THE GREAT SELL-OFF:

HOW LEBANON'S BANKING SECTOR SOLD OFF THE COUNTRY'S FINANCIAL FUTURE TO FOREIGN INTERESTS

AN INVESTIGATION BY BADIL REVEALS PREVIOUSLY UNKNOWN DETAILS OF LEBANON'S EUROBOND DEFAULT AND HOW THE BANKING SECTOR MANIPULATED IT TO FACILITATE BILLIONS OF DOLLARS IN FOREIGN TRANSFERS.

BY NICHOLAS NOE

OVERVIEW

As with so many of its national tragedies, Lebanon's disorderly default on US$31.3 billion of sovereign Eurobonds in March 2020 was preventable but detonated as a result of the usual mix of personal greed, outright incompetence and the corrosive manipulation of powerful foreigners. With new data available and some of the actors directly involved finally willing to talk, a fuller picture of a particularly shameful episode in Lebanon's modern history is now available.

On March 16 2020, Lebanon defaulted on a US$1.2 billion Eurobond. This much, we all know. However, this deceivingly simple sentence does not come close to conveying the true scale of the tragedy that has befallen the country. Nor does it expose any of the events that led to the fateful decision which, given Lebanon's massive debt, could arguably not have been avoided but, surely, could have been taken in an orderly fashion.

Moreover, the plain fact that Lebanon was not able to repay a loan tells us nothing about the shocking incompetence of a finance minister who decided to share a confidential memo on debt restructuring more than a year before the default, not with his staff but with the press, prompting Moody's to launch an immediate downgrade of the country's credit rating and effectively suspending an already badly belated treatment effort.

It also fails to fully articulate the ruthlessness and greed of Lebanon's banks both before and after the default. Pushed by top management and their largest depositors - both hungry for cash to flee a deepening national crisis - the banks did not hesitate to sell Eurobonds into foreign hands, knowing perfectly well that doing so would severely weaken the government's negotiating position and hamper the prospect of a debt restructuring.

Indeed, most media have long assumed that "the great sell-off" only started in early 2020. It has now become clear that Lebanese banks already sold up to US$1.2 billion in Eurobonds to foreigners between January and October 2019. It did not stop there. Another US$3.5 billion in Eurobonds was sold between the October 17 uprising and March 16, 2020 - the day of the default. Even then, it did not stop.

Lebanese banks happily continued selling after the default, unloading another US$1.4 billion in Eurobonds before the year's end. In total, local banks are thought to have sold over US$6.1 billion in Eurobonds, which amounts to almost 40% of what they owed before a confidential note on debt restructuring reached the finance minister, who thought it a good idea to digest it by reading it directly to a newspaper reporter.

Incredibly - though certainly less so in retrospect - even the Lebanese Central Bank (BDL) got in on the disgrace. Although Riad Salameh was well aware that Lebanon was dangerously short on US dollars and a debt restructuring was back on the political agenda, the BDL Governor in November 2019 insisted on paying a US$1.5 billion Eurobond, as well as US$632 million in interest.

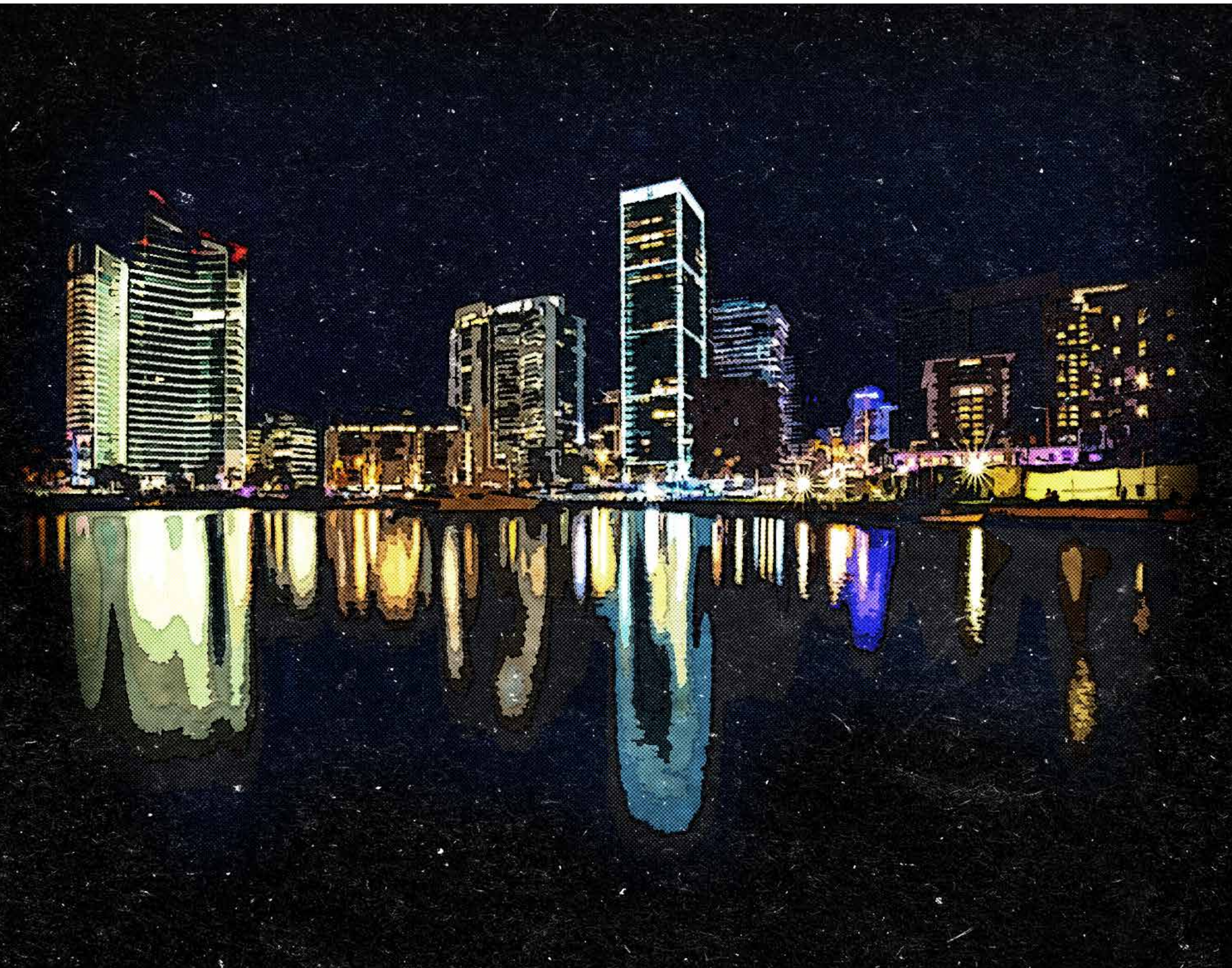
In the months that followed, he consistently downplayed the effects of the accelerating Eurobond sell-off to foreigners, pleading with government policymakers, like the inexperienced new premier, that the "leakage" of precious US Dollars would be minimal.

