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Lebanon: Iran's Financial Safe Haven

A SOVEREIGN MONEY LAUNDERING SCHEME

The Strength of Lebanon's Economy and the Strength of its Sovereign Debt is Inexplicable and an International Outlier

1. Lebanon's Tenuous Politics
2. By Traditional Indicators, Lebanon's Economy is in Shambles
3. Lebanese Sovereign Debt Suspiciously Trades at Low Yields with No Rational Economic Explanation
4. Credit Default Swaps to Insure its Sovereign Debt Trade at Very Low Premiums
5. Where is the Investment Demand for Lebanese Bonds Coming From?
6. Next Steps & U.S. Government Action

1. Lebanon's Tenuous Politics

Country Overview



General

Population	4.2 million
Area	10,450 sq km
Languages	Arabic, English, French
Borders	Syria, Israel, Mediterranean Sea
Nationality	Sunni, Shia, Christian
Capital	Beirut

Political Structure

Political Parties	Organized on sectarian basis The "March 14" alliance is headed by the Future Movement (Sunni) with the Lebanese Forces (Christian) in loose alliance with the Progressive Socialist Party (Druze) and the Phalange (Christian) The "March 8" block comprises Hezbollah (Shia), Amal (Shia) and Free Patriotic Movement (Christian)
Form of State	Parliamentary republic The national assembly has 128 seats equally divided between Muslims and Christians
Prime Minister	Najib Mikati (Sunni)
President	Michael Suliman (Maronite Christian)
Next Elections	June 2013

Economic Data

Currency	Lebanese Lira/Pound (LBP) The LBP is kept at a tight exchange rate band to the USD
GDP	US\$38.5 billion
Gross Government Debt	US\$53.8 billion
Growth	8.1% average 2007-2010 Expected 1.5% in 2011
GDP Per Capita	US\$15,600
Main Industries	Banking, tourism

Lebanon's Politics & its False Economy

- **A Precarious Political Situation**
 - Severe domestic political tensions with a Hezbollah-dominated cabinet
 - Heavily influenced by the neighboring political conflict in Syria
 - Upcoming elections in June 2013
- **Deceiving the Markets & Artificially Stabilized Sovereign Debt**
 - Real risk of Lebanese debt not accurately reflected in the markets
 - Unstable economy with severe debt burden – one of the highest in the world
 - Lebanon unable to reduce budget deficit with declining underlying growth
 - Lebanese sovereign bond pricing does not reflect these major issues
 - Sovereign default has artificially maintained a low-risk profile
 - Evidence of third party (Iran/Syria) influence, and/or corruption artificially propping up the Lebanese economy

A Precarious Political Situation

The potential for political instability creates a downside risk to GDP growth and to the overall economy.

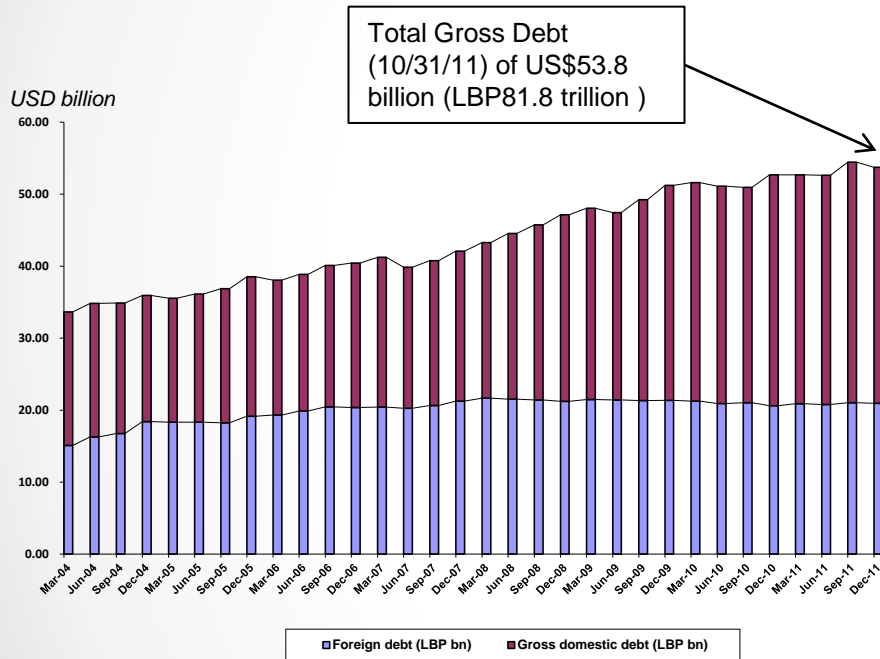
- Entrenched in sectarian tensions keep market reforms slow and cautious
 - Cabinet composed largely of Hezbollah members (“March 8th” alliance), supported by Iran and Syria
 - “March 8th” and “March 14th” have about even allocations in parliament with elections in 2013
- Political crisis in Syria will have an important bearing on the balance of power in Lebanon
 - Civil uprising against Bashar al-Assad’s regime has led to increased violence in Syria
 - Lebanon abstained from voting on the Arab League sanctions against Syria
 - As more Syrians flee to Lebanon, there is increasing risk of spillover
- Despite relative government stability following the assassination of Prime Minister Rafiq al-Hariri, unity remains precarious
 - UN investigation calls for the arrest of four Hezbollah members
 - The Lebanese government only agreed recently to hold to its part of financing the investigation
- Potential armed conflict with Israel
 - Hezbollah has rearmed after the 2006 conflict with Israel
 - An Israel-Iran conflict could draw in Hezbollah as a local proxy for Iran
- Relations with moderate allies impaired
 - Politicians aligned with the Assad regime may face censure from Arab allies in post-Assad world
 - U.S., France and Saudi Arabia, who support the “March 14” block will remain wary of Hezbollah’s influence in Lebanon



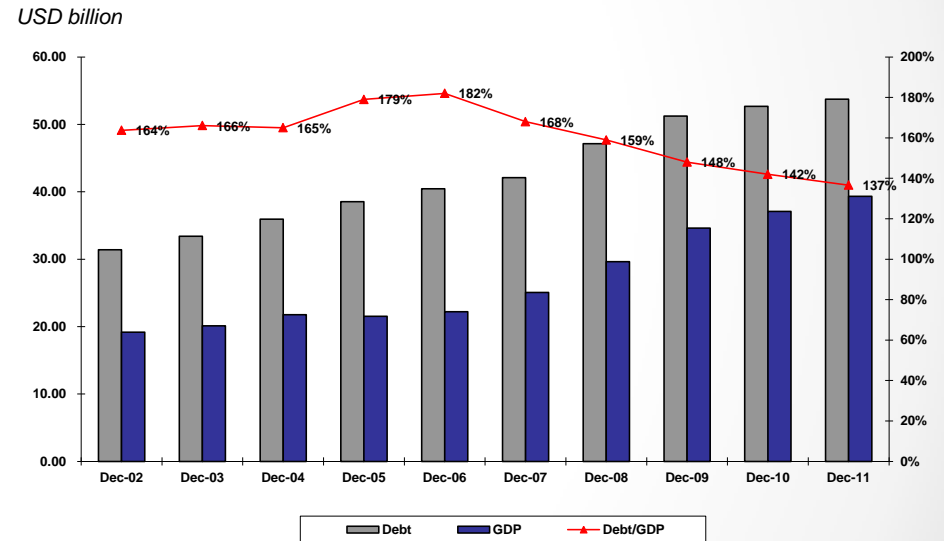
2. By Traditional Indicators, Lebanon's Economy is in Shambles

