64: The <u>countervalue of unexchanged subdivision notes or coins shall be posted to a special account provided for by Article 115</u>." (Emphasis added)

<u>"Deferred capital loss on T bill swaps and discounts" and "realized loss on sales of Euro Bonds"</u>

3.3.22 Articles 115, 55 and 64 appear to account for the creation of the Unrealised gain on exchange – Article 115 account and for the movements described in i, ii, iii, and v in paragraph 3.3.18 above.

3.3.23 Whereas, item iv "deferred capital loss on treasury bill swaps and discounts" and "realized loss on sales of Euro Bonds", which are netted against the unrealised gains, are not. The notes to the audited financial statements state that these remain "*subject to the appropriate authorities' approval*".[22] They also state:

"The deferral of losses was sustained by the Bank as a result of the monetary policies applied to stabilize the Lebanese Pound exchange rate and to contribute to the Government's efforts to restructure its debt. According to the Bank's management, this is carried out according to the provisions of Article 115 and 116 of the Money and Credit Law and in line with the interpretation of a legal opinion issued in 1985 by the Legislative and Consultancy Committee of the Ministry of Justice."

3.3.24 As noted above, Article 115 does not appear to support these movements. Article 116 of the Money and Credit law states:

"The debit balance of the special account referred to in the preceding article [Article 115] shall not be subject to payment nor interest-bearing, so long as it does not exceed the 25% of the countervalue, at the legal parity rate, of the Bank's gold and currency holdings.

Sums in excess of the 25% limit shall be covered by the State, either in cash, or by interest-bearing Treasury Bonds, according to conditions to be laid down in agreement with the Bank.

If the special account shows a creditor balance, it shall be used for the advance redemption of the Treasury Bonds issued by virtue of Decree No. 581 of 8 December 1949, amended by

[22] See the note in relation to 'Unrealized Gain on Exchange – Article 115'. The financial statements do not define "appropriate authorities".

Decree No. 3453 of 21 November 1950, and for the redemption of Treasury Bonds which will have been issued by virtue of the preceding sub-paragraph of the present article.

In case this special account shows a creditor balance following the amortizations referred to in the preceding subsection, it shall be necessary to retain, compulsorily, the equivalent of twenty per cent thereof in the bank as treasury deposit, the remaining eighty per cent to be switched to Treasury account."

Distribution of unrealised gains

3.3.25 In the opinion of the Bank's management, the distribution of up to 80% of the balance of the "unrealized gain on exchange – Article 115" account to the MoF and the allocation of the remaining 20% to provisions for contingencies, is derived from the provisions of Articles 115 and 116 of the Code of Money and Credit Law[23] and in line with the interpretation of a legal opinion issued in 1985 by the Legislative and Consultancy Committee of the Ministry of Justice.

3.3.26 Distributions to the MoF and to the provisions for contingencies account have been made in 4 tranches, pursuant to the approval of the Central Account, as described in the notes to the accounts:[24]

Table 3.6 Summary of distributions to MoF account and transfer to provisions for contingencies

	MoF (LBP'm)	Provisions for contingencies (LBP'm)
2002	2,700,000	200,000
2003		475,000
2004	517,000	129,000
2007	2,380,000	595,000
Total	**5,597,000**	**1,399,000**

3.3.27 These transactions are not reflected in the income statement for the years ended December 31, 2002, 2003, 2004 and 2007 nor in the movement of general reserves within the statement of changes in equity.

[23] Exhibit 02 – Code of Money and Credit Law.

[24] See the note in relation to 'Unrealized Gain on Exchange – Article 115'.

Provisions and deferred costs

3.3.28 This balance included provisions for contingencies and deferred interest expense and other finance costs. There was limited movement in the provision for contingencies balance in the period 2014 to 2020, with the majority arising before our Review Period.

3.3.29 The deferred interest expense and other finance costs balance is a contra-liability within the liabilities section of BdL's balance sheet. The balance was used by BdL to record transactions related to its financial engineering program, including deferred interest on time deposits and CD, the unamortized premium from the redemption of CDs, and the commissions charged to the financial engineering counterparties.

3.3.30 The "Deferred interest expense and other finance costs" note to BdL's balance sheet further breaks down the balance as follows:

Table 3.7 Deferred interest expense and other finance costs breakdown (LBP'm)

	2014	2015	2016	2017	2018	2019	2020
Unamortized premium on redemption of LBP CDs	-	-	12,712,363	14,492,790	20,766,435	18,988,715	17,114,952
Deferred interest expense and cost of CDs	1,320,257	1,480,176	(2,356,773)	1,993,220	(4,978,622)	(3,931,003)	(5,954,231)
Total	**1,320,257**	**1,480,176**	**10,355,589**	**16,486,011**	**15,787,813**	**15,057,712**	**23,069,183**

Unamortized premium on LBP CDs - Summary of balances and movements

3.3.31 The unamortized premium on redemption of Lebanese Pounds CDs was first recorded in the financial year ending 31 December 2016 and the note on deferred interest expense and other finance costs in BdL's financial statements stated:

"During 2016, as part of its monetary policy, the Bank entered into several financial engineering transactions, whereby, the Bank redeemed certificates of deposit with a nominal value of LBP12,976billion at a premium of LBP12,980billion (nil in 2015). The unamortized premium amounted to 12,712billion as of December 31, 2016."

3.3.32 The more detailed breakdown in the audited financial statements is as follows:

Table 3.8 Unamortized premium on Lebanese Pound CDs

LBP'000	2015	2016	2017	2018
Balance - Beginning of the year	-	-	12,712,362,594	14,492,790,306
Premium from redeemed CDs	-	12,980,048,189	2,478,274,553	7,956,463,109

LBP'000	2015	2016	2017	2018
Amortization of Premium during the year	-	(267,685,595)	(1,022,509,514)	(1,654,521,155)
Other transactions	-	-	324,662,673	(28,297,379)
Balance - End of the year	-	**12,712,362,594**	**14,492,790,306**	**20,766,434,881**

3.3.33 These amounts have been identified as the net amount of the premiums and discounts on CDs issued by BdL.

3.3.34 Whilst these are represented in the audited financial statements as part of the deferred interest expense and other finance costs balance, the trial balance for BdL includes the transactions that comprise the above balances under the CD balance. However BdL's accounting function makes a manual adjustment to transfer the total balance from the CD liability balance and to the deferred interest expense and other finance costs balance.

3.3.35 The impact of this adjustment is to increase the CD liability balance and to create a contra-liability on the balance sheet of BdL under deferred interest expense.

Deferred interest expense and costs of CDs - Summary of balances and movements

3.3.36 In relation to "deferred interest expense and costs of certificates of deposit" BdL state the following in their financial statements:[25]

"From 2003, the Bank has deferred interest expense and the loss from discounting certificates of deposit over the period from deferral date to the end of the year 2017 extended during 2008 to the year 2037 and during 2015 to the year 2050. Furthermore, effective 2004, the bank has been deferring interest expense on time deposits taken from local banks. The deferral of costs is sustained by the Bank as a result of the monetary policies applied to stabilize the Lebanese Pound exchange rate and to contribute to the Government's efforts to restructure its debt, as derived from its interpretation of the provisions of Articles 115 and 116 of the Money and Credit Law and in line with the interpretation of a legal opinion issued in 1985 by the Legislative and Consultancy Committee of the Ministry of Justice."

3.3.37 The movement in this balance is as follows:

[25] For example, see the 2016 and 2018 audited financial statements.

Table 3.9 Movements in deferred interest balances (LBP'm)

	2014	2015	2016	2017	2018
Balance - Beginning of the year	**882,075**	**1,320,257**	**1,480,176**	**(2,356,773)**	**1,993,220**
Interest expense deferred during the year - CDs	2,769,270	3,118,980	3,871,115	4,411,360	5,291,437
Interest expense deferred during the year - time deposits	2,167,397	2,546,162	2,781,815	4,688,860	8,711,954
Amount amortized during the year	(57,402)	(42,291)	(48,772)	(60,401)	(96,664)
Amount transferred from/to seigniorage liability on T- bills (a)	(3,262,082)	3,262,082	-	(701,946)	-
Amount transferred to seigniorage liability on financial stability (a)	-	-	-	-	(10,270,279)
Amount offset against seigniorage liability on currency	(199,000)	(6,447,181)	-	-	-
Adjustments charged against income of the year (a)	(980,000)	(1,224,527)	(1,250,034)	(1,430,317)	(2,382,980)
Surplus from financial engineering strategy (a)	-	(1,053,307)	(9,727,403)	(2,557,562)	(8,071,861)
Other	-	-	536,330	-	(153,449)
Balance - End of the year	**1,320,257**	**1,480,176**	**(2,356,773)**	**1,993,220**	**(4,978,622)**

3.3.38 The 2018 notes to the financial statements further state in relation to items demarcated with an "(a)":

"The mechanism of allocating amounts from the deferred interest expense and other finance costs is determined in accordance with the Central Council decision number 48/12/18 dated April 11, 2018, which stipulates that such allocation is determined by the Governor based on the suggestion of the Organization and Development Department."

3.3.39 As shown in Table 3.9 above, there are entries described as amounts transferred to seigniorage liability on currency, treasury bills and financial stability.

3.3.40 The financial statements indicate that these balances are recorded as a credit to deferred interest expense and other finance costs and a debit to the seigniorage liability ledger. Without the seigniorage balances against which to offset the deferred interest costs arising out of the financial engineering transactions would need to have been recorded through the reserves of BdL.

3.3.41 As discussed in the financial engineering section of this report, the deferred interest costs on CDs and time deposits are considered by BdL to create a deferred interest pool, that is offset against a combination of the following and specified annually by the Governor:

i) The maximum amount of net income that allows USD 40m to be distributed to the MoF;

ii) Commission earned from financial engineering; and

iii) Seigniorage.

3.3.42 The financial statements indicate that the creation and offset of the pool are recorded as a credit to deferred interest expense and other finance costs and a debit to the seigniorage liability ledger, the P&L or commissions from financial engineering. Without the offsetting, the deferred interest costs arising out of the financial engineering transactions would need to have been recorded through the reserves of BdL.

3.3.43 In the Review Period, the pool comprised the following:

Table 3.10 Deferred interest and cost of the CDs

LBP'000	2015	2016	2017	2018	2019	2020
Interest expense deferred - CDs:						
CD_EUR	0	0	0	160,304	2,822,167	3,097,074
CD_LBP	2,424,193,357	2,853,857,440	2,621,321,823	3,579,534,518	3,732,978,321	2,949,010,732
CD_USD	694,786,626	1,017,257,461	1,790,038,344	1,711,741,754	1,461,085,278	1,594,976,568
Interest expense deferred - TDs:						
TD_EUR	218,862,385	213,927,082	249,913,699	235,616,073	237,631,404	246,061,521
TD_LBP	865,669,810	967,871,683	2,435,962,975	5,399,854,386	88,446,053,501	8,133,524,622
TD_USD	1,466,686,233	1,601,383,350	1,997,109,298	3,078,674,590	4,155,113,909	4,921,044,133
FX Interventions	0	0	0	0	0	10,116,034,476
TB disposal losses / interest	0	0	0	0	0	3,118,994,836
Fiduciary Contracts Interest						26,327
Total	**5,670,198,411**	**6,654,297,016**	**9,094,346,139**	**14,005,581,626**	**98,035,684,581**	**31,082,770,289**
FX adjustments	(5,056,250)	(1,367,348)	5,873,594	(2,190,750)	(1,050,398)	4,771,016
Total per financial statements	**5,665,142,161**	**6,652,929,668**	**9,100,219,733**	**14,003,390,877**	**98,034,634,184**	**31,087,541,305**

3.3.44 The pool comprises:

i) Interest and disposal revenues on CDs;

ii) Interest on time deposits;

iii) Interest on Fiduciary Contracts (2020 only);

iv) Costs of foreign exchange intervention (2020 only);

v) treasury bill disposal losses and interest (2020 only).

3.3.45 The following were used to offset the above:

i) Excess income above the amount needed to ensure a USD 40m distribution to the MoF;

ii) Amortised interest expense in the period;

iii) Commissions earned from the financial engineering transactions;

iv) Seigniorage from currency, Treasury bond swaps and financial stability; and

v) Others, such as losses on treasury bills.

3.3.46 These offsets to the pool are summarised below:

Table 3.11 Pool offset

LBP'000	2015	2016	2017	2018	2019	2020
Income	(1,224,526,994)	(1,250,034,037)	(1,430,316,943)	(2,382,980,265)	(3,438,808,506)	(4,951,440,382)
Amortised expenses	(42,290,747)	(48,771,821)	(60,400,614)	(96,663,722)	(133,576,046)	(106,027,949)
Commissions	(1,053,306,505)	(9,727,403,419)	(2,557,562,454)	(8,071,860,749)	0	3,000,000,000
Seigniorage - Currency	(6,447,180,805)	0	0	0	0	(19,099,967,696)
Seigniorage - financial stability	0	0	0	(10,270,278,814)	(13,754,530,628)	0
Seigniorage - TB swaps	3,262,082,272	0	(701,946,187)	0	0	0
Other	0	536,330,190	0	(153,449,239)	(60,100,699)	(71,171,609)
Total	**(5,505,222,779)**	**(10,489,879,088)**	**(4,750,226,198)**	**(20,975,232,790)**	**(17,387,015,879)**	**(21,228,607,636)**

Equity

3.3.47 The balance includes capital; grants (restricted); revaluation reserve; other reserves; income after appropriations; and general reserves. The total equity balance increased from LBP 1.6tn in 2014 to LBP 1.8tn in 2019, with a decline to LBP 1.4tn in 2020.

