



**PRELIMINARY FORENSIC AUDIT REPORT
BANQUE DU LIBAN
07 August 2023**

ALVAREZ & MARSAL MIDDLE EAST LIMITED

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1 Introduction

1.1 Background to A&M's appointment

1.1.1 Alvarez & Marsal is a global professional services firm, offering a range of advisory services to its clients, including complex financial investigations and regulatory advisory services.

1.1.2 Under an engagement letter dated 24 August 2021 (the "Agreement") Alvarez & Marsal Middle East Limited ("A&M") was engaged by the Republic of Lebanon as represented by the Ministry of Finance (the "Client" or the "MoF") to perform a forensic audit and a governance and controls assessment of the Banque du Liban (the "Central Bank" or "BdL").

1.1.3 The forensic audit comprises the following areas:

- i) Validate that funds relating to financial transactions that have occurred at BdL level, or through accounts at BdL during the last five years (the "Financial Transactions") have been used for their intended purposes (or if not, to indicate this);
- ii) Examine whether any Financial Transaction prices or values were unduly inflated or otherwise unsubstantiated;
- iii) Examine whether payments were made to fictitious companies or otherwise served any similar improper purpose;
- iv) Assess, review and analyze any potential red flags that may indicate inappropriate financial reporting schemes, misappropriation, embezzlement or inappropriate use of funds;
- v) Assess, review and analyze any expenditures and liabilities for an improper purpose;
- vi) Examine how the assets and liabilities of the BdL balance sheet have accumulated and moved over time;
- vii) Examine the composition of BdL's foreign currency reserves and liabilities;

- viii) Examine conditions surrounding issuances of government bonds and T-bills and Bdl's subscription to these instruments;
- ix) Examine financial engineering transactions conducted in the last 5 years;
- x) Perform a detailed analysis of the breakdown of the movement in commercial bank deposits over time at a customer and group level especially during the period of financial engineering operations;
- xi) Summarize the identified key commercial banks holding government debt and the integrity of their relevant balances held on deposit with the Bdl; and
- xii) Analyze the nature of reporting of deposits and loan exposure by financial institutions to the Bdl and the surrounding governance.

1.1.4 The governance and controls assessment comprises the following:

- i) Review the compliance and internal controls procedures in place at Bdl;
- ii) Assess whether such procedures are sufficient to prevent financial irregularities and misappropriation taking place;
- iii) Assess whether controls meet international standards followed by other leading Central Banks around the world; and
- iv) Make appropriate recommendations and discuss initial findings with the Client.

1.1.5 Our work covers the period 1 January 2015 to 31 December 2020 (the "Review Period").

1.2 Use of this report

1.2.1 This report is A&M's Final Preliminary Forensic Audit Report (the "the Preliminary Forensic Audit Report") incorporating the clarifications / inquiries received from the Client.

1.2.2 A&M's reports and all advice (written or oral) given by A&M to the Client in connection with this engagement (together the "Advice") are intended solely for the benefit and use of the Client in considering the matters to which this engagement relates. The Minister of Finance shall have the right, upon its sole discretion, to share the full Preliminary Forensic Audit

Report (or excerpts thereof) with any authority forming part of the Client without the prior approval of A&M, provided that the Minister of Finance takes reasonable steps to ensure that they acknowledge and accept (i) that they receive the Preliminary Forensic Audit Report on a non-reliance basis, (ii) that A&M does not accept a duty of care or responsibility to them, and (iii) that the Preliminary Forensic Audit Report is confidential.

- 1.2.3 Notwithstanding the foregoing, to the extent the Client is required to disclose the Preliminary Forensic Audit Report in court proceedings against any individual or party implicated by the Preliminary Forensic Audit Report, it shall, to the extent permitted by law, first seek A&M's approval (which shall not be unreasonably withheld or delayed), provided that in such event A&M may, in its sole discretion, (i) provide a revised or redacted report for the purposes of such proceedings or (ii) provide the Preliminary Forensic Audit Report not marked as A&M's work product and without any further references to A&M as part of the Preliminary Forensic Audit Report (the reports revised as per (i) or (ii) referred to as the "Unmarked Report"). The Client shall be free to disclose the Unmarked Report to other parties as required to facilitate such court proceedings, provided that the Client (including for the purposes of this subparagraph any of its affiliates or successors) shall not reference A&M in connection with the Unmarked Report or Services or attribute the Unmarked Report or Services to, or imply that the Unmarked Report or Services are provided by A&M, and to this extent shall keep A&M indemnified as provided in clause 8 of the Agreement (including the Indemnification Provisions referenced therein). The Client undertakes to disclose the Preliminary Forensic Audit Report or, as the case may be, the revised or redacted report or Unmarked Report only in its entirety and including any disclaimers attached by A&M to it. For the avoidance of doubt, the restrictions and limitations set out in this subparagraph shall only apply in relation to the use of the Preliminary Forensic Audit Report in connection with court proceedings, and shall not restrict the use by the Client of the Preliminary Forensic Audit Report in any other manner to the extent permissible under the terms of the Agreement, including pursuant to the first subparagraph of this clause or as may be required by any order of a court of competent jurisdiction.

1.3 Summary of work performed

Initial review and commencement decision

- 1.3.1 In accordance with the Agreement, A&M issued a detailed Information Request List (“IRL”) on 20 October 2020. Following delays in receipt of the data and termination of our initial engagement, A&M was informed in October 2021 that the data would be available for review.
- 1.3.2 Bdl refused A&M’s requests to complete its review on site at the premises of Bdl and provide direct, read only, access to Bdl’s data systems. Instead, information was provided to A&M on a stand-alone environment set up at the MoF premises. Data was loaded to a stand-alone server set up by Bdl. A&M was granted access to the data via eight workstations provided by Bdl. USB ports were disabled, and no data could be extracted from the servers by A&M.
- 1.3.3 Because Bdl provided data in a separate work environment it was necessary to perform validation steps to assess the integrity and reliability of the data received. These validations related to data extracted from Bdl’s Oracle ERP system, Core Banking System (“CBS”) and SWIFT database. Validation steps included:
- i) Totals checking;
 - ii) Validation of the data extract queries;
 - iii) Extracting samples of data from the live production systems (CBS, ERP, and SWIFT) alongside Bdl database administrators to determine if there were any differences between the number of records provided to us when compared to the live systems; and
 - iv) Reconciliations against Trial Balances, financial statements and other schedules.
- 1.3.4 After re-engaging with the Client, in August 2021, A&M carried out a preliminary review of the data provided to determine whether sufficient information had been collated in order for A&M to be able to commence the review. A&M completed its preliminary review and issued its decision to commence the review (the “Commencement Decision”) on 20 June 2022. The delay between re-engagement and the Commencement Decision was due to the need to perform such detailed validation steps and the length of time taken to provide us with information.

Mobilisation and site visits

1.3.5 Having made the Commencement Decision and received outstanding fee payments, A&M mobilised its review team on 20 June 2022 (the “Mobilisation Date”). Due to repeated delays in provision of documents requested, it was necessary to pause our review at various intervals. A&M was present at the MoF offices and conducted its review of the data on the following dates:

- i) 13 June 2022 to 17 June 2022;
- ii) 27 June 2022 to 7 July 2022;
- iii) 12 July 2022 to 29 July 2022;
- iv) 25 September 2022 to 30 September 2022;
- v) 3 October 2022 to 7 October 2022;
- vi) 10 October 2022 to 14 October 2022;
- vii) 24 October 2022 to 28 October 2022;
- viii) 22 November 2022 to 25 November 2022;
- ix) 18 December 2022 to 22 December 2022;
- x) 15 February 2023 to 16 February 2023;
- xi) 6 March 2023 to 10 March 2023;
- xii) 13 March 2023 to 17 March 2023; and
- xiii) 20 March 2023 to 22 March 2023.

Information requests

1.3.6 A&M issued 13 updates to the BdL IRL, as summarised in the below table, and one IRL to the MoF.

Table 1.1 IRL updates issued

Date	F.A.O.
3-Jan-23	BdL ¹
28-Oct-22	BdL
4-Aug-22	BdL
14-Jul-22	BdL
7-Jul-22	BdL ²
5-Jul-22	MoF ³
1-Jul-22	BdL
27-Jun-22	BdL
17-Jun-22	BdL
7-Mar-22	BdL
25-Jan-22	BdL
1-Nov-21	BdL
20-Oct-20	BdL
9-Sep-20	BdL

1.3.7 The information not provided is summarised at Appendix 5.

Questions to individuals

1.3.8 A&M initially requested interviews with 47 employees of BdL, as listed in Appendix 1. We were requested to reduce the number of interviewees, which we did, to nine BdL employees. We were then refused face to face interviews, and instead requested to provide questions in writing. We submitted written questions to 14 members of BdL staff on 31 October 2022⁴. We received responses from 14 staff on 13 February 2023.

1.4 Limitations

Data completeness

1.4.1 BdL refused to provide access to third party data in system data extracts. BdL gave as a reason for the refusal their belief that to provide such information would be a breach of the banking secrecy law. As such, they omitted or removed the following from the data extracts:

- i) Transaction description fields from CBS extracts for all transactions that are not automatically generated in the system; and

¹ Appendix 2 – IRL dated 3 January 2023.

² Appendix 3 – IRL dated 14 July 2022. The IRLs issued after this date did not include earlier requests that had been responded to.

