Between a rock and a hard dollar

Lebanon, the country once known as “The Switzerland of the Middle East” for being a prosperous banking hub with the only secrecy laws in the region, is now in the midst of a financial crisis that is inextricably entwined with the fate of its banking sector. A liquidity and financial crisis erupted in 2019 after years of mismanaged, ad hoc fixes to deeply-rooted economic, social, and political plights. As ruling elites abandoned their feeble and fake solution attempts, the crisis was compounded by the COVID-19 pandemic and the Beirut port explosion, further aggravating the already chaotic scenario. To date, the state has not yet managed to pass on a feasible, full-on restructuring program with long-term efficacy, and the many prevailing crises, namely economic and financial, continue to spur in the absence of capable leadership.

Trial and error

In what were supposed to be efforts to appreciate or even stabilize the Lebanese pound against the dollar, on May 10, 2021, Banque du Liban (BDL), the Lebanese central bank, launched “Sayrafa”, an electronic currency exchange platform. Law firm Melki & Associates, in an internal translation that explains the content of basic circular 157 on Sayrafa to English- speaking audiences, says that “the purpose of this platform is to identify the exchange rates at any point in time and to allow the BDL to supervise and intervene when needed.” Its debut rate on May 17 was 12,000 Lebanese pounds to $1. “The Sayrafa platform was supposed to bring down the FX rate. In fact, it had an adverse effect, the reason probably being some abuse, some arbitrage in the market,” says Khaled Zeidan, an expert in investment advisory and financial markets. Whenever there is more than one exchange rate for a currency in one market, this creates room for manipulation, with people buying and selling to benefit from the discrepancy between the rates. In Lebanon, there are four rates for the dollar: the official 1,515 Lebanese pounds peg, the 3,900 Lebanese pounds bank exchange rate; the 12,000 Lebanese pounds rate on Sayrafa; and the black market rate which had been fluctuating between 17,000 and 22,000 Lebanese pounds in the month of July 2021. This creates room for extensive arbitrage by buying at the lowest possible price and selling at the highest.

The most recent of the BDL’s extemporary solutions, followed by basic circulars 151 and 157, is basic circular 158, issued on June 8, which allows depositors who have foreign currency creditor accounts opened before October 31, 2019 to withdraw a monthly amount of $400 in so-called fresh dollars (dollar bank notes), and another $400 in Lebanese pounds converted at the exchange rate of the Sayrafa platform, only half of which can be withdrawn in Lebanese pounds from the account, with the other half is reserved for credit or debit card transactions. The central bank has defined the eligibility of depositors, by setting strict limitations not only on accounts, but also on depositors. Only natural persons, excluding those who have transferred an amount exceeding $500,000 abroad between July 1, 2017 and August 27, 2020 without repatriating 15 percent of the amount and depositing it in a special account blocked for five years, are allowed to benefit from the circular. This stipulation has the effect of reducing the number of beneficiaries by a non-disclosed percentage. If they wish to benefit from circular 158, however, qualified depositors should forsake their right to benefit from basic circular 151, which allows depositors to withdraw cash from their foreign currency account in LBP at the market exchange rate which is currently 3,900 Lebanese pounds to $1, compared to the black market exchange rate which varied between 17,000 and 22,000 Lebanese pounds in the month of July, thus instigating a haircut above 75 percent. Zeidan tells Executive that according to his friends and associates from different banks, there has not been much demand on circular 158. Depositors don't want to lose access to 151 given that the latter is more comprehensible and user-friendly in terms of restrictions. He adds, depositors do not believe that banks will be capable of honoring it for too long, and this is where the psychological barrier kicks in.

Questions that breed more questions

Every Lebanese depositor has the right to know the fate of their deposits. Whether they choose to benefit from the BDL's circulars or keep their deposits in their bank accounts, a clear identification of what the future holds for their life savings would go a long way. Depositors are not well informed about their legal rights in relation to the circulars, confirmed a random sample of depositors approached by Executive for this story. Their unified opinion implies that they do not know what is best for them, as they think they are incurring huge losses no matter the scenario they choose to go by. With confidence going further down the drain in the government and the banking system, depositors cannot choose their way to go, but they are definitely inclined towards exiting the financial system in the least loss incurring method.
Paradoxically, the BDL issued circular 158 while the government was drafting a capital control law to legitimize and organize the capital controls enacted by the banks. Paul Morcos, founder of JUSTICIABeirutConsult law firm, remarks that whenever the law is issued, it will prevail over any administrative decision including that of the BDL. "This is when the latter has to issue new circulars abiding by the course of law and amending circular 158," says Morcos. The real question now becomes, what is the reason behind the law delay, or in other words, why was it replaced by a tentative circular? Is the issuance of the law undesirable by the state officials and bank shareholders in first place to move on with their illegal capital controls? Is it realistic as some business experts alleged? Or are they distracting depositors from their iniquitous deeds – namely the subsidy lifts, electricity cuts, fuel shortages, etc. – with the hassle of setting a contract with Lebanese banks that are further complicating the process by limiting the benefits of depositors even more? Or should we instead choose to go in good faith, as Zeidan opines, settling for the idea that the institutions of the country are trying to come up with the best they can to alleviate the situation of the general public? The answer remains hazy.