3.3.48 Set out below are BdL's balance sheet and P&L in LBP and USD.

Table 3.12 BdL Balance Sheet 2014 to 2020 (LBP)

	2014 LBP'm	2015 LBP'm	2016 LBP'm	2017 LBP'm	2018 LBP'm	2019 LBP'm	2020 LBP'm	Movement %
Assets								
Foreign assets in foreign currency								
Cash at banks	8,878,482	8,612,323	9,380,900	5,992,954	8,713,438	17,389,272	13,336,279	50%
Reverse repurchase agreement	361,197	992,387	3,211,427	3,806,287	958,469	-		-100%
Interest bearing time deposits with banks	39,597,128	36,573,375	38,686,509	43,245,547	36,195,588	18,151,962	12,571,460	-68%
Foreign bonds	6,347,145	7,483,636	6,135,472	3,696,799	2,368,082	1,816,211	1,816,211	-71%
Certificates of deposit	-	243,073	1,975,979	1,427,707	1,618,344	188,151		
	55,183,952	53,904,794	59,390,287	58,169,294	49,853,921	37,545,596	27,723,950	-50%
Local assets in foreign currency								
Asset-backed and credit linked notes	602,036	659,390	623,508	1,213,929	1,037,475	863,778	859,124	43%
Government eurobonds	1,292,283	1,351,740	1,351,241	2,976,792	5,760,551	8,768,757	5,326,067	312%
	1,894,319	2,011,130	1,974,749	4,190,721	6,798,026	9,632,535	6,185,191	227%
Securities								
Lebanese treasury bills	19,590,456	25,580,214	37,350,345	42,482,543	44,843,665	55,626,627	58,943,272	201%
Funds							265,320	new
Excess in end-of-service indemnity investment fund	43,731	65,327	47,656	24,253	62,763	64,523	82,494	89%
	19,634,187	25,645,541	37,398,001	42,506,796	44,906,428	55,691,149	59,291,086	202%
Loans								
Loans and advances, less provision for credit losses	389,911	386,827	411,502	421,640	420,260	387,227	376,993	-3%
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	63%
Soft loans to banks and financial institutions	614,711	614,733	658,907	658,681	659,005	658,931	414,948	-32%
Loans under leverage agreements	-	-	-	9,971,622	41,936,785	11,994,420	11,907,619	new
	6,418,293	7,564,488	9,528,114	19,937,750	53,098,803	28,660,384	21,539,896	236%
Investments								
Investments in subsidiaries	1,123,031	1,246,646	1,246,646	1,279,785	1,279,785	1,279,785	974,159	-13%
Investment in an associate	344,912	344,912	344,912	344,912	344,912	344,912	344,912	0%
Other investments	11,306	11,306	11,306	11,306	11,306	15,554	15,554	38%
	1,479,249	1,602,864	1,602,864	1,636,003	1,636,003	1,640,251	1,334,625	-10%
Gold, at market value	16,508,663	14,846,181	16,138,435	18,033,092	17,743,082	21,012,714	26,116,388	58%
Fixed and other assets								
Real estate acquired in satisfaction of loans to problematic banks	241,923	239,955	233,461	227,185	244,206	285,601	281,258	16%
Properties and equipment	99,932	90,799	93,163	133,916	103,462	107,870	113,892	14%
Accrued income and other assets	49,931	56,046	72,304	65,939	66,901	100,748	90,136	81%
	391,786	386,800	398,928	427,040	414,569	494,220	485,286	24%
Assets from exchange operations of financial instruments and seigniorage	26,011,349	29,196,448	29,196,448	29,898,394	40,168,673	53,923,203	73,023,170	181%
Total assets	127,521,798	135,158,246	155,627,826	174,799,090	214,619,505	208,600,053	215,699,592	69%
Liabilities								
Bank notes in circulation	4,177,558	4,624,889	5,199,346	5,572,723	5,766,692	10,467,515	30,820,278	638%
Coins in circulation	76,107	81,542	85,581	89,760	94,073	96,025	97,444	28%
	4,253,665	4,706,431	5,284,927	5,662,483	5,860,765	10,563,541	30,917,722	627%
Banks and financial institutions								
Current and demand deposits	6,085,081	7,007,511	7,526,361	10,165,082	7,001,372	7,718,130	20,234,254	233%
Term deposits	59,529,444	61,057,177	81,041,945	103,583,071	121,351,205	138,405,298	125,581,246	111%
Blocked deposits	115,413	250,539	33,491	51,512	30,285	36,235	-	-100%
Certificates of deposit	36,206,693	43,487,407	50,448,485	45,797,615	42,864,649	39,528,019	31,704,549	-12%
Term deposits under leverage agreement		-	-	1,248,418	27,439,699	-	-	
Certificates of deposit under leverage agreement		-	-	-	2,638,000	-	-	
Other	13,367	11,732	9,916	8,602	8,367	14,246	14,095	5%
	101,949,998	111,814,366	139,060,198	160,854,300	201,333,577	185,701,929	177,534,144	74%
Public sector								
Demand deposits	7,461,160	7,829,705	7,728,230	8,254,806	7,118,520	7,938,507	6,469,188	-13%
Time deposits-margin accounts	1,621,039	276,775	535,484	595,253	444,191	257,645	353,653	-78%
Blocked deposits	37,882	47,071	48,102	41,918	15,427	6,631	15,036	-60%
Other	52,567	45,950	51,783	49,002	38,134	61,151	58,333	11%
	9,172,648	8,199,501	8,363,599	8,940,979	7,616,272	8,263,933	6,896,210	-25%
Accrued expenses and other liabilities	148,897	180,274	141,253	564,265	554,233	628,469	690,938	364%
Total liabiliities	115,525,208	124,900,572	152,849,977	176,022,027	215,364,847	205,157,871	216,039,014	87%
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	113%
Provision for contingencies	3,615,669	3,697,074	3,772,449	3,836,517	3,864,406	3,931,003	3,975,727	10%
Deferred interest expense and other finance costs	(1,320,257)	(1,480,176)	(10,355,589)	(16,486,012)	(15,787,813)	(15,123,290)	(23,069,183)	1647%
Total provisions and deferred costs	2,295,412	2,216,898	(6,583,140)	(12,649,495)	(11,923,407)	(11,192,287)	(19,093,456)	-932%
Equity								
Capital	15	15	15	15	15	15	15	0%
Grants (restricted)	150,750	150,750	150,750	150,750	150,750	150,750	150,750	0%
Revaluation reserve	896,016	1,019,631	1,019,631	1,052,770	1,052,770	1,052,770	747,145	-17%
Other reserves	86,528	32,679	31,782	30,877	28,921	33,040	37,179	-57%
Income after appropriations	76,429	76,304	75,853	75,531	75,448	141,424	-	-100%
General reserve	345,162	360,447	375,708	390,879	405,985	421,075	436,093	26%
Total equity	1,554,900	1,639,826	1,653,739	1,700,822	1,713,889	1,799,073	1,371,182	-12%
Total liabiliites and equity	127,521,801	135,158,246	155,627,826	174,799,077	214,619,503	208,600,053	215,699,594	69%

Table 3.13 BDL Balance Sheet 2014 to 2020 (USD)

	2014 USD'm	2015 USD'm	2016 USD'm	2017 USD'm	2018 USD'm	2019 USD'm	2020 USD'm	Movement %
Assets								
Foreign assets in foreign currency								
Cash at banks	5,890	5,713	6,223	3,975	5,780	11,535	8,847	50%
Reverse repurchase agreement	240	658	2,130	2,525	636	-	-	-100%
Interest bearing time deposits with banks	26,267	24,261	25,663	28,687	24,010	12,041	8,339	-68%
Foreign bonds	4,210	4,964	4,070	2,452	1,571	1,205	1,205	-71%
Certificates of deposit	-	161	1,311	947	1,074	125	-	
	36,606	35,758	39,397	38,587	33,071	24,906	18,391	-50%
Local assets in foreign currency								
Asset-backed and credit linked notes	399	437	414	805	688	573	570	43%
Government eurobonds	857	897	896	1,975	3,821	5,817	3,533	312%
	1,257	1,334	1,310	2,780	4,509	6,390	4,103	227%
Securities								
Lebanese treasury bills	12,995	16,969	24,776	28,181	29,747	36,900	39,100	201%
Funds	-	-	-	-	-	-	176	new
Excess in end-of-service indemnity investment fund	29	43	32	16	42	43	55	89%
	13,024	17,012	24,808	28,197	29,789	36,943	39,331	202%
Loans								
Loans and advances, less provision for credit losses	259	257	273	280	279	257	250	-3%
Loans to banks and financial institutions	3,591	4,354	5,610	5,894	6,688	10,361	5,864	63%
Soft loans to banks and financial institutions	408	408	437	437	437	437	275	-32%
Loans under leverage agreements	-	-	-	6,615	27,819	7,956	7,899	new
	4,258	5,018	6,320	13,226	35,223	19,012	14,288	236%
Investments								
Investments in subsidiaries	745	827	827	849	849	849	646	-13%
Investment in an associate	229	229	229	229	229	229	229	0%
Other investments	7	7	7	7	7	10	10	38%
	981	1,063	1,063	1,085	1,085	1,088	885	-10%
Gold, at market value	10,951	9,848	10,705	11,962	11,770	13,939	17,324	58%
Fixed and other assets								
Real estate acquired in satisfaction of loans to problematic banks	160	159	155	151	162	189	187	16%
Properties and equipment	66	60	62	89	69	72	76	14%
Accrued income and other assets	33	37	48	44	44	67	60	81%
	260	257	265	283	275	328	322	24%
Assets from exchange operations of financial instruments and seigniorage	17,255	19,367	19,367	19,833	26,646	35,770	48,440	181%
Total assets	84,592	89,657	103,236	115,953	142,368	138,375	143,084	69%
Liabilities								
Bank notes in circulation	2,771	3,068	3,449	3,697	3,825	6,944	20,445	638%
Coins in circulation	50	54	57	60	62	64	65	28%
	2,822	3,122	3,506	3,756	3,888	7,007	20,509	627%
Banks and financial institutions								
Current and demand deposits	4,037	4,648	4,993	6,743	4,644	5,120	13,422	233%
Term deposits	39,489	40,502	53,759	68,712	80,498	91,811	83,304	111%
Blocked deposits	77	166	22	34	20	24	-	-100%
Certificates of deposit	24,018	28,847	33,465	30,380	28,434	26,221	21,031	-12%
Term deposits under leverage agreement	-	-	-	828	18,202	-	-	
Certificates of deposit under leverage agreement	-	-	-	-	1,750	-	-	
Other	9	8	7	6	6	9	9	5%
	67,629	74,172	92,246	106,703	133,555	123,185	117,767	74%
Public sector								
Demand deposits	4,949	5,194	5,127	5,476	4,722	5,266	4,291	-13%
Time deposits-margin accounts	1,075	184	355	395	295	171	235	-78%
Blocked deposits	25	31	32	28	10	4	10	-60%
Other	35	30	34	33	25	41	39	11%
	6,085	5,439	5,548	5,931	5,052	5,482	4,575	-25%
Accrued expenses and other liabilities	99	120	94	374	368	417	458	364%
Total liabiliities	76,634	82,853	101,393	116,764	142,862	136,091	143,309	87%
Unrealized gain on exchange - Article 115	5,404	4,246	5,113	6,452	6,278	8,514	11,531	113%
Provision for contingencies	2,398	2,452	2,502	2,545	2,563	2,608	2,637	10%
Deferred interest expense and other finance costs	(876)	(982)	(6,869)	(10,936)	(10,473)	(10,032)	(15,303)	1647%
	6,926	5,717	746	(1,939)	(1,631)	1,090	(1,135)	-116%
Equity								
Capital	0	0	0	0	0	0	0	0%
Grants (restricted)	100	100	100	100	100	100	100	0%
Revaluation reserve	594	676	676	698	698	698	496	-17%
Other reserves	57	22	21	20	19	22	25	-57%
Income after appropriations	51	51	50	50	50	94	-	-100%
General reserve	229	239	249	259	269	279	289	26%
Total equity	1,031	1,088	1,097	1,128	1,137	1,193	910	-12%
Total liabilites and equity	84,592	89,657	103,236	115,953	142,368	138,375	143,084	69%

Table 3.14 BdL P&L 2014 to 2020 (LBP)

