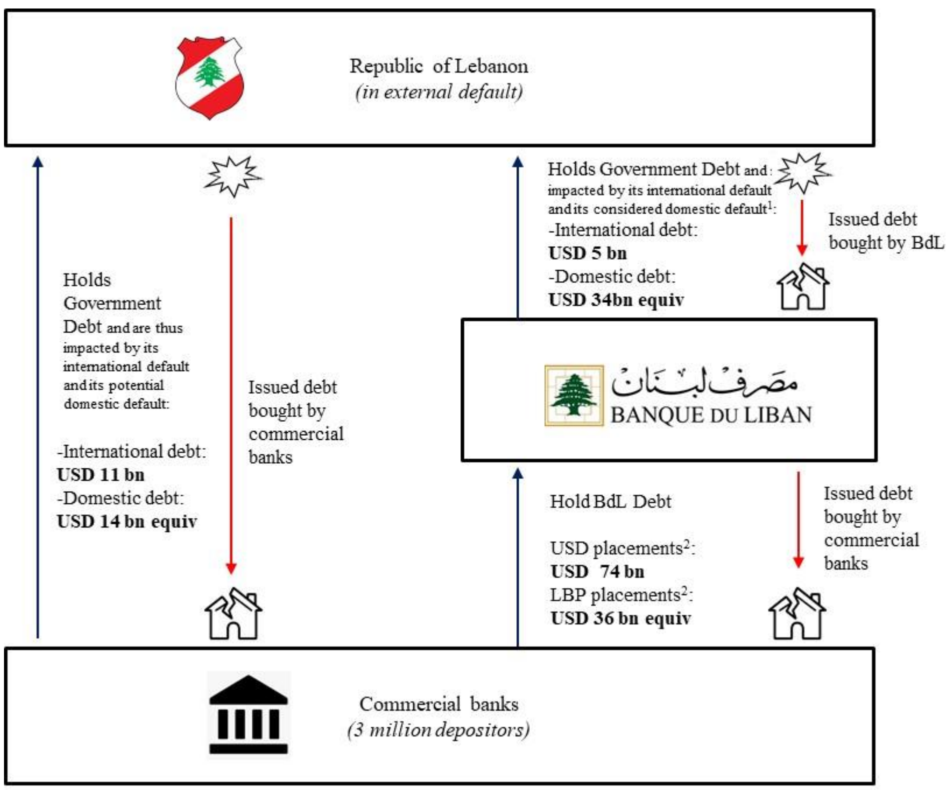
Talking points for communication purposes
Contribution of the Association of Banks in Lebanon ('ABL')
to the Government's Financial Recovery Plan

Representing c. 3 million depositors, the Association of Banks of Lebanon ('ABL') is willing to contribute to the effort required to take Lebanon out of the crisis it is facing. This starts with good faith discussions with the authorities about the optimal solution to be implemented, in the interest of the country. Until now, the ABL has not been associated to the ongoing work and in particular has not been consulted before the release of the Financial Recovery Plan on April 30th.

The Lebanese banking sector is one of the most dynamic sectors of our economy. We contribute 6% of our GDP, a very significant amount of the public sector financing needs and fiscal revenues, and we employ nearly 26,000 highly skilled employees.

Figure 1 : Banking sector's contribution to Government financing: Overview of Government debt holdings



As of March 31st, 2020 – Official exchange rate (1507.5 LBP/USD) – Commercial banks holdings on BdL are net of BdL holdings on Commercial banks – Note1: as per the Government's Financial Recovery Plan of April 30th, 2020 Note 2: ABL estimates

I. The Government's Financial Recovery Plan has several flaws

If implemented, the government's financial recovery plan will lead Lebanon to a socio-economic catastrophe. Although Lebanon is in an unprecedented crisis and short-term pain is already unavoidable, there is no reason why the country's collective misery should deepen further, and the recovery delayed. There is a better way to manage the crisis and a healthier way to emerge from it strengthened.