"Basic circular 158 could be challenged before the administrative court for not having guaranteed equal chances for citizens by virtue of article 7 of the Lebanese Constitution that clearly stipulates that all citizens have to be equal under the law," says Morcos. To challenge a law, you need a specific number of parliament members to present a formal challenge; a circular on the other hand can be challenged by a single natural person before the administrative court.

“In order to challenge it you need to have an interest and a standing,” states William Melki, partner at Melki & Associates. There are two ways in which a citizen can go forward with the process; a depositor’s first option would be to start benefitting from the circular and then challenging it for not reaping benefits to the extent that he/she wishes. Otherwise, a depositor has to take a written statement by the bank to the court stating why he/she does not benefit, and would challenge it accordingly. However, as per Melki, banks are not giving out such statements, making it even a more strenuous of a process.

The options for ill-fated Lebanese depositors amount to four. Initially, they can choose to settle for the $800/month of circular 158, or more precisely the variations of 158 under bank contracts.

Another option would be disregarding 158 for the sake of 151, meaning depositors can withdraw cash from their foreign currency account in Lebanese pounds at the exchange rate (bank rate) set by the BDL which is currently 3,900 Lebanese pounds to $1 compared to the black market exchange rate. Banks are also allowed to set their own limitations; they can apply the circular at their own pace; “The ‘limits and procedures set by the bank,’ referred to in this circular, are similar to those imposed by banks on the cash withdrawal of US dollars. Lebanese banks will therefore have significant flexibility in the application of this circular,” states the internal translation of circular 151 by Melki & Associates.

A depositor can also opt for buying valuable assets using checks, also at 3,900 Lebanese pounds to $1 – that is if the buyer does not insist on fresh dollars. The haircut on the dollar amount in such transactions exceeds 80 percent as at end-July 2021.

The fourth and last option would be to keep their money at the bank, taking into account the expected haircut and accepting the future risk that is disputed in the framework of a capital control law, although the Association of Banks in Lebanon states otherwise. However, the BDL cannot decree a mandatory haircut, it can only lay down the conditions of a contractual voluntary haircut, just as it does with its circulars 151 and 158. Parliament legislation is the precondition for imposing a legal haircut on large – or, much more unlikely, all – deposits at banks, but one must not forget that there also is a loss of purchase power attributable to raging inflation.

Aside from adopting one of these not very remunerative options, depositors might choose to utilize two or more of them together, in efforts to recoup the utmost possible under their varied needs. As Zeidan advises, one should keep a small amount of cash at home to increase preparedness for any shock in a disruptive environment such as that of Lebanon. In his longer-term view, he says that as the size of total liabilities of the BDL shrinks, and if banks are successfully able to maintain the asset side, meaning the reserves and the gold, intact, any form of haircut will be dramatically reduced with time. On that account, depositors can keep some liquidity in their bank accounts for future gain, or more accurately, for loss compensation. Lastly, Zeidan affirms: “I would highly recommend that if you find valuable assets that you can buy with local dollars, do so, because medium to long term, I think that financial assets will fare less well in general than hard assets."

Financial exclusion

Zeidan asserts that the global language of the past 5-10 years has been financial inclusion. It promotes bank stability by keeping the state abreast with the flow of money according to Zeidan, and by increasing economic activity along with the velocity of money according to the Center for Financial Inclusion. The Lebanese banking practice of the last two years since the 2019 liquidity crisis has been the diametrical opposite of the worldwide sought-after. Whoever managed to draw money out of the system has them sitting in a safe, inviting troubles. Not only does it affect the country socially, but inert money also does not interest the economy, as it might eventually find its way out of the country. Our financial tools are also contracting, with credit cards being denied by most of retail stores, restaurants, etc., and that constitutes another obstacle to financial inclusion.

Melki agrees that currently operating or at least semi-operating banks are under the risk of bankruptcy. However, he predicts the expansion of branches of foreign banks in Lebanon as well as the merging of Lebanese banks with one another to meet the capital requirements enacted upon them by the BDL, otherwise the situation will result in bank bail-ins. Melki contends that BDL governor Riad Salameh is good at matching investors so he will probably find banks a way out of bankruptcy. The tough part however is reengaging previous depositors in the financial system, and this will definitely not happen overnight. Confidence needs to be restored by a competent leadership that is transparent and willing to undertake a tough restructuring journey.

A vision forward

Many experts and advisors are coming up with rescue plans for Lebanon, and banking sector restructuring hits the headlines. Distributing the losses is part of the process, but the focus needs to be shed on the importance of rebuilding new sectors or enhancing already existent ones, competitive enough to spread out in the region. Once we ideate and define our role, setting up our various policies – economic, social, political, financial, etc. – becomes easier and much more effective, says Zeidan.

Confidence is a major part of the narrative; it is an essential cornerstone at the basis of Lebanese relations with the international community as well as with the public. And even if confidence is restored, the banking sector's standing in the country will differ, affirms Zeidan: "I do have a theory that the banking sector will no longer be the sole gatekeeper of the finances of the country, nor the economy of the country. I think the banks at best will be one of many other gatekeepers." He adds: "You need fresh equity and capital from overseas, you need new management and banks, you need stability, and again, confidence." If the International Monetary Fund were to be part of the process, we need it most for the discipline and due diligence. We need to embark on risk capital with the inert money and initiate businesses that generate value through exports and allow room for self-sufficiency to decrease imports. But more and most importantly, we need to establish a well-structured, comprehensive plan excluding contradicting and overlapping decisions by the various institutions of the state.

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