Following the default, he directed the BDL to sell some US$700 million in Eurobonds, thus further diminishing the Lebanese government's bargaining position, while he and his family arguably netted millions in secret commissions.

As a result, Lebanon is no longer a master of its debt destiny. Foreigners hold more than US$17 billion in Lebanese Eurobonds and claim to exercise veto power in 40% of all of the country's Eurobond series. Among them are the so-called "vulture funds," which purchase distressed debt, often significantly below market value, have no interest in any nationally sound debt restructuring and seek to recover the bonds' full amount, plus interest, often through draining litigation.

What's more, foreign Eurobond holders could argue that some of the operations BDL has engaged in since March 2020 cannot be considered traditional central banking functions. If such arguments hold in court, BDL funds and properties - including Lebanon's gold reserves worth an estimated US$17 billion - could be exposed to foreign seizure.

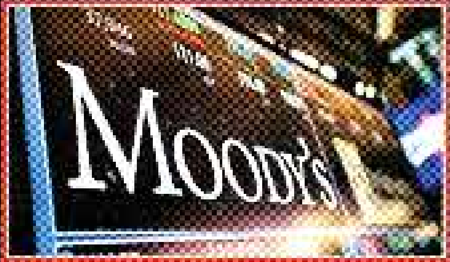
On March 16, 2020, Lebanon defaulted. It is a seemingly simple phrase that does not do justice to the world of suffering and betrayal it conceals. The Great Sell-Off, in six acts and stunning detail, shines a light on what went on before, during and after that fateful day.



LEBANON'S DISORDERED DEFAULT

JANUARY 9 2019

Confidential memo recommends Eurobond restructuring; Finance Minister Khalil reveals parts to Al Akhbar reporter



JANUARY 21 2019

Moody's downgrades Lebanese debt; several Lebanese banks start selling Eurobond holdings to foreigners

SEPTEMBER 2019

Lebanese Pound depreciates as the Dollar Peg comes unmoored after decades of stability

OCTOBER 1 2019

Since Khalil's "mishap" Lebanese banks sold US$1.2 billion in Eurobond holdings

OCTOBER 17 2019

Lebanon's "WhatsApp revolt" kicks off

OCTOBER 18 2019

BDL Governor Salameh is told in Washington a debt restructuring is back on the table

OCTOBER 29 2019

Hariri government resigns in the face of sustained protests and bank closures

NOVEMBER 21 2019

Despite a collapsing economy and dwindling reserves caretaker government pays $1.5 billion Eurobond and $632 million in monthly interest

DECEMBER 2019

As "vulture funds" cruise Beirut, Lebanese banks sell more Eurobond holdings to foreigners undermining the government's ability to negotiate new debt terms

JANUARY 1 2020

The Great Sell-Off accelerates

JANUARY 15 2020

Salameh's efforts to get local banks on board with a Eurobond swap fail as the caretaker finance minister announces a suspension of swap efforts

JANUARY 21 2020

Incoming premier Diab struggles to understand the enormity of the problem and entertains Salameh's insistence that the $1.2 billion March Eurobond can be paid without much "leakage" of dollars

FEBRUARY 15 2020

Since start of the year Lebanese banks have sold $1.7 billion in Eurobonds to foreigners

FEBRUARY 26 2020

Diab's cabinet decides to postpone monthly interest payments on Eurobonds but discovers later in the day that Salameh and Finance Minister Wazni have already paid the $71 million due

MARCH 2 2020

Government officials inform Diab, due to the Great Sell-Off, at least $6 billion in payments will go to foreign accounts in next 21 months and only $477 million out of $2.5 billion in Eurobonds due in the next few months is still owned by Lebanese banks

MARCH 7 2020

Diab's government announces it will not pay the $1.2 billion Eurobond which triggers a "cross-default" on all $31.3 billion in Lebanese Eurobonds

MARCH 9 2020

Salameh finally sends Diab data disclosing he had effectively been hiding BDL losses for years - possibly more than $60 billion

MARCH 16 2020

Lebanon officially defaults for the first time in its history

APRIL 1 2020

Local banks have sold $3.5 billion in Eurobonds to foreigners since October 2019

DECEMBER 2020

Local banks have sold another USD 1.4 billion in Eurobonds to foreigners following the default

