



March 28, 2024

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The visit of Jesse Baker, (Deputy Assistant Secretary of the Treasury for Asia and the Middle East in the Office of Terrorist Financing and Financial Crimes) to Lebanon on March 7th-8th, 2024, has raised speculations and inquiries concerning the message that he was delivering to the Lebanese state, BDL, and the commercial banks regarding money laundering and terrorism financing. The US Treasury's top official is pinpointing to the possibility of terrorist financing. The US Treasury officials are concerned about the Lebanese large illicit financial services companies, along with a cash economy representing around 46% of Lebanon's GDP, as per World Bank estimates, which will service the financing of Hamas and Hezbollah that are blacklisted and sanctioned by the US Treasury Department.

This visit raised fears of listing Lebanon in the Financial Action Task Force (FATF) Grey list after it avoided being listed on it in June 2023 despite the key findings of MENA FATF that will be mentioned in details thereafter. For those who are not well informed about FATF, it is an international policy-making and standard-setting body committed to combating money laundering and terrorist financing.

As such, news started spreading regarding BDL's circular #165 and that the US Treasury top official is inquiring about the possibility that this circular will ease money laundering and financing terrorism. For a quick reminder, BDL circular #165 issued by BDL on 19/04/2023 in relation to the electronic settlement operations related to "banknotes" or "cash money" (cash money indicates money transferred from abroad and/or received banknotes in foreign currencies after the date of 17/11/2019, and money deposited or to be deposited cash in new accounts in Lebanese pounds). In more details, the circular stated that all banks must open new accounts with cash (Banknotes) in US dollars and Lebanese pounds, to be used exclusively for settling electronic bank transfers for cash money and for settling checks clearing that are traded with cash money.

Moreover, the circular allowed cash transfers to be made electronically, and also permits the exchange of checks issued by Fresh accounts in Lebanese pounds

and US dollars. The main article that alerted US Treasury Department is that banks have to open fresh accounts at BDL and not at correspondent banks abroad.

This circular did not only raise flags to Lebanese media and law experts, but also to foreign media in which the Washington Institute for Near East Policy published a policy analysis paper on June 22nd, 2024 titled “Cash Cabal”. In this paper, the authors mentioned how the financial crisis started since the Lebanese government’s default decision regarding the US\$32 billion in sovereign foreign debt. It also discussed BDL circular #165 and stated that the transfers between clients in different banks (client in Bank A transferring to client in Bank B), BDL would directly settle and clear the transaction by debiting Bank A’s fresh dollar account and crediting that of Bank B at BDL rather than having the banks’ correspondents abroad handle the transaction. And in this transaction, the bank receiving the transfer (Bank B) will have no clue about the origin of the money and especially if the bank (Bank A) where the transfer is issued from is a small bank and has no correspondent bank. The publication concluded that this mechanism if approved by US Treasury will likely generate problems more than the cash-dollar economy can control.

Regarding the above analysis concerning the negative effects of the BDL circular #165, BDL sources defended the circular and stated that the new checks clearing mechanism is an extension for the old checks clearing mechanism in USD that started in the beginning of 1990s, noting that the value of checks cleared in 2019 averaged monthly more than \$3 billion compared to the average monthly of \$9 million after the issuance of this circular. Moreover, the sources added that this circular played a vital role for Lebanon to avoid being listed on FATF Grey list in June 2023. To note, being listed on FATF Grey list means that the country is actively working with FATF to address strategic deficiencies in its regime to counter money laundering and terrorist financing and committed to resolve these deficiencies with an agreed timeframe. In this case, the country will be under increased monitoring.

The MENA FATF report issued in December 2023 (*Anti-money Laundering and Counter-terrorist Financing Measures: The Republic of Lebanon Mutual Evaluation Report*) was based on the on-site visit from July 18th, 2023 to August 3rd, 2023 regarding the anti-money laundering (AML) and counter-terrorist financing (CFT) measures in place. It examines the degree of obedience with the FATF 40 recommendations, level of efficacy of the AML/CFT system along with providing recommendations about the approaches to strengthen the system operated.

Before going deep with the MENA FATF report, it is interesting to note that the Lebanese Parliament in its legislative session on 13/11/2015 endorsed the law no. 44 regarding fighting money laundering and terrorist financing. This law encompassed a list of 21 money laundering (ML) predicate offenses such as human trafficking and migrant smuggling, corruption and bribery, smuggling and piracy, and insider trading and market manipulation, to name a few. Moreover, Lebanon performed the national ML/TF risk assessment (NRA) in 2019 and was updated in 2022.