³ Appendix 4 – MoF IRL dated 5 July 2022.

⁴ Exhibit 33 – A&M Questionnaires submitted to BdL staff

ii) SWIFT beneficiary, originator and description fields.

1.4.2 This has limited A&M's ability to identify the ultimate originator or beneficiary of SWIFT transfers and to understand the transaction narrative for CBS transactions.

1.4.3 As stipulated in the engagement letter, A&M was informed by the Client that by law number 2000 dated 29 December 2020 the banking secrecy law dated 3/9/1956 was suspended for a period of one year initially then extended until completion of the forensic audit on Banque du Liban, thus allowing for the provision of information deemed necessary for A&M to provide the services contemplated under the original engagement letter. Therefore, our report has been prepared on the basis of this suspension.

1.4.4 In all other material areas, we have successfully validated the integrity and completeness of the data provided to A&M.

Data access

1.4.5 BdL's refusal to provide direct access to its systems and to allow work to be conducted on site at BdL has significantly delayed and slowed progress on the assignment. Data was received from BdL in unformatted (i.e., raw), multiple text file formats, which required us to restore this data into another database environment and work with BdL to rebuild and verify the connections between various sources and data tables in order to extract meaningful information, requiring additional time and resources.

1.4.6 Furthermore, the requirement that we access the data through the BdL server at the MoF caused further delays, as there were frequent power outages, which then required BdL employees to visit the MoF to restore our access to the data.

Delays

1.4.7 Delays in the provision of data by BdL has significantly impacted the agreed deadlines on the assignment. A&M agreed to complete its work to produce a Preliminary Forensic Audit Report in a period of 12 weeks from the Mobilisation Date. The review was in fact completed 49 weeks after mobilisation due to the frequent delays in receipt of data.

Interviews

1.4.8 BdL refused to allow face to face interviews with any employees.⁵ As a result, we were limited to submitting questions in writing to a limited number of employees. This limited our ability to ask follow up questions and to explore certain topics in depth.

1.4.9 Despite the above limitations we were able to validate the data provided, where there had been redactions; full extractions of ERP, Core Banking and SWIFT systems; and receive significant responses to our information requests.

1.5 Structure of this report

1.5.1 This Report is structured as follows:

Table 1.2 Structure

Section 1 'Introduction'	Sets out the background to our appointment, our scope of work, the work performed and limitations faced in our review
Section 2 'Executive Summary'	Sets out our response to the mandate, key findings, conclusions and recommended next steps
Section 3 'Understanding the Financials'	Examines the main elements of the financials of BdL and their movements over the period 2015 to 2020
Section 4 'Foreign currency reserves'	Examines the composition of BdL's foreign currency reserves and liabilities
Section 5 'Financial Engineering'	Details the financial engineering operations executed by BdL over the period 2015 to 2020 and the consulting commissions charged
Section 6 'BdL's financial position'	Discusses the key accounting policies of the BdL, how the financial statements diverge from IFRS and restates BdL's financial position over the period
Section 7 'Transparency of financials'	Provides a comparison between the published balance sheet of BdL and the audited financial statements and discusses how the financial position was presented
Section 8 'Commercial banks positions'	Summarises the positions of commercial banks with BdL and movements over the period 2015 to 2020
Section 9 'Operational expenses'	Analyses the accrued and operational expenses of BdL
Section 10 'Employee remuneration'	Analyses employee remuneration and related benefits
Section 11 'Regulatory framework'	Introduces the legal framework applicable to BdL, its mandate and decision-making structures

⁵ See Appendix 1 for a list of interviews requested but denied.

Section 12 'Unexercised scrutiny'	Considers the exercise of scrutiny and control over the Bank, the Governor and operations
Section 13 'BdL Operations'	Discusses the roles of key departments within BdL and unconventional monetary policies
Section 14 'Transparency Assessment'	Summarises our conclusions on the level of transparency in governance, policies, operations, outcomes and relations

2 Executive Summary

2.1 Information access

- 2.1.1 As detailed in the Limitations section above, A&M has encountered many challenges in conducting the forensic audit, including that we have not been allowed access on site at BdL, nor have we been permitted to conduct interviews with BdL staff or leadership. Because of these limitations we have placed significant effort in obtaining and validating full extracts of BdL’s CBS transactions, accounting system, including the General Ledger (“GL”) and SWIFT payment database (together the “System Extracts”).
- 2.1.2 We have also submitted numerous information requests and written questions to BdL employees. For several requests, no information was submitted to us and, unless otherwise specified by BdL, where the requested information was not provided to us our assumption is that this information does not exist.
- 2.1.3 During the course of our work, we regularly communicated with the MoF in relation to the issues encountered and associated delays. As a result of the delays, several extensions to the originally agreed timeframe for delivery for this Preliminary Forensic Audit Report were agreed between the MoF and A&M. Notwithstanding the limitations, we have addressed the scope of our engagement based on the information available.
- 2.1.4 This report is “preliminary”. As a result, the figures contained herein may be subject to change based on receipt and analysis of additional data or new findings. Some lines of enquiry remain open – we highlight below areas for potential further investigation.

Table 2.1 Key findings

Section	Key Findings
Section 4: BdL’s FX position deteriorated rapidly over the period 2015-2020	BdL’s foreign currency shortage grew dramatically. Over the period, BdL moved from a foreign currency surplus of LBP 10.7tn (USD 7.2bn) ⁶ at the end of 2015 to a shortage of LBP 76.4tn (USD 50.7bn) at the end of 2020. This was driven by a 119% increase in foreign-currency denominated deposits, fuelled by the BdL’s

⁶ In this report, unless specified otherwise, LBP has been converted to USD at the official exchange rate of 1,507.5.

	<p>financial engineering programs, while foreign-currency denominated assets fell by 18%.</p> <p>Furthermore, a large, and increasing, percentage of the foreign-currency denominated assets were domestic assets, i.e., amounts due from Lebanese residents, from a Lebanese-incorporated firm or bank, or from the Lebanese government. These amounts, if ever repaid, would be a future burden on the Lebanese state, people and economy.</p> <p>Non-domestic foreign-currency assets halved, falling from USD 35.8bn in 2015 to USD 18.4bn in 2020 while domestic foreign-currency assets increased from USD 12.7bn in 2015 to USD 21.2bn in 2020, driven by a growth in a MoF overdraft and holdings of Lebanese Eurobonds which are in default.</p> <p>Excluding domestic foreign-currency assets, the shortage in foreign currency reserves as at 31 December 2020 increases to USD 71.9bn. Given GDP in 2020 of USD 31.2bn,⁷ this equates to 230% of GDP.</p> <p>At the official exchange rate of LBP 1,507.5 to the USD, the 2020 deficit is LBP 108tn. At end of 2020 the market exchange rate was circa LBP 100,000 to the USD, and the LBP has since further deteriorated.</p> <p>It is perhaps not meaningful to attempt to quantify the deficit using LBP, as that exchange rate itself is unstable. It would likely fall precipitously due to the resultant increase in LBP money-supply, if BdL were to attempt (using market exchange rates) to repay its foreign-currency liabilities using LBP.</p>
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⁷ GDP per World Bank – see <https://data.worldbank.org/indicator/NY.GDP.MKTP.CD>.

<p>Sections 6: BdL’s financial position deteriorated rapidly over the period 2015-2020</p>	<p>For the reasons described above, the BdL’s financial position deteriorated rapidly. However, this deterioration was not reported in BdL’s balance sheet presented in its annual financial statements, which were prepared using unconventional accounting policies. Those policies allowed BdL to overstate assets, equity and profits while understating liabilities – and to close each year-end in amounts specified by the Governor without explanation for the amounts chosen.</p> <p>A restatement of BdL’s financial statements results in a negative equity position of LBP 77.3tn (USD 51.3bn) in 2020.</p> <p>On 7 July 2023, BdL responded to the above by stating that “Cost deferral is part of the accounting policy approved by the Central Council. Most Central Banks adopt unconventional accounting policies tailored to their needs and to the central banking monetary operations. Interest paid on CDs and TDs was in line with the prevailing Eurobond yield curve”.</p> <p>BdL’s accounting policy in respect of financial engineering was exceptional in the extent of personal, unscrutinised, discretion given to the Governor to determine accounting estimates. Even an unconventional accounting policy, in order to be a policy, needs to have certain basic features, e.g. to be clearly stated, capable of being audited, and not dependent upon ad hominem judgment. The BdL’s accounting policy failed in this respect.</p>
<p>Sections 3 & 5: The deterioration in the financial position from the increasing costs of Financial Engineering was obscured in the financial statements due to it being reported as</p>	<p>In 2015, BdL reported that it had taken actions to bolster the supply of USD to the Lebanese banking system, through a scheme referred to as “Financial Engineering”. According to BdL, financial engineering was designed to achieve two overall objectives:</p>

**Deferred Interest
Expense and
Seigniorage**

- Provide the conditions to allow local banks in Lebanon to attract US Dollar deposits; and
- Further encourage the local banks to deposit these US Dollars with BdL.

There were further financial engineering actions in subsequent years, at increasing cost.

Based on our review, financial engineering was costly. The costs included:

- Premium paid on the purchase of treasury bills and redeemed CDs (equivalent to all future coupons on the instruments);
- Interest expense of term deposits and CDs;
- High exchange rate differential paid; and
- In 2020, there were also costs arising from the difference between the rate at which depositors were allowed to withdraw dollars from the banks (around LBP 8,000) and the official fixed rate (around LBP 1,500) following the issuance of circular 151.