A Country with Very High Debt Load

Lebanese Government Debt



Lebanese Government Debt to GDP

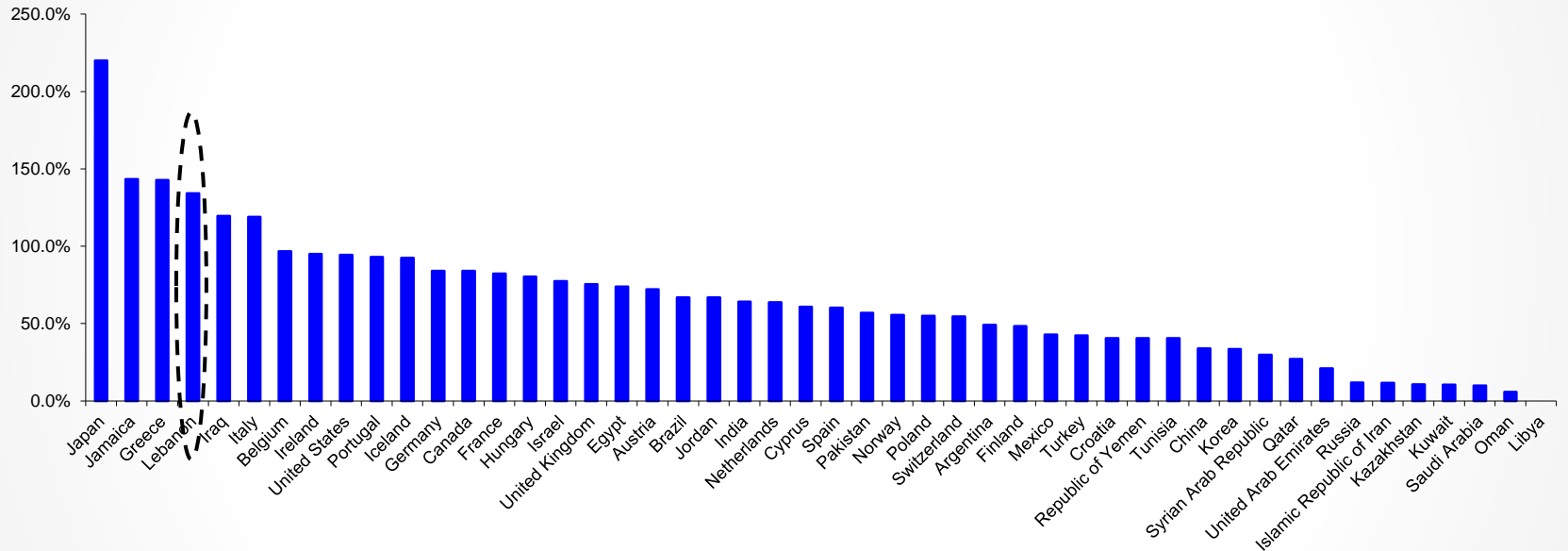


Lebanon has consistently increased its public debt level over the last 10 years.

Source: Lebanon Ministry of Finance, Banque du Liban

...One of the Highest Debt Levels in the World

Debt to GDP – The International Benchmark



Lebanon has the fourth largest debt to GDP ratio in the world, higher than several of the most distressed economies in the world such as Ireland and Italy.

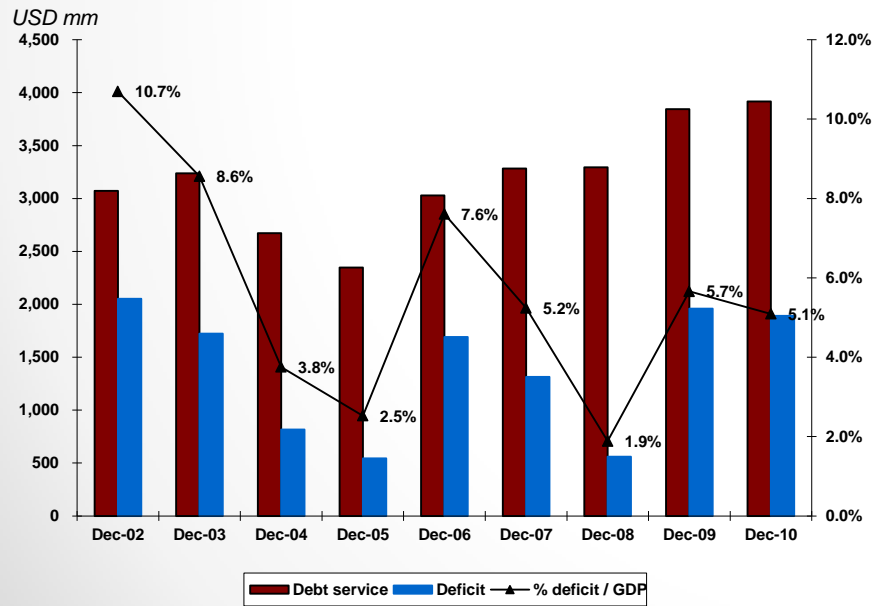
Source: International Monetary Fund, figures as of 2010

A Country that Carries a High Budget Deficit, Heavily Impacted by its Debt Burden

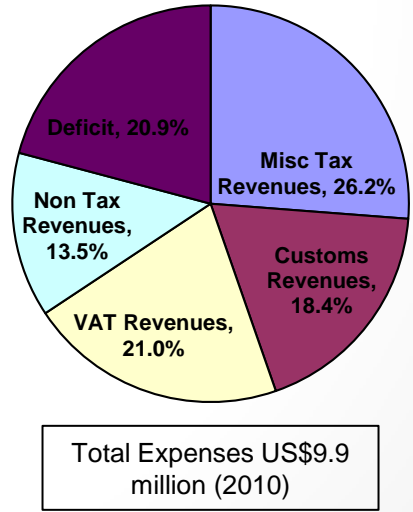
Budget and Deficit

USD m m	Dec-02	Dec-03	Dec-04	Dec-05	Dec-06	Dec-07	Dec-08	Dec-09	Dec-10	Sep-10	Sep-11
Revenue	3,587	4,132	4,701	4,641	4,577	5,378	6,508	7,998	7,986	5,853	6,604
General expenditure	2,568	2,615	2,847	2,836	3,239	3,409	3,773	6,113	5,960	4,366	4,892
Debt service	3,071	3,239	2,672	2,348	3,028	3,282	3,294	3,843	3,916	2,967	2,785
Total expenditure	5,639	5,854	5,519	5,184	6,267	6,691	7,067	9,956	9,876	7,332	7,677
Deficit	(2,052)	(1,722)	(818)	(544)	(1,690)	(1,313)	(559)	(1,959)	(1,890)	(1,479)	(1,073)
GDP	19,184	20,117	21,775	21,524	22,218	25,061	29,646	34,620	37,104		
% deficit / Expenditure	36.4%	29.4%	14.8%	10.5%	27.0%	19.6%	7.9%	19.7%	19.1%	20.2%	14.0%
% deficit / GDP	10.7%	8.6%	3.8%	2.5%	7.6%	5.2%	1.9%	5.7%	5.1%		

Deficit as % of GDP and Debt Service



Breakdown of Revenue and Deficit



Total Expenses US\$9.9 million (2010)

Source: Lebanon Ministry of Finance

Struggling to Reduce the Budget Deficit

The politically entrenched process has prohibited material economic progress.