<u>1/ First, the government's plan is not an economic plan but an accounting exercise</u>. It fails to address the roots of the crisis. Even if a rebalancing were achieved in months to come, it would only last a fraction of a second, giving way to self-perpetuating new imbalances that will have to be redressed on the backs of the Lebanese.

<u>2/ Second, the government's plan seeks to achieve that ephemeral equilibrium through an internal default</u>. Because they entail such serious consequences, internal defaults are extremely rare. If plunged into an internal default-induced depression, there would be no light at the end of the tunnel for Lebanon: our capital is human and would cross borders. An internal default would plunge our output to a level somewhere beyond Yemen's and Cambodia's and our people would be impoverished for the next decade. The government's plan calls for BDL to also default. Other than the Reserve Bank of Zimbabwe, central bank have always honored their obligations.

3/ Third, the government's plan does not foresee even its first order consequences. <u>An economic depression coupled with an internal default renders the government's fiscal revenue figures a mirage</u>. The government fails to understand that the internal default will lead to a much sharper GDP drop than projected (25% vs. 14%). It also fails to understand that tax revenues will collapse even further. Tax compliance would plummet as citizens would feel defrauded by their own government, and many people and businesses would become bankrupt, not owing taxes anymore.

4/ Finally, <u>the government offers no economic vision to drive the economy out of recession</u>. We, at the ABL hold the firm view that Lebanon can achieve substantial economic growth of the order of 5-6% per year by adopting an economic structure which leverages our competitive advantages in the way that Hong Kong, Ireland, Singapore and others did. They share much with us: all have small territories, large neighbors, scarce natural resources and abundant human capital.

II. The Association of Banks in Lebanon's Contribution to the Government's Financial Recovery Plan rests on a two-pillar approach with a clearly phased and timely implementation:

A/ A two-pillar approach

- **An immediate balanced and effective response addressing the external financing needs and putting the medium-term fiscal and debt path on a sustainable footing, while avoiding an internal debt default that would have damaging consequences on the Lebanese people and on confidence;**
- **The launch of long-overdue structural reforms in the coming months, to promote sustainable and inclusive growth as the result of economic diversification.**

B/ A clearly phased and timely implementation:

1/ We have articulated an economic vision that rests on the asset of Lebanon -its population- and the factors that led to the success of comparable countries. Our vision is centered on the diversification of the Lebanese economy from a rentier economy to a productive one, leveraging our vast human capital to successfully insert Lebanon in the knowledge economy.

2/ This economic diversification will be coupled with an ambitious but realistic infrastructure plan in transport and telecommunications as well as ambitious structural reforms.

3/ Unlike the government's plan, our balance of payments projections directly follow from the above economic vision.

- **Our balance of payments will swing to a modest surplus by 2024.**
- **On the fiscal front, our vision is consistent with a realistic primary surplus goal of 2.1% of GDP in 2024, which will be sufficient to achieve debt sustainability.**
- **This fiscal result will include the establishment of a social safety net worth an unprecedented 4% of GDP by 2024. We're not planning on this level of social spending gratuitously: it is the level that we consider necessary for avoid that our citizens continue descending into poverty and indigence.**

4/ These results can be obtained only if the government abandons its dangerous choice of adding a (far graver) internal default and the defiance of our Constitution that it envisages as short-lived fixes to our economic and financial woes. Neither financial stability nor economic growth are possible in a country that unilaterally repudiates its debts, illegally expropriates property, or interferes with private contracts. It is beyond debate that the rule of law and the respect for the sanctity of contracts are indispensable for economic growth. We will not succeed as a nation if we adopt a quick fix to our problems which is the exact opposite of what those prosperous nations did in their times of crisis.

5/ ABL's Alternative Plan is predicated on the need to avoid an internal default, and brings the external financing requirement to a realistic c. USD 8 bn over the same time horizon as the Government's plan[1].