We observed that in order to avoid booking losses, the Bank transferred costs to the Balance Sheet. As a result, the Bank was able to show a profit in all years and consequently continue to distribute approximately USD 40m per year to the account of the MoF. This distribution was made in accordance with Article 113 of the Code of Money and Credit. The Code of Money and Credit, under Article 113, also states that the Ministry of Finance is liable to cover the losses of the Bank. The transfer of losses from the P&L to the Balance Sheet avoided the need for the Ministry to bail out the Bank.

	<p>The interest expense transferred to the Balance Sheet was booked to a liability account titled “Deferred Interest Expense and Cost of Certificates of Deposit”, known internally as the “Pool”.</p> <p>The mechanism for booking the costs of financial engineering was applied in accordance with the Accounting Manual, amendments to which were approved by the Central Council in 27 January 2016 and 11 April 2018.</p> <p>The overall cost of financial engineering is estimated at LBP 115tn as at 31 December 2020.</p>
<p>Section 5: Financial Engineering transactions were approved only in concept by the Central Council, with unsupervised discretion given to the Governor to determine the amounts, coupon rates and allocations</p>	<p>The financial engineering transactions evolved in three phases:</p> <p>In 2015, BdL implemented a financial engineering program whereby it lent to Lebanese banks for the purpose of purchasing LBP Lebanese treasury bills, discounted by BdL in exchange for a commission. The collected commissions were recorded in a special account at BdL to offset the financial correction cost. The CC authorised this in a Decision at its meeting on 7 January 2015. That decision stated that the program was to continue until the commission reached LBP 500bn. This appears to be the only financial constraint that the CC placed on the Governor in the execution of the financial engineering transactions.</p> <p>In 2016, BdL implemented a new financial engineering program in order to attract US dollars into Lebanon. This comprised the exchange of LBP treasury bills from BdL’s portfolio for a newly-issued Eurobonds. The CC authorised this in a Decision at its meeting on 27 April 2016. The decision referred to Eurobonds worth USD 2bn and stated that the interest and maturity on the subscribed Eurobonds will be determined later by the Governor.</p>

In 2017, BdL implemented yet another financial engineering program. It allowed the banks to discount BdL-issued USD CDs conditional on them subscribing in the same amount to the Lebanese-Government Eurobonds. The CC authorised this in a decision dated 22 February 2017. The Decision did not reference any financial limit to the authorised transactions.

With respect to the CC decisions, we note the following:

The CC's financial-engineering decisions appear not to have been properly reasoned, based on a clear articulation of the economic rationale, e.g., benefits, costs, risks, alternatives etc. The CC minutes include only a brief explanation from the Governor that is devoid of any acknowledgement of the obvious risks. No written rationale appears to have been provided to the CC to enable it to form a judgement. We asked to be given such document if it existed and none was provided.

To the above, BdL responded in July 2023, citing the 'BDL's Financial Engineering' article authored by the First Vice-Governor, and provided academic research papers on financial engineering. As per our analysis, later detailed in Section 5 of this report, the documentation neither clarifies the rationale behind the financial engineering decisions nor supports or enables any judgment that the CC could rely upon.

The CC decisions as to the design of financial-engineering transactions allowed (explicitly or, by silence, implicitly) the Governor discretion, that: (i) was unconstrained, (ii) was not required to be demonstrably equitable as between different Lebanese banks, and (iii) the use of which was unscrutinised. We saw no sufficient reporting back to the CC of actual transactions that

	<p>would enable the CC to understand or scrutinise the Governor’s use of the discretion.</p> <p>In these respects, the CC, in our view, fell significantly below the minimum standards of good governance found in central bank practice internationally.</p> <p>We note a similar lack of good governance in the Open Market Committee’s (“OMC”) scrutiny of the financial-engineering transactions. Its mandate was to supervise and discuss BdL’s open market operations, such as purchase or sell securities. It also appears to have been satisfied with brief explanations by the Governor insufficient to enable it to scrutinise his decisions.</p>
<p>Sections 3 & 5: The Bank was inflating the balance sheet throughout the year on both the assets and liabilities side. At the end of the year, the Bank used the credit side to credit the “pool” – deferred interest expense and partially offsets losses.</p>	<p>Each year, close to the year end, the Governor issued instructions to the Accounting Department for <i>“offsetting the burdens from the financial correction plan at year end”</i>. Implementation of the mechanism was to be supervised by the Organisation and Development Department. The instructions were sent in a letter, signed by the Governor, Riad Salameh.</p> <p>Each instruction letter begins:</p> <p><i>“Based on CC decision number 46/30/16 dated 28 October 2016 you are requested to calculate the maximum limit of net burdens that are associated with the financial correction plan that can be offset at the current year end in accordance with the mechanism explained below and in coordination with the Organisation and Development Department for the purpose of supervising and completing the task.”</i></p> <p>The offsets included:</p> <p>First, the maximum possible from net income after removing the costs of the financial correction plan, while preserving approximately LBP 200bn in net income, allowing the Bank to meet</p>

	<p>a target of distributions to the MoF of approximately USD 40m each year. This amount is booked to provision for contingencies.</p> <p>Second, commission due resulting from financial engineering.</p> <p>Third, seigniorage – Initially seigniorage from currency, followed by seigniorage from treasury bill swaps and then seigniorage from financial stability.</p>
Section 7: The summary Balance Sheets published by BdL failed to adequately disclose the financial position of the Bank	<p>The full audited financial statements of BdL were not made public during the Review Period. Instead, BdL published summary balance sheets. No profit and loss statement, cash flow statement, audit report or notes to the accounts were ever published.</p> <p>In summary, the published financials do not provide an accurate picture of the financial position of BdL. The positions and losses of BdL are presented through netting of assets and liabilities and recording them in unexplained and general accounts such as “Other Assets” and “Clearance and settlement accounts”.</p> <p>The full extent of the accounting practices used to present the costs of financial engineering, the use of the ‘Pool Account’ and the seigniorage on currency and financial stability are not disclosed. By excluding the full details of the seigniorage and deferred interest expense and other finance costs from the annual report balance sheet, in addition to the absence of explanatory notes, makes it difficult for the reader to interpret how seigniorage was created and how the transactions related to financial engineering were recorded.</p> <p>No loss is shown at all in the balance sheet. This is before taking into account the misstatements and accounting policies adopted for disguising the costs of financial engineering.</p>

	<p>Important information was not made public over the Review Period which did not allow the public to know the extent of the position of BdL. Such information includes:</p> <p>BdL's profit and loss/income statement in each of the years 2015 to 2020;</p> <p>The specific interest rates it provided to the largest depositors or creditors of the Bank, nor does it disclose the methodology used in setting such rates;</p> <p>Details of the commercial bank deposits at BdL;</p> <p>Information as to the costs involved in BdL's financial engineering or the decisions made in relation to how the intervention would be accounted for.</p> <p>BdL's use of seigniorage increased the LBP money supply, which in turn fuelled additional expenditure in Lebanon, including government expenditure. Whilst all central banks sometimes take decisions that increase the money supply, too much creates an issue with inflation.</p> <p>Increasing or decreasing the LBP money supply impacts upon the ability to sustain a fixed exchange rate against the USD. In an attempt to sustain the exchange rate whilst increasing LBP money supply, BdL was using financial engineering to keep USD in the banking system in Lebanon.</p> <p>However, once Lebanon had fixed its currency to the USD, it became unconventional and unsustainable to recognise seigniorage profits. This is because such profit is based on an increase in the LBP. Profit recognition implies that LBP money supply increase was sustainable, i.e. consistent with (i) low inflation, and (ii) the fixed LBP-USD</p>
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	<p>exchange rate. Broadly speaking, this would only be so if (over the long-term) LBP money supply growth matched GDP growth in the Lebanese economy, especially with respect to sectors of the economy that would generate foreign currency earnings.</p> <p>As such, BdL's use of seigniorage was highly imprudent and this imprudence was not disclosed to Lebanese society.</p>
<p>Section 5: There is evidence of the payment of illegitimate commissions during the period totalling USD 111m. This appears to be a continuation of the commission scheme under investigation by Lebanese and international prosecuting authorities.</p>	<p>In 2021, Lebanese and international news agencies published a leaked copy of a Mutual Legal Assistance Request ("MLAR") sent by Swiss prosecuting authorities to the Lebanese authorities requesting further information related to payments received by Swiss banks from accounts held at BdL.</p> <p>The letter details payments totalling USD 333m sent between 2002 and March 2015 from a BdL account with IBAN number LB0209990000001001260632009 to an account at HSBC Private Bank (Suisse) SA ("HSBC") held in the name of Forry Associates Ltd ("Forry"). Forry was a British Virgin Islands ("BVI") registered company reportedly owned by Riad Salameh's brother, Raja Salameh.</p> <p>The payments were made under a 6 April 2002 agreement between BdL and Forry, under which Forry acted as "<i>agent for the introduction of BDL products</i>", earning a commission limited to 3/8 of 1% of the value of transactions in Lebanese Eurobonds, Lebanese treasury bills, and CDs held at BdL.</p> <p>A copy of this agreement has been provided to A&M by BdL⁸. The version provided to A&M contains the signatures of Riad Salameh, signing on behalf of BdL, and Kevin Walter, purportedly the Chief Executive Officer of Forry. However, according to the Swiss MLAR, a second version of the agreement was held by HSBC Bank, which</p>

⁸ Exhibit 01 – Forry-BdL agreement, 6 April 2002

contains the signatures of Riad Salameh for BdL and Salameh's brother, Raja Salameh, on behalf of Forry.