	2014 LBP'm	2015 LBP'm	2016 LBP'm	2017 LBP'm	2018 LBP'm	2019 LBP'm	2020 LBP'm	Change %
Interest income								
Time and overnight deposits with banks	143,264	165,656	322,599	559,494	872,086	762,404	96,604	-33%
Loans	93,371	118,745	164,399	195,062	686,850	1,529,884	2,601,967	2687%
Tax on loans							(113,391)	
Reallocation to interest subsidy - retail loans granted by banks					(66,687)	(72,686)	(64,017)	
Reverse repurchase agreements	527	1,692	11,950	27,999	34,647	98,875	17,165	3157%
Treasury bills, securities and certificates of deposit	1,181,131	1,342,597	1,363,894	1,286,877	1,752,881	1,962,227	3,012,575	155%
Other	7,091	7,448	7,978	8,815	8,641	9,044	14,666	107%
	1,425,384	1,636,138	1,870,820	2,078,247	3,288,418	4,289,748	5,565,569	290%
Interest expense								
Banks and financial institutions	1,119,542	1,344,248	1,520,130	1,715,897	2,874,645	(3,860,334)	5,279,513	372%
Public sector	4,038	4,188	6,748	-	14		-	-100%
Other	1,031	48	43	16		(11)	11	-99%
	1,124,611	1,348,484	1,526,921	1,715,913	2,874,659	(3,860,345)	5,279,524	369%
Net interest income	300,773	287,654	343,899	362,334	413,759	429,403	286,045	-5%
Gain on sale of Lebanese treasury bills, Government bonds and other securities (net)	8,602	574	(43,215)	33,205	(93,444)	(171,405)	-	-100%
Gain on sale of real estate	5,191	5,717	5,043	5,200	16,110	50	10,146	95%
Commissions (net)	13,194	15,762	14,590	15,813	15,302	25,411	16,553	25%
Other income	6,808	13,555	5,663	6,985	3,047	3,027	6,510	-4%
Dividend income	82,773	82,773	82,773	82,773	88,690	82,773	500	-99%
Write-back of accrued expenses	15,276	2,850	8,538	6,906	3,789	4,907	8,931	-42%
Prior year adjustments	605	1,010	1,423	(33,758)	732	10,207	(53,256)	-8903%
Net financial income	433,222	409,895	418,714	479,458	447,985	384,373	275,429	-36%
Other expenses								
Salaries and related charges	151,904	156,609	165,659	164,900	167,199	155,634	156,698	3%
End-of-service indemnity, net of recoveries	4,134	5,592	5,540	7,047	4,834	(1,284)	1,461	-65%
Salaries and related charges - early retiremnet of employees	16,874	41,038	42,816	113,824	70,222	20,781	2,028	-88%
Depreciation	1,072	-	-	-	-		-	-100%
General operating expenses, net of recoveries	44,200	41,077	38,744	43,148	49,204	51,129	63,526	44%
Write-down of properties and equipment	50,019	60,512	14,727	10,939	53,190	10,688	1,744	-97%
	268,203	304,828	267,486	339,858	344,649	236,949	225,457	-16%
Income for the year	165,019	105,067	151,228	139,600	103,336	147,424	49,972	-70%
Add/(less)								
Write-back from/(appropriation to) other reserves	(13,216)	52,639	-	-	-	(6,000)	(6,000)	-55%
Appropriation to provision for contingencies	(75,375)	(81,405)	(73,375)	(64,069)	(27,889)	(66,330)	(43,972)	-42%
Income after appropriations	76,428	76,301	77,853	75,531	75,447	75,094	-	-100%
Income for the year, before appropriation	165,019	105,067	151,228	139,600	103,336		49,972	-70%
Other comprehensive income								
Items that will not be reclassified subsequently to profit or loss:								
Change in fair value of investment in an associate	(56,788)	-	-	-	-		-	
Change in fair value of investment in a subsidiary	-	123,615	-	33,139	-		(305,625)	
Total other comprehensive income/(loss) for the year	(56,788)	123,615	-	33,139	-		(305,625)	
Total comprehensive income for the year	108,231	228,682	151,228	172,739	103,336		(255,653)	

Table 3.15 BdL P&L 2014 to 2020 (USD)

	2014 USD'm	2015 USD'm	2016 USD'm	2017 USD'm	2018 USD'm	2019 USD'm	2020 USD'm	Change %
Interest income								
Time and overnight deposits with banks	95	110	214	371	578	506	64	-33%
Loans	62	79	109	129	456	1,015	1,726	2687%
Tax on loans	-	-	-	-	-	-	(75)	
Reallocation to interest subsidy - retail loans granted by banks	-	-	-	-	(44)	(48)	(42)	
Reverse repurchase agreements	0	1	8	19	23	66	11	3157%
Treasury bills, securities and certificates of deposit	784	891	905	854	1,163	1,302	1,998	155%
Other	5	5	5	6	6	6	10	107%
	946	1,085	1,241	1,379	2,181	2,846	3,692	290%
Interest expense								
Banks and financial institutions	743	892	1,008	1,138	1,907	(2,561)	3,502	372%
Public sector	3	3	4	-	0	-	-	-100%
Other	1	0	0	0	-	(0)	0	-99%
	746	895	1,013	1,138	1,907	(2,561)	3,502	369%
Net interest income	200	191	228	240	274	285	190	-5%
Gain on sale of Lebanese treasury bills, Government bonds and other securities (net)	6	0	(29)	22	(62)	(114)	-	-100%
Gain on sale of real estate	3	4	3	3	11	0	7	95%
Commissions (net)	9	10	10	10	10	17	11	25%
Other income	5	9	4	5	2	2	4	-4%
Dividend income	55	55	55	55	59	55	0	-99%
Write-back of accrued expenses	10	2	6	5	3	3	6	-42%
Prior year adjustments	0	1	1	(22)	0	7	(35)	-8903%
Net financial income	287	272	278	318	297	255	183	-36%
Other expenses								
Salaries and related charges	101	104	110	109	111	103	104	3%
End-of-service indemnity, net of recoveries	3	4	4	5	3	(1)	1	-65%
Salaries and related charges - early retiremnet of employees	11	27	28	76	47	14	1	-88%
Depreciation	1	-	-	-	-	-	-	-100%
General operating expenses, net of recoveries	29	27	26	29	33	34	42	44%
Write-down of properties and equipment	33	40	10	7	35	7	1	-97%
	178	202	177	225	229	157	150	-16%
Income for the year	109	70	100	93	69	98	33	-70%
Add/(less)								
Write-back from/(appropriation to) other reserves	(9)	35	-	-	-	(4)	(4)	-55%
Appropriation to provision for contingencies	(50)	(54)	(49)	(43)	(19)	(44)	(29)	-42%
Income after appropriations	51	51	52	50	50	50	(0)	-100%
Income for the year, before appropriation	109	70	100	93	69		33	-70%
Other comprehensive income								
Items that will not be reclassified subsequently to profit or loss:								
Change in fair value of investment in an associate	(38)	-	-	-	-	-	-	
Change in fair value of investment in a subsidiary	-	82	-	22	-	-	(203)	
Total other comprehensive income/(loss) for the year	(38)	82	-	22	-		(203)	
Total comprehensive income for the year	72	152	100	115	69		(170)	

3.4 Audit opinions

3.4.1 The audit reports were signed as follows:

Table 3.16 Audit reports

Financial Year	Signature Date	Auditor 1	Auditor 2
31 December 2015	5 June 2017	Deloitte[26]	EY[27]
31 December 2016	20 July 2018	Deloitte	EY
31 December 2017	29 May 2019	Deloitte	EY
31 December 2018	30 June 2020	Deloitte	EY

3.4.2 In each of these years the auditors issued a qualified opinion of the financial statements, primarily related to the accounting for financial engineering in the financial statements. The qualification stated:

In our opinion, except for the effect of such adjustments, if any, as might have been determined to be necessary, had we been able to perform further auditing procedures as described in paragraphs (a) to (d) in the Basis for Qualified Opinion paragraph, and except for the effect of the matters discussed in paragraph 1 in the Basis for Qualified Opinion paragraph, the financial statements reflect the financial position of the Central Bank of Lebanon as of December 31, 2017, and its financial performance and its cash flows for the year then ended in accordance with the Bank's accounting policies as included in the Financial Accounting Manual for the Banque du Liban approved by the Bank's Central Council in its Decision Number 21/3/2016 dated January 27, 2016, as set forth in Note 2 to the accompanying financial statements.[28]

3.4.3 Whilst the auditors explain the impact of the financial engineering, they did not consider the accounting for the financial engineering to reflect the financial position and/or performance of BdL, in line with the accounting standards and policies approved by BdL's Central Council.

3.4.4 The auditors also note certain other limitations in their work that, had they been able to perform their auditing procedures, may have resulted in adjustments to the financial statements (items (a) to (d) in the 'Basis for Qualified Opinion' section of the auditors report). These limitations include:

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[26] Deloitte & Touche, Beirut, Lebanon

[27] Ernst & Young p.c.c., Beirut, Lebanon

[28] Extracted from the Audited Financial Statements dated 31 December 2017.

i) The auditors were unable to conduct a physical inventory of the gold held at BdL; and

ii) They did not receive direct confirmations of all balances outstanding in relation to cash at bank, reverse purchase agreements, interest bearing time deposits with banks, public sector credit balances, and bank and financial institution credit balances.

3.5 Profit distribution

3.5.1 BdL's audited financial statements recorded a profit in each of the years 2015 to 2018, as summarised below:

Table 3.17 Profit per financial statements[29]

	2015 LBP'm	2016 LBP'm	2017 LBP'm	2018 LBP'm	2019 LBP'm	2020 LBP'm
Profit[30] for the year	**105,067**	**151,228**	**139,600**	**103,336**	**147,424**	**49,972**
Write-back from/(appropriation to) other reserves	52,639	-	-	-	(6,000)	(6,000)
Appropriation to provision for contingencies	(81,405)	(73,375)	(64,069)	(27,889)	(66,330)	(43,972)
Profit after appropriations	**76,301**	**77,853**	**75,531**	**75,447**	**75,094**	**-**
Allocation to General Reserves (20%)	15,281	15,171	15,106	15,089	15,015	
Distribution to the Ministry of Finance (80%)	61,043	60,683	60,425	60,358	60,074	

3.5.2 Profits after appropriations are distributed 80% to the account of the MoF and 20% to General Reserves in accordance with the Accounting Manual and Article 113 of the Money and Credit Law, which states:

"Excess receipts over overheads, charges, amortization and diverse provisions, constitute the net profit.

Fifty per cent of this net profit shall be carried into an account "General Reserve Fund" of the Central Bank and the other 50% shall be paid into Treasury.

[29] 2015 to 2018 audited financial statements and the 2019 and 2020 income statement provided by BdL to A&M.

[30] In the Audited Financial statements the term 'Income' is used, rather than 'Profit'.

When the amount of the "General Reserve Fund" has reached fifty per cent of the Bank's capital, the net product shall be distributed in the proportion of 20% to this "Fund" and 80% to the Treasury.

If the outcome of a financial year has been adverse, the loss shall be covered by drawing on the "General Reserve Fund" and, if unavailable or short, by a compensatory payment from the Treasury."

3.5.3 As a result, circa LBP 61,000 million (USD 40 million) is distributed to the MoF in each year by debiting the Equity Profit & Loss account and crediting the MoF current account, with circa LBP 15,250 million is allocated to general reserves. Consequently, the balance on the general reserves increased over the period, as follows:

Table 3.18 General reserve – BdL statement of financial position

(LBP,m)	2014	2015	2016	2017	2018	2019	2020
General reserve	345,162	360,447	375,708	390,879	405,985	421,075	436,093

3.5.4 As discussed in detail above, BdL used a number of methods to manage its balance sheet and help ensure that it reported a profit in each financial year, resulting in the payment of a near constant amount to the Ministry of Finance.

3.6 Conclusion

3.6.1 BdL's balance sheet has grown considerably over the Review Period from LBP 127.5tn to LBP 215.7tn. Balances related to financial engineering, including seigniorage and deferred interest, have grown more quickly than other balances. In addition, BdL's ratio of foreign held to locally held assets fell from 1.9 to 0.3 from 2014 to 2020, as BdL's holdings of government debt increased.

4 BdL's Foreign Exchange Reserves

4.1 Introduction

4.1.1 A summary of BdL's foreign currency assets and liabilities composition from 2015 to 2020 is provided in Table 4.1 below together with detailed notes. Foreign currency assets are split into foreign assets held with overseas banks (held with investment-grade banks) and locally held assets (held with local banks and the Government of Lebanon). Liabilities predominantly include USD denominated deposits from Lebanese banks. Section 8 provides details of the banks with which loans and deposits are held.

4.2 Movement in BdL's foreign currency assets and liabilities

4.2.1 Over the Review Period, BdL moved from a foreign currency surplus of LBP USD 7.2bn at the end of 2015 to a shortage of USD 50.7bn at the end of 2020. This was driven by a 119% increase in foreign currency deposits, fuelled by the BdL's financial engineering programs, while foreign currency assets fell by 18%.

4.2.2 Furthermore, the quality of assets has declined. Foreign currency assets held overseas fell from USD 35.8bn in 2015 to USD 18.4bn in 2020, while locally held 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 Lebanese Eurobonds.

4.2.3 We consider it appropriate to consider the shortage in foreign currency reserves excluding the locally held foreign currency assets (primarily amounts owed to BdL from the state), as there is considerable uncertainty as to its recoverability.

4.2.4 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,[31] this equates to 230% of Lebanon's GDP. As Lebanon has operated a deficit in its net trade in goods and services for the past 20 years,[32] it is not apparent how BdL will obtain the dollars required to fill the shortage in foreign currency reserves.

[31] GDP per World Bank – see GDP (current US$) | Data (worldbank.org).

[32] Net trade in goods and services - Net trade in goods and services (BoP, current US$) - Lebanon | Data (worldbank.org)

4.2.5 On the 7 July 2023 BdL commented that during the last 10 months of 2020 covering the repercussions of the disorderly default and cabinet's subsidy policies and the port explosion, foreign currency deposits at BDL dropped by around USD 4.5 billion. BdL also provided a table that shows the split of foreign currency assets and liabilities from the year end of 2015 to 2020. We have compared the table provided by BdL with the numbers shown in the table below and found that they do not match. Given that BdL has not provided us with the underlying data supporting the table and that the table below is based on the information in the audited financial statements (2015-2018) unaudited (2019-2020) we have not taken into account the split provided by BdL.