- The Lebanese government has struggled to pass budgets for the last 5 years due to political disputes and external conflicts
 - 2012 budget is now before the cabinet
 - 2012 budget includes contentious tax increases which would help pull in revenue but may prevent budget from being passed
 - Tax increase are expected to impose additional burden on the weaker social layers
- The electricity sector is in bad shape and in dire need of reform
 - The country continues to suffer from power shortages, particularly in the summer months
 - A large investment program was recently approved by the cabinet for US\$5 billion
- Privatization initiatives aimed at freeing up government resources are not moving forward
 - Private sector sees high political risk in Lebanon and has lowered demand for privatized assets
 - Infrastructure development in partnership with the private sector is slow
- Government income from the telecom sector is booked in its fiscal statistics based on expected surplus rather than actual transfers
 - Expected income is not a reliable for debt servicing

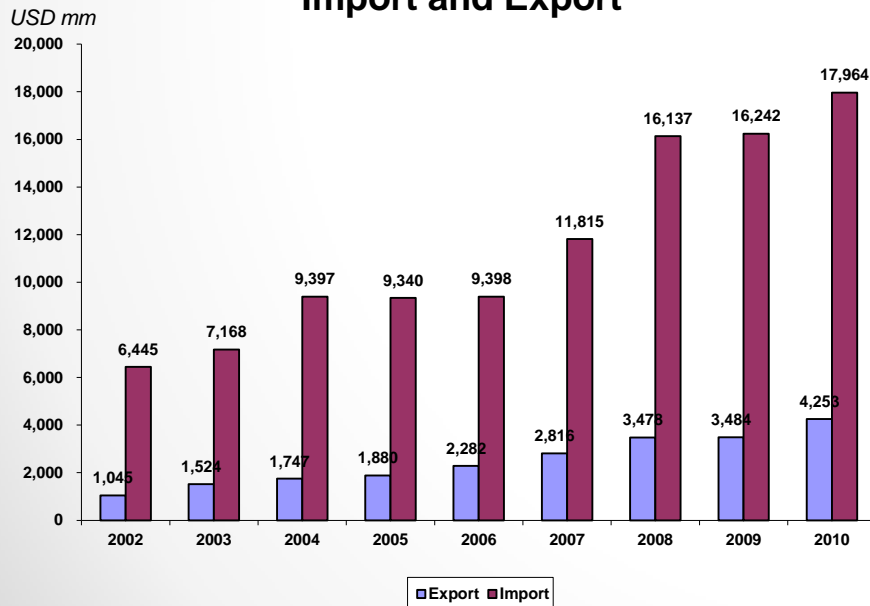


A Country with a Consistent Current Account Deficit

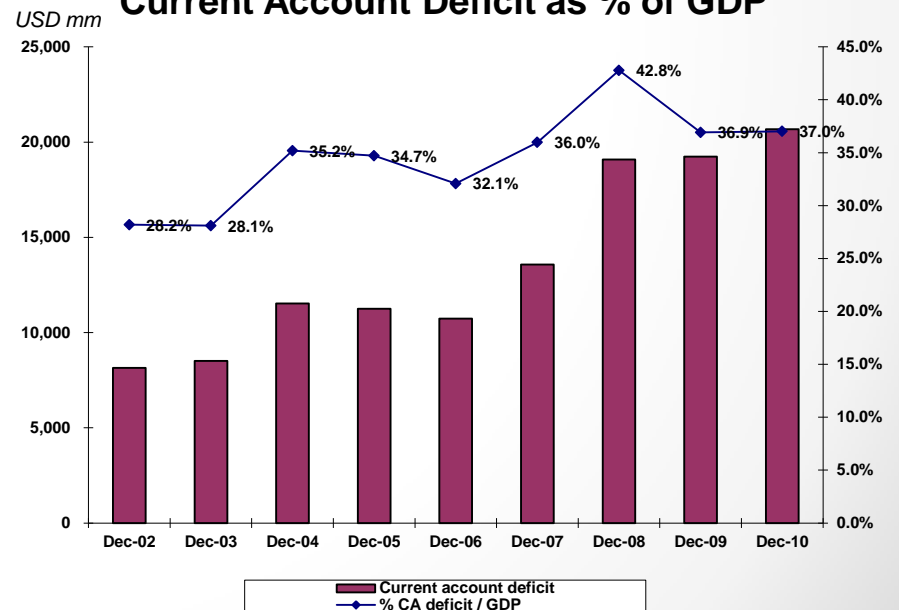
Trade Statistics

	2002	2003	2004	2005	2006	2007	2008	2009	2010
Export (\$m)	1,045	1,524	1,747	1,880	2,282	2,816	3,478	3,484	4,253
Import (\$m)	6,445	7,168	9,397	9,340	9,398	11,815	16,137	16,242	17,964
Current account deficit (\$m)	5,400	5,644	7,650	7,460	7,116	8,999	12,659	12,758	13,711
GDP (\$bn)	19.18	20.12	21.78	21.52	22.22	25.06	29.65	34.62	37.10
%CA deficit / import	83.8%	78.7%	81.4%	79.9%	75.7%	76.2%	78.4%	78.5%	76.3%
%CA deficit / GDP	28.1%	28.1%	35.1%	34.7%	32.0%	35.9%	42.7%	36.9%	37.0%

Import and Export



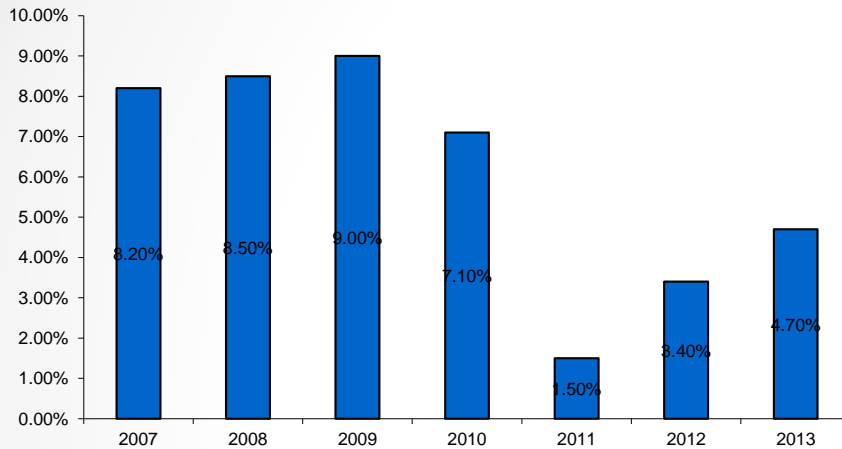
Current Account Deficit as % of GDP



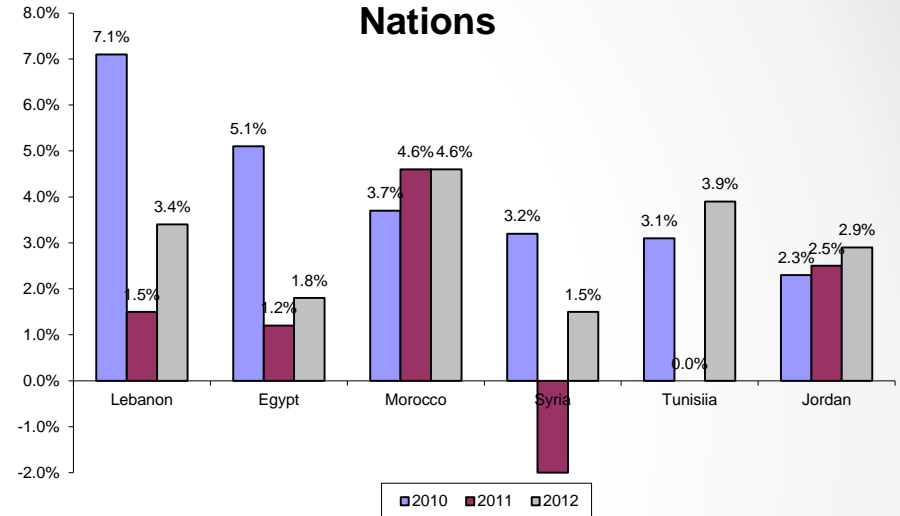
Source: Lebanon Ministry of Finance

Underlying Growth is Declining

Lebanon Historical and Projected GDP



Lebanon Growth Relative to Other Arab Nations



- The Lebanese economy is facing a material slowdown in GDP growth
 - “After four years of strong growth, Lebanon’s economy has lost momentum, reflecting domestic political uncertainty and regional unrest...” (IMF, November 2011)
- Lebanon’s growth prospects will depend upon regional performance as Arab states are the principal consumer of Lebanon’s service-oriented economy
 - Unrest in the region impacts tourism in Lebanon; tourists are primarily from Arab countries and have chosen more stable destinations like Turkey or Morocco
 - Tourism indirectly supports ¼ of jobs and generates much of the demand for construction
- Heavy government borrowing and limited price competition suggests that banks’ prime lending rates will remain prohibitively expensive for small and medium businesses, putting pressure on real economic growth
- Lebanese growth will continue to struggle and all signs point to even higher risk of sovereign debt default

Source: Lebanon Ministry of Finance

3. Lebanese Sovereign Debt Suspiciously Trades at Low Yields with No Rational Economic Explanation

Lebanon's Weak Economy and Political Situation is Reflected in its Weak Credit Rating

Lebanon's Rating

	Long Term	Short Term	Outlook
Moody's	B1	-	Stable
S&P	B	B	Stable
Fitch	B	B	Stable

"The ratings are constrained by our view of Lebanon's high public debt burden, large external imbalances, and the risk of a breakdown of the current consensus in the government..."