We have verified the 2015 payment made to HSBC for the benefit of Forry against bank accounting and payment records.

We have identified a total of USD 111.3m during during the Review Period in payments from the same account to seven banks – one Swiss bank and six Lebanese banks.

Table 1: Summary of recipients of transfers from the Consulting account, 1 January 2015 – 31 December 2020

Receiving account / bank	Sum of Amount (LBP)	Sum of Amount (USD)	No of payments
Banque Misr Liban SAL	71,192,822,000	47,023,000	6
IBL Bank SAL	30,958,319,000	20,475,057	5
BLC Bank SAL	20,355,730,000	13,445,000	4
AM Bank SAL	11,203,600,000	7,400,000	1
Bank Audi SAL	8,137,750,000	5,375,000	1
Fransabank SAL	8,137,750,000	5,375,000	1
HSBC Private Bank (Suisse) SA	18,292,737,500	12,134,486	4
Ministry of Finance	83,601,000	55,457	5
	168,362,309,500	111,283,000	27

We cannot confirm from the BdL records the ultimate beneficiary name or account of the transfers out from the consulting account as BdL has removed both the beneficiary details from the SWIFT extracts, and the transaction narrative fields from the Core Banking extracts provided to A&M, citing the banking secrecy law.

Information contained in these fields would confirm the identity of the beneficiary of the transfers and is key to finalising our investigation of these transfers.

We have confirmed the source of funds that generated the ability to make a portion of the outward transfers – the amounts were generated from financial engineering transactions and other credits designed specifically to raise funds for the payment of these commissions.

The book entries are not as would be expected – commissions are not linked to the underlying transactions and are not directly charged to the banks.

	<p>Period end balances on the consulting account are recorded in the financial statements under 'Accrued Expenses' with no detailed explanation.</p> <p>The credits were in part approved by the CC according to minutes of the meetings. Amounts and the destination of transfers were set by the Governor.</p> <p>BdL has to date failed to provide any further documentation or explanation of the book entries and transfers to and from the consulting account.</p> <p>We have identified no records to confirm that a service was actually performed to justify the commission payments.</p>
<p>Section 5: A&M has completed a preliminary analysis of accounts held at BdL in the name of Riad Salameh. We have traced USD 75m of overseas FX transfers to 23 banks in Switzerland, Germany, Luxembourg, UK, Lebanon, USA and France.</p>	<p>The Swiss MLAR also details further information on various transfers from the accounts of Riad Salameh held at BdL to accounts held in his name with Swiss banks.</p> <p>A&M has completed a preliminary analysis of accounts held in the name of Riad Salameh. The accounts receive credits, net of FX transfers between accounts, of USD 98.8m over the 6-year Review Period, an average of USD 16.5m per year. Credits are largely in the form of cheque deposits. Salary receipts total USD 1.5m, approximately USD 250,000, accounting for 1.5% of total credits.</p> <p>Debits, or transfers out of the accounts, total USD 103m, USD 78m of which are overseas FX transfers in USD, EUR and GBP. We have traced USD 75m through SWIFT records to 23 banks in Switzerland, Germany, Luxembourg, UK, Lebanon, USA and France. These include the transfers mentioned in the Swiss MLAR that occurred during the Review Period.</p>

	<p>Further investigation is required to confirm the source of the cheque deposits and to identify the ultimate beneficiaries of the outward transfers.</p>
<p>Section 8: Commercial bank positions</p>	<p>The assets of BdL that relate to its interactions with the commercial banks are represented on its balance sheet as loans and soft loans (i.e. loans made to support bank mergers) to banks and financial institutions, and loans under leverage arrangement.</p> <p>These assets have been analysed to show which banks these relate to over the period 2015 to 2020.</p> <p>The liabilities of BdL that relate to its interactions with the commercial banks are represented on its balance sheet under a 'Banks and financial institution' category and includes commercial banks' current and demand deposits; term deposits; CDs; and term deposits and CDs under leverage arrangement.</p> <p>These liabilities have been analysed to show which banks these relate to over the period 2015 to 2020.</p>
<p>Section 9: Operating expenses</p>	<p>Over the Review Period operating expenses have shown a slight drop from LBP 41bn in 2015 to LBP 38.7bn in 2016 followed by a steady increase year over year reaching LBP 63.5bn in 2020, an increase of approximately 55% from 2015 to 2020.</p> <p>A&M reviewed all the accounts that had a cumulative balance equivalent to USD 1M or more during the Review Period. We further evaluated those accounts based on the descriptions and movements in the balance year-on-year, which resulted in a list of 29 GL accounts for review, which we have grouped into six main categories:</p> <ol style="list-style-type: none"> I. Aids and donations;

	<ul style="list-style-type: none">II. Repairs and maintenance of assets used by the bank;III. Prior year adjustments;IV. Training and conference attendance costs;V. Advertising and publications; andVI. Fees and contracts tax of Chapter iii. <p>Our review of BdL’s expenditures recorded under these categories during the Review Period showed transactions that require further investigation as significant amounts were paid towards items which may not be considered appropriate had BdL’s financial position been scrutinised.</p>
Section 10: Employee remuneration	<p>A&M reviewed salaries and remuneration paid to employees and recorded on the P&L during the Review Period and provided a comparison of the changes in salary expenses charged year-on-year to identify any specific categories that show significant movements.</p> <p>BdL’s salaries and related charges were in the range of LBP 155bn and LBP 167bn per year. A&M’s preliminary analysis of the items that make up the balance of salaries and related charges showed unexplained fluctuations in the amounts charged under the “Allowances and Bonuses” and “Healthcare Services” categories.</p> <p>Indemnity provisions and settlements rose significantly with a spike in provisions in 2017. We understand from responses received from BdL that they had not fully accounted for the EOS indemnity related to the early retirement scheme and that this was rectified in 2017, necessitating the increase in provisions.</p> <p>For the period from 2015 to 2017 there were significant increases in the amounts paid in relation to early retirement; the amount recorded in 2017 was more than twice the amount paid in the previous year.</p>

<p>We consider the authority concentrated and exercised by the Governor goes beyond what is reasonably expected in Central Banks, with insufficient scrutiny over the use of such authority</p>	<p>As per the Code of Money and Credit, the key decision-making authority within BdL is the Central Council, which is empowered to decide on, among other matters, monetary and credit policies and framework for the functioning of BdL. The Governor is vested with extensive residual powers in the law, but subject to scrutiny through both internal and external mechanisms.</p> <p>In reality, whether exercised through the formal mechanisms of the CC or otherwise through organisational policies and procedures, based on the evidence we have seen, the Governor acted as the key decision-making figure and exercised largely unscrutinised authority. This was possible due to weak governance and controls framework internally, and a largely ineffective and understaffed external supervisory mechanism.</p>
<p>Based on our assessment and the information we have been provided with, the Central Council was largely ineffective as a governing body with no challenge to the Governor’s exercise of decision making power</p>	<p>As per the law, the CC is composed of the Governor, the four Vice-Governors, and two ex-officio representatives of the government, being the Director General of the Ministry of Finance and Director General of the Ministry of Economy and Trade.</p> <p>Section 12 of this report, “Unexercised Scrutiny”, outlining the exercise of scrutiny and control over the Bank, the Governor and operations, details the Central Council’s quorum and voting rights. BdL responded on 7 July 2023, stating that the Central Council members enjoy equal voting powers and deliberation rights.</p> <p>However, as per our analysis of the CC minutes we have been provided with, we observe that the Governor monopolized the discussions and decisions.</p> <p>Prior to March 2019, each meeting started with a monologue from the Governor, which formed the background of the decision to be taken by the CC, followed by the approval of the decision. We have</p>

	<p>not identified any challenge or dissenting opinions/views in these minutes.</p> <p>Between March 2019 and June 2020, the CC did not meet pending the nomination of the Vice-Governors, during which period the Governor unilaterally took decisions based on his mandate.</p> <p>Post June 2020, the pre-March 2019 meeting structure has been re-established, though we have observed some challenge in relation to the proposed decisions.</p>
Lack of overall good governance and risk management arrangements at BdL	<p>As part of our investigation, we requested various documentation related to governance and risk management within BdL, including roles and responsibilities of the Vice Governors, minutes of the various sub-committees, and policies, procedures or other documentation related to the functioning of the departments, to further understand how the three line of defence model is applied at BdL. Our requests were in line with how central banks globally function.</p> <p>Most of the documentation we requested did not exist at BdL, i.e., there is no up-to-date charter or other document on the roles and responsibilities of the senior management within BdL, most of committee charters and meeting minutes were not available, and policies and procedures for the functioning of the departments were either not available, or we were provided with undated versions which we could not verify had been approved through an appropriate governance mechanism. BdL commented on 7 July 2023, that “ whatever documents available at BdL on Governance policies and procedures were made available”. As outlined in the Information Access section, where the requested information was not provided to us, our assumption is that this information does not exist. There is no dedicated risk management function and BdL and</p>

there is a general absence of central identification, monitoring and managing of risk across the organisation.