NOVEMBER 2021

Salameh has directed BDL to sell a total of $700 million in its Eurobond holdings since 2020, netting his brother's company millions in commissions

DECEMBER 2021

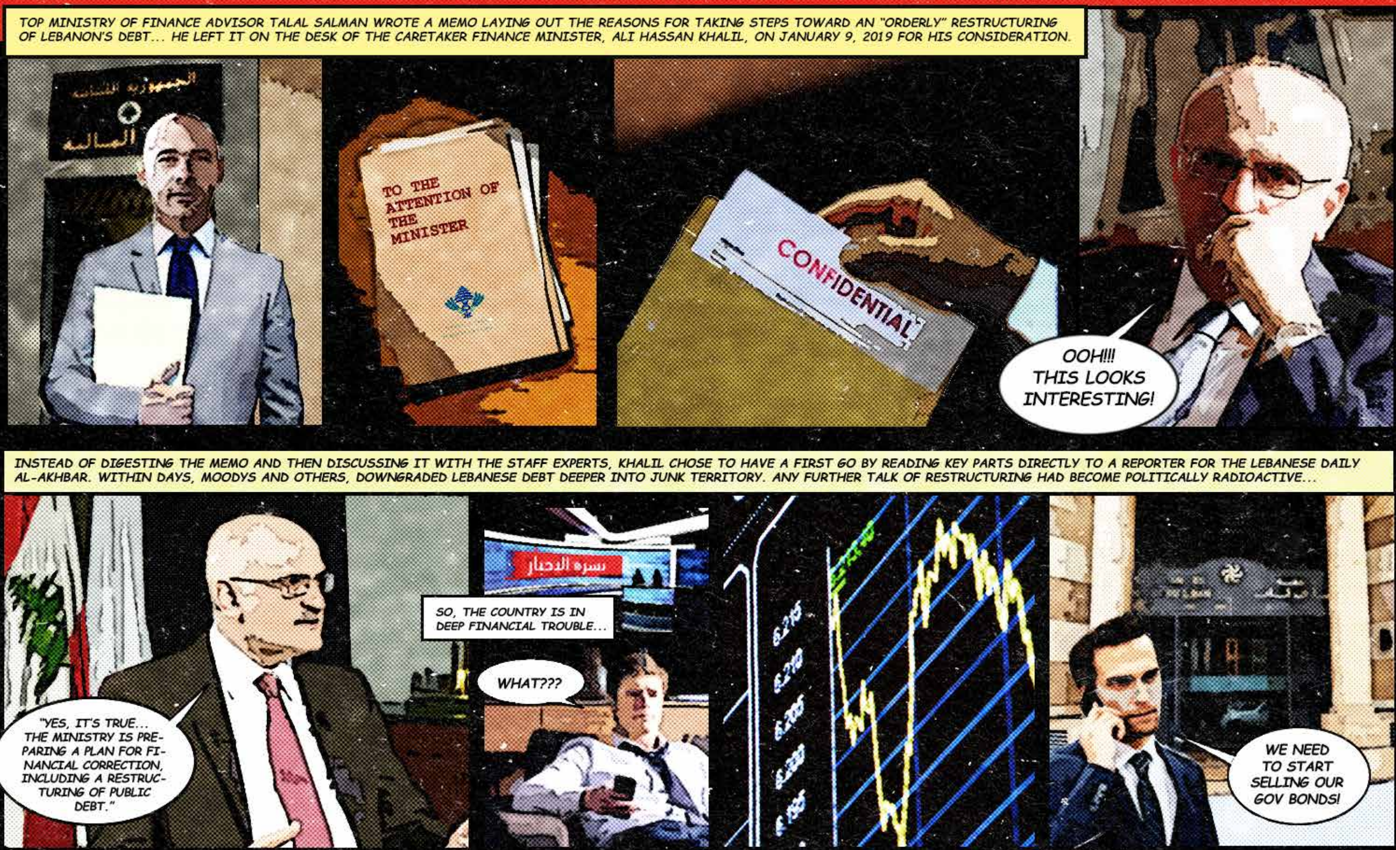
In total, local banks sold over $6.1 billion of Eurobonds since January 2019; Foreigners hold over $17 billion in Lebanese Eurobonds and claim to exercise veto power in 40% of all of Lebanon's Eurobond series

BADIL
THE ALTERNATIVE

ACT I

JANUARY TO SEPTEMBER 2019

THE "HOUSE OF CARDS" SHAKES



On New Year's Eve 2018, a Lebanese sovereign default and collapse of the country's financial and economic systems probably seemed a remote possibility to most Lebanese. Yet, some bankers and government officials finally saw the country's incredible debt burden, long one of the world's worst, as the clear and present danger it had become: A "House of Cards" that could bring down the entire nation.

With this in mind, Talal Salman, the finance ministry advisor in charge of the country's Eurobond file, put together a detailed memo regarding an "orderly" restructuring of Lebanon's rapidly mounting debt obligations. He left it on the desk of caretaker Finance Minister Ali Hassan Khalil on January 9, 2019.

Unfortunately, Khalil had little background in finance, a shortcoming that would arguably hurt Lebanon on that particular day, more than on any other day during his six-year tenure. Instead of discussing the memo with his staff, according to Salman, Khalil chose to read key parts to a reporter for the Lebanese daily Al-Akhbar, ignoring the bolded headline "Highly Confidential."

As The Economist put it a few days later, "Khalil did a staggeringly poor job when he told [the reporter] his country was ready to default." Khalil had told Al-Akhbar: "It's true that the ministry is preparing a plan for financial correction, including a restructuring of public debt."