"...key source of political tension at present is the U.N. Special International Tribunal's investigation into the circumstances surrounding the assassination of Prime Minister Rafik Hariri...could ultimately cause Hezbollah to withdraw from the government. We believe that this would severely undermine prospects for sustainable growth and political stability..."

"Lebanon's current account deficit, which stands at over 20% of GDP, remains in our view a source of vulnerability and we believe its financing will remain highly reliant on continued investor confidence over the medium term."

S&P, November 2010

Selected Comparable Country Ratings & Cost of Debt

	Moody's	S&P	Fitch	10yr Bond Yield (4/17/12)
Bulgaria	Baa3	BBB	BBB-	-
Egypt	Ba3	BB	BB	6.9 or 8.2
Gabon	-	BB-	BB-	4.250
Georgia	Ba3	B+	B+	5.650
Ghana	-	B	B+	-
Greece	C	CCC	B-	-
Indonesia	Ba1	BB+	BB+	6.050
Ireland	Ba1	BBB+	BBB+	6.800
Israel	A1	A+	A	3.950
Jamaica	B3	B-	B-	7.500
Jordan	Ba2	BB	-	-
Lebanon	B1	B	B	5.400
Lithuania	Baa1	BBB	BBB-	5.800
Nigeria	-	B+	BB-	-
Philippines	Ba2	BB	BB+	3.100
Senegal	B1	B+	-	7.450
Spain	A3	AA-	AA-	5.850
Sri Lanka	-	B+	BB-	5.950
Turkey	Ba2	BB	BB+	5.100
Ukraine	B2	B+	B	9.450
Vietnam	B1	BB	B+	5.250

Lebanese Historic Cost of Debt

Cost of Debt 2005-2007

<HELP> for explanation. Corp HP

BGN/ CLOSE/BID/YTM Page 1/1 Historical Price Table

GENERIC 10YR LEBAN 6.1 10/22 102.0630/102.9370 (5.83/5.72) BGN @11:50

Range - Period Avg 9.146 on 12/29/06
Market Low 8.522 on 10/31/06

DATE	YIELD	DATE	YIELD	DATE	YIELD
1/07	8.611				
12/06 H	9.146				
11/06	9.143				
10/06 L	8.522				
9/06	8.736				

Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2012 Bloomberg Finance L.P.
SN 720570 0638-1732-1 13-Apr-12 11:50:47 EDT GMT-4:00

Cost of Debt in 2012

<HELP> for explanation. Corp HP

BGN/ CLOSE/BID/YTM Page 1/1 Historical Price Table

GENERIC 10YR LEBAN 6.1 10/22 102.0350/102.8960 (5.84/5.73) BGN @ 4/20

Range - Period Avg 5.891 on 1/31/12
Market Low 5.831 on 3/30/12

DATE	YIELD	DATE	YIELD	DATE	YIELD
3/12 L	5.831				
2/12	5.889				
1/12 H	5.891				

Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2012 Bloomberg Finance L.P.
SN 227156 6549-2134-0 21-Apr-12 13:41:44 EDT GMT-4:00

Historically, cost of Lebanese sovereign debt was much higher in 2006 and 2007 (~9%) than is it today (~5% to 6%).

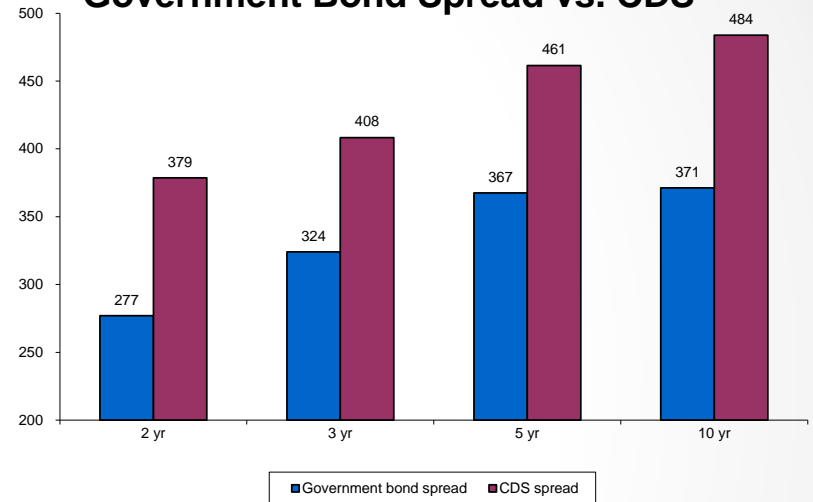
Sovereign Bonds are Trading at Tight Spreads

Lebanon government bonds trade at high cash prices, reflecting spreads even lower than applicable CDS* spreads, falsely suggesting that these bonds are backed by a more robust economy than that of Lebanon.

Lebanon Government Bond Trading Stats

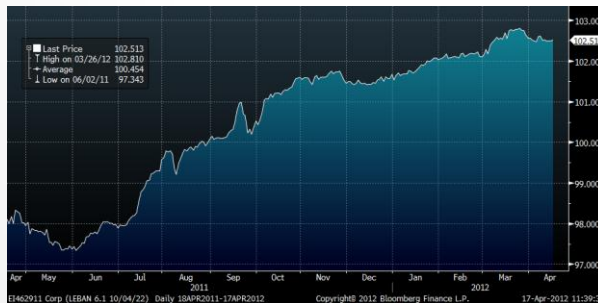
Maturity	Coupon	Price	Yield	Benchmark	
				Yield	Spread
3/25/2014	6.00%	105.1	304	27	277
5/2/2014	9.00%	111.2	306	27	279
4/22/2015	6.00%	106.2	365	41	324
7/15/2015	6.00%	106.3	376	41	335
11/30/2015	6.00%	106.3	397	41	356
1/19/2016	8.50%	114.6	410	87	323
5/11/2016	11.63%	127.0	413	87	326
3/20/2017	9.00%	118.9	454	87	367
11/12/2018	5.15%	100.6	496	87	409
11/28/2019	5.45%	100.7	526	201	325
4/12/2021	8.25%	118.9	548	201	348
10/4/2022	6.10%	102.5	572	201	371

Government Bond Spread vs. CDS

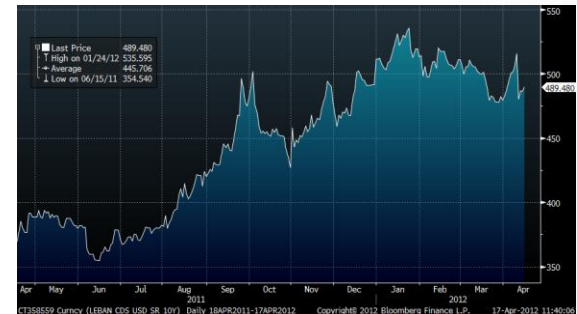


Recently and counter to intuition, both CDS and cash bonds are going up.