We specifically requested a response from the Governor of BdL on the absence of a fit-for-purpose risk management function and framework, to which we received the following response: *“BDL is governed by the articles stipulated in the Code of Money and Credit and its internal regulations. Although there is no dedicated risk management department, such functions are handled by various entities, each according to their relevant tasks, such as the Accounting Department, REFA Department, Finance Unit, FX Department, Compliance Unit, Internal Audit and Inspection Department”*.

Based on the information provided, we have also not been able to identify or determine if and how each function within BdL is able to sufficiently manage its own risk, and how the aggregate risk at the bank-wide level is then identified, monitored, and managed. Nor do we see evidence that such function-level risk management, if present at all, was relevant to enabling the GC to scrutinise the activities of the Governor, including with respect to the operational implementation of the financial engineering and/or the payment of commissions.

On 7 July 2023, BdL responded to the above by stating that “the lack of a dedicated risk management department is compensated for by a distributed mechanism of checks and balances and several layers of controls”. Based on our analysis, we have not been able to confirm the existence of such checks.

As described on BdL’s website, and in the general organization of BdL’s departments, the Inspection and Audit Department is responsible for internal audit and inspection procedures at BdL and its branches, including records, operations, assets, and accounts. We

	<p>requested the Department’s audit / inspection reports for 2015 – 2020.</p> <p>The information provided exclusively related to minor operational incidents reports as part of the day-to-day business of the Central Bank. As a result, we see no evidence that the Department’s audits or inspections were relevant to enabling the GC to scrutinise the activities of the Governor, including with respect to the operational implementation of the financial engineering and/or the payment of commissions.</p>
<p>Lack of effective oversight from Government Commissioner</p>	<p>In practice, the office of the Government Commissioner was never fully able to perform the functions assigned to it.</p> <p>For over 5 years of mandate, we have not been provided with any documentation that would support the duties performed by the Government Commissariat. We have only been provided with two reports which describe the state of the day-to-day relationships with BdL.</p> <p>The Government Commissariat is required by the CMC⁹ to periodically inform the MoF and the Central Council of the supervision carried out. At the close of every financial year, he is required to report to the Minister of Finance on the discharge of his duties in the course of the preceding year. A copy of this report has to be addressed to the Governor.</p> <p>In practice, no reporting was provided.</p>

2.2 Recommendations

- 2.2.1 Given the issues identified, we recommend that immediate action is taken to introduce further governance, oversight and scrutiny measures to mitigate any further risk arising from BdL’s misconduct.

⁹ Article 45 of CMC

2.2.2 We have not been made aware of any steps taken to strengthen the governance arrangements at BdL. In summary, our recommendations are set out as per the following:

- i) The CMC sets out the powers vested in the Governor, the Central Council and the supervisory mechanisms. We recommend refreshing the CMC in light of our findings to further include:
 - a) **Responsibility to maintain oversight** over BdL from external bodies, e.g. closer oversight from the Government Commissioner, greater parliamentary oversight and scrutiny, and systematic independent audit commissioned by the Ministry of Finance.
 - b) **Strong accountability mechanism** requiring the Central Bank to give account of the decisions made in the execution of its responsibilities.
- ii) Considering the absence of fit-for-purpose governance arrangements within BdL, we recommend **implementing a proper governance mechanism** covering the following:
 - a) **Clear roles and responsibilities of the senior management within BdL** (the Governor, the Vice-Governors), including a clear mapping and allocation documented in a statement of responsibilities;
 - b) **Independent members (i.e. not BdL employees or ex-officio) to be part of the Central Council**, providing independent oversight and constructive challenge to the Governor, the Vice-Governors and the ex-officio members;
 - c) **Executive decision-making committees** that have the power to feed the Central Council;
 - d) **Strengthened policies and procedures**, including clear delegations of authority and powers e.g., policies & procedures, management information, escalation framework, conduct framework and Central Council terms of reference.

- iii) Central banks expose themselves to a variety of financial and non-financial risks. Effective risk management arrangements inform business decisions, enhance strategic planning and strengthen contingency planning. Considering the absence of fit-for-purpose risk management arrangements, we recommend implementing **function-level risk management mechanisms to exercise oversight on the activities performed by Bdl, the Central Council and ultimately the Governor**, with respect to the operational implementation of the financial engineering and/or the payment of commissions, by:
- a) Introducing a three line of defence model across Bdl, per international practices, including:
- a. **Implementing strong internal controls** across Bdl's risk taking departments as a 1st line of defence;
 - b. **Establishing an independent risk management** division as a 2nd line of defence;
 - c. **Empowering the Internal Audit function** (currently reporting to the Governor) by creating a functional reporting to the Central Council, as a 3rd line of defence.
- b) **Implement fit-for-purpose, i.e. specific to a central bank, risk management arrangements**, including but not limited to a clear risk policy, risk appetite and risk management policies and procedures;
- c) **Implement functioning, up-to-date and strong risk internal controls framework** across Bdl to allow central identification, monitoring and risk management at a Central Council level.
- iv) Considering the lack of external oversight from the Government Commissioner, we recommend **empowering the Government Commissariat** as per the following:

- a) **Refresh the CMC to further strengthen the role and responsibilities of the Government Commissariat** as per the powers vested in the function, including but not limited to strong mechanisms of escalation, if need be;
- b) **Properly staff the Government Commissariat with experienced profiles**, allowing them to fully perform their assigned duties;
- c) **Put in place a binding reporting mechanism of BdL to the Government Commissariat**, avoiding the option for BdL to withhold information;
- d) **Ensure proper governance arrangements between the Government Commissariat and the Ministry of Finance.**

2.3 Further lines of enquiry

2.3.1 As envisaged when commencing the forensic audit, not all lines of enquiry have been investigated to their full extent. To do so would require 1. a greater level of cooperation from BdL; 2. more complete responses to our information requests; 3. the ability to carry out face to face interviews; and 4. full, unredacted system data extracts with transaction descriptions and third party data fields.

2.3.2 Our accounting and transactional analysis has been conducted largely based on extracts from the Core Banking, ERP and SWIFT systems with limited access to underlying documentation. In particular with regards to Sections 9 and 10, we have analysed major movements over the Review Period and identified entries and transactions that may warrant further investigation.

2.3.3 Further enquiries and investigation may be warranted in relation to:

- i) Understanding the internal approvals given to enter into financial engineering transactions with certain institutions, the rationale behind the coupon rates, interest rates, amounts and contractual terms awarded and the relative benefits received by Lebanese banks and financial institutions.

- ii) Identifying the ultimate beneficiary of payments made out of the 'Consulting' account during the Review Period and justification for commissions paid on the Financial Engineering transactions.
- iii) Understanding the justification and approvals for BdL expenses that do not, on the face of it, appear to be related to BdL's mandate or that appear to be excessive in relation to the financial position of the bank.
- iv) Understand the purpose of a number of property transactions identified in our review and the circumstances for obtaining approval and payment for the properties and related expenses.
- v) Understanding the source and destination of funds passing through the Governor's accounts.

3 BdL Financials

3.1 Introduction

3.1.1 BdL produced audited financial statements for the years ending 31 December 2015 to 31 December 2018.¹⁰ These have been audited by 'Big 4' auditors, Deloitte & Touche ("Deloitte") and Ernst & Young ("EY") and include an auditor report, statement of financial position ("balance sheet"), statement of profit & loss ("P&L"), statement of changes in equity and statement of cash flows and are accompanied by a full set of notes.

3.1.2 For the years ending 31 December 2019 and 31 December 2020 we have been provided with unaudited financial statements which contain a statement of financial position, P&L and statement of cash flows, with no notes to the accounts.

3.1.3 A&M has also been provided with Special Purpose Financial Statements prepared by KPMG for the year ended 31 December 2019 which do include notes and substantial restatements to the draft accounts, ostensibly to bring them in line with IFRS.

3.1.1 The financial statements were not made public, although they form the basis of abbreviated balance sheets published on the BdL website biweekly.

3.2 Understanding the Financial Statements

3.2.1 Tables 3.12 to 3.15 provide the detailed balance sheet and P&L of BdL for the years 2014 to 2020 in LBP and in USD, translated at a rate of LBP 1507.5¹¹ to USD.

3.2.2 Over the period 2014 to 2020 the size of BdL's balance sheet has grown from LBP 127.5tn to LBP 215.7tn. The figures below summarise the assets of BdL as both actual balances (Figure 3.1) and as a percentage of the total (Figure 3.2). These show that there have been sustained increases in the value of seigniorage and the securities portfolio (primarily Lebanese treasury bills) over the period, both in total and as a percentage of total assets.

3.2.3 There has been a decline in the foreign assets in a foreign currency, particularly after 2017. BdL's loan balance increased significantly to 2018, before recording a steep decline in 2019 and 2020.

¹⁰ These audited financial statements are not appended to this report as they were stored at the MoF.

¹¹ The official exchange rate and the rate used internally at BdL in the Review Period.

