumental to revitalizing the banking sector and rebooting the economy.
- The endorsement of the IMF is indispensable for restoring trust in the financial sector and Lebanese economy, and in unlocking financial support from the international community. Without it, the draft bill risks to fail in achieving its objectives.
- *To date, there is no confirmation that the draft bill is approved by the IMF.*