The resulting uproar proved costly. Within days, Moody's downgraded Lebanese debt deeper into junk territory. Three more rating agency downgrades followed before the October 17 revolt, dramatically reducing the country's ability to open Letters of Credit for trade, issue new debt and, most noticeably to the public, maintain the "currency peg," which had held the Lebanese Pound (LBP) steady in value to the US Dollar (USD) for more than two decades.

Khalil's misadventure proved even more costly in terms of how it slowed down the already belated effort to restructure Lebanon's exploding debt.

"We lost precious months," explained Salman, who would later lead Lebanon's IMF and Eurobond negotiations. "After the interview, everyone - politicians especially - were all much more risk-averse to even exploring the need for a change. Instead of working quietly to develop a plan and hammer out a political consensus, the issue became radioactive."

In retrospect, this was perhaps the worst moment for such a setback. Lebanon's now-infamous "financial engineering" had gone into overdrive by 2019, with BDL and local Lebanese banks working together to offer unheard-of terms to anyone bringing in fresh dollars.

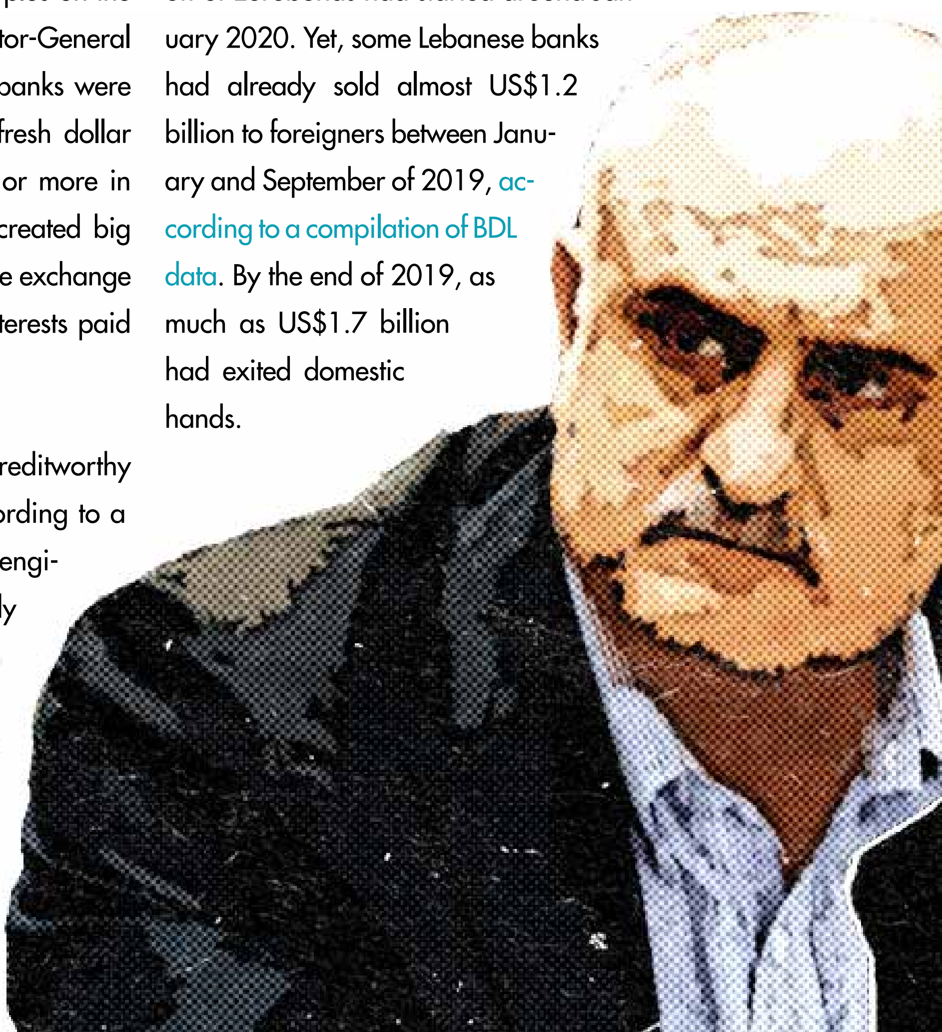
"A few banks were already paying 20 percent plus on the dollar," explained Alain Bifani, who was Director-General of the Ministry of Finance at the time. "Some banks were making it public, and many would take one fresh dollar coming from abroad and deposit 2.5 dollars or more in the bank account against it. The system had created big amounts of local dollars in the system through the exchange operations on Eurobonds and the very high interests paid locally on the dollar."

Of course, by 2019, Lebanon had not been creditworthy for at least four years. As we now know, according to a leaked report, when BDL began its financial engineering campaign in 2016, the IMF had already identified and communicated to the central bank that there was a hole of more than US$4.7 billion in its reserves (the report was never officially released following protests by Salameh).

There were other red flags in the months before the October 17 revolt. The finance ministry had been unable to sell new Eurobonds on the primary market for almost two years, while several local banks had marked down the real value of their legacy holdings. By summer, some were restricting transfers abroad and limiting cash withdrawals. With the USD currency peg finally wobbling, the market signals were clear: Lebanon's structural problems were rapidly reaching a tipping point.

Despite knowing that a debt restructuring was being discussed and that sales of Eurobonds to foreigners would harm any government effort to negotiate new terms, some Lebanese banks decided well before the October 17 revolt that the financial writing was on the wall. The time had come to start exiting BDL's "financial engineering" scheme.

Many media later assumed that a Lebanese sell-off of Eurobonds had started around January 2020. Yet, some Lebanese banks had already sold almost US$1.2 billion to foreigners between January and September of 2019, according to a compilation of BDL data. By the end of 2019, as much as US$1.7 billion had exited domestic hands.