Returning to the MENA FATF report, the on-site visit uncovered several key findings mentioned below regarding the compliance with FATF recommendations.

- Despite the fact that the NRA included the most critical crimes and the financial and non-financial sectors that are at a great risk of money laundering and terrorist financing, the NRA uncovered a *low level of understanding* of ML and TF threats resulting from the unregulated financial sector, the senior-level government corruption, and the activities of the main paramilitary group.
- After conducting several sectoral reviews for the financial sector regarding ML and TF, these reviews revealed that most public entities have a good understanding of ML while some of them have developing level of understanding. Concerning TF, competent authorities have a good understanding of the main risks of terrorism financing except for the case of the potential threats associated with the local paramilitary group. When it comes to the private sector, the report found that mainly banks have good understanding of ML/TF risks while others have developing level of understanding.
- Due to the financial crisis, most Lebanese citizens began purchasing precious metals and stones as a safe haven for saving and investing. Therefore, there is a need to update the assessments of risk related to this sector and make it more comprehensive to cover the risks related to the activities of the traders of precious metals.
- Competent authorities have access to financial and other related data either directly or indirectly during inspecting ML and TF cases. In TF cases, the authorities depend mainly on financial intelligence by requesting from Cassation Public Prosecutor to get the needed financial intelligence from

Special Investigation Commission (SIC)¹. However, in ML cases, there is a limited dependence on financial intelligence.

- Internal Security Forces and SIC run inspections in order to detect ML cases based on reports mainly from Cassation Public Prosecution and every now and then from tax and customs authorities. It is interesting to note that ML investigations executed by the Lebanese authorities on customs smuggling, tax evasion, illicit drug and human trafficking crimes are not in agreement with its risks.
- Lebanese authorities have put in place a good legal framework for seizure of crime related proceeds, being “The National Fund for the Management and Investment of Assets under Recovery or Recovered Related to Crimes and Proceeds during the Freezing or Seizure Phase”. Nonetheless, there is no clear policy followed by the respective authorities to adapt the preventive actions concerning freezing and seizure into a final ML confiscation. Similarly, there is no clear policy to detect the priorities of recovering assets detained or transferred to other territories.
- Law Enforcement Agencies (LEAs) represented by General Intelligence Directorate of the Lebanese Army, the Information Division of the General Directorate of Internal Security Forces, and the General Directorate of State Security were able to track the trace of the funds through either formal or informal sectors or physically across borders, but their inspections did not consider the threats related to actions of the main local paramilitary group.
- There are some gaps in the implementation of freezing and reporting to the SIC concerning accused people and entities.
- Designated Non-Financial Businesses and Professions (DNFBPs) are not aware of their responsibilities regarding revising updates of UNSCRs 1718 and 2231 sanctions lists related to North Korea and Iran daily compared to banks, money transfer companies, and type “A” exchange companies who trace the updates on timely basis.
- Notaries public revealed some deficiencies in applying AML/CFT requirements in addition to the inadequate understanding of ML risks concerning their operations and not applying the risk-based approach (RBA) in contrast to banks and money transfer companies.

¹ SIC is the center piece of Lebanon’s AML/CFT regime, and a platform for international cooperation; it plays a vital role in safeguarding concerned sectors from illicit proceeds.

- Despite the fact that financial institutions are performing their “Customer Due Diligence” (CDD) duty, they are identifying the real owners only and not identifying the beneficial owners of the accounts. In addition, banks’ dealing with notaries public’s accounts differ.
- The degrees for detecting the beneficiary owners in financial institutions are being inadequate to detect entities exercising indirect control. Also, there are no recurring measures to confirm the persistent integrity of criminal records and no measures to avoid associates of criminals from being professionally certified to operate Designated Non-Financial Businesses and Professions (DNFBPs). Moreover, the risk-based supervisory approach applied by the Financial Intelligence Unit (FIU) are not briefly applied on lawyers and notaries’ sectors; and the Bar Association that regulates lawyers’ sector faces hurdles related to the professional secrecy which is inhibiting them from accessing data to confirm lawyers’ compliance with AML/CFT requirements.
- The mutual legal assistants (MLA) requests provided and requested by Lebanon and the cooperation to fighting money laundering are not coherent with country’s risk profile.
- There is a delay in sending MLA requests and a lack in making requests for recovery of stolen assets and the absence of further efforts to overcome the hurdles to performing these requests.

