

How banks should save their depositors from a haircut

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In recent days, the voices of lawmakers preparing a law for a haircut on the depositors' money at Banks have been heard, and many economists stated that there will be an inevitable haircut of up to 50 percent of the deposits. We believe that this move is not at all justified in its timing and can even be avoided through new and creative steps that banks can undertake. If the Haircut Law passes, will banks be able to pay depositors money and transfer depositor's funds abroad in a normal way? The answer is No! Is there a guarantee now that no other haircut will be made after two or three years? Also the answer is no!

Therefore banks should at this point take the initiative to protect their depositors and announce it explicitly in order to preserve what is left of their reputation and remain able to attract funds and protect the sector from what is called "Debankarisation". This means escaping from banks by smuggling money abroad with rebates running up to 35 percent in the markets today, resorting to gold and shares investments placing money at home, as well as bringing money to Lebanon when needed through other means than banks.

The problems facing the state are big, and the government is preoccupied with attempts to undertake the necessary reforms and reduce corruption, and is traditionally inefficient. Therefore, banks have a responsibility to act immediately to protect individual property as well as the free and liberal financial system existing in Lebanon since its foundation, and to protect its depositors and to demonstrate its professionalism as a private sector. Consequently, the banks should not leave the decision of the haircut to the Parliament, turning itself into a traitor toward its depositors. Also, it should not go for the easy solution, but the right one.

There are measures that banks can take to significantly reduce the possibility of haircut, if not entirely avoid it, despite the size of the hole in which the financial system has fallen. Those responsible for this catastrophe have to bear responsibility, which is primarily and essentially the politicians and the state, and to a much lesser degree, those who have been subject to what we call "Collateral Damage" and did not remedy matters when they should have made errors of judgment in where they invested depositors funds and who were politically and financially greedy. They are the banks and the Central bank.

Now and in view of the situation banks must take immediate action on the following:

1- Create an operations room whose goal is to contact the top depositors, i.e. 1 percent of them who own 55 percent of the deposits in the initial stage, (or 80 billion dollars of deposits) and offer them, as an alternative the haircut, to trade a small part of their deposits against four different types of investment.

First: Preferred shares which give them a higher interest than ordinary deposits and are less risk than ordinary shares. Second: Medium term bonds issued the bank. They are less risky than stocks and earn more than regular deposits. Third: Bonds called "Convertible Bonds" that are a debt that earns higher interest than deposits but can be converted any time into ordinary shares at a pre-agreed price when and if the bank finances improves in the future and fourth into ordinary shares by issuing new shares for the bank in favor of the large depositors.

2- To commit with the help and support of the Central Bank in undertaking immediate mergers between the banks to strengthen their financial condition whereby the strong bank must trade its shares against those of a financially fragile bank or buy the fragile bank outright and thus strengthening the whole sector and its reputation and strengthen the banks

vis a vis correspondent banks, that are essential element in the survival of Lebanese bank. This merger would also reduce expenses because of avoiding duplication of tasks. For example, one administration is sufficient and one accountant instead of two and one IT system. It also achieves a reduction in the number of branches and a higher return on investment of funds as it will be subject to “economies of scale”. By strengthening banks, this measure reduces the need for withholding of deposits and forbidding foreign money transfers as is done at the present time.

3- Immediately initiate an offer to the large depositors to exchange part of their deposits with real estate owned by banks themselves or owned by clients which defaulted on payments. In the matter of the bank’s real estate, such as the tower of the main administration and the branches, they could be packaged then exchanged for part of the deposits of large depositors. The banks attract them to this solution by re-renting these properties from them for a period of 10 years with a higher return than deposits, or about 7 percent, which is a procedure called Sale-Leaseback.

As for real estate inherited from defaulted borrowers, they would be offered at an attractive price in exchange of part of their deposits.

4- Speeding up the increase of their capital by attracting new investors, if possible or by increasing the capital of the existing shareholders by 30 and by 20 percent as requested by the Central Bank and this before the end of 2020. This is a very logical and realistic amount due to the size of the crisis the financial system is facing, in view of the bank gains in financial engineering in past 3 years and it will help banks to absorb what is expected to be a government rescheduling of the debt in Lebanese pounds, and a restructuring of the debt in dollars. The focus here should be on partnering with large regional banks or others that are not present in the Lebanese market. They could be interested in entering this market at today’s attractive prices and in a much healthier market given the ongoing shake up that will result in a more “normal” banking market.

5 - Actively support and assist the judicial authorities with the information and logistics required to recover the stolen funds of the past 20 years as well as the transferred funds when transfers were forbidden by the Association of Banks. Part of these funds could be returned and enhance the state’s financial situation and banks could hope for the government to be able to pay its dues to them, others would be returned and enhance the bank’s financial position. On the other hand, instead of playing spectators with the issue of funds transferred outside Lebanon, which we estimate at four billion dollars since Oct. 17 and \$13 billion prior to that in 2019 the source of these funds has become vital to subject some of their owners to the "illegal enrichment" law, and the recovery of this money will make it easier for the state to fulfill its obligations toward banks.

6- Initiating immediately a reduction of their expenses and expenditures as a necessary reaction to the crisis and in line with the shrinking of their deposits. This includes closing some branches as the number of bank branches in Lebanon in relation to its population and to its size is currently among the highest in the world. This step is also justified by the progress in electronic banking, technology and ATMs, which reduces the need for branches. This also includes the sale of its unproductive assets abroad to meet their financial needs domestically.

7- Banks should also set up a special team that initiates negotiations with the state to grant it some of its assets in exchange for a portion of the debt that the government cannot honor. Work out an exchange of these bonds against assets that will be placed in a private company owned by major depositors that is created against part of their deposits, and on which depositors can hope to receive good profits. This procedure is called Debt/Asset swap. These assets taken from the state may be for example state-owned buildings that the state will go back and rent from them, one of the two phone cellular companies, the port of Beirut or Tripoli, real estate from the hundreds of millions of square meters owned by the state, the MEA and surely these assets received in replacement of the government debt to banks will become much more

productive and profitable than they are today under state administration. The state could receive taxes in five years equal to all its income it is receiving from these assets today.

8- If these steps above are not enough, after the banks have prepared an action plan to save the sector and secure their customer deposits, then it is possible to negotiate with the major depositors and owners of the Swaps that the central bank has offered them to forego half of the interest on their deposits of the last five years when the interest paid was exorbitant in comparison to interest in the world.

These measures will allow banks in the medium term to meet all the smallest depositors requests for funds without any haircut and avoid the revolution of millions of depositors who represent only 10 to 15 percent of the total deposits, because their funds are limited, but their anger and poverty represent a time bomb for banks and the state. This plan allows large depositors not to lose part of their deposits through a haircut, but to replace them with productive assets and investments, and it allows banks to consolidate their balance sheets and strengthen their financial situation. This program requires the conversion of part of the banking business into an “Investment bank” that innovates and creates imaginative solutions and structures required in this situation. It will be fully understood by the big depositors who are knowledgeable in business. And if there is a necessity to present a draft law to accomplish some of the above, then so be it, because it is much more beneficial and objective than the draft law of haircutting the deposits which is not logical at this time, not fair, not legal, and avoidable if there is a will.

So, the solution exists if it is not magic. First, all the points of the above plan must be accomplished to protect the Lebanese citizen and ensure that whoever is responsible here will be first held accountable and pay the price. It should be done in parallel with a recovery of looted funds and wasted money, that will help the state's finances, before resorting to the money of the innocent depositor who is not guilty of anything that is happening. The best bank assets are their customers, so they should not let Parliament offer them on the haircut altar!

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