ACT II

OCTOBER 18, 2019

A FRIGHTENED SALAMEH IS TOLD RESTRUCTURING IS IMMINENT

During a break at the annual IMF meeting in Washington, D.C., on October 18, Khalil's advisor Salman took BDL Governor Riad Salameh aside and informed him that the upcoming US$1.5 billion Eurobond payment in November would have to be restructured and not merely rolled over with new debt as had been "normal practice" for years.

It had taken ten months to overcome the damage done by Finance Minister Khalil's "financial correction" comments but, apparently, a political consensus had been reached to start addressing the looming Eurobond threat.

Salameh was "frightened," according to Salman. Even though BDL and local banks still held as much as 66% of all outstanding Eurobonds, a decent negotiating position for the government, Lebanon's overall financial architecture had become so vulnerable after years of "engineering" that an attempt to treat the rot by restructuring could lead to a cataclysmic unravelling. It would also mean a deep public embarrassment for Salameh personally.

'Have you got the backing for this from [Parliament Speaker Nabih] Berri and [Prime Minister Saad] Hariri?' Salameh asked. He had, Salman replied. It was a crucial point since BDL is legally beholden on such matters to the government and the ministry of finance controlled by Berri appointee Ali Hassan Khalil. Salameh said he needed time to consult back in Beirut. Salman assumed he wanted to hear a directive for restructuring directly from the main political actors and try to convince them otherwise (a point further confirmed by one of Salameh's long-time confidants who spoke to him shortly after he returned).

As Salameh and Salman headed home, neither one, like the rest of the political elite, could have predicted that the "WhatsApp" street protest that erupted the night before on October 17 would soon collapse the Hariri-led government. Nor could they have expected that one night of burning tires and blocking roads would grind the banking system to a halt and precipitate a massive outflow of foreign currency for a few privileged Lebanese, who had seen the ship sinking for years, but had the power to grab a lifeline when it mattered most.

ACT III
NOVEMBER TO DECEMBER 2019
THE GREAT SELL-OFF BEGINS

Contrary to expectations, the October 17 revolt sustained itself and rapidly expanded. In response, the Lebanese establishment did what it perhaps does best: key leaders refused to take responsibility and kicked the country's problems down the road where they would be even more difficult to address. One result was that the ministry of finance's ultimatum to restructure was, for the moment, withdrawn.

Some in the resigned Hariri government, like caretaker Labour Minister Camille Abousleiman, continued to argue for the non-payment of the upcoming US$1.5 billion Eurobond and monthly interest on all other Eurobonds. According to Abousleiman and several other government officials, however, Hariri refused to be seen as the one who pushed Lebanon into its first-ever default, orderly or not.

Although his caretaker government could take such a decision, Hariri's weakly-grounded legalistic pleadings that he did not have the authority, combined with Salameh's insistence to keep paying, ultimately carried the day. First, the monthly interest on all of Lebanon's Eurobond obligations – a whopping US$632 million – was settled at the end of November.

Then, on November 27, the US$1.5 billion Eurobond was paid, siphoning an estimated US$500 million out of the country to foreign holders. That same day, the Lebanese government issued another US$1.5 billion Eurobond, which BDL bought, thus further diminishing its dwindling USD reserves by effectively transferring cash to the government.

As Bifani later wrote in a report for the Hoover Institution, the full payment in "fresh USD cash" for the November 27 Eurobond "immediately left the country in the absence of capital controls." Adding: "Clearly, the country was splitting between those who were sucking the dollars to the last penny and those who were seeing their savings vanish." For Hariri and his ministers, he continued, "what mattered was to secure the flow of money in the direction of the elites, despite the terrible consequences for the population."

One of the "terrible consequences" of the November payments, according to several leading figures in the sector, was that the top management of several Lebanese banks figured that Lebanon's Ponzi Scheme was indeed about to collapse and that it was unlikely the political class could do much to cushion the shock. They then took the fateful decision to unload most, if not all, of their Eurobond holdings to foreign funds, in particular to so-called "vulture funds," which were aggressively cruising Beirut hotels and board rooms looking for deals no matter what the cost for Lebanon might be.

According to BDL data and Bank of America, Lebanese banks sold as much as US$500 million in Eurobonds to foreigners between October and December 31, 2019, while another US$3 billion was sold in the first quarter of 2020 (Q1). According to a confidential Banking Control Commission (BCC) report provided to several government officials at the time, US$1.7 billion was sold to foreigners between January 1 and February 15 alone.

This enormous transfer of sovereign USD-denominated debt to foreigners, especially "vulture funds" such as the UK-based Ashmore Group, provided a double blow to Lebanese hopes for an orderly restructuring of the country's debt obligations. On the one hand, foreign funds are harder to negotiate terms with, given the lack of domestic pressure, especially when they gain "blocking strength" of more than 25% in any one Eurobond series[1] as Ashmore and US-based Fidelity did in late 2019 and early 2020.

On the other hand, and perhaps more importantly, given the currency crunch that had become acute by the end of 2019, the sell-off also meant a substantial part of monthly USD interest payments (an estimated US$2.26 billion in 2020), on top of the USD payments for the Eurobonds maturing in 2020 (totalling US$2.7 billion), would transfer even more "fresh cash" out of the country, slashing the amount available for depositors and vital imports.

Bank Audi was very likely the single biggest seller between October 2019 and March 2020. Unlike most Lebanese banks, Audi must file periodic reports since it is traded on the Beirut Stock Exchange. While most banks simply stopped publishing meaningful data after October 2019 to cover their tracks, Audi continued reporting.

According to Audi's 2020 Annual Report, it held almost US$2 billion in Eurobonds on January 1, 2020. Fully aware of the difficulties for the Lebanese government, the bank nevertheless sold "the vast majority of [our] Lebanese Eurobonds exposure" so that by the end of June 2020 Audi held a mere US$57 million in Eurobonds.