Figure 3.1 BdL assets - balance sheet (totals, LBP'm)

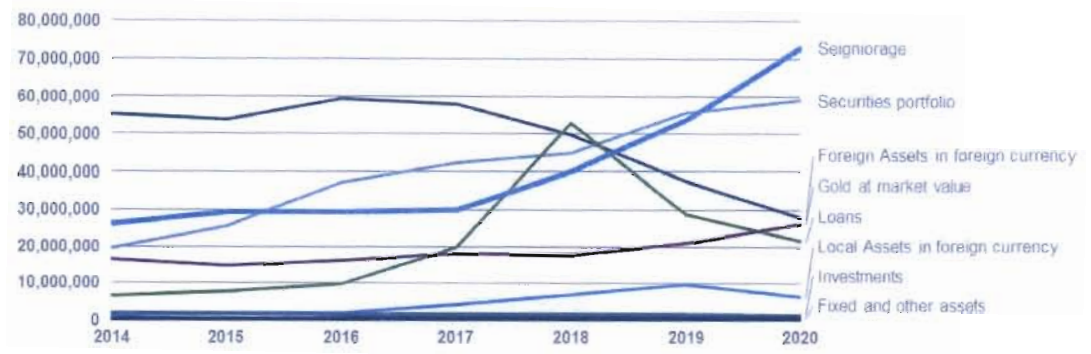
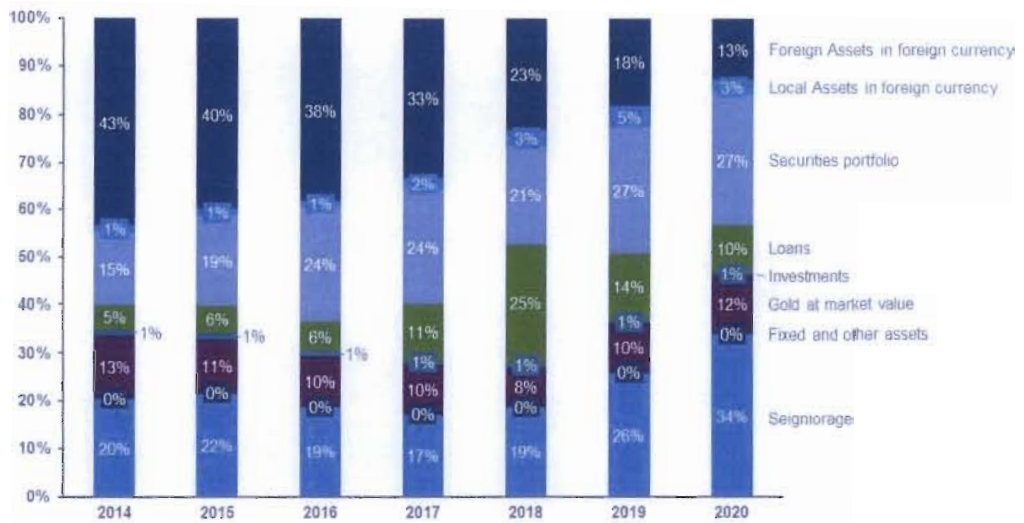
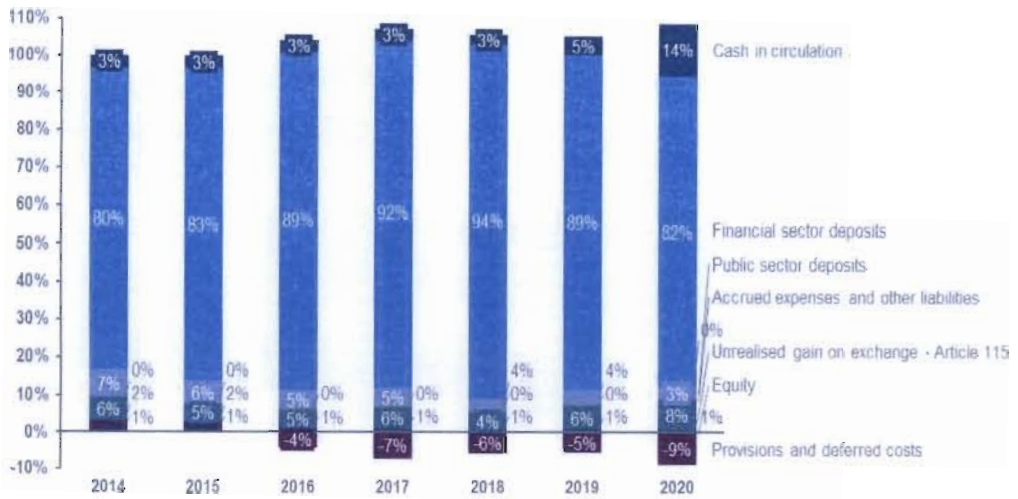


Figure 3.2 BdL assets – balance sheet (percentage of total)



3.2.4 Over the period 2014 to 2020 BdL's deposits from the financial sector increased from 80% of total liabilities and equity to 82%, but peaked at 94% in 2018. The provisions and deferred interest cost have moved from a liability position of LBP 2.3tn to a contra-liability position of LBP 19.1tn. Summarised at Figure 3.3 are the liabilities and equity of BdL.

Figure 3.3 Bdl liabilities and equity – balance sheet (percentage of total)



Assets

Foreign assets in foreign currency

3.2.5 Foreign assets held in foreign currency include cash held at foreign correspondent banks; reverse repurchase agreements; time deposits; foreign bonds; and certificates of deposit (“CDs”), held in USD, EUR, GBP and other currencies. Foreign assets halved from 2014 to 2020, falling from LBP 55tn (USD 36.6bn) to LBP 27.7tn (USD 18.4bn), and from 43% to 13% of total assets.

Local assets in foreign currency

3.2.6 Local assets held in foreign currency include asset-backed and credit linked notes and Lebanese government Eurobonds. Holdings in government Eurobonds quadrupled from 2016 to 2020 from LBP 1.35tn (USD 0.9bn) to LBP 5.3tn (USD 3.5bn), peaking at LBP 8.8tn (USD 5.8bn) in 2019 as they increasingly served as a means of transferring USD to the Lebanese Government as part of the financial engineering transactions.

Securities portfolio

3.2.7 The Securities portfolio consists largely of Lebanese treasury bills. Holdings in treasury bills tripled between 2014 to 2020 from LBP 19.6tn (USD 13bn) to LBP 58.9tn (USD 39bn), growing at an average annual growth rate of 17%. The proportion of holdings in Lebanese

treasury bills to total assets increased from 15% to 27%. The ratio of foreign held to locally held assets fell from 1.9 to 0.3 from 2014 to 2020.

Table 3.1 Ratio of foreign held assets to local held assets (LBP'm)

	2014	2015	2016	2017	2018	2019	2020
Foreign assets	55,183,952	53,904,794	59,390,287	58,169,294	49,853,921	37,545,596	27,723,950
Local assets (exc. Gold, FA, seigniorage)	29,426,048	36,824,023	50,503,728	68,271,270	106,439,260	95,624,320	88,350,798
Ratio foreign / local assets	1.9	1.5	1.2	0.9	0.5	0.4	0.3

3.2.8 This category also includes the excess of end-of-service indemnity investment fund. This balance represents the excess of assets over the provision made for BdL employee end of service indemnities. The assets held for the purposes of settling the end of service indemnities comprise Lebanese treasury bills.

3.2.9 The total indemnity amount in each year is increased by a provisioned amount (charged to the profit and loss) and reduced for the amounts paid out in the year in benefits. There is a significant increase in the provisioned amount from 2014 to 2016, when the provision was LBP 16.3bn, to 2017 when the provision was increased to LBP 68.7bn.

3.2.10 The end of service benefit is discussed in more detail in Section 10.

Loans

3.2.11 This includes loans and advances less provision for credit losses; loans to banks and financial institutions; soft loans to banks and financial institutions; and loans under leverage agreements.

3.2.12 Over the period 2014 to 2020 there was a 236% increase in the value of these loans, however the highest value occurred in 2018 when it reached LBP 53.1tn. The most significant movements relate to loans under leverage agreements, as summarised below:

Table 3.2 Loans 2014 to 2020 (LBP'm)

	2014	2015	2016	2017	2018	2019	2020
Loans and advances, less provision for credit losses	389,911	386,827	411,502	421,640	420,260	387,227	376,993
Loans to banks and financial institutions	5,413,671	6,562,928	8,457,705	8,885,807	10,082,753	15,619,806	8,840,336

	2014	2015	2016	2017	2018	2019	2020
Soft loans to banks and financial institutions	614,711	614,733	658,907	658,681	659,005	658,931	414,948
Loans under leverage agreements	-	-	-	9,971,622	41,936,785	11,994,420	11,907,619
Total	6,418,293	7,564,488	9,528,114	19,937,750	53,098,803	28,660,384	21,539,896

Investments

- 3.2.13 This balance includes investments in subsidiaries; investments in an associate; and other investments, with the majority of the balance comprising BdL's ownership of Middle East Airlines. This balance has fallen over the period 2014 to 2020 by approximately 10%. It also includes BdL's investment in Midclear.

Gold, at market value

- 3.2.14 BdL's holding of gold has increased in the period 2014 to 2020 by 58%, with gold valued at the prevailing market rate. We have not performed any work to confirm the amount of gold held by BdL and its audit reports indicate that the auditors have also not confirmed the amount of gold held.

