Notre Dame University
Faculty of Business Administration & Economics
Graduate Division

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Bordeaux Management School
Institute of International Business

Corporate Governance: The Case of Standard Chartered Bank in Lebanon

A Thesis Submitted in Partial Fulfillment of the Requirements for the Joint Degree of the Master of Business Administration (M.B.A.) and the Master of Science in International Business (M.I.B.)

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NDU-Lebanon

2010

Approval Certificate

Corporate Governance:
The Case of Standard Chartered Bank in Lebanon

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June 2010

DECLARATION

I hereby declare that this Thesis is entirely my own work and that it has not been submitted as an exercise for a degree at any other University.

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ABSTRACT

Corporate governance in the case of the banking industry reveals that laws, shareholder interests, bank interests and sound economics are factors to take into account. Banks are to balance profits with regulatory requirements and sound economics so as to be successful and management practices to be considered include adequate representation of shareholders, allowing for monitoring, minority control and compliance with legal procedures.

While corporate governance is still an ambiguous subject and a fresh topic for most of the companies in Lebanon, it is fundamental to present a general and comprehensible explanation about corporate governance, and to discuss its relation with the banking sector.

The aim of this thesis is to highlight the importance of corporate governance, especially in the banking sector, and to study its application by Standard Chartered bank Sal in Lebanon, while stressing the nuances between the requirements of the local regulator, Standard Chartered Bank PLC's policies and procedures and International Accords such as BASEL II.

I will take advantage of my working experience with Standard Chartered Bank to thoroughly analyze the composition of Standard Chartered Bank PLC, its corporate governance policies and procedures, and its application in the subsidiaries, particularly in Lebanon. Interviewing the bank's officials as well as consulting the bank's annual report would add a great value to this research.

Although there will be some differences between the applied policies and procedures at Standard Chartered Bank Sal and the local regulator's requirements, it will be obvious by the end of this thesis, that the bank is satisfying both the Group and the Central Bank's requirements, and that the model adopted by the bank is a good example to be implemented by the banks that wish to expand outside the Lebanese market.

Keywords: Corporate Governance, Basel II, Banking Industry, Legal Framework

LIST OF TABLES

LIST OF FIGURES

ACKNOWLEDGMENTS

First and foremost I offer my sincerest gratitude to my supervisor, Dr. Georges Labaki, who has supported me throughout my thesis with his patience and knowledge while allowing me the room to work in my own way. I attribute the level of my Masters degree to his encouragement and effort.

I would also like to thank my thesis' reader, Dr. Raja Shaffu, for the valuable remarks he gave me and the support he has made available through a number of ways.

I extend my gratitude to all the faculty members and staff at my beloved Notre Dame University, for making the years I spent on campus pleasurable and full of learning, education and experiences.

Special thanks to the persons involved in the success of the joint program with Bordeaux Business School, and its faculty members that were "drilling" information into our heads.

This thesis would not have been completed without the help and support of the staff at Standard Chartered Bank Sal, especially Mr. Fouad Nakfour, Head of Legal, Compliance and Assurance, and Mr. Michel Choueiry, Chief Finance Officer, who supported me in obtaining all the needed information.

Finally, I thank my parents for supporting me throughout my studies at University, funding my education, and providing a home in which I completed my writing up. They have always been an inspiration, and an asset to be proud of.

For the resting soul of my father, who has always been an idol and a guidance to follow I dedicate this thesis.

CONTENTS

Chapter 1: Corporate Governance

1.1 General Background

Business ethics and corporate governance have become key factors influencing investment decisions and determining the flows of capital worldwide. In part, this is the result of recent scandals in both developed and developing countries. However, in a more positive sense, the growing demand for good governance also flows from the lessons learned about how to generate rapid economic growth through market institutions.

Business author Gabrielle O'Donovan (2003) defines corporate governance as *"An internal system encompassing policies, processes and people, which serves the needs of shareholders and other stakeholders, by directing and controlling management activities with good business savvy, objectivity, accountability and integrity"*.