It is very likely, however, that Audi sold the vast majority of its Eurobonds to foreigners before the default in Q1, when prices for the bonds were higher, as the selling of Eurobonds substantially slowed in the three months after the default. Audi's subsequent 2021 Annual Report obliquely states it disposed of "the majority of [our] Eurobonds during Q1-2020.

In all cases, Audi's selling of almost US$2 billion in Eurobonds in early 2020, even in the unlikely event that some sales were made as late as June, represents more than 55% of the total amount of Eurobonds sold by all Lebanese banks to foreigners during the first six months of 2020.

According to several industry insiders, the Eurobond sell-off during the first months of the crisis by Audi and several other banks was specifically driven by the narrow desire of top managers, big shareholders and ultra-wealthy depositors to gain "fresh cash" and transfer it abroad to escape the financial "death spiral" they had long seen coming. As the BCC noted in its confidential report of February 2020, the extra dollars also helped individual bankers and large depositors protect their international reputations by paying back individual and institutional commitments.

This was, of course, all possible because the Lebanese government and BDL refused to put in place formal capital controls (as is still the case until this writing), leaving each bank to decide for itself how much and for whom to transfer their ever-scarcer USD reserves. The Eurobond sell-off thus provided a vital lifeline of discretionary cash at the moment of maximum danger (US$828 million from sales between January 1 and February 15, 2020, according to the BCC), all the more so because foreign fund demand rose substantially: The market price of the US$1.2 billion Eurobond set to mature in March 2020 rose from 77 cents on the dollar in November 2019 to 87 cents by mid-January 2020.

Although the scope of financial self-preservation was unclear at the time, the evidence of a massive outflow of funds before the default, benefiting a handful of Lebanese, is now compelling. According to BDL raw balance of payments data, US$14.7 billion flowed out of the country between October 2019 and March 2020.

Although it is impossible to know without a full forensic audit of the banking system how much was attributable to depositor transfers abroad rather than other balance of payment operations, for a financial system severely restricted for almost all Lebanese and an economy ground to a halt, the number is startling, as it represented only a US$6 billion decrease in payments abroad compared to the same period the year before.

According to an additional leaked BCC report, US$2.3 billion in deposits left Lebanese banks for Switzerland between October 17 and December 31, 2019, while the number of accounts holding more than US$100 million fell from 36 to 23 between January 2019 and March 2020.

An investigative report by Albin Szakola in L'Orient Le Jour calculated that "between Switzerland, Luxembourg and the British Crown Dependencies — in banks serving as gateways to a world of multi-trillion dollar offshore wealth — deposits belonging to individuals and companies based in Lebanon have grown by US$3.5 billion [between] the summer of 2019 and October 1, 2021."

"Beyond just these offshore havens deposits held by Lebanon-based individuals at banks in all 31 countries reporting to the Bank of International Settlements rose from US$7.6 billion in March 2019 to US$12.1 billion at the end of September 2021, with the largest spike coming at the end of 2019," the report continued.

Importantly, not all Lebanese banks decided to unload their Eurobonds to foreigners. While Bank Audi stands out, Bank of Beirut, SGBL and Bankmed, at the very least, are widely believed to have joined in the sell-off from October 2019 to March 2020, even though all three simply stopped reporting detailed financial data after 2019.

In contrast, according to their own reporting, BLOM Bank, Bank Byblos and Credit Libanais seem to have not engaged in the pre-default sell-off and mostly held on to their substantial Eurobond holdings, at least until the end of 2020.

By the time Hassan Diab was finally able to form a government and take office as prime minister on January 21, 2020, Lebanon had lost three precious months to a governance vacuum and was only six weeks away from having to pay the US$1.2 billion Eurobond due in March. As several of Diab's advisors realised, the various foreign sides buying up hundreds of millions of dollars of Eurobonds in January were not only dramatically eroding the new government's negotiating position, they were also complicating efforts to promptly identify who owned the 29 different Eurobonds extending to 2035, each of which would have to be restructured with a 75% approval rate, as required by Lebanon's disadvantageous Eurobond contract language.[2]

But there were even more pressing problems. Although a political consensus had formed by late January that some kind of default was necessary, Diab had a limited understanding of finance, which led to more delays in grappling with the gathering storm, according to two of his advisors who requested anonymity. For example, Diab was shocked to learn it was not merely a matter of paying Eurobonds coming due. Interest payments, sometimes totalling hundreds of millions of USD, also had to be paid each month. And to his befuddlement, Eurobonds had nothing to do with the Euro currency.

More problematically, Diab lost precious weeks listening to Salameh's increasingly misleading pleadings that there was still plenty of money to meet the country's debt commitments and that any USD payment would mostly be kept within the country. According to his advisors, he was also reluctant to start his mandate with a historical default and hoped his exhortations to local banks to buy back the Eurobonds they had just sold would work.

Of course, Diab was aware that Salameh had tried unsuccessfully to offer swaps into longer maturities for some local

Eurobond holders at the end of 2019 and early 2020 to avert a March default. Those entreaties had failed as banks spurned him, preferring to reap fresh cash by unloading billions in Eurobonds at more advantageous (though deflated) prices to foreign firms which seemed confident that Lebanon would meet its commitments.

As JP Morgan put it on January 15, 2020: "Among the reasons banks may not be on board is that the notes maturing in March trade at 87 cents, much higher than the price of Lebanon's longer-dated debt, most of which trades at less than 50 cents."