Table 4.1 Composition of BdL's foreign currency assets and liabilities, 2015 to 2020[33]

	2015 LBP'm	2016 LBP'm	2017 LBP'm	2018 LBP'm	2019 LBP'm	2020 LBP'm
Foreign assets in foreign currencies						
Cash at banks (1)	8,612,323	9,380,900	5,992,954	8,713,438	17,389,272	13,336,279
Reverse repurchase agreement	992,387	3,211,427	3,806,287	958,469	-	
Interest bearing time deposits with banks (2)	36,573,375	38,686,509	43,245,547	36,195,588	18,151,962	12,571,460
Foreign bonds (3)	7,483,636	6,135,472	3,696,799	2,368,082	1,816,211	1,816,211
Certificates of deposit	243,073	1,975,979	1,427,707	1,618,344	188,151	
	53,904,794	59,390,287	58,169,294	49,853,921	37,545,596	27,723,950
Local assets in foreign currencies						
Asset-backed and credit linked notes (4)	659,390	623,508	1,213,929	1,037,475	863,778	859,124
Government eurobonds (5)	1,351,740	1,351,241	2,976,792	5,760,551	8,768,757	5,326,067
Loans to banks and financial institutions in foreign currency (6)	1,350,913	2,630,105	1,790,287	2,254,436	8,238,653	2,167,463
Ministry of Finance Overdraft (7)	15,850,137	16,894,416	19,281,094	20,435,117	23,284,544	23,535,789
	19,212,179	21,499,271	25,262,101	29,487,580	41,155,733	31,888,442
Total assets in foreign currencies	**73,116,973**	**80,889,558**	**83,431,395**	**79,341,501**	**78,701,328**	**59,612,392**
Less: Deposits and other liabilities in foreign currency						
Deposits in foreign currency (8)	48,922,074	50,283,607	57,635,222	53,300,280	57,459,150	110,951,783
Deposits in foreign currency under leverage agreement			7,946,757	23,726,282	43,188,513	
Certificates of deposit in foreign currency (9)	11,411,608	28,735,914	27,907,652	22,372,865	23,176,628	22,275,028
Certificates of deposit in foreign currency under leverage agreement				587,035	648,603	
Accued interest on foreign currency deposits	476,868	914,217	1,181,109	1,196,211	1,770,143	1,569,364
Other liabilities in foreign currencies (10)	1,431,054	1,552,822	1,605,366	1,438,108	1,283,641	1,235,275
Total liabilities in foreign currency	**62,241,604**	**81,486,560**	**96,276,106**	**102,620,781**	**127,526,678**	**136,031,450**
Shortage of foreign currency reserves	**10,875,370**	**(597,002)**	**(12,844,711)**	**(23,279,280)**	**(48,825,349)**	**(76,419,058)**
Shortage in foreign currency reserves-USD equivalent (USD'm)	7,214	(396)	(8,521)	(15,442)	(32,388)	(50,693)
Shortage of foreign currency reserves (excl. local assets in FX)	(8,336,810)	(22,096,273)	(38,106,812)	(52,766,860)	(89,981,082)	(108,307,500)
Shortage of foreign currency reserves (excl. local assets in FX) (USD'm)	(5,530)	(14,658)	(25,278)	(35,003)	(59,689)	(71,846)

[33] This information has been obtained from BdL's audited financial statements, its trial balance, and CBS.

Notes

(1) Cash at banks consists of funds held in current accounts and overnight deposits at overseas commercial banks and central banks, primarily held in USD and EUR.
(2) Interest bearing time deposits with banks are maintained with international banks and central banks and held primarily in USD.
(3) Foreign bonds as at 31-Dec-20 consists of bonds issued by supranational entities denominated in USD, with a coupon rate of 3.5%, maturing on 30 August 2024.
(4) Asset backed and credit linked notes by 2020 consist primarily of three asset backed notes. The credit linked notes all matured by February 2021.

	Subscription date	Maturity date	Nominal value (LBP'm)	Nominal value (USD'm)	Interest rate	Underlying assets
Asset backed note	15-Jun-17	30-Jun-24	535,160	355	6%	
Perpetual callable convertible note	20-Nov-15	29-Dec-49	150,750	100	8.5%	Shares in
Callable convertible note	21-Dec-12	30-Oct-22	150,750	100	6.5%	Lebanese bank

(5) Lebanon remains in Restricted Default (RD) on its outstanding stock of Eurobonds following its failure to pay the principal on the Eurobond maturing on 9 March 2020, pending a debt restructuring. As at 31 December 2019 Lebanese Government Eurobonds mature as follows:

	Maturity date	Nominal value USD	Coupon rate	Carrying value USD	Fair value USD	Unrealized Gain/Loss USD
	9-Mar-20	15,505,000	6.38%	15,440,885	13,508,731	(1,932,154)
	14-Apr-20	4,900,000	5.80%	4,817,016	3,999,625	(817,391)
	19-Jun-20	15,000,000	6.15%	14,779,639	11,831,250	(2,948,389)
	12-Apr-21	50,442,000	8.25%	48,615,004	28,499,730	(20,115,274)
	4-Oct-22	14,235,000	6.10%	14,235,000	6,992,944	(7,242,056)
	22-Apr-24	9,000,000	6.65%	6,634,814	4,095,000	(2,539,814)
	3-Dec-24	3,920,000	7.00%	3,920,000	1,793,400	(2,126,600)
	12-Jun-25	1,000,000	6.25%	1,000,000	450,000	(550,000)
	27-Nov-26	14,663,000	6.60%	11,109,210	6,598,350	(4,510,860)
	29-Nov-27	4,000,000	6.75%	2,794,232	1,800,000	(994,232)
	20-Mar-28	9,700,000	7.00%	8,050,744	4,656,000	(3,394,744)
	3-Nov-28	1,000,000	6.65%	700,926	450,000	(250,926)
	25-May-29	5,000,000	6.85%	3,489,422	2,250,000	(1,239,422)
	27-Nov-29	1,500,000,000	11.50%	1,500,000,000	985,065,000	(514,935,000)
	20-Nov-31	1,647,000,000	7.15%	1,598,230,938	743,208,750	(855,022,188)
	17-May-33	349,000,000	8.20%	349,000,000	175,808,750	(173,191,250)
	17-May-34	670,500,000	8.25%	670,500,000	336,088,125	(334,411,875)
	27-Jul-35	1,500,000,000	12.00%	1,500,000,000	1,066,110,000	(433,890,000)
	23-Mar-37	6,500,000	7.25%	4,546,020	2,957,500	(1,588,520)
Total		**5,821,365,000**		**5,757,863,850**	**3,396,163,155**	**(2,361,700,695)**
Counter value in LBP '000		8,775,707,738		8,679,979,754	5,119,715,956	(3,560,263,798)
Accrued interest receivable				88,777,216		
				8,768,756,970		

(6) Loans to banks and financial institutions in foreign currency consist of the following. These are broken bown by debtor bank in Section 8 of this report.

	2015 LBP'm	2016 LBP'm	2017 LBP'm	2018 LBP'm	2019 LBP'm	2020 LBP'm
Revolving short term loans (USD)	1,350,913	2,630,105	1,790,287	2,072,509	7,780,569	1,462,574
Revolving short term loans (EUR)	-	-	-	-	217,071	-
Facilities granted to banks and financial institutions (USD)	-	-	-	181,927	207,338	671,069
Overdraft facilities (USD)	-	-	-	-	33,675	33,820
Total	**1,350,913**	**2,630,105**	**1,790,287**	**2,254,436**	**8,238,653**	**2,167,463**

(7) MoF overdraft relates to a USD overdraft recorded in a Treasury liability account as a contra balance, netted against Treasury LBP deposits in the Trial Balance. The audited financials net the overdraft against the deposis. In the KPMG Special Purpose Balance Sheet and A&M's restated balance sheet, the overdraft and deposits are stated without netting. There is a small discrepancy between the Trial Balance and KPMG Special Special Purpose Balance Sheet. The figures shown here are from the Trial Balance in the year 2018 and KPMG Special Purpose Balance Sheet in 2019, where foreign currency balances were not provided by BdL for the year.
(8) Deposits in foreign currency include current, demand, term deposits and frozen accounts and reconcile to the Trial Balance. See Section 8 for a breakdown by bank. A&M was not provided with the breakdown between deposits in foreign currency and deposits in foreign currency under leverage agreement - the combined figure is shown.
(9) Certificates of deposit in foreign currency includes the premium and discount and reconciles to the Trial Balance. A&M was not provided with the breakdown between certificates of deposit in foreign currency and certificates of deposit in foreign currency under leverage agreement for the year 2020. The combined figure is shown.
(10) Other liabilities in foreign currency consist of the following:

	2015 LBP'm	2016 LBP'm	2017 LBP'm	2018 LBP'm	2019 LBP'm (11)	2020 LBP'm
Public sector liabilities - foreign currency						
Demand deposit	1,143,110	1,025,863	826,545	832,063	838,101	773,178
Time deposit - margin accounts	263,440	493,436	572,391	407,580	225,517	245,306
Blocked deposits	1,787	1,785	192	191	189	205
Other (12)	22,717	31,739	36,407	29,558	50,788	48,317
	1,431,054	1,552,822	1,435,535	1,269,392	1,114,594	1,067,006
Loan from Arab Fund in Kuwaiti Dinar (KWD)	-	-	169,831	168,713	169,047	168,270
Other liabilities in foreign currency	**1,431,054**	**1,552,822**	**1,605,366**	**1,438,105**	**1,283,641**	**1,235,275**

(11) 2019 currency breakdown not provided to A&M - figures derived from KPMG Special Purpose Balance Sheet.
(12) 'Other' is broken down in the Trial Balance as follows:

	2015 LBP'm	2016 LBP'm	2017 LBP'm	2018 LBP'm	2019 LBP'm	2020 LBP'm
Current accounts 'Governors'	22,697	22,708	26,189	19,802	26,909	19,415
Current accounts 'Individuals'	20	20	20	20	20	20
Loans from abroad	-	9,011	10,198	9,736	23,860	26,186
Subsidized debit interests	-	-	-	-	-	2,697
	22,717	**31,739**	**36,407**	**29,558**	**50,788**	**48,317**

4.3 Conclusion

4.3.1 BdL's foreign currency shortage grew dramatically. Over the period, BdL moved from a foreign currency surplus of LBP 10.7tn (USD 7.2bn) at the end of 2015 to a shortage of LBP 76.4tn (USD 50.7bn) at the end of 2020.

4.3.2 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.

4.3.3 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,[34] this equates to 230% of GDP.

4.3.4 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.

4.3.5 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.

[34] GDP per World Bank – see GDP (current US$) | Data (worldbank.org).

5 Financial Engineering

5.1 Introduction

5.1.1 In the late 1990s, the US Dollar became the main currency in Lebanon. The government used different strategies to increase the supply of US Dollars to the Lebanese banking system. One of the strategies was a 'Financial Engineering' scheme that was introduced by BdL in 2015. This section first provides a background to the financial situation in Lebanon. It then considers the two phases of financial engineering and its costs. Finally, it analyses consulting commissions and Riad Salameh accounts.

5.2 Background to the financial situation in Lebanon

5.2.1 In an attempt to stabilise the Lebanese economy, in 1997, BdL pegged the Lebanese Pound to the US Dollar. To support the peg, BdL and the Lebanese government sought to attract foreign currency to the country by implementing various strategies.

5.2.2 One consequence of this strategy was that the US Dollar became the dominant currency for bank deposits, while the government used LBP to meet public spending needs. A constant flow of USD was required to pay interest on public debt issued by the state and BdL, maintain the peg, and cover the USD cost of subsidies on imports of goods including fuel, medication, and food.

5.2.3 To attract USD, BdL and the MoF offered interest rates above international market rates to local banks, in return for the banks' investment in USD Lebanese government debt and USD CDs.

5.2.4 In the first half of 2002, Lebanon was facing difficult macroeconomic conditions, including a record low in its international reserve position.[35] At the Paris II conference held in November 2002 Lebanon received commitments for assistance in the amount of USD 4.3bn. An IMF report in 2003 notes the following developments around the time of the conference:[36]

i) BdL issued a large amount of CDs in order to "sterilize" inflows from abroad;

[35] Exhibit 03 - IMF Public Information Notice No. 03/36: IMF Concludes 2002 Article IV Consultation with Lebanon, dated 20 March 2003.
[36] Exhibit 03 – IMF Public Information Notice dated 20 March 2003.

ii) The Lebanese government planned to use the Paris II inflows and revenues from the planned privatisation of certain government controlled entities to retire a portion of its debt;

iii) The Government had also agreed with commercial banks to reduce interest payments on its debt;

iv) BdL cancelled USD 1.8bn of government treasury bills against the gold revaluation account;

v) BdL's remaining holdings of government debt of USD 1.8bn were exchanged for a 15 year Eurobond carrying a 4% coupon.

5.2.5 From 2003, BdL deferred interest expense and the loss from discounting CDs over the period from the deferral date to the end of the year 2017, then extended during 2008 to the year 2037 and during 2015 to the year 2050. Furthermore, effective from 2004, the Bank has been deferring interest expense on time deposits taken from local banks. These deferral costs were booked in a liability account titled "Deferred interest expense and other finance costs", internally referred to as the "Pool Account". According to the audited financials the deferrals are derived from BdL's interpretation of a legal opinion issued in 1985 by the Legislative and Consultancy Committee of the Ministry of Justice.

5.2.6 We have included the 1985 legal opinion, and an English translation of the same, at Exhibit 04. In the opinion it is noted that under paragraph 2 of Article 13 of the Code of Money and Credit law that BdL is deemed to be a trader in its relationships with third parties and in the context of maintaining its accounting records, but that it is not wholly and comprehensively subject to the laws of banks and joint-stock companies. BdL is the bank of the state and were it to become insolvent the insolvency would be made good by the state treasury. It is a public national economic facility and complies with the public facilities requirements. As such, unlike commercial enterprises, it can distribute profits and any bankruptcy losses would be covered by the state.

5.2.7 From around 2007, BdL began offsetting deferred costs in the Pool Account against seigniorage assets created on the balance sheet and revenues transferred from the profit & loss account.

5.2.8 Triggered by the civil war in Syria, the supply of USD began to falter from around 2011 due to lack of confidence in the Lebanese economy, decreasing foreign investment, remittances and capital inflow from expatriates abroad. This external pressure was intensified by the oil crisis in the Gulf and internally by more than two years of Lebanese presidential vacuum following 2014.