Sovereign Bonds Trade Well



Lebanon CDS Spreads Are Range-Bound

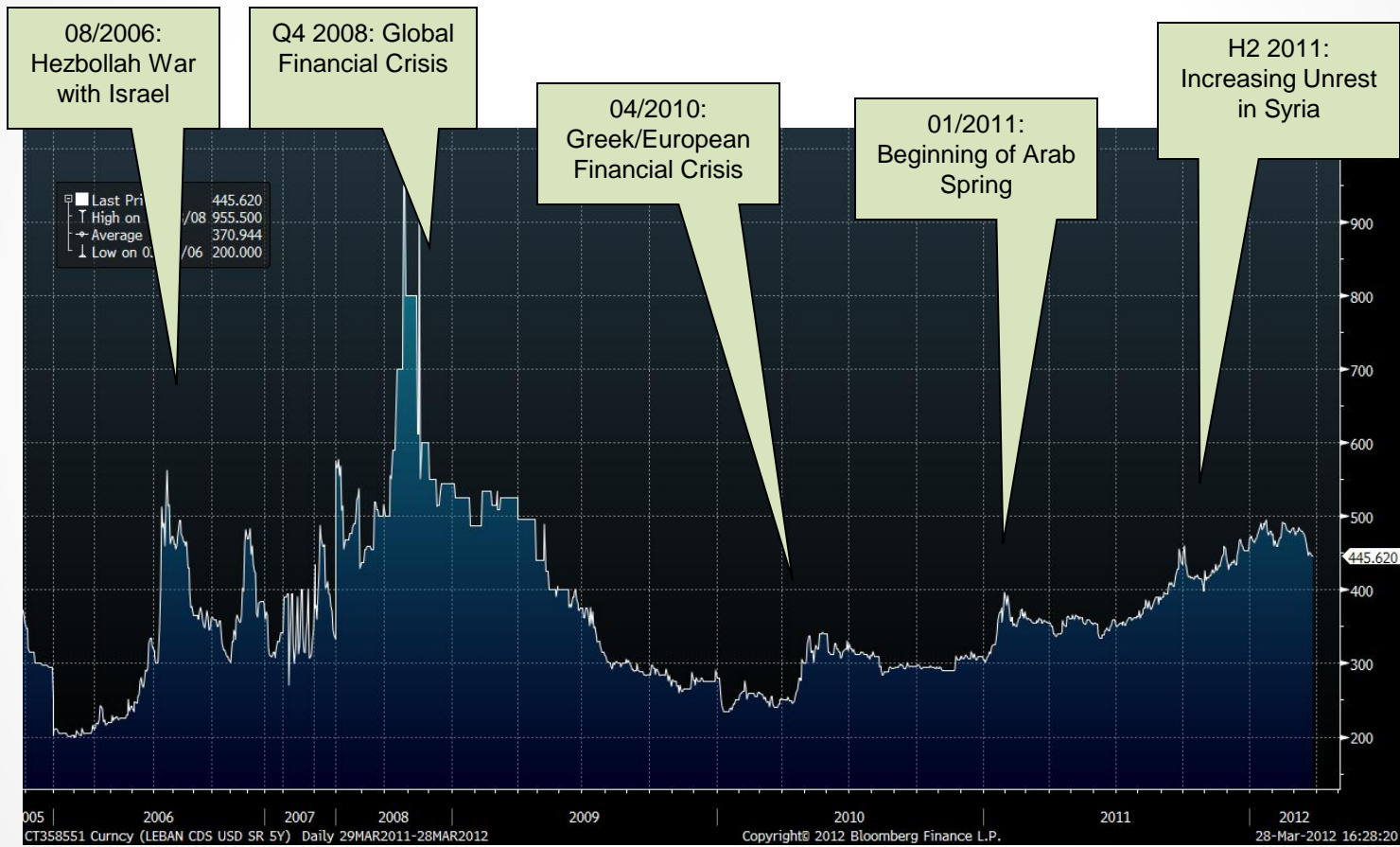


*Credit Default Swaps (CDS): A financial swap designed to transfer the credit exposure of fixed income products between parties. The buyer of a CDS receives credit protection, and the seller of a swap guarantees the credit worthiness of the debt security.

4. Credit Default Swaps to Insure its Sovereign Debt Trade at Very Low Premiums

Premium to Insurance Against Sovereign Default Suspiciously Remains at Low Levels

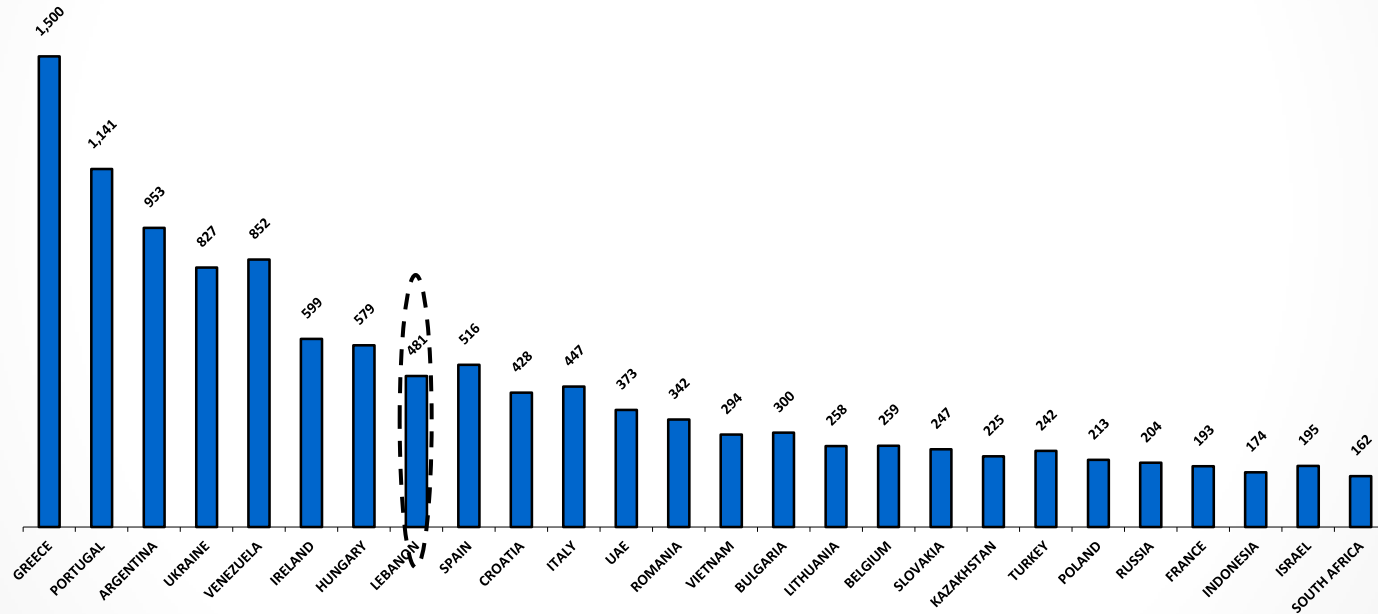
Lebanon 5 Year Credit Default Swap (CDS) Spread Levels



In spite of severe risk indicators, the market registers Lebanese CDS as less risky.

Low CDS Levels Difficult to Justify

5 Year CDS Spreads of Selected Countries

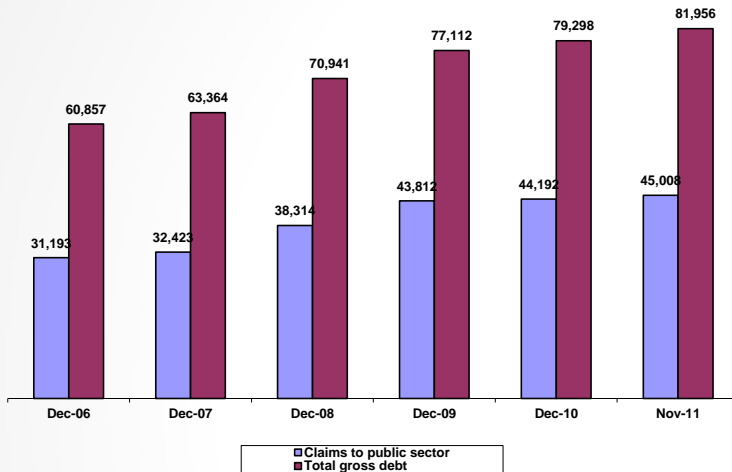


* Excluding recent movement due to default. Data as of 03/28/2012.