Undeterred by Salameh's earlier failures with local banks in more advantageous circumstances, and despite data becoming available in February showing the significant "leakage" of cash to foreigners, it was not until the end of the month that Diab took the first decisive steps towards a default. This was also when he realised that Salameh had hoodwinked him and that even members of his government might not be reliable.

On the morning of February 26, according to then Justice Minister Marie-Claude Najm and Diab himself, the cabinet postponed the monthly interest payment on Lebanon's Eurobonds (US$71 million) until a final decision was made on the US$1.2 billion Eurobond due a week and a half later.

However, as the government was preparing a press release to this effect, several cabinet ministers and government advisors were surprised to learn that BDL had already paid the SWIFT transfer of the interest payment. To bolster his repeated assurances of payment, especially to such foreign funds as Ashmore, Salameh had effectively abrogated a government decision by moving fast and exercising the power and political relationships he had built up as the longest-serving central banker in the world.

"Finance Minister [Ghazi] Wazni had signed off on the SWIFT," explained a former minister who requested anonymity, indicating that perhaps Wazni's political boss, Speaker Berri, had been in on the payment end-run. "Even though we had agreed not to, he did it anyway with Salameh!"

Wazni did not respond to requests for comment. A spokesperson for BDL insisted that only the Finance Minister could approve SWIFT transfers of funds from the ministry's account at BDL.

ACT V
MARCH 2020
SALAMEH IS EXPOSED AND A DISORDERLY DEFAULT IS INEVITABLE

On March 2, just seven days before the first of three Eurobonds was coming due, Diab, Salameh and over two dozen government officials, bank representatives and ministerial advisors met at the Serail to finally make a decision. Salman and other government advisors provided the data, most of which had circulated for weeks, that proved Salameh had consistently underestimated and underrepresented the leakage of USD abroad through Eurobond interest and principal payments.

They cited the BCC report, which had been made available to some officials, disclosing that out of the US$2.5 billion in Eurobonds due in the next few months, a mere US$477 million was owned by Lebanese banks. Of this, less than

US$239 million was held within Lebanon's clearing system. The rest was held by Lebanese banks' foreign branches, which would receive USD payments abroad. BCC estimated that over 90% of the three upcoming Eurobonds payments for 2020 would transfer the money abroad, and at least US$6 billion in principle and interest payments would go to foreign accounts over the next 21 months.[3]

Ashmore and Fidelity, in particular, had effectively cornered the market for "triggering" 2020 Eurobonds, with Ashmore alone gaining much more than 25% blocking stakes in all three.

A familiar, but nevertheless toxic mix of self-interested Lebanese bankers, unprepared and timorous Lebanese leaders and powerful, profiteering foreigners had conspired to push the country towards the worst of all options: a disorderly default.

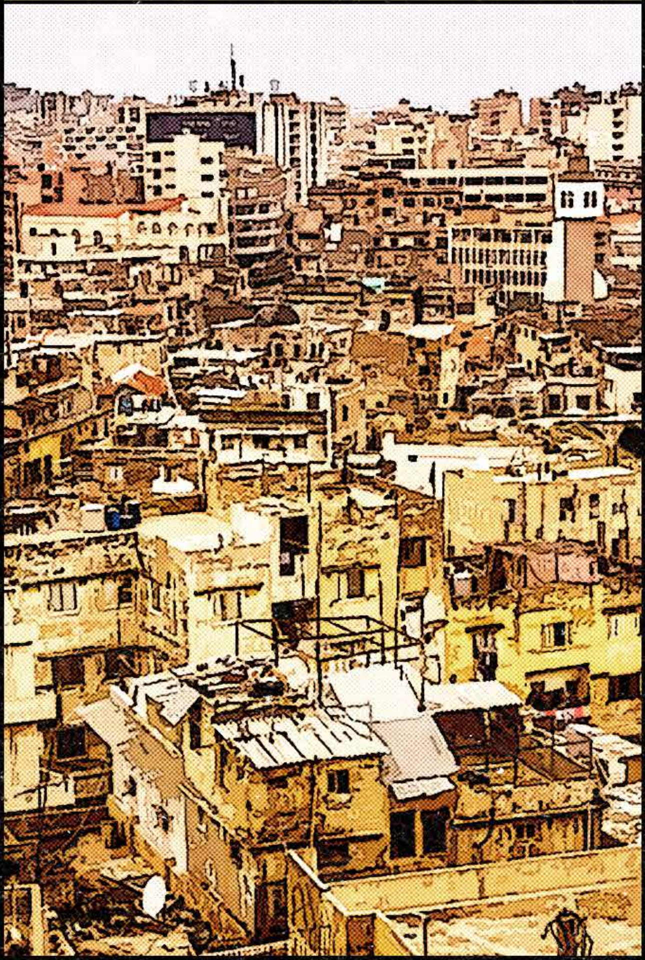
On March 7, 2020, the Diab government announced it could not pay the US$1.2 billion Eurobond due in the coming days, triggering a default on all US$31.3 billion in Lebanese sovereign Eurobonds. In what would not be his last spiteful move, Salameh, on March 9, sent Diab's office a binder of BDL data, which the government had requested for weeks. Among other disclosures, Salameh admitted he only had US$22.8 billion in USD reserves left, demonstrating he had effectively been hiding significant BDL losses for years - possibly more than US$60 billion - with a range of accounting tricks and obfuscations.

ACT VI

THE AFTERMATH

MORE EUROBONDS ARE SOLD AND THE HOLE DEEPENS

DESPITE THE DAMAGE THAT THEY HAD ALREADY DONE, SOME LOCAL BANKS CONTINUED TO SELL AFTER THE DEFAULT. ALMOST $1.4 BILLION WAS SOLD TO FOREIGNERS BETWEEN APRIL AND DECEMBER 2020.