5.2.9 In 2015, BdL reported that it had taken actions to bolster the supply of US Dollars to the Lebanese banking system, through a scheme referred to as "Financial Engineering". Financial Engineering was designed to achieve two overall objectives:

i) Provide the conditions to allow local banks in Lebanon to attract US Dollar deposits; and

ii) Further encourage the local banks to deposit these US Dollars with BdL.

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

5.2.11 BdL commented on 7 July 2023 stating that, "it had to engage in unconventional operations for an extended period in response to a multiple of adverse circumstances namely: the public sector's foreign currency needs (electricity sector...), a prolonged presidential vacancy, the P.M.'s resignation from abroad in 2017, the cabinet's subsidy policies". The table below provides a summary as provided by BdL of how BdL's foreign currency reserves were used to meet the requirements of the Lebanese government between 2010 and 2021.[37]

Table 5.1 Summary of how BdL's foreign currency reserves were used between 2010 and 2021

Uses	USD
Ministry of Energy and Lebanon Electricity	
Credits in favor of Lebanon Electricity	18,386,090,578.00
Direct Transfers in favor of Lebanon Electricity	543,098,409.00
Ministry of Energy	5,608,275,211.00
Requirements of Public sector for foreign currency	
Various Credits	235,944,610.00
Transfers	8,084,096,388.00
Financing to import all products subsidised by the government	**7,572,914,075.00**
Net negative balance as a result of the movement in Eurobonds	**7,446,931,738.00**
Net total of USD paid by BdL from the foreign currency reserves for the period from 2010 - 2021	**47,877,351,009**

[37] This table was provided by BdL as part of their comments. We have not verified the source or accuracy of the figures in this table.

5.2.12 In August 2019 the IMF published its staff report which detailed a number of issues that were impacting Lebanon and BdL's financial position, including:[38]

i) The budget deficit reached 11% of GDP and the current account deficit 25%;

ii) Economic activity had slowed;

iii) 2018 tax revenues were lower than forecast;

iv) Deposit growth had turned negative and BdL's foreign reserves were declining; and

v) The ratings agencies had downgraded Lebanon's sovereign ratings in early 2019.

5.2.13 Financial Engineering proved insufficient and by September 2019 dollars started to be informally rationed by banks. Following protests in October 2019, there was a change in government in January 2020 and on 9 March 2020 Lebanon defaulted on a USD 1.2bn Eurobond. In the period between the protests and the sovereign default, the black market LBP / USD exchange rate became detached from the official rate, reaching approximately LBP 3,000 to USD 1.[39]

5.3 Phases of Financial Engineering

5.3.1 We have summarised BdL's Financial Engineering mechanisms in two phases: Phase 1 - 2015 to 2018 swaps with a commission; and Phase 2 - loans under leverage. In order to support the understanding of these mechanisms we attach at Appendices 6 to 8 detailed extracts from BdL meeting minutes and financial records as follows:

i) Appendix 6 – Extract of relevant Central Council meeting minutes and decisions;

ii) Appendix 7 – Extract of audit report summaries of Financial Engineering transactions;

iii) Appendix 8 – Extracts from the notes to the accounts relevant to the Financial Engineering transactions; and

[38] Exhibit 05 – IMF Country Report 19/312 dated October 2019.

[39] See Exhibit 06 – Blom Bank blog charting the movement in LBP against USD between July 2019 and August 2021.

iv) Appendix 8 – Extracts from accounting policies relevant to the Financial Engineering transactions.

5.4 Phase 1: 2015 – 2018 "swaps with commission"

5.4.1 The increasing costs of financial engineering were discussed in a 7 January 2015 meeting of the Central Council. According to the minutes, in order to reduce the cost of the Financial Correction Plan, the Governor suggested performing lending operations with the financial sector in which BdL would lend to commercial banks for the purpose of purchasing treasury bills to be immediately discounted with BdL in exchange for a commission to partially offset the cost of the Financial Correction Plan. The mechanisms and commissions were to be *"determined later by the Governor"*. This was approved under Central Council decision 29/1/15, up to the point that commissions reached LBP 500bn.[40]

5.4.2 According to the BdL's financials, the mechanism for implementing this plan was as follows:

i) BdL acquired Lebanese treasury bills from Lebanese banks at a premium, equivalent to the value of the complete coupons to maturity.

ii) This was conditional on the banks investing in Eurobonds with medium to long term maturities.

iii) In return, BdL charged a commission of an amount *"to be determined by the Governor"*, accounted for as fees credited to deferred interest expense.

iv) The premium is amortised and refunded over time from proceeds of interest until maturity without generating future income which would have otherwise been realized over time.

5.4.3 In order to generate sufficient funds for the subscription to the Eurobonds, BdL allowed banks to discount USD CDs issued by BdL under the condition that the Banks resubscribe the proceeds in Eurobonds[41].

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[40] Decision 29/1/15 – 7 January 2015

[41] Decision 44/2/15 – 21 January 2015.

5.4.4 Throughout the year, the Central Council continued to approve acceptance of additional USD deposits and CDs with long term maturities, with the interest and maturities *"to be determined later by the Governor"*[42].

5.4.5 Additional and separate commissions (which we refer to as the "Consulting Commissions"; see further detail in Section 5.8 – Consulting Commission analysis) were approved by the Central Council *"to pay commissions on operations performed with the financial private sector"*. The commissions were paid on certain deposits raised and on a specific lending operation designed explicitly to raise the funds for payment of the consulting commissions.

5.4.6 Consulting commissions were approved under two Central Council decisions:

i) Firstly, Central Council decision 38/19/15 dated 22 July 2015 approved acceptance of deposits and CDs capped at USD1bn on which commission of 3/8 of 1% would be charged.

ii) Secondly, Central Council decision 51/30/2015 dated 2 December 2015 approved lending operations by BdL to purchase Lebanese treasury bills, to be instantly discounted at BdL, for the purpose of providing an amount of LBP 35bn (USD 23.2m) to be recorded in account number 260632009 at BdL *"to pay commissions on operations performed with the financial private sector"*.

5.4.7 The above approvals appear highly irregular. They indicate that consulting commissions were not charged regularly on deals specifically introduced by certain entities but that schemes were developed with the express purpose of raising funds to pay consulting commissions, to unspecified parties.

5.4.8 The following summarises the BdL accounting entries in 2015.[43]

Figure 5.1 2015 treasury bills - Eurobond swap accounting

	CCY	DR	CR
Lebanese treasury bills acquired from banks			
Treasury bills (nominal)	LBP	1,283	
Treasury bills (premium)	LBP	560	

[42] Decision 28/5/15 – 25 February 2015; Decision 39/14/15 – 10 June 2015; Decision 38/19/15 – 22 July 2015.

[43] The information used to summarise these entries was obtained from BdL's ERP and CBS systems.

Banks c/a	LBP		1,843
Eurobonds sold to banks			
Eurobonds	USD		1,436
BdL c/a	USD	1,436	
Commission charged to banks			
Deferred interest expense	LBP		1,053
Banks c/a		1,053	
Amortisation of treasury bills premium			
Treasury bills (premium)	LBP		67
Interest income from treasury bills	LBP	67	

5.4.9 In 2016, BdL significantly increased the size of the financial engineering activities, which followed the following steps:

i) BdL swapped treasury bills for Eurobonds with the MoF for an amount equivalent to USD 2bn, swapping LBP government debt for USD debt at more preferential rates.

ii) BdL acquired Lebanese treasury bills from Lebanese banks as well as redeemed CDs in LBP at a premium, equivalent to the value of the complete coupons to maturity.

iii) This was conditional on the banks placing foreign currency deposits at BdL in the form of CDs or investing in Eurobonds with medium to long term maturities. This operation enhanced BdL's foreign currency reserves and helped it to meet the Government's US Dollar requirements until November 2016, while lowering the commercial banks' assets held outside Lebanon from USD 10bn to USD 860m.[44]

iv) The premium on the treasury bills is amortised and refunded over time from proceeds of interest until maturity without generating future income which would have otherwise been realized over time.

v) Premium on the redeemed CDs was deferred and the unamortised amount was reflected under deferred interest expenses.

[44] Central Council meeting minutes dated 30 November 2016.

vi) In return, BdL charged a commission amounting to 50% of the remaining coupons until maturity, accounted for as fees credited to deferred interest expense.

5.4.10 Similar to 2015, the Central Council approved acceptance of USD CDs and lending operations on which consulting commissions would be paid:

i) Central Council decision 57/15/16 dated 1 June 2016 approved lending operations to purchase treasury bills, to be instantly discounted at BdL, the amounts of which to be determined later by the Governor, and for the earned amounts to be recorded in account number 260632009 "*to cover and pay commissions on operations with the financial private sector*".

ii) Central Council decision 33/18/16 dated 2 June 2016 approved acceptance of long-term deposits and CDs capped at USD 1bn, with interest and maturity to be determined by the Governor, on which commission of 3/8 of 1% would be charged.

iii) Central Council decision 47/16/16 dated 8 June 2016 approved acceptance of long-term deposits and CDs capped at USD 1bn, with interest and maturity to be determined by the Governor, on which commission of 3/8 of 1% would be charged.

5.4.11 Excess LBP liquidity in the banking sector was generated as a result of the Financial Engineering transactions. According to the 19 October 2016 Central Council meeting minutes, the Governor presented that Bank Audi had offered to subscribe to LBP 1,200bn of 5-year treasury bills at 5% interest and that the offer had been presented to the Minister of Finance. Acceptance of the offer was approved by the Central Council and the Governor instructed the Head of Financial Operations to present the same offer to other banks.

5.4.12 In the 19 October 2016 meeting, the same was approved for other banks. The operation constituted 14% of amounts resulting from discounting the treasury bills and/or CDs since May 2016.

5.4.13 According to minutes of the 30 November 2016 meeting, the Financial Engineering operations provided the commercial banks with income of LBP 5,000bn out of which LBP 2,400bn was to be used to implement BdL circulars relating to solvency ratios as per Basel requirements.[45]

5.4.14 The following summarises the BdL accounting entries in 2016.

Figure 5.2 2016 Treasury bills & CDs - Eurobonds and USD CDs swap accounting[46]

	CCY	DR	CR
Lebanese treasury bills acquired at premium			
Treasury bills (nominal)	LBP	9,217	
Treasury bills (premium)	LBP	6,489	
Banks c/a	LBP		15,706
CDs redeemed at premium			
CDs (nominal)	LBP	12,976	
Deferred Interest Expense (premium)	LBP	12,980	
Banks c/a	LBP		25,956
Commission charged to banks (50% of premium)			
Deferred interest expense	LBP		9,727
Banks c/a	LBP	9,727	
Eurobonds sold to banks			
Eurobonds	USD		3,193
BdL USD c/a	USD	3,193	
CD deposits by banks			
CDs (nominal)	USD		18,903
BdL USD c/a	USD	18,903	
Amortisation of treasury bills premium			
Treasury bills (premium)	LBP		950
Interest income from treasury bills	LBP	950	
Amortisation of CDs premium			
Deferred Interest Expense (premium)	LBP		268
Interest income from treasury bills	LBP	268	

5.4.15 In 2017 and 2018, BdL continued the practice of redeeming CDs at a premium and charging a commission in order to partially offset the costs of the Financial Correction Plan. This practiced ended by 2019.

45 The circulars are not specified in the Central Council meeting minutes.

46 The information used to summarise these entries was obtained from BdL's ERP and CBS systems.

5.4.16 The following summarises the BdL accounting entries in 2017 and 2018.

Figure 5.3 2017 CDs redeemed at premium for commission[47]

	CCY	DR	CR
CDs redeemed at premium			
CDs (nominal)	LBP	4,056	
Deferred Interest Expense (premium)	LBP	2,478	
Banks c/a	LBP		6,534
Commission charged to banks (50% of premium)			
Deferred interest expense	LBP		2,287
Banks c/a	LBP	2,287	
Amortisation of CDs premium			
Deferred Interest Expense (premium)	LBP		66
Interest income from treasury bills	LBP	66	

Figure 5.4 2018 CDs redeemed at premium for commission

	CCY	DR	CR
CDs redeemed at premium			
CDs (nominal)	LBP	5,569	
Deferred Interest Expense (premium)	LBP	7,956	
Banks c/a	LBP		13,525
Commission charged to banks (50% of premium)			
Deferred interest expense	LBP		8,072
Banks c/a	LBP	8,072	
Amortisation of CDs premium			
Deferred Interest Expense (premium)	LBP		397
Interest income from treasury bills	LBP	397	

5.5 Phase 2 – Loans under leverage agreement

5.5.1 In 2017, BdL introduced a new Financial Engineering scheme ("loans under leverage agreement").

i) In accordance with Central Council decision No. 39/21/17 dated 17 August 2017, BdL granted banks loans in LBP at an amount equivalent to 125% of USD term deposits placed by banks, subject to a fixed interest rate of 2%.[48]

[47] The information used to summarise these entries was obtained from BdL's ERP and CBS systems.
[48] BdL Audited Financial Statements dated 31 December 2017, Note 12.F. (page 45 and 46)

ii) The banks were required to invest the loan proceeds in treasury bills or time deposits acquired from BdL and pledged against the loans, at the prevailing interest rates.

iii) The Central Council decision approved the Governor to determine the percentage of USD deposits required to benefit from the facilities.

iv) In accordance with Central Council decision No. 45/27/17 dated 25 October 2017, BdL increased the interest on term deposits in LBP by 3% in exchange for commercial banks increasing the interest rates on their clients' deposits and extended the maturities.[49]

v) The Financial Operations Department confirmed to us that the purpose of the policy was to encourage banks to increase the term of their clients LBP deposits and discourage the conversion of deposits from LBP to USD. BdL either extended banks' LBP deposits for longer maturities ranging between seven and 30 years, at interest rates between 9.32% and 11.92% or received new LBP deposits for seven to 30 years tenors at interest between 11.08% and 13.68%. A&M has reviewed the ERP/CBS data and confirmed that these deposits were recorded at the aforementioned interest rates.