The deterioration of the economic and financial situation in Lebanon makes it easier for money laundering and terrorist financing and that is what worries the international financial officials. In the last four years, the national currency depreciated and lost around 98% of its value, gross domestic product (GDP) decreased from \$55B in 2018 to \$21.13B in 2022 as per latest figures published by the World Bank. It is interesting to note that total global remittances to Lebanon in 2023 recorded \$6.4B and representing 27.5% of GDP. Furthermore, the banking system, which is struggling recently, represents 96% of total assets of the financial sector.

As per the latest update of the National Risk Assessment (NRA) in 2022, it showed that corruption, tax evasion (either through fake invoices to decrease custom fees or illegal VAT refunds due to tax fraud schemes) in addition to trafficking of subsidized goods to other countries and illicit transferring of narcotic drugs and psychotropic substances are the main predicate offenses that generate illegal proceeds of money laundering.

The report has mentioned priority actions that Lebanon must apply and they are as follows:

- Lebanon must monitor the risk assessment of precious metals and stone traders and the characteristics of this sector in addition to providing all stakeholders with a detailed copy of the latest updated NRA (each within its expertise). Moreover, there should be a more serious work regarding lowering the risk of illicit drug smuggling and corruption and unfortunately the corruption is arising from the senior-level government.
- Lebanon must prioritize the implementation parts of the AML/CFT Action Plan related to the unregulated financial sector that arose after the difficulties faced by the banking system.
- Lebanon must perform an assessment and mitigation of the risks related to the main local paramilitary group.
- There should be a significant effort to train and develop the skills of the concerned competent authorities mainly Customs & Tax Directorates so that they can effectively utilize financial intelligence proactively in order to trace ML evidences and perform their investigations.
- The law enforcement entities and Cassation Public Prosecutor should maintain reliable, consistent and centralized data that makes it easier for them to review it regularly in order to build ML evidence.
- The law establishing the “National Fund for the Management and Investment of Assets under Recovery or Recovered Related to the Crimes and Proceeds during the Freezing or Seizure phase” should be put in effect as soon as possible. Concurrently, the Cassation Public Prosecution must improve supervision related to tracing and recovering assets and deepen international coordination with related counterparts regarding asset tracing. Also, a “Cases Management System” should be formed due to its significance in generating large number of requests with the raise in quality and speed of information they provide.
- A timely international cooperation should be done proportionate to the size of the predicate offenses and ML/TF crimes.
- A mechanism should be formed regarding combating narcotic drugs to guarantee international cooperation done in a timely and effective manner.

- The authorities should put in efforts to allow the General Intelligence Directorate and the Information Division to access all financial intelligence in a timely manner in order to enhance financial investigations.
- Supervisory authorities must remind financial institutions and DNFBPs regularly with the requirements of the national mechanism related to updates in UN lists to implement immediate freezing. Moreover, they should monitor the FI's and DNFBPs' compliance with Targeted Financial Sanctions (TFS) requirements and enforce sanctions upon the violation of the requirements.
- Notaries public, precious metals and stones traders, exchange houses and real estate agents should be well-informed with the ML/TF risks entailing their activities. This is the duty of the Ministry of Justice and SIC given that they are the entities that control these sectors.
- A unified notion of beneficial owners should be put in place in order to clarify how to treat the bank accounts held by notaries public.
- Financial institutions' regulators should continue their efforts in monitoring unlicensed activities. In addition, FIs and DNFBPs should be well-informed regarding the requirements of UNSCRs 1718 and 2231 on North Korea and Iran.
- The activities of accountants should be supervised and reassessed if it is complying with AML/CFT requirements as per article 5 of the law no. 44 regarding money laundering. Similarly, lawyers' activities should be supervised also by the Ministry of Justice similar to what is done with notaries public.
- Non-profit organizations (NPOs) should be supervised since they receive foreign support.
- The General Directorate of Customs must improve their technological and technical skills for seizing banned goods across borders and detecting sanctions evasion.

As such, Lebanese authorities in all of its institutions and entities have to exert additional efforts to improve and update the actions taken and find solution to the key findings -- noting that the next MENAFATF meeting (38th meeting) will be held in Manama, Kingdom of Bahrain from May 19th, 2024 to May 23rd, 2024 -- in order to avoid being placed on FATF Grey list along with countries such as

Democratic Republic of Congo, Nigeria, Namibia, South Africa, and Syria, to name a few.

In case Lebanon was listed on the Grey list, this will have several negative consequences that will worsen the economic and financial situation of Lebanon. The main concern is lowered attractiveness of foreign direct investments which is much needed nowadays. Another risk, for companies based in Lebanon, is the increase in cost of doing business with foreign counter parties due to increased due diligence. Lastly, there might be increased restrictions in countries with rigid measures on cross-jurisdictional operations to and from countries listed on the Grey list.

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