Fixed and other assets

- 3.2.15 Fixed and other assets include real estate acquired in satisfaction of loans to problematic banks; properties and equipment; and accrued income and other assets.
- 3.2.16 The fixed and other assets acquired in satisfaction of loans to problematic banks primarily include land and buildings, with BdL reserving the right to sell these assets if the banks do not meet certain conditions.
- 3.2.17 Property and equipment balance includes land and work-in-progress, with all other assets (including buildings, furniture, IT equipment) written down to zero in the year of acquisition.
- 3.2.18 Accrued income and other assets include accounts receivable, the cost of the new bank notes and medals in stock and prepaid or deferred charges. Traditionally, the cost of the new bank notes and medals comprised the largest balance in this category, but in 2019 there was an increase in the other category from LBP 13.4bn to LBP 58.5bn that includes a LBP 30.8bn of tax refunds paid on behalf of BdL from banks.

Assets from exchange operations of financial instruments and seigniorage

- 3.2.19 In monetary economics, 'seigniorage' refers to the profits from money creation. The BdL included accounting entries labelled 'seigniorage' in its financial statements and references this concept as a key part of its justification for its Financial Engineering. BdL's use of seigniorage was highly imprudent and this imprudence was not disclosed to Lebanese society.
- 3.2.20 On 18 July 2023, in response to A&M's criticisms of both its accounting and its justification, the BdL sent A&M copies of nine monetary-economics academic articles on which it had marked selected passages with yellow highlighter. Apparently, but in A&M's view mistakenly, the BdL believe these articles support their point of view.
- 3.2.21 To illustrate the A&M point, a brief description of one of the academic articles – the most recent (published in 2013) – is set out below.

Good and bad seigniorage

- 3.2.22 The 2013 academic article¹² defines three types of seigniorage:
- i) Issue Seigniorage: the difference between the issue revenue (i.e., the face value of the currency issued) and the production costs of the new issued currency.
 - ii) Opportunity Cost Seigniorage: the interest earned on the bank's portfolio of government securities, where that portfolio is purchased with proceeds obtained from the public's holdings of outstanding currency.
 - iii) Inflation tax seigniorage: the loss of purchasing power of currency holders' cash balances.
- 3.2.23 The background to all three types of seigniorage is that issued currency is a liability of the central bank. However, the three types of seigniorage exploit different aspects of this liability.

¹² Exhibit 39 - Seigniorage: Meaning, Measurement and Management: Profits from the Business of Cash, Edgar I Feige, published by Banco de Espana (Spain's Central Bank), 2013

- 3.2.24 The first type of seigniorage implicitly assumes that the currency once issued will remain permanently in circulation, retaining its value. Therefore, it will never need to be redeemed, and so can be disregarded as a liability. However, because it retains its value the holders of the currency suffer no loss because of the central bank taking this form of seigniorage.
- 3.2.25 The second type of seigniorage exploits the fact that although issued currency is a liability of the central bank, it is a non-interest-bearing¹³ liability. However, the proceeds obtained from its issuance may be used to fund the purchase of interest-bearing securities. That interest is the seigniorage. Here also, provided the currency in circulation retains its value, the holders of that currency / cash suffer no loss. They have forgone interest but that for them is a fair exchange for the liquidity and convenience of cash. The principal value is retained.
- 3.2.26 The third type of seigniorage occurs significantly where the issuance of currency is such that it does not retain its value. In this case, although the central bank might temporarily give the appearance of engaging in the first (or second) type of seigniorage it is in fact engaging in the third kind.
- 3.2.27 The first (and second) type of seigniorage arise from the issuance of a stable currency. There is a seigniorage profit to the central bank but no loss to the public as holders of the currency. The third type of seigniorage is a profit to the central bank that arises because there is – or is going to be – a loss to the (present or future) holders of currency.
- 3.2.28 The 2013 academic paper states:

“Central banks have two critical responsibilities. The first is to conduct monetary policy to maintain a relatively stable price level. This assures the public that the currency, which it holds, will remain as a medium of exchange because it does not lose significant value over time due the loss of purchasing power via inflation. The second key responsibility of the central bank ... is ... to provide efficiently a secure currency and maintain its quality and ready availability over time. The profit earned by the central bank from the provision and maintenance of the currency circulation system is what we call seigniorage.”

¹³ That is for bank notes issued. As commercial banks hold accounts at the central banks, it may also create money by crediting the account of a commercial bank. Credit balances at a central bank sometimes are interest bearing but typically at a low interest rate (and so may still allow for some (of the second type of) seigniorage.

3.2.29 Put simply, the first (and second) type of seigniorage occur from a central bank discharging its responsibilities. The third from it failing to do so.

Seigniorage and the fixed exchange rate

3.2.30 An important context to the BdL's seigniorage was the twin facts that:

- i) BdL was seeking to maintain a fixed (USD) exchange rate,
- ii) but (due to Lebanon's inefficient tax structure) BdL was also issuing currency / creating money to finance government expenditure.

3.2.31 The latter if persistent inevitably leads to bad (type three) seigniorage. The former delays – and may serve temporarily to disguise – but cannot ultimately prevent the latter occurring.

3.2.32 The 2013 academic paper states that:

“Countries with inefficient tax structures tend to rely more heavily on inflation tax seigniorage, however, over time, the public will tend to reduce its demand for the local currency in favor of a more stable alternative currency such as the dollar or the euro.”

3.2.33 This aptly describes Lebanon but is quite inconsistent with the maintenance of a fixed exchange rate.

Accounting for seigniorage

3.2.34 Seigniorage is a concept of monetary economics not accounting. Its importation into accounting is at best unconventional and controversial. In the context of a central bank seeking to maintain a fixed exchange rate it is misleading. The essence of (the first type of) seigniorage is that issued currency will never need to be redeemed, and so can be disregarded as a liability. In contrast, the implicit promise of a fixed exchange rate is that the central bank stands ready to purchase / redeem its issued currency and to do so by paying US dollars at the fixed exchange rate. In that context, issued currency therefore remains a liability incapable of properly being disregarded.

3.2.35 This point is neatly illustrated by another of the academic papers proffered by BdL on 18 July to A&M. This 2003 Academic Paper¹⁴ was authored by an economist formerly at the Austrian central bank. In the excerpt below from that paper, the reference to monetary seigniorage corresponds to the first type of seigniorage described above.

3.2.36 *“The most widespread definition in the earlier literature ... uses monetary seigniorage, which is the increment of the monetary base over a defined period (usually a year). According to this definition, the increment of the monetary base could be regarded as profit of the central bank after deducting the costs that arise from the creation of the monetary base Whenever the monetary base contracts, the central bank would be considered as suffering a loss. **This concept does not correspond to the current, generally accepted accounting rules, as these consider the components of the monetary base repayable liabilities. An increase in repayable liabilities can be regarded as profit only in unlawful pyramid schemes.**”*
(Emphasis added)

3.2.37 The author explains that the focus of his academic paper was six Eastern European countries who (at the time) were aspiring to join the Euro and who therefore were seeking to achieve stability for their national currencies against the Euro.

3.2.38 The author states.

“The ambition of all countries ... is to join the euro area. In this case, the national banknotes will be exchanged for euro banknotes; this process can be seen as the central bank paying back the monetary base to the general public.”

3.2.39 In the case of Lebanon, the “paying back” in contemplation was the exchange of the Lebanese pounds for US Dollar as and when needed to support the fixed exchange rate.

Seigniorage as applied in BdL financial statements

3.3 Contrary to the economic and accounting logic just described above, BdL recognizes three types of seigniorage in its financial statements¹⁵:

¹⁴ Exhibit 40 – Seigniorage in Selected Acceding Countries: Current Situation and Future Prospects on the Road towards Monetary Integration, Janos Kun, 2003

¹⁵ Details provided in a word document, undated, unsigned. This exhibit was provided as part of information reviewed.

- i) **Seigniorage on currency:** BdL recognizes seigniorage on issued banknotes and coins whereby the Bank records an asset and a liability balance resulting from seigniorage representing the difference between the cost of printing the issued money and the cumulative face value of this money prior cost calculations. This includes recognising the seigniorage on currency capped at 2.5% of the cumulative annual GDP of Lebanon since 2002, effective from 2015, further to a Central Council decision on 27 January 2016. This decision permitted BdL to recognise seigniorage in 2015 relating to the previous 13 years, based on Lebanon’s cumulative GDP in that period.
- ii) **Seigniorage on T-Bills:** BdL recognizes seigniorage on Lebanese T-Bills swapped against Lebanese Republic Eurobonds (policy adopted in 2009) or outstanding in the Bank’s portfolio (from 2014)¹⁶. As such, the Bank records asset and liability balances from this seigniorage representing the value of these T-Bills.
- iii) **Seigniorage on financial stability:** Effective from 2018, following a decision of the Bank’s Central Council dated 11 April 2018,¹⁷ BdL recognizes seigniorage on financial stability, whereby the Bank records on a yearly basis asset and liability balances from this seigniorage representing an amount deemed appropriate by the Governor in view of the Bank’s role and operations.

3.3.2 The balance of seigniorage recorded in BdL’s financial statements has increased 181% over the period 2014 to 2020, as summarised below:

Table 3.3 Seigniorage by category (LBP’m)

LBP’m	2015	2016	2017	2018	2019	2020
Seigniorage on currency	11,817,754	11,817,754	11,817,754	11,817,754	11,817,754	30,917,722
Seigniorage on T-bills	17,378,694	17,378,694	18,080,640	18,080,640	18,080,640	18,080,640
Seigniorage on Financial stability	0	0	0	10,270,279	24,024,809	24,024,809
Total	29,196,448	29,196,448	29,898,394	40,168,673	53,923,203	73,023,171

¹⁶ As set out in BdL’s Audited Financial Statements.