5.5.2 During 2018, upon approval of the Governor, BdL granted banks loans under leverage agreement conditional on proceeds being reinvested in the following USD and other foreign currency items:

i) Purchases of CDs;

ii) Purchase of Eurobonds;

iii) Foreign exchange transactions; and

iv) Placement of term deposits in foreign currency.[50]

[49] Central Council decision No. 45/27/17 dated 25 October 2017

[50] BdL Audited Financial Statements dated 31 December 2018, Note 14 (page 48).

5.5.3 By 31 December 2018, the loans under leverage amounted to LBP 41,766bn (USD 31.7bn) against foreign currency investments held by banks equivalent to LBP 32,817bn (USD 21.8bn).

5.5.4 The 'Loans Under Leverage Arrangement' note to the 2019 Special Purpose Balance Sheet states:

"Management's objective of increasing foreign currency reserves by these varied underlying transactions is consistent with the objective of the Central Council decision mentioned above[51]. By mid-2019, foreign currency inflows from remittances decreased significantly, and as such, management's objective became to retain foreign currency deposits."

5.5.5 Minutes of the Central Council meeting dated 20 March 2019 includes commentary from the Governor on the requirement of Lebanese banks to comply with IFRS 9 in preparing their audited financial statements. The Governor noted that banks are netting facilities they are provided by BdL against the deposits they had placed at the Bank, so as not to inflate their balance sheet (and in agreement with their auditors). The Governor stated that BdL will perform the same offsetting in preparation of its own balance sheet.

5.5.6 During 2019, loans under leverage arrangement in the amount of LBP 56,178bn and LBP 2,638bn were offset against term deposits and CDs under leverage agreement respectively. The comparable figures for 2018 indicated LBP 27,440bn and LBP 2,638bn of the loans under leverage were offset against term deposits and CDs under leverage agreement respectively.[52]

5.5.7 The 2018 year end balances are broken down in the table below.

Table 5.2 Breakdown of loans under leverage agreement by deposit and transaction type, BdL 2018 audited financials

	Loans under leverage agreement (LBP'000)	Foreign currency investments (LBP'000)	Loans / investments	Foreign currency investments (USD)
Loans against:				
Purchase of CDs in USD	681,346,409	545,040,952	*125%*	361,552,870
Purchase of Eurobonds in USD	4,116,984,455	3,293,380,342	*125%*	2,184,663,577
Foreign exchange transactions in USD	3,959,586,000	2,745,345,938	*144%*	1,821,125,000

[51] Central Council decision number 39/21/17 dated 17 August 2017.

[52] 2019 Special Purpose Balance Sheet, Note 13 'Loans Under Leverage Agreement' and Note 23 'Banks and Financial Institutions'.

Placement of term deposits in foreign currency	18,681,781,874	14,923,123,458	125%	9,899,252,709
Total loans under leverage against term deposits	**27,439,698,738**	**21,506,890,690**		**14,266,594,156**
Purchase of CDs in USD	52,629,748	41,994,308	125%	27,856,921
Purchase of Eurobonds in USD	439,236,946	354,115,350	124%	234,902,388
Placement of term deposits in foreign currency	11,195,995,555	8,803,158,365	127%	5,839,574,371
Total Loans under leverage against treasury bills	**11,687,862,249**	**9,199,268,023**		**6,102,333,680**
Purchase of Eurobonds in USD	2,638,000,000	2,110,500,000	125%	1,400,000,000
Total Loans under leverage against CDs	**2,638,000,000**	**2,110,500,000**		**1,400,000,000**
Grand Total	**41,765,560,987**	**32,816,658,713**		**21,768,927,836**

5.5.8 The following summarises the BdL accounting entries.

Figure 5.5 Loans under leverage accounting entries[53]

	CCY	DR (LBP)	CR (LBP)
Loans under leverage against term deposits			
BdL USD c/a	USD	545	
CDs	USD		545
Loans under leverage agreements	LBP	681	
Banks c/a	LBP		681
Banks c/a	LBP	681	
Term deposits	LBP		681
BdL USD c/a	USD	3,293	
Eurobonds	USD		3,293
Loans under leverage agreements	LBP	4,117	
Banks c/a	LBP		4,117
Banks c/a	LBP	4,117	
Term deposits	LBP		4,117
BdL USD c/a	USD	2,745	
Banks c/a	USD		2,745
Loans under leverage agreements	LBP	3,960	
Banks c/a	LBP		3,960
Banks c/a	LBP	3,960	
Term deposits	LBP		3,960
BdL USD c/a	USD	14,923	
Term deposits	USD		14,923

[53] The information used to summarise these entries was obtained from BdL's ERP and CBS systems.

Loans under leverage agreements	LBP	18,682	
Banks c/a	LBP		18,682
Banks c/a	LBP	18,682	
Term deposits	LBP		18,682
<u>Loans under leverage against treasury bills</u>			
BdL USD c/a	USD	42	
CDs from Banks	USD		42
Loans under leverage agreements	LBP	53	
Banks c/a	LBP		53
Banks c/a	LBP	53	
Treasury bills	LBP		53
BdL USD c/a	USD	354	
Lebanese Government Eurobonds	USD		354
Loans under leverage agreements	LBP	439	
Banks c/a	LBP		439
Banks c/a	LBP	439	
Treasury bills	LBP		439
BdL USD c/a	USD	8,803	
Term deposits from banks	USD		8,803
Loans under leverage agreements	LBP	11,196	
Banks c/a	LBP		11,196
Banks c/a	LBP	11,196	
Treasury bills	LBP		11,196
<u>Loans under leverage against CDs</u>			
BdL USD c/a	USD	2,111	
Eurobonds	USD		2,111
Loans under leverage agreements	LBP	2,638	
Banks c/a	LBP		2,638
Banks c/a	LBP	2,638	
CDs from Banks	LBP		2,638

5.6 BdL public statements regarding Financial Engineering

5.6.1 BdL published two papers to explain the rationales behind the Financial Engineering transactions:

a) November 2016 – paper on Financial Engineering transactions.

b) 4 April 2017 – paper authored by the First Vice Governor, which we retrieved in the archived versions of BdL's website. This document was not publicly available during the period of our investigation, i.e., taken out from the public domain of BdL's website. Commenting on our analysis, BdL responded in July 2023[54], referring to the 'BDL's Financial Engineering' article authored by the First Vice-Governor, as the reference for its financial engineering public statements.

<u>November 2016 paper on Financial Engineering transactions</u>

5.6.2 BdL published a paper dated November 2016 titled *"Banque Du Liban's Financial Engineering: Background, Objectives and Impact"*.[55] The paper outlines the "additional financial engineering" policies adopted "as part of its monetary policy objectives". It describes the mechanism as being carried out on orders in place between May and August 2016 as follows:

"First, BDL swapped Lebanese Pound (LBP) treasury bills (TBs) held in its portfolio with equivalent Eurobonds issued by the Ministry of Finance, amounting to USD 2 billion.

Second, BDL sold the recently acquired Eurobonds and issued USD Certificates of Deposits (CDs) to commercial banks against fresh USD inflows provided by banks.

Third, BDL discounted at 0% an amount equivalent to the previous transaction (Eurobonds and USD CDs) of LBP denominated debt held by commercial banks in their portfolio. This transaction was subject to voluntary 50% haircut[56] on interest in favor of BDL."

5.6.3 The paper then lays out the impacts of the 2016 financial engineering mechanism, stating that the objectives of the mechanism were achieved, as follows.

i) *"Strengthening BdL's foreign currency assets"*. After the Financial Engineering, BdL foreign currency assets reached a historical record level of USD 41bn, conferring stability to the Lebanese Pound and to interest rates.

[54] The article had been made publicly available on BdL's website in July 2023.

[55] Exhibit 07 - Banque Du Liban's Financial Engineering: Background, Objectives and Impact, www.bdl.gov.lb

[56] The 'haircut' are the commissions paid to BdL.

ii) *"Beefing up the capital base of banks"*. BdL instructed banks to book the proceeds from the mechanism to their Tier Two Capital, enabling them to add additional general reserves ahead of the implementation of IFRS 9.

iii) *"Increasing liquidity in local currency"*. After Financial Engineering deposits growth increased on an annualised basis from 2% to 5%. The fresh liquidity would enable banks to expand their credit portfolio, particularly to small and medium sized entities.

iv) *"Improving the government debt profile"* by reducing the cost of borrowing – decreasing the interest rate of 5 year treasury bills from 6.74% to 5% and lowering the interest rate on long term LBP denominated CDs and time deposits from 9% to 8.4%.

v) *"Improving the balance of payments"*, turning a cumulative deficit of USD 1.7bn in May 2016 to a cumulative surplus of USD 555m in September 2016.

vi) *"Targeting positive inflation rate below 4%"* – inflation rate rose to 2% in September 2016, in line with objectives.

vii) *"Improving the country's rating and outlook"* – in September 2016, S&P revised Lebanon's outlook from negative to stable.

5.6.4 The paper concludes:

"this financial engineering was based on a win-win situation, whereby it didn't burden the Central Bank neither the Lebanese Government with any costs. On the contrary, it enhanced both BDL's balance sheet and Lebanon's credit profile."

<u>4 April 2017 paper on Financial Engineering transactions</u>

5.6.2 In BdL's Financial Engineering article published on 4 April 2017[57], the First vice-governor details the background behind the *"unconventional"* financial engineering policies. This article was deleted from the public domain of BdL's website. The article outlines the reasons

[57] Exhibit 34 - BDL's Financial Engineering: A financial, monetary and economic leverage; authored by first vice-governor Raed H. Charafeddine; archived version (document deleted from accessible domain of the website during the period of A&M's assessment)
رائد شرف الدين، "هندسة مصرف لبنان المالية :رافعة مالية ونقدية واقتصادية"، مصرف لبنان، نيسان 2017

behind BdL's unconventional monetary policies in the second half of 2016, namely (i) to preserve monetary and financial stability, (ii) maintain the government's solvency, and (iii) to stimulate internal demand and economic activity.

5.6.3 The article[58] quotes articles 33, 70, 76 and 104 of the CMC, as legal provisions conferring to BdL by law the power to implement the financial engineering transactions. The article then lays out the implementation decisions and measures issued in accordance with the legal provisions:

a) First, BdL's Central Council has unanimously decided to issue four decisions, the content of which was published in the form of intermediate circulars[59].

b) Second, the Governor acted under the provisions of Article 26 of the CMC, "to implement the Central Council's above-mentioned decisions".

c) Third, "the application of these decisions on banks was subject to the same standards that were circulated to all banks. However, it is noted that it is normal that results differ from one bank to another".

d) Fourth, Article 151 of the CMC requires each person working or having worked in any manner at the central bank to comply with the Banking Secrecy Law of September 3, 1956; restricting BdL from giving detailed information about the identity of the banks benefiting from the financial engineering and about the extent to which each has separately benefited from this engineering.

e) Fifth, the Governor of BdL has explained the financial engineering mechanism and objectives in the mass media through newspaper and television statements and interviews.

<u>Annual reports</u>

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[58] Exhibit 34 - BDL's Financial Engineering: A financial, monetary and economic leverage; authored by first vice-governor Raed H. Charafeddine; archived version (document deleted from accessible domain of the website during the period of A&M's assessment)
رائد شرف الدين، "هندسة مصرف لبنان المالية :رافعة مالية ونقدية واقتصادية"، مصرف لبنان، نيسان 2017

[59] Publicly available circulars: Intermediate Circular 428 of June 25, 2016; Intermediate Circulars 439 and 440 of November 8, 2016; Intermediate Circular 446 of December 30, 2016.

5.6.5 The BdL annual reports published on its website note aspects of BdL's financial engineering in 2016 through to 2020.[60] In the 2016 annual report financial engineering is discussed under the section for non-traditional mechanisms and the report notes that financial engineering has been adopted to provide monetary stability, solvency and improve economic drive. The benefits of financial engineering in this year are reiterated in this report.

5.6.6 Financial engineering in 2017 and 2018 is discussed under the section of the annual report that comments on traditional monetary instruments. The report notes that:

i) BdL continued its operations with banks to attract long term deposits in foreign currency to improve its reserves;

ii) Cooperation between MoF and BdL stabilized the interest rate on foreign and local currency issued government bonds. BdL performed financial operations to motivate banks to attract foreign currency long term deposits and deposit them at BdL against LBP long term deposits which stabilized interest on foreign currency; and

iii) BdL paid the government's debt principle and coupons in the international market.

5.6.7 In 2018 the annual report also notes that BdL paid all Eurobonds due during 2018, with BdL exchanging USD 5.5bn of treasury bills for Eurobonds to provide the required liquidity. This significantly reduced BdL's foreign currency reserves.

5.6.8 In 2019 the report notes the exodus of funds in local currency and foreign currency from the banking sector as people were withdrawing their funds due to the economic situation in Lebanon and the creation of a second exchange rate (black market rate). It states that BdL continued to focus on attracting foreign currency deposits.

5.7 Costs of Financial Engineering

<u>Summary</u>

[60] See Exhibit 08.

5.7.1 Each year, the financial correction plan generated substantial costs, which were partly offset by revenues and by inflated seigniorage assets. The costs and offsets were transferred to the balance sheet, resulting in a substantial overstatement of the profit of the BdL, avoiding the requirement for a bailout by the MoF and allowing the continued distribution of a target USD 40m to the account of the MoF in years in which the actual losses were several billions of dollars.