Corporate governance can influence the share price as well as the cost of raising capital of a company. Quality is determined by legislation, policies and how processes are implemented and people are led.

External forces are, to a large extent, outside the circle of control of any board. Yet, the internal environment is what differentiates competitors. Executives are often mislead by the legislative policies, and are usually focused on treating the symptoms and not the cause.

Corporate governance is the acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of them.

Since the 19th century, the rights of individual owners and shareholders have become increasingly derivative and dissipated. The concerns of shareholders over administration pay and stock losses have periodically led to more frequent calls for corporate governance reforms.

After the Wall Street Crash of 1929 legal scholars such as Adolf Augustus Berle, Edwin Dodd, and Gardiner C. Means pondered on the changing role of the modern corporation in society. Berle and Means' monograph "The Modern Corporation and Private Property" (Macmillan, 1932) continues to have a profound influence on the conception of corporate governance in scholarly debates today.

Later in the 1970's, corporate governance has been the subject of significant debate in the U.S. and around the globe. Efforts to reform corporate governance have been driven, in part, by the needs and desires of shareowners to exercise their rights of corporate ownership and to increase the value of their shares and, therefore, wealth.

During the 1990s, the issue of corporate governance in the U.S. received considerable press attention due to the wave of CEO dismissals (e.g.: IBM, Kodak, Honeywell) by their boards (Crawford, 2007).

In addition, the East Asian Financial Crisis saw the economies of Thailand, Indonesia, South Korea, Malaysia and The Philippines severely affected by the exit of foreign capital after property assets collapsed. The lack of corporate governance mechanisms in these countries highlighted the weaknesses of the institutions in their economies.

In the early 2000s, the massive bankruptcies and criminal malfeasance, (e.g. Enron and Worldcom), led to increased shareholder and governmental interest in corporate governance.

Nowadays, if the owning institutions don't like what the President/CEO is doing and they feel that firing them will likely be costly and/or time consuming, they will simply sell out their interest. The Board is now mostly chosen by the President/CEO, and may be made up primarily of their friends and associates, such as officers of the corporation or business colleagues.

1.2 Need for the Study

As mentioned above, corporate governance is becoming a necessity for the success of every institution. Investors are getting more and more involved in the way companies are managed and they rely on the consistency of the systems, rules and processes related to corporate governance, to decide whether to invest or not.

Corporate governance assures an essential part of any institutional infrastructure underlying sound economic performance, and the latter is directly correlated to the quality of policies and procedures of corporate governance.

Because corporate governance in Lebanon is still an ambiguous issue, and as we are living in a globalised economy, it is important to start highlighting the subject, and to raise awareness among Lebanese businesses and entrepreneurs, and eventually the Lebanese government to start integrating corporate governance rules in the Lebanese

Code of Commerce and commence the establishment of a sound related infrastructure.

1.3 Objectives

The aim of this thesis is to give a clear idea about corporate governance, enabling every reader to understand clearly the concept, and to identify the pillars that create a good corporate governance model. For that reason, we will be studying the case of a bank operating in Lebanon, and will seek to find out if the bank is applying good corporate governance and whether it is breaching any of the regulator's requirements related to that matter.

1.4 International Perspective

This thesis will study the case of a well reputed international bank, the Standard Chartered Bank PLC, and its subsidiary in Lebanon, Standard Chartered Sal. Since the bank is listed in both London Stock Exchange and Hong Kong Stock Exchange, it is bound to apply the rules and regulations of the financial authorities in these countries and abide by their requirements. This will enlarge the scope of the study, and we will be able to analyze the bank's corporate governance strategy versus the requirements of Basel II and the principles set by the Organization for Economic Co-operation and Development (OECD).

1.5 Brief overview of the chapters

The subject of corporate governance is of enormous practical importance. In fact, even in advanced market economies, there is a great deal of disagreement on how good or bad the existing governance mechanisms are.

The definition of corporate governance and its evolution, the importance and the purpose of this study, as well as the international perspective of the subject will be covered in the first of this thesis.

The second chapter will provide the reader with a literature review about the topic, and will talk about some