WE NOW KNOW THAT OVER $6.1 BILLION OF EUROBONDS WERE SOLD BY LEBANESE BANKS TO FOREIGNERS FROM JANUARY 1, 2019, UNTIL TODAY, REPRESENTING ALMOST 40% OF THE AMOUNT OWNED BY THESE BANKS ON NEW YEAR'S EVE 2018.

THROUGHOUT THE ENTIRE CRISIS, SALAMEH VERY LIKELY MADE MILLIONS OF DOLLARS BY DIRECTING BDL TO SELL AN ESTIMATED $700 MILLION OF ITS EUROBOND HOLDINGS, SINCE HIS BROTHER'S FIRM, FORRY ASSOCIATES, MAKES A COMMISSION ON EACH BDL EUROBOND SALE.

AS SEVERAL LEBANESE FINANCIAL ANALYSTS HAVE PUBLICLY WARNED, EUROBOND HOLDERS COULD ARGUE THAT SOME OF THE OPERATIONS BDL HAS ENGAGED IN SINCE MARCH 2020, ESPECIALLY ITS SUPPORT FOR SOME COMMERCIAL ENTERPRISES, ARE NOT TRADITIONAL CENTRAL BANKING FUNCTIONS. IF THESE ARGUMENTS ARE SUCCESSFUL IN THE NEW YORK COURTS WHERE SUCH SUITS MUST BE FILED, BDL FUNDS AND PROPERTIES, INCLUDING LEBANON'S GOLD (WITH AN ESTIMATED WORTH OF OVER $17 BILLION) WOULD BE SHORN OF SOVEREIGN PROTECTION AND BECOME EXPOSED TO SEIZURE.

Despite the damage done by selling Eurobonds to foreigners ahead of the default, Lebanese banks continued to do so after March 2020: Almost US$1.4 billion in Eurobonds were sold from April 2020 until the end of the year, according to BDL. As a result, we now know that over US$6.1 billion of Eurobonds were sold by Lebanese banks to foreigners from January 1, 2019, until today, representing almost 40% of the amount owned by these banks on New Year's Eve 2018.

Most debilitating for Lebanon is that as much as US$4.9 billion was sold by Lebanese banks to foreigners during the last two and a half years of the Lebanese crisis, representing 31% of all Eurobonds owned by local banks before the October 17 revolt.

The corrosive result of this huge transfer abroad goes far beyond Ashmore and Fidelity's lock on the three "triggering" Eurobonds in 2020. Foreigners now hold US$17.2 billion in Lebanese Eurobonds out of the US$31.3 billion outstanding, according to a March 2022 estimate by Bank of America, and exercise veto power in 40% of all of Lebanon's Eurobond series. Reuters reported in September 2021, that the "heavyweight funds" concerned also include Amundi, BlackRock, BlueBay, T-Rowe Price and a group of smaller hedge funds.

However, it was not only Lebanese banks that sold to foreigners and saved themselves, while diminishing the Lebanese government's bargaining positioning. Throughout the entire crisis, Salameh very likely made millions of dollars by directing BDL to sell an estimated US$700 million of its Eurobond holdings, according to tallies from Bank of America, since his brother's firm, Forry Associates, makes a commission on each BDL Eurobond sale. As has been widely reported since the Forry contract was leaked in 2021, the Salameh brothers have probably netted hundreds of millions of dollars in commissions during the last 20 years of the contract.

As so many times in the past, Lebanon's failure to rationally and expeditiously deal with its problems is only pushing the country further into a hole. Indeed, Lebanon is now far less able to defend its remaining assets from creditors because of how BDL conducted itself during the prolonged crisis. As several Lebanese financial analysts have publicly warned, Eurobond holders could argue that some of the operations BDL has engaged in since March 2020, especially its support for some commercial enterprises, are not traditional central banking functions.

If these arguments are successful in the New York courts where such suits must be filed, BDL funds and properties, including Lebanon's gold (with an estimated worth of over US$17 billion), would be shorn of sovereign protection and become exposed to seizure. What's more, the success of any IMF deal is now compromised by the spectre of negotiations with foreign bondholders, given that the cornerstone of any IMF programme is debt sustainability.

The Eurobond default is but one episode in a long-running saga of Lebanon's financial tragedy, one where the country's financial future was sold off to those who have the least to gain from its recovery. And while that moment cannot be reversed, it serves as a stark warning that Lebanon's bankers and their enablers still need to be held to account for what may prove to be the country's darkest financial hour.

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1 Additionally, because Lebanon's Eurobond contracts are "cross-triggering," defaulting on one Eurobond puts all of the country's US$31.3 billion in Eurobonds in arrears. By holding majorities in just the first three maturing Eurobonds in 2020 - i.e. March (US$1.2 billion), April (US$0.7 billion), and May (US$0.8 billion) - Ashmore and Fidelity therefore exercised even greater leverage in negotiations than their actual stakes.

2 Lebanon's Eurobond contracts don't provide for a "collective action clause" (CAC) that would allow the state to negotiate the terms of debt restructuring all at once but instead require an issue-by-issue vote of these terms with 75% consent. According to Abousleiman and supported by Salman, as early as December 2015, Abousleiman and Finance Ministry staff had strongly recommended that Lebanon adopt the CAC, "but the Minister of Finance at the time did not forward this proposal to the Council of Ministers." As a result, the CAC was never added to Lebanon's Eurobonds, greatly impeding its position later on ahead of the default.

3 The government was supposed to pay US$2.72 billion and US$2.26 billion in 2020 - almost US$5 billion total - as principal and interest on Eurobonds respectively at exactly the moment when the country's economy, financial and governance systems were all experiencing multiple, sustained shocks rarely seen in modern history.