Costs

5.7.2 Financial engineering was costly. The costs included:

i) Premium paid on the purchase of treasury bills and redeemed CDs (equivalent to all future coupons on the instruments);

ii) Interest expense of term deposits and CDs;

iii) High exchange rate differential paid; and

iv) 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.

5.7.3 In order to avoid booking losses, BdL 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 MoF 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.

5.7.4 The interest expense transferred to the Balance Sheet was booked to a balance titled "Deferred Interest Expense and Cost of Certificates of Deposit", known internally as the "Pool".

5.7.5 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 and11 April 2018. The Accounting Manual states:[61]

"BDL operations on deposits taken from local banks either by issuing a certificate or as a regular time deposit are considered as intervention in the market which is part of monetary policy. Interest expense on these certificates of deposit and time deposits, in addition to related cost of discounting is deferred as an offset to provision for contingencies and reversed to the credit side of seigniorage to the extent of available credit balances in seigniorage accounts. Similar treatment applies to capital gains and losses, finance costs and costs paid over fair value of financial instruments. [...]"

5.7.6 On 7 July 2023 BdL commented that Financial engineering operations' cost by no means resulted from the payment of exchange rate differentials, let alone "high" such differentials. The only costs that relate to exchange rate differentials are those corresponding to later circulars such as 151 ..., not having anything to do with financial engineering operations that had been conducted.

5.7.7 However, we note that Central Council decision 39/21/17 provided commercial banks with LBP facilities at 2% interest to purchase LBP T-bills, this transaction was conditional on commercial banks placing a USD deposit at BDL to benefit from these facilities. Based on notes to 2017 financial statements, specifically note 12 F (b), the value of those LBP 2% loans were based on exchanging the value of the USD deposit at 125% of the prevailing exchange rate, this caused an interest rate differential from 1,507.5 to 1,884.375 or in the value of 376.875 LBP for each USD exchanged. This differential has been a cost borne by BDL due to this intervention in 2017.

5.7.8 The costs of the deferred interest and foreign exchange costs of financial engineering can be broken down as follows:

Table 5.3 Costs in the Pool Account[62]

LBP'm	2015	2016	2017	2018	2019	2020
Interest expense deferred - CDs:						

[61] BdL 2018 Accounting Manual – 'Deferred Finance Costs' (page 7)

[62] Data obtained from BdL CBS data.

EUR				160	2,822	3,097
LBP	2,424,193	2,853,857	2,621,322	3,579,535	3,732,978	2,949,011
USD	694,787	1,017,257	1,790,038	1,711,742	1,461,085	1,594,977
Interest expense deferred - TDs:						
EUR	218,862	213,927	249,914	235,616	237,631	246,062
LBP	865,670	967,872	2,435,963	5,399,854	8,846,054	8,133,525
USD	1,466,686	1,601,383	1,997,109	3,078,675	4,155,114	4,921,044
Costs of FX Intervention						10,116,034
Treasury bill disposal losses and interest						3,118,995
Fiduciary Contracts Interest						26
Total	**5,670,198**	**6,654,297**	**9,094,346**	**14,005,582**	**18,435,685**	**31,082,770**
FX adjustments	(5,056)	(1,367)	5,874	(2,191)	(1,050)	4,771
Total per financial statements	**5,665,142**	**6,652,930**	**9,100,220**	**14,003,391**	**18,434,634**	**31,087,541**

5.7.9 The premiums paid on treasury bills and CD's are summarised as follows:

Table 5.4 Treasury bill and CD premiums

LBP'bn	2015	2016	2017	2018
Premium paid - Treasury Bills	560	6,489		
Premium paid – CDs	-	12,980	2,478	7,956
Total	**560**	**19,469**	**2,478**	**7,956**

5.7.10 The total of the above costs is LBP 115tn.

5.7.11 On 7th of July 2023 BdL commented on the above by stating that *"the amount of 115 TLL referred to as "cumulative cost of financial engineering" covers both costs channelled to the deferral pool (around 85 TLL) and premiums on TBs and CDs (around 30 TLL). It's worth noting that the 30 TLL considered as part of the "cumulative cost of financial engineering" will be fully offset by coupon revenues till the maturity of the said TBs and CDs. Hence, the cost during 2015-2020 is around 85 TLL and not 115 TLL."*

5.7.12 A&M disagrees with BdL's view that that the premiums paid on TBs and CDs of 30tn will be fully offset by the coupon revenues received till maturity for the reasons explained below:

i) The market value of a T-bill is the present value of future cash flows (coupon payments and eventual principal repayment) discounted at the market discount rate;

ii) Given the T-bills were newly issued, the coupon rate was presumably the market discount rate for the Lebanese government. That being the case, the present value of the future cashflows from the T-bills would be equal to their nominal value;

iii) Therefore, unless this discount rate is zero, BdL bought the T-bills at a price that was in excess of the market value and so incurred a loss at point of purchase.

<u>Offsetting</u>

5.7.13 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.

5.7.14 Each year, close to the year end, the Governor issued instructions to the Accounting Department for *"offsetting the burdens from the financial correction plan at year end 'xxxx'"*. 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.

5.7.15 Each instruction letter begins:

"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."

5.7.16 CC decision number 46/30/16 states:

"The cumulative burdens subject to the financial correction plan are reduced by the end of each year from the following sources:

Current net profit, commissions charged on Financial Engineering, net proceeds from the swap of LL T-bills for Eurobonds, net proceeds from payment on Government foreign currency dues, net proceeds from issuing currency (considering the cap of 2.% of cumulative GDP since the implementation of the financial correction plan in 2002), Net proceeds from LL T-bills and general provisions.

The Governor, based on suggestions from the Organization and Development Department, determines prior to year end the details of reducing the cumulative burdens subject to the financial correction plan for the current year. The Accounting department implements the mechanism specified by the Governor by year end and prior to implementing the financial correction plan."

5.7.17 The offsets included:

i) First, the maximum possible from **net income** after removing the costs of the financial correction plan, while preserving approximately LBP 200bn[63] in net income which allows the Bank to meet a target of distributions to the MoF of approximately USD 40m each year. This amount is booked to provision for contingencies.

ii) Second, **commission due resulting from financial engineering**, booked to account 182606001 (LBP) under GL account 01.65.10.20.02.

iii) Third, **seigniorage –** Initially seigniorage from currency, followed by seigniorage from treasury Bill Swaps and then seigniorage from financial stability, booked to account 190989002 (LBP) under GL account 01.65.90.09.03.

5.7.18 The offsets are set out in the table below:

Table 5.5 Offsets

LBP'm	2015	2016	2017	2018	2019	2020
Income	(1,224,527)	(1,250,034)	(1,430,317)	(2,382,980)	(3,438,809)	(4,951,440)
Amortised interest expense	(42,291)	(48,772)	(60,401)	(96,664)	(133,576)	(106,028)
Commissions	(1,053,307)	(9,727,403)	(2,557,562)	(8,071,861)	0	3,000,000
Seigniorage - Currency	(6,447,181)	0	0	0	0	(19,099,968)
Seigniorage - financial stability	0	0	0	(10,270,279)	(13,754,531)	0
Seigniorage - TB swaps	3,262,082	0	(701,946)	0	0	0
Other	0	536,330	0	(153,449)	(60,101)	(71,172)
Total	**(5,505,223)**	**(10,489,879)**	**(4,750,226)**	**(20,975,233)**	**(17,387,016)**	**(21,228,608)**

Balance

5.7.19 The conclusion of each instruction letter summarises the estimated total cost of the financial correction plan. In each year costs in all accounts related to 01.65.10 with the exception of account 182 606 001 (LBP) are offset. The balancing amount remains and is reflected in the Balance Sheet under deferred interest expense and other finance costs.

Profit distribution

[63] LBP 200bn does not reconcile to the net income preserved, however we have not been able to determine why this amount is noted in the letter.

5.7.20 In the first quarter of each year, the accounting department sends a letter to the Governor, requesting approval for the appropriation of net income to provisions for contingencies and for the remaining income to be distributed 80% to the MoF and 20% to general reserves. In 2020 there was no request for distributions – the full appropriated amount was booked to general reserves.

5.7.21 The distribution of 80% of BdL's reported profits was recorded in the CC meeting minutes as follows:

i) During the CC meeting held on 16 March 2016 it approved the distribution of 80% 2015's net profit of LBP 76bn to the MoF and 20% to be retained in the general reserves of BdL;

ii) During the CC meeting held on 22 February 2017 it approved the distribution of 80% 2016's net profit of LBP 76bn to the MoF and 20% to be retained in the general reserves of BdL;

iii) On 25 February 2020 the Governor passed a decision that 80% of BdL's 2019 net profit be distributed to MoF and 20% to be retained in BdL.

5.7.22 In 2002, 2004 and 2007 BdL made distributions to the MOF using the unrealised gain on BdL's holding of gold and recorded against the unrealised gain on exchange balance on BdL's balance sheet. BdL's audited financial statements state that such a distribution is, in the opinion of the Bank's management, derived from the provisions of articles 115 and 116 of the Money and Credit Law and in line with the 1985 Legal Opinion.

5.8 Consulting Commissions

Mutual Legal Assistance Request – Forry Associates

5.8.1 In 2021, Lebanese and international news agencies published a copy of a Mutual Legal Assistance Request ("MLAR")[64] sent by Swiss prosecuting authorities to the Lebanese authorities requesting further information related to payments received by Swiss banks from accounts held at BdL.

5.8.2 The MLAR details payments totalling USD 333m sent between 2002 and March 2015 from a BdL account with IBAN number LB02099900000001001260632009 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.

5.8.3 The payments were made under a 6 April 2002 agreement between BdL and Forry, under which Forry acted as "*agent for the introduction of BDL products*", 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.

5.8.4 A copy of this agreement has been provided to A&M by BdL.[65] Along with the Forry Agreement, A&M was provided with a copy of a document purportedly providing Central Council approval to contract with Forry[66]. The letter is on BdL letterhead and states the following:

"Subject: Contracting with Forry

In reference to the subject referenced above, we inform you that the Central Counsel meeting which took place on 26 December 2001 took the decision number 23/41/01 as follows:

Assign the Governor the authority to contract with Forry Associates Ltd as an agent to market financial products for the benefit of Banque du Liban in return for commissions paid from outside the bank's money".

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[64] Exhibit 09 – Swiss MLAR, https://int.nyt.com/data/documenttools/swiss-investigation-into-riad-salameh-and-raja-salameh/b4062a5c6acbe72d/full.pdf, November 2020. See Appendix 9 for a translation of this document.

[65] Exhibit 01 – Forry-BdL agreement, 6 April 2002

[66] Exhibit 01 – Central Council approval re Forry

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

5.8.6 BdL drafted a memo on Forry in response to A&M's draft report on 7 July 2023[67], stating:

"It was at the request of HSBC, the bank of Forry Associates Limited, that an additional copy of the contract was signed in July 2015 by Raja Salame on behalf of Forry Associates Limited, as evidenced by the e-mail dated July 21, 2015[68] sent by Raja Salame to HSBC's representatives. It was signed after the end of the relationship between BDL and Forry Associates Limited. The content of such additional copy is identical in all respects to the copy signed on April 6, 2002, except for the address of [sic.] behalf of Forry Associates Limited and the signatory on behalf of Forry Associates Limited.

The fact that additional copy was requested by HSBC in July 2015 was also confirmed by HSBC itself in a letter dated 18 June 2021, sent to the Swiss Confederation Prosecutor's Office...[69]"

5.8.7 An article published by the National Newspaper in February 2023[70], explains the reason for the existence of two versions of the contract, by reference to French judicial documents[71], including an attachment order drafted by Aude Buresi, a French judge investigating the flow of funds from BdL. The article claims that in 2015, HSBC requested an additional copy of the contract which was signed, this time, by Raja Salameh. The article also reports that the judicial investigators have been unable to identify or locate Kevin Walter and that his identity *"does not appear in any document provided to the HSBC bank"*. Raja Salameh reportedly stated in evidence to the Lebanese investigating judge that Kevin Walter was an employee of Forry.

[67] Exhibit 35 – BdL memorandum addressing the "Forry case"

[68] Exhibit 36 – Email dated 21 July 2015 sent by Raja Salame to HSBC representatives.

[69] Exhibit 37 – letter dated 18 June 2021 sent by HSBC to the Swiss Confederation Prosecutor's Office

[70] Exhibit 10 – *Revealed: How investigators say Riad Salameh conducted central bank embezzlement operation*, The National News, 2 February 2023

[71] Note, A&M has not seen the documents referenced in the National News article and has not verified their authenticity.

5.8.8 The National News article goes on to state that neither Kevin Walter nor Raja Salameh were listed as directors of Forry, leading the French judge to conclude that "*Riad Salameh engaged the BdL with a company under the terms of a legally non-existent contract*". To be legally binding the contract would need to be signed by one of the directors of the company.

5.8.9 BVI public records do not provide details of the ultimate beneficial owners of companies. However, we have obtained documentation from the BVI registry that confirms that Forry was incorporated on 20 November 2001[72] and dissolved on 17 May 2016[73].

5.8.10 According to the MLAR, the HSBC account held in the name of Forry received more than USD 326m via 310 banking transactions between April 2002 and October 2014 as well as a transfer of USD 3,663,294 on 4 October 2014 and a transfer of USD 3,554,255 on 9 March 2015, whose origin is BdL account LB02099900000001001260632009. HSBC records marked the transfers as "commissions" or "fees".

5.8.11 The MLAR summarises the onward transfer of USD 210m (approximately two thirds of the received amounts) of the Forry funds back to accounts in Lebanon held in the name of Raja Salameh at four Lebanese banks (BANKMED, BLM BEIRUT, CREDIT LIBANAIS, BANK AUDI and SARADAR BEIRUT) and the transfer of various remaining amounts to entities controlled by Riad Salameh and associates seemingly for the purchase of real estate in Switzerland.