¹⁷ Central Council Decision 47/12/18.

3.3.3 During the same Central Council meeting Decision 48/12/18 was passed stating that accumulated costs related to the financial correction plan would be offset against the following:

- i) Net profit from financial stability;
- ii) Commissions due from Financial Engineering;
- iii) Net profit from exchanging LBP treasury bills with Eurobonds;
- iv) Net profit as result of payment of Lebanon's dues in foreign currency;
- v) Net profit on exporting notes and monies (with a cap of 2.5% of GDP);
- vi) Net profit on Lebanese treasury bills and public reserve.

3.3.4 The decision states that BdL's Governor is to determine the details of this arrangement and the accounting department will implement the process at year-end. This is recorded in BdL's Accounting Manual which states that the seigniorage on financial stability will be "*an amount deemed appropriate by the Governor in view of BDL's role and operations*".¹⁸

Liabilities

Cash in circulation

3.3.5 The Cash in circulation included the value of the bank notes and coins issued by BdL and currently in circulation. Between 2014 and 2020 the value of cash in circulation increased from LBP 4.3tn to LBP 30.9tn, an increase of 627%.

Financial sector deposits

3.3.6 These balances relate to deposits from commercial banks and other financial institutions comprising current and demand deposits; term deposits; blocked deposits; CDs; term deposits under leverage agreement; CDs under leverage agreement; and a small amount categorised as 'Other'.

¹⁸ The Accounting Manuals of BdL are not exhibited to this report as we were not permitted to take copies of these from the BdL server.

3.3.7 The largest component of the financial sector deposits comprises term deposits, which were, on average, 63% of total deposits in each year. Over the period 2014 to 2020 this balance increased from LBP 59.5tn to LBP 125.6tn, an increase of 111%.

3.3.8 CDs averaged 29% of total deposits over the period 2014 to 2020. However, the amounts held as a CD fell from LBP 36.2tn in 2014 to LBP 31.7tn in 2020, having peaked at LBP 50.4tn in 2016.

3.3.9 In the same 2014 to 2020 period, current and demand deposits have increased by 223% from LBP 6.1tn to LBP 20.2tn.

Public sector deposits

3.3.10 These balances relate to deposits from the Lebanese public sector, including demand deposits; time deposits / margin accounts; blocked deposits; a small amount categorised as 'Other'. These balances are considerably smaller than the financial sector deposits and have fallen in the period 2014 to 2020 from LBP 9.2tn to LBP 6.9tn, a decline of 25%.

3.3.11 The majority of the public sector balances are held as demand deposits, which declined from LBP 7.5tn in 2014 to LBP 6.5tn in 2020.

Accrued expenses and other liabilities

3.3.12 These balances include accounts payable for matured treasury bills; transitory accounts; accrued expenses; social security dues; payables due to a problematic bank group; payment orders; unearned income and other liabilities.

3.3.13 In the period 2014 to 2020 these have increased by 364% from LBP 0.15tn to LBP 0.69tn.

Unrealised gain on exchange – Article 115

3.3.14 The unrealised gain on exchange account is a "specially designated account" in which unrealised and realised gains and losses are deferred instead of being booked through the P&L.

3.3.15 Note 26 to the 2017 audited financial statements explains the unrealised gain on exchange account as follows:

“The unrealized gain on exchange account represents a specially designated account where the unrealized appreciation/depreciation of gold and net unrealized appreciation/depreciation of translation of assets and liabilities denominated in foreign currencies are deferred in accordance with Article 115 of the Lebanese Money and Credit Law. Also deferred under this account are realized losses on treasury bill swaps and discounts being a tool used by the Bank to support the stability of the Lebanese Pound (Refer to Note 2.2B¹⁹).”

3.3.16 Table 3.4 shows the balance on the account reflected in the financial statements at each year end. The balance increased by 113.4% over the relevant period from 2014 to 2020, with the most significant increases occurring from 2018 to 2020.

Table 3.4 Statement of Financial Position – Unrealised Gain on Exchange (LBP'm)

	2014	2015	2016	2017	2018	2019	2020
Unrealized gain on exchange - Article 115	8,146,281	6,400,950	7,707,250	9,725,723	9,464,174	12,835,396	17,382,854

3.3.17 Movements in the balance are summarised in the Table 3.5 below.

Table 3.5 Breakdown of movements in Unrealised Gain on Exchange (LBP'm)

	2014	2015	2016	2017	2018	2019	2020
Gold at market	16,508,663	14,846,181	16,138,435	18,033,092	17,743,082	21,012,714	26,116,388
Cost of Gold	(1,244)	(1,244)	(1,244)	(1,244)	(1,244)	(1,244)	(1,244)
Net depreciation on translation of asset and liabilities in foreign currency (1996)	(68,486)	(68,486)	(68,486)	(68,486)	(68,486)	(68,486)	(68,486)
Net depreciation on translation of asset and liabilities in foreign currency (1997)	(126,851)	(126,851)	(126,851)	(126,851)	(126,851)	(126,851)	(126,851)
Net appreciation on translation of assets and liabilities in foreign currencies (prior & current years)	227,393	144,545	158,590	282,406	310,867	412,457	(143,759)
Balance	16,539,474	14,794,144	16,100,444	18,118,916	17,857,368	21,228,589	25,776,048
Transfer in 2002 of prior years change in currency fair value to unrealized gain on gold	(156,524)	(156,524)	(156,524)	(156,524)	(156,524)	(156,524)	(156,524)
Transfer in 2004 of prior years change in currency fair value to unrealized gain on gold	87,866	87,866	87,866	87,866	87,866	87,866	87,866
Deferred capital loss on T bill swaps and discounts	(1,458,373)	(1,458,373)	(1,458,373)	(1,458,373)	(1,458,373)	(1,458,373)	(1,458,373)

¹⁹ Note 2.2B states: “Gold is valued at the published market price in an active international market at the date of the Bank’s official closing date. Unrealized gain or loss is deferred and recognized periodically under “Unrealized gain on exchange - Article 115” account based on fluctuations in the market value of gold in accordance with Article 115 of the Lebanese Money and Credit Law”

	2014	2015	2016	2017	2018	2019	2020
Realized loss on sales of Eurobonds	(34,766)	(34,766)	(34,766)	(34,766)	(34,766)	(34,766)	(34,766)
Destroyed bank notes	164,946	164,946	164,946	164,946	164,946	164,946	164,946
Allocation to provision for contingencies	(1,399,269)	(1,399,269)	(1,399,269)	(1,399,269)	(1,399,269)	(1,399,269)	(1,399,269)
Distribution to MOF	(5,597,074)	(5,597,074)	(5,597,074)	(5,597,074)	(5,597,074)	(5,597,074)	(5,597,074)
Total	8,146,281	6,400,951	7,707,250	9,725,723	9,464,174	12,835,396	17,382,854

3.3.18 Movements are built up as follows:

- i) Compute unrealised gain on revaluation of the cost of BdL's gold to the market price, with the market price of gold valued at the published market price in an active international market.²⁰
- ii) Subtract / add "net depreciation / appreciation on translation of asset and liability in foreign currency".
- iii) Subtract / add "transfer in 2002 and 2004 of prior year changes in currency fair value to unrealized gain on gold", an amount that has not changed in the period 2014 to 2018.
- iv) Subtract "deferred capital loss on T bill swaps and discounts" and "realized loss on sales of Eurobonds", an amount that has not changed in the period 2014 to 2018.
- v) Add "destroyed bank notes", an amount that has not changed in the period 2014 to 2018.

3.3.19 The above results in a liability balance on the financial statements which has then been partly distributed to the MoF and allocated to a provision for contingencies account.

Article 115

3.3.20 Article 115 of the Code of Money and Credit Law²¹ covers the provisions under which revaluations of gold and foreign currencies are booked to a special account "in the name of the Treasury":

²⁰ Audited financial statements – Significant Accounting Policies - B. Gold.

²¹ Exhibit 02 – Lebanese Money and Credit Law



“115. A special account shall be opened in the name of the Treasury for the following entries:

- (a) The differences between the countervalue, at the legal parity rate, of the Bank’s gold and currency holdings, and the actual purchasing or sale value of these holdings;*
- (b) The profit or loss entailed by the Bank’s gold and currency holdings from the alteration of the legal parity rate of the Lebanese Pound or of a foreign currency;*
- (c) The sums referred to in articles 55 and 64.”*

3.3.21 Articles 55 and 64 of the Money and Credit Law, and other related articles, refer to the mechanism by which the value of notes withdrawn from circulation that have passed the time limit for exchange is transferred to the same “special account”. Relevant articles state:

“51. The Bank may decide the withdrawal from circulation of one or several types of notes to be exchanged for new types of notes.

52. The notice bringing this decision to the public attention must state the time limit during which the notes subject to exchange may be presented to any of the Bank’s counters.

At the expiry of the time-limit, the Bank shall pay over the notes under exchange only at its central counter in Beirut.

53. Three years after the expiry of the time-limit referred to in the first sub-paragraph of the preceding article, the amount of the notes under exchange and not yet presented for exchange shall be carried into a provision account from which refund of the notes will be subsequently made.

...

55: Seven years after the expiry of the time-limit set by article 53, the right to exchange shall be invalidated and the balance of the provision account shall be transferred to the special account referred to in Article 115. (Emphasis added)

...