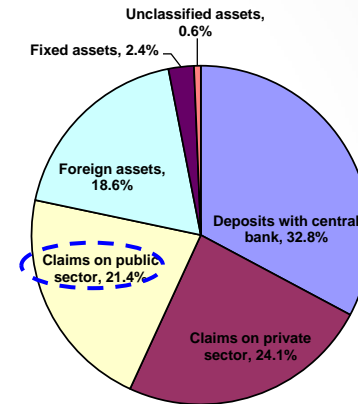
5. Where is the Investment Demand for Lebanese Bonds Coming From?

Unexplained Inflows into Lebanon's Commercial Banking System

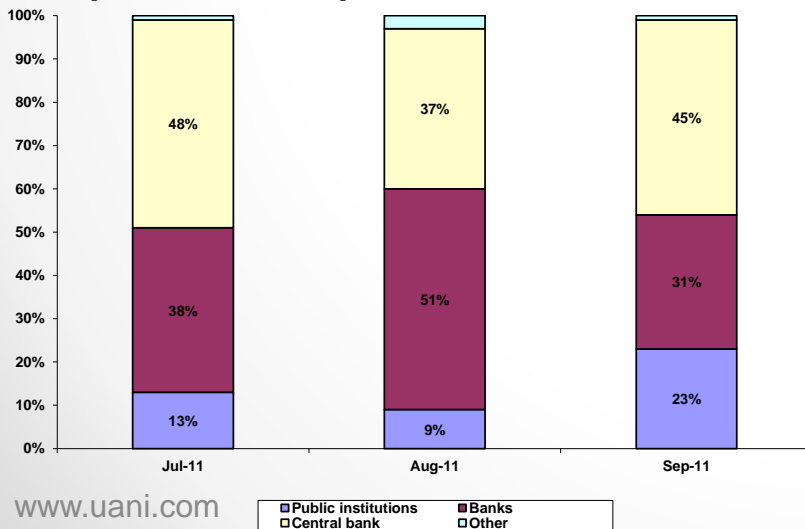
Bank's Claim on Public Sector vs. Debt



Bank Asset Split



Split of Subscriptions in Recent Auction

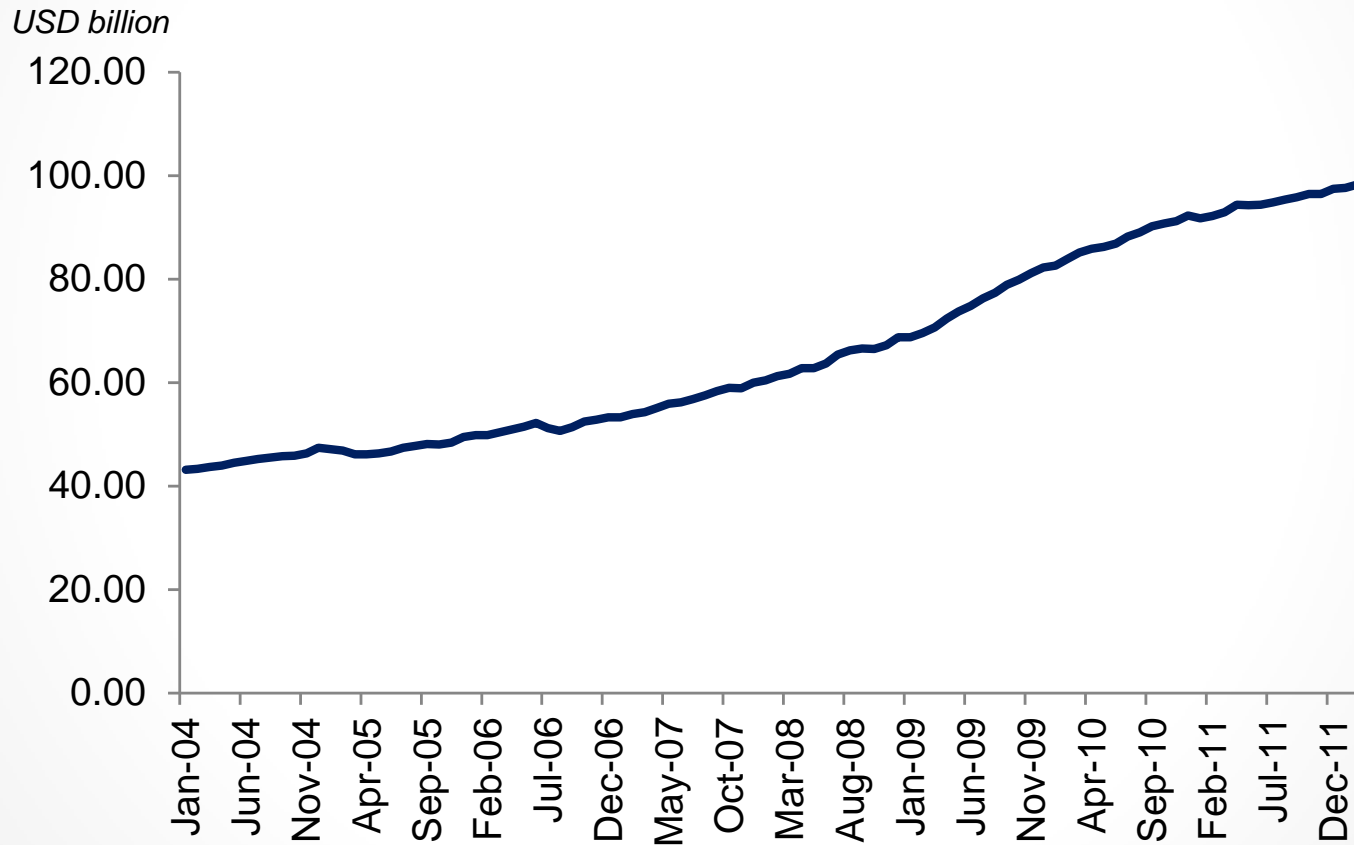


- The commercial banking system has been the leading factor in the demand for government bonds both in local and foreign currency
- Over the last few years, the Lebanese commercial banks have enjoyed material inflows of deposits. Those deposits, however, carry a relatively high interest rate and need to be put to work (LBP savings account at 2.59% and LBP checking/current accounts at 0.91%). A significant portion goes to buying government bonds.
- The fact that cash bonds trade at significantly tighter spreads than CDS supports the notion that Lebanese bonds are inflated by significant inflows of funds into the banking system rather than fundamental investment analysis.