A&M review of the 'Consulting' account

5.8.12 A&M has identified in the CBS records of BdL the account with IBAN number LB02099900000001001260632009 which is referenced in the MLAR as the source of the payments to Forry. The account is a liability account in the CBS general ledger with the title 'Consulting' (CBS account number 260632009). The account maps to a miscellaneous accrued expenses account in the ERP general ledger which maps to the line item on the financial statements, 'Accrued expenses and other liabilities'.

[72] Exhibit 11 – Forry Certificate of Incorporation.

[73] Exhibit 12 – Forry Certificate of Dissolution.

Table 5.6 Summary of 'Consulting' account core banking and ERP details

Account type	CBS account number	CBS account name	IBAN number	Currency	Branch	CBS GL name	ERP GL account no.	ERP GL Account description
Liabilities	260632009	Consulting	LB02099900000 0010012606320 09	LBP	Head Office	Commitments and settlements – charges payable	2405090301	Other liabilities-Attachment & Settlement Accounts-Accrued Expenses Payable-Other Expenses: Miscellaneous

5.8.13 BdL stated in the 7 July 2023 memo:

"The account No. 01260632009, entitled "consulting account", is actually a clearing account opened with BDL. It is not an account of BDL. It is an off-balance sheet account.

The clearing (consulting) account can be identified by its own IBAN which is different from the IBANs of the accounts of BDL on which funds owned by BDL are deposited."

5.8.14 A&M disagrees with BdL's description of the Consulting account as an "off-balance sheet account". The term "off-balance sheet" refers to certain assets and liabilities that do not appear on an entity's balance sheet. Between 2015 and 2020, the Consulting account recorded an outstanding credit balance in all years that was reflected in the liabilities section of BdL's balance sheet. While an accrued expenses account can sometimes be referred to as a clearing account, it cannot be referred to as an "off-balance sheet account".

5.8.15 A&M also disagrees with the statement, "it is not an account of BdL". While it is not a bank account or cash account of BdL, it is a liability account which reflects short term payment obligations of BdL.

<u>Movements on the Consulting account, 2015-2020</u>

5.8.16 A detailed listing of movements from 1 January 2015 to 31 December 2020 across the 'Consulting' CBS account, including the corresponding debits and credits, is shown in Table 5.9 below. The account contains a total of 35 debit and credit entries during the Review Period; 27 debit entries and eight credit entries. We searched and extracted details of all the SWIFT messages related to the entries from the SWIFT database extract and were able to confirm the originator / beneficiary banks of incoming / outgoing transfers. The beneficiary name fields were removed from the SWIFT extracts by BdL and so the ultimate beneficiary or account holder cannot be seen from the data available.

Debits / transfers from the Consulting account

5.8.17 The 27 debit entries totalling LBP 168,362,309,500 (USD 111,283,000) mainly represent transfers out of the account to accounts held at HSBC and Lebanese banks, with a small amount credited to a MoF account as summarised in Table 5.7 below.

Table 5.7 Summary of recipients of transfers from the consulting account, 2015 - 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**

5.8.18 The outward transfers include four SWIFT transfers made between January and March 2015 to HSBC totalling USD 12,134,486 from BdL's USD account at Standard Chartered Bank. These transfers include the amount of USD 3,544,305 referenced in the MLAR and confirmed as being transferred for the ultimate benefit of Forry. No further transfers were made to HSBC after 23 March 2015.

5.8.19 Between 22 April 2015 and 9 September 2019, a further 18 SWIFT transfers were made, debited to the consulting account and credited to six Lebanese banks for a total of LBP 149,985,971,000 (USD 99,093,057): Banque Misr Liban SAL; IBL Bank SAL; BLC Bank SAL; AM Bank SAL; Bank Audi SAL; and Fransabank SAL.

5.8.20 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.

5.8.21 A&M asked BdL for an explanation of all transactions booked through the consulting account '260632009', together with underlying documentation for each transaction. BdL has, at the date of this report, failed to respond to our information request.

Table 5.8 Detailed listing of movements across the 'Consulting' CBS account with double entry, 1 January 2015 to 31 December 2020[74]

Credits to the Consulting account

	DR		CR									
Date	CBS account no.	CBS account name	CBS account no.	CBS account name	NPS account number	NPS / SWIFT account name	Beneficiary Bank	Amount (LBP)	Amount (USD)	USD rate	Consulting balance (LBP)	Consulting balance (USD)
16-01-15	01.001.260632009	Consulting	01.001.700361115	Ministry of Finance				15,526,000	10,299	1507.5	27,850,627,322	18,474,711
16-01-15	01.001.260632009	Consulting	01.002.60643115	Standard Chartered Bank		Standard Chartered Bank	HSBC Private Bank (Suisse) SA	5,159,721,500	3,422,701	1507.5	22,690,905,822	15,052,010
11-02-15	01.001.260632009	Consulting	01.001.700361115	Ministry of Finance				16,906,000	11,215	1507.5	22,673,999,822	15,040,796
11-02-15	01.001.260632009	Consulting	01.002.60643115	Standard Chartered Bank		Standard Chartered Bank	HSBC Private Bank (Suisse) SA	5,618,129,000	3,726,785	1507.5	17,055,870,822	11,314,010
09-03-15	01.001.260632009	Consulting	01.001.700361115	Ministry of Finance				16,123,000	10,695	1507.5	17,039,747,822	11,303,315
09-03-15	01.001.260632009	Consulting	01.002.60643115	Standard Chartered Bank		Standard Chartered Bank	HSBC Private Bank (Suisse) SA	5,358,114,500	3,554,305	1507.5	11,681,633,322	7,749,010
23-03-15	01.001.260632009	Consulting	01.001.700361115	Ministry of Finance				6,490,000	4,305	1507.5	11,675,143,322	7,744,705
23-03-15	01.001.260632009	Consulting	01.002.60643115	Standard Chartered Bank		Standard Chartered Bank	HSBC Private Bank (Suisse) SA	2,156,772,500	1,430,695	1507.5	9,518,370,822	6,314,010
22-04-15	01.001.260632009	Consulting	01.002.190901071	FX RTGS: payment system Clearance: operations	600521113	IBL Bank SAL		9,489,799,000	6,295,057	1507.5	28,571,822	18,953
22-04-15	01.001.260632009	Consulting	01.001.700361115	Ministry of Finance				28,556,000	18,943	1507.5	15,822	10
17-12-15	01.001.190901061	Financial Operations RTGS: payment system clearance: operations	01.001.260632009	Consulting	610701116	Optimum Invest SAL		35,488,500,000	23,541,294	1507.5	35,488,515,822	23,541,304
21-12-15	01.001.260632009	Consulting	01.002.190901071	FX RTGS: payment system Clearance: operations	600011116	Fransabank SAL		8,137,750,000	5,375,000	1514	27,350,765,822	18,143,128
19-01-16	01.001.260632009	Consulting	01.002.190901071	FX RTGS: payment system Clearance: operations	600111111	BLC Bank SAL		5,223,300,000	3,450,000	1514	22,127,465,822	14,678,253
19-01-16	01.001.260632009	Consulting	01.002.190901071	FX RTGS: payment system Clearance: operations	600521113	IBL Bank SAL		4,542,000,000	3,000,000	1514	17,585,465,822	11,665,317
24-02-16	01.001.260632009	Consulting	01.002.190901071	FX RTGS: payment system Clearance: operations	600561110	Bank Audi SAL		8,137,750,000	5,375,000	1514	9,447,715,822	6,267,142
01-04-16	01.001.260632009	Consulting	01.002.190901071	FX RTGS: payment system Clearance: operations	600111111	BLC Bank SAL		4,087,800,000	2,700,000	1514	5,359,915,822	3,555,500
01-04-16	01.001.260632009	Consulting	01.002.190901071	FX RTGS: payment system Clearance: operations	600521113	IBL Bank SAL		5,344,420,000	3,530,000	1514	15,495,822	10,279
24-06-16	01.001.260632009	Consulting	01.002.190901071	FX RTGS: payment system Clearance: operations	600111111	BLC Bank SAL		3,406,500,000	2,250,000	1514	(3,391,004,178)	(2,249,422)
24-06-16	01.001.182606001	Commissions receivable resulting from financial engineering	01.001.260632009	Consulting				3,874,467,000	2,559,093	1514	483,462,822	320,705
30-06-16	01.001.190901061	Financial Operations RTGS: payment system clearance: operations	01.001.260632009	Consulting	610701116	Optimum Invest SAL		18,738,035,290	12,376,509	1514	19,221,498,112	12,750,579
04-07-16	01.001.260632009	Consulting	01.002.190901071	FX RTGS: payment system Clearance: operations	600521113	IBL Bank SAL		4,314,900,000	2,850,000	1514	14,906,598,112	9,888,291
03-08-16	01.001.260632009	Consulting	01.002.190901071	FX RTGS: payment system Clearance: operations	600521113	IBL Bank SAL		7,267,200,000	4,800,000	1514	7,639,398,112	5,067,594
08-08-16	01.001.260632009	Consulting	01.002.190901071	FX RTGS: payment system Clearance: operations	600111111	BLC Bank SAL		7,638,130,000	5,045,000	1514	1,268,112	841
13-06-17	01.001.190901181	Payment system RTGS: payment system clearance: operations	01.001.260632009	Consulting	601011113	AM Bank SAL		13,474,599,640	8,900,000	1514	13,475,867,752	8,939,216
06-07-17	01.001.182606001	Commissions receivable resulting from financial engineering	01.001.260632009	Consulting				37,687,500,000	24,892,668	1514	51,163,367,752	33,939,216
06-09-17	01.001.260632009	Consulting	01.002.190901071	FX RTGS: payment system Clearance: operations	600031111	Banque Misr Liban SAL		12,112,000,000	8,000,000	1514	39,051,367,752	25,904,722
19-10-17	01.001.260632009	Consulting	01.002.190901071	FX RTGS: payment system Clearance: operations	600031111	Banque Misr Liban SAL		10,598,000,000	7,000,000	1514	28,453,367,752	18,874,539
24-10-17	01.001.260632009	Consulting	01.002.190901071	FX RTGS: payment system Clearance: operations	600031111	Banque Misr Liban SAL		9,084,000,000	6,000,000	1514	19,369,367,752	12,848,668
26-10-17	01.001.182606001	Commissions receivable resulting from financial engineering	01.001.260632009	Consulting				24,224,000,000	16,000,000	1514	43,593,367,752	28,917,657
23-01-18	01.001.190901181	Payment system RTGS: payment system clearance: operations	01.001.260632009	Consulting	601011113	AM Bank SAL		1,059,800,000	700,000	1514	44,653,167,752	29,620,675
16-04-18	01.001.260632009	Consulting	01.002.190901071	FX RTGS: payment system Clearance: operations	600031111	Banque Misr Liban SAL		18,168,000,000	12,000,000	1514	26,485,167,752	17,568,934
16-07-18	01.001.260632009	Consulting	01.002.190901071	FX RTGS: payment system Clearance: operations	600031111	Banque Misr Liban SAL		9,724,422,000	6,423,000	1514	16,760,745,752	11,118,239
15-01-19	01.001.260632009	Consulting	01.002.190901071	FX RTGS: payment system Clearance: operations	600031111	Banque Misr Liban SAL		11,506,400,000	7,600,000	1514	5,254,345,752	3,485,470
07-02-19	01.001.190901181	Payment system RTGS: payment system clearance: operations	01.001.260632009	Consulting	601011113	AM Bank SAL		6,056,000,000	4,000,000	1514	11,310,345,752	7,502,717
09-09-19	01.001.260632009	Consulting	01.002.190901071	FX RTGS: payment system Clearance: operations	601011113	AM Bank SAL		11,203,600,000	7,400,000	1514	106,745,752	70,810

[74] Data sources from CBS and SWIFT system extracts obtained from BdL.

Credits / how the payments were funded

5.8.22 The account began the period at 1 January 2015 with an opening credit balance of LBP 27,866,153,322 (USD 18.49m). We do not have the records to show how this balance was funded. The balance effectively funded the first five debits to the consulting account. This includes the four payments to HSBC and the payment which we know to have been made for the benefit of Forry.

5.8.23 During the Review Period, a total of eight credits were booked to the consulting account as summarised in Table 5.9. The credits total LBP 140,602,901,930 (USD 92,969,930).

Table 5.9 Summary of credits to the consulting account, 31 January 2015 to 31 December 2020

DR	CR	NPS account name / SWIFT Receiver	Sum of Amount (LBP)	Sum of Amount (USD)	No of entries
Opening balance			*27,866,153,322*	*18,485,010*	
Financial Operations RTGS: payment system clearance: operations	Consulting	Optimum Invest SAL	54,226,535,290	35,917,803	2
Commissions receivable resulting from financial engineering	Consulting	(blank)	65,785,967,000	43,451,762	3
Payment system RTGS: payment system clearance: operations	Consulting	AM Bank SAL	20,590,399,640	13,600,000	3
Grand Total			**168,469,055,252**	**111,454,575**	**8**

5.8.24 The credits were booked in 3 different ways.

1. <u>By entering into financial engineering transactions via Optimum Invest SAL designed explicitly to create commissions to be paid to third parties</u>

5.8.25 Two credits were created by entering into financial engineering transactions with Optimum Invest SAL designed explicitly to create commissions to be paid to third parties.

5.8.26 The first was for an amount of LBP 35,488,500,000 (USD 23,541,294) credited to the consulting account on 17 December 2015 which results from Central Council decision 51/30/2015 dated 2 December 2015, which states:

"Perform lending operations to purchase Lebanese T-bills to be instantly discounted at BDL for the purpose of providing an amount of LL 35b and recording the LL 35b in account number