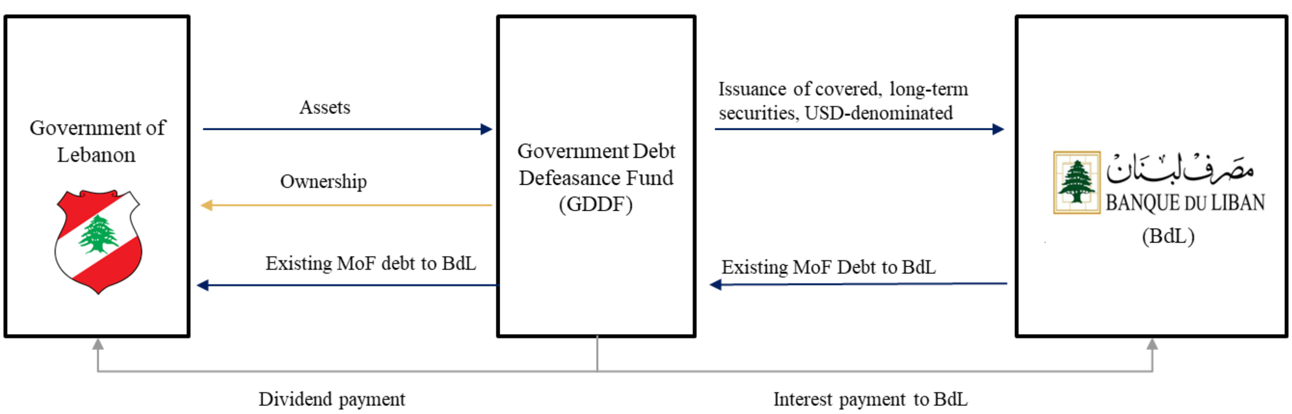
It relies on the recognition of BdL's key role in Lebanese financial sector restructuring and public debt reprofiling. Therefore, as a first step, the Government's debt to BdL needs to be settled fairly.

Our plan envisages <u>a settlement mechanism that would include the following features</u>:

- **The creation of a <u>Government Debt Defeasance Fund ("GDDF");</u>**
- **The contribution by the Government of public assets[2] valued at USD40 bn to the GDDF in exchange for 100% of the GDDF's shares;**
- **The issuance by the GDDF of long-dated, interest-bearing, covered securities in the amount of USD 40 bn to BdL in exchange for and final settlement of the Government 's debt to BdL[3];**
- **The delivery by BdL to GDDF of all title and interest related to its Government's holdings;**
- **The delivery by GDDF to the Government of all of the above title and interest in BdL's Government's holdings, in exchange for the assets contributed by the Government to GDDF; and**
- **The Government 's cancellation of the debt previously owed to BdL.**

This default-avoiding internal exchange can be executed both quickly and smoothly in the interest of all stakeholders – allowing the Government to move on into dealing with other much needed matters.

<u>Figure 2 : Settlement mechanism</u>



[1] The delta stems mainly from the fact that deposits would not flow out of the country (impact of USD 9 bn in 2021 only and of USD 13 bn by 2024 in the Government's Financial Recovery Plan)
[2] Public assets include some or a combination of shares in State Owned Enterprises (e.g. telcos), public lands and other public real estate assets, and/or exploitation rights/concessions (e.g., Lebanon's waterfront).
[3] BdL would benefit from the interest of the GDDF securities

6/ Lebanon's banks are not asking for a bailout because we don't need one. Our industry is sound and what we need is for the government to pays us back – in time. **We recognize that the government is now undergoing a cash shortage that impedes the fulfillment of its obligations on time. We understand that and the ABL wants to be part of the solution by engaging in a good faith dialogue with the government to agree on a payment formula that is based on our nation's wealth and our potential to generate the balance of payments and fiscal surpluses needed to achieve the macroeconomic stability required to the fulfillment of Lebanon's economic promise. We stand ready to take our fair part of the induced losses.**

7/ The ABL wants to be part of the solution and we are willing to discuss with the government a consensual repayment arrangement which is consistent with Lebanon's ability to pay and our laws and constitution.