Source: Banque du Liban

Increasing Money Supply

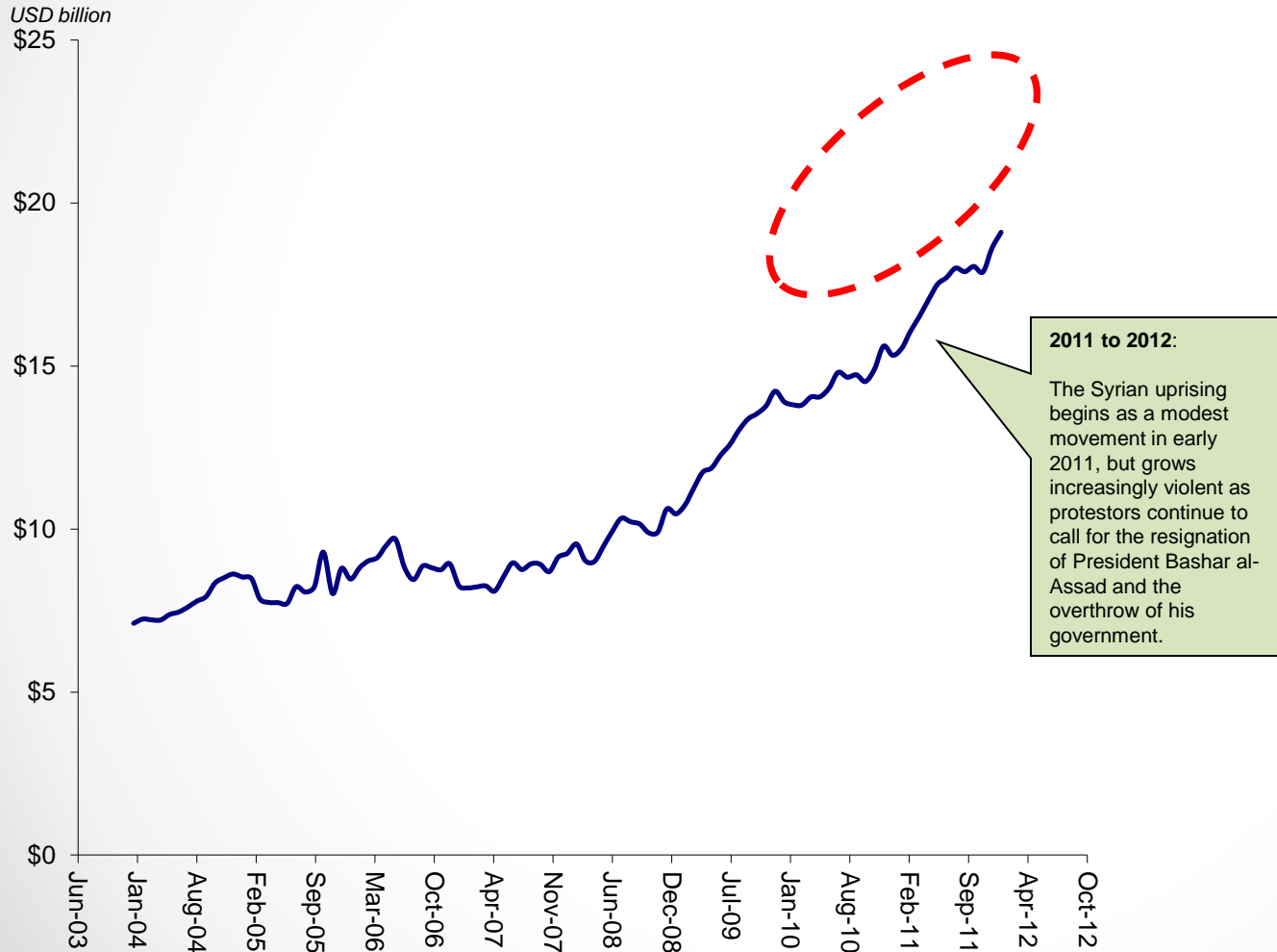
A clear gradual increase in money supply. Where is it coming from?



Source: Banque du Liban

Increased Inflows Coinciding with the Syrian Conflict?

Foreign Currency Deposits in Lebanon of Non-Residents



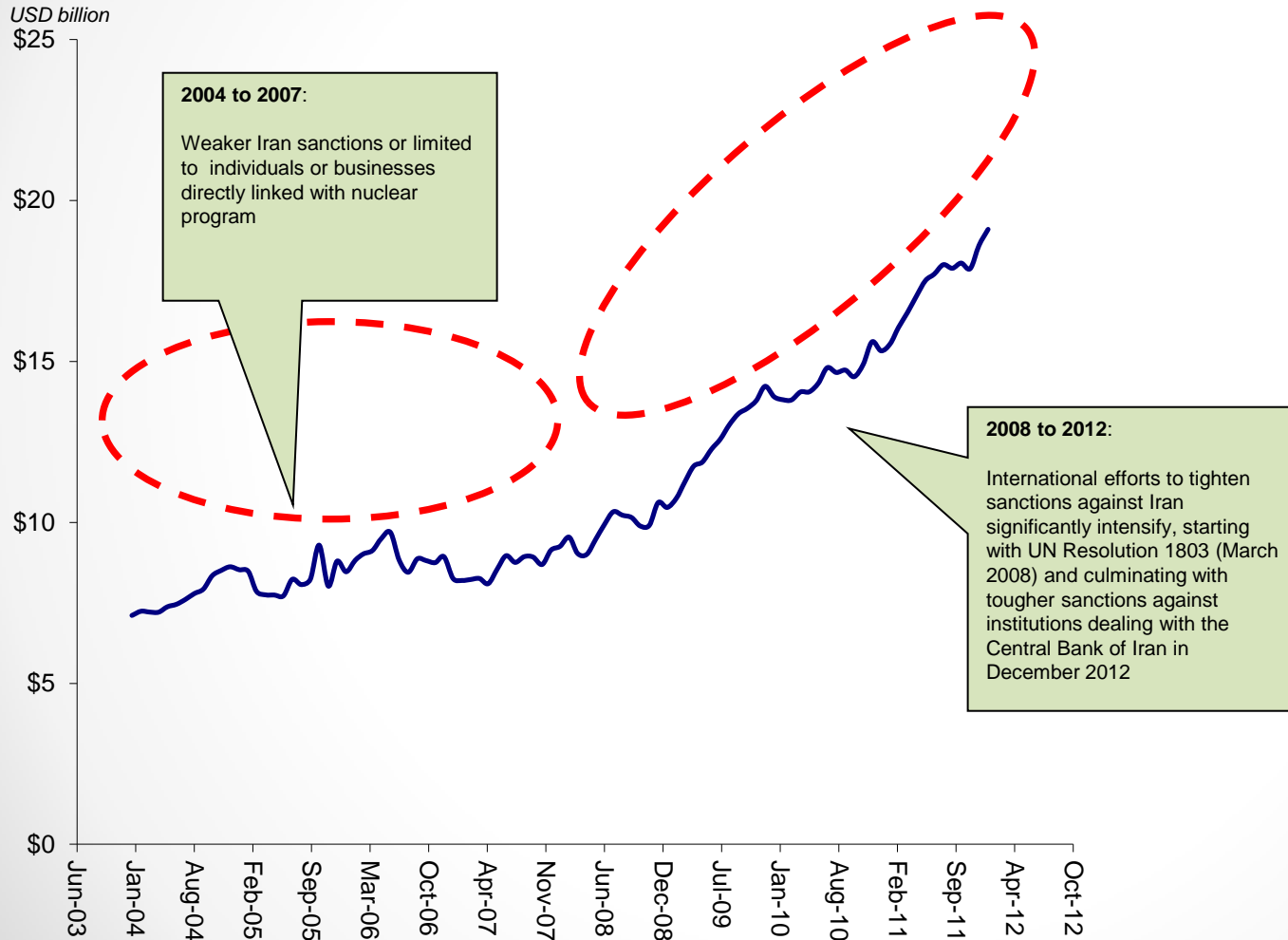
Source: Bank of Lebanon

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The increase in inflows has likely been partially influenced by the Syrian conflict. However, the increase of foreign currency deposits appear to more closely follow other events...

Increased Inflows Coincides with Sanctions Against Iran

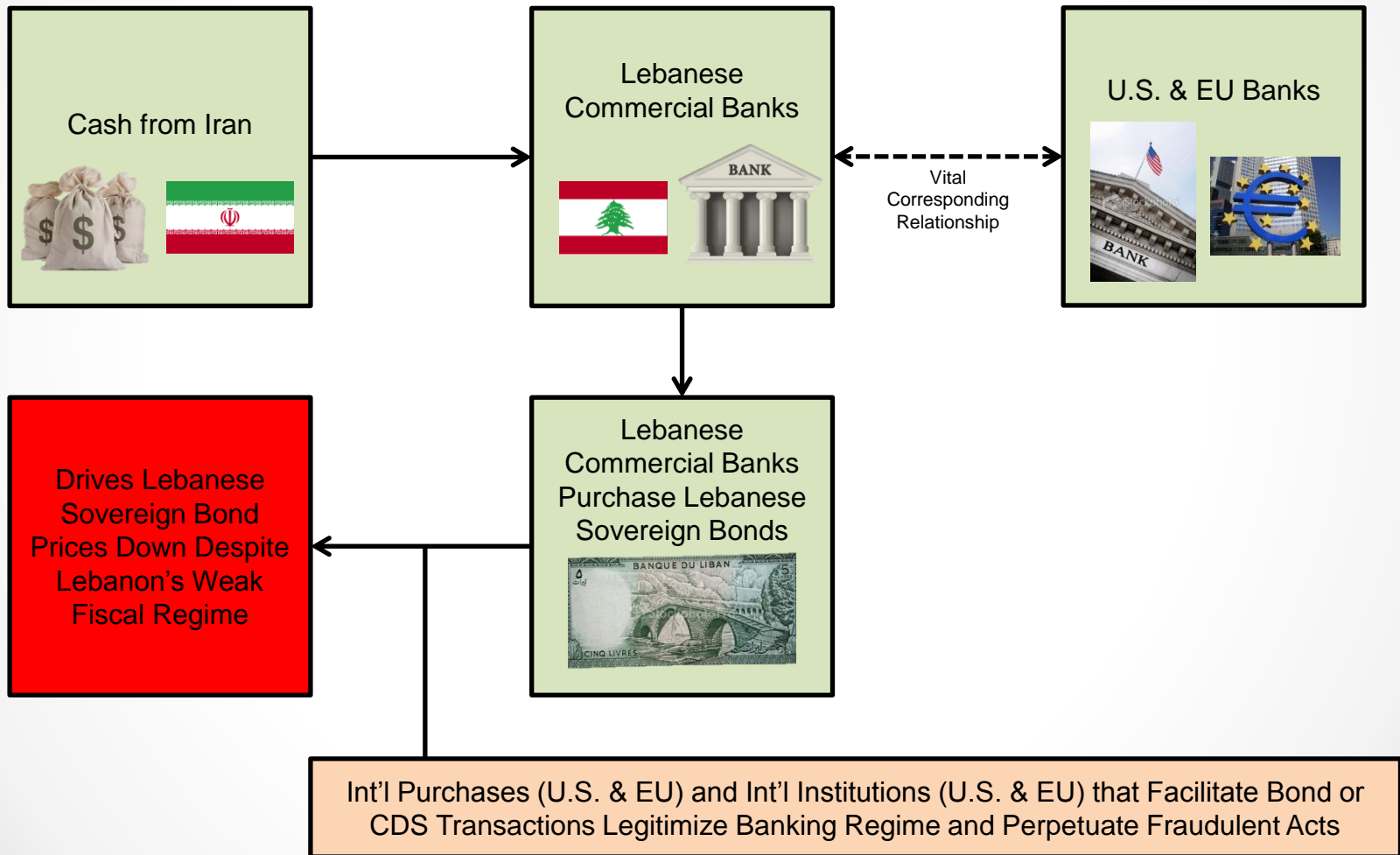
Foreign Currency Deposits in Lebanon of Non-Residents



The increase in inflows coincides with the adoption of more robust Iran sanctions, indicating a likely relationship.

A Sovereign Money Laundering Scheme

The Iran-Lebanon Connection



6. Next Steps & U.S. Government Action

Rating Agencies Should Issue a ‘No Rating’ for Lebanese Bonds

- A bond credit rating assesses the credit worthiness of a corporation’s or a government’s debt issues
- Rating agencies that issue any kind of rating (either ‘investment grade’ or ‘junk bonds’) help to legitimize the exchange of these artificially stable bonds
- **UANI calls upon all credit rating agencies to withdraw ratings for Lebanese bonds due to their fraudulent values**
 - Without an official rating, no reputable institution would purchase such bonds
 - Without an official rating, no institution can justify the purchase of Lebanese bonds to its clients
 - A ‘no rating’ will drive buyers and sellers out of the Lebanese bond market
- Further, there is already an extremely small ownership level by foreign institutions of Lebanese bonds

Lebanese Sovereign Bonds

Total Bonds Outstanding	\$	21,559,668,069.90
Total Bonds Foreign Owned	\$	559,892,335.00
% Foreign Owned		2.60%

Source: Bloomberg, figures as of April 9, 2012

Lebanese Bond Holders & Firms Facilitating Transactions

- Institutions that engage in the buying and selling of Lebanese bonds help legitimize this debt instrument as a serious investment
- By investing in Lebanese bonds, institutions facilitate the Iranian regime in hiding large amounts of hard currency in the Lebanese banking system
 - Providing a safe haven for Iranian currency as the regime actively pursues an illicit nuclear program, supports terrorism and is responsible for egregious human rights abuses
- Firms cannot justify holding/facilitating transactions of junk-rated Lebanese bonds that have been artificially valued as a sovereign money laundering enterprise
- **UANI calls on all such firms to divest from Lebanese sovereign debt and to end its transaction services for these bonds and CDS**

Involved Parties of Bond Transactions

Abouseleiman & Partners
Bank Audi SAE
Bank of America Merrill Lynch
Bank of Beirut
Bank of New York
Bank of New York London
Banque Audi Sal
Banque de la Mediterranee Sal
Banque Libanaise pour le Commerce
Banque Mediterranee
BLOM Bank SAL
BNP Paribas
BNP Paribas/London
Byblos Bank
Citigroup Global Markets Ltd
Credit Libanais SAL
Credit Suisse First Boston (Europe)
Credit Suisse First Boston Corp
Credit Suisse First Boston Ltd
Credit Suisse Securities USA LLC
Deutsche Bank AG
Deutsche Bank AG London
Deutsche Bank Luxembourg SA
Deutsche Bank Securities Inc
Deutsche Bank Trust Company Americas
Dewey & LeBoeuf LLP
Dewey Ballantine LLP/London
EI Khoury & Partners
Fransabank SAL
Freshfields Bruckhaus Deringer
HSBC Bank PLC
HSBC Holdings
Lebanese Canadian Bank
LeBoeuf Lamb Greene & Macrae LLP
Merrill Lynch International
Morgan Stanley & Co International
Nabil Abdel-Malek
Societe Generale
Standard Chartered Bank

Source: Bloomberg as of April 17, 2012

Lebanese Bond Holders

Advanced Series Trust
AGF Management Limited
Aktia Fund Management Ltd
Aletti Gestielle SGR SPA
American Life Insurance Company
Amundi
Aviva Funds Sicav
Blackrock Asset Management
Blackrock Fund Advisors
BNP Paribas Asset Management SG
Consultinvest Asset Management
Deka International SA
Eaton Vance Advisors Ireland Lt
Erste Sparinvest Kagmbh
Eurizon Capital SA
Fidelity Investments Canada Ltd
Fidelity Management & Research
Fideuram Gestions SA
GE Asset Management
GE Asset Management Incorporate
Hartford Life & Accident Ins Co
HSBC Investment Funds Inc
Interfund Advisory Co SA
JP Morgan Investment Management
Jyske Invest
Lombard Odier Darier Hentsch
Mackay Shields Financial Corp
Nationwide Fund Advisors
Neuberger Berman LLC
Nord Est Asset Management SA
Normura Asset Management Co. Ltd.
Price T Rowe Associates Inc
RBC Global Investment Management Inc.
Riversource Investments LLC
San Paolo IMI Asset Management
SEI Investments Fund Management
Sparinvest
Sparinvest Fondsmaglerselskab
T Rowe Price Global Asset Management
T Rowe Price Global Investment Management
Thrivent Financial Lutherans
Union Bancaire Privee
Union Investment Luxembourg SA
Universal Investment Lux SA

Source: Bloomberg as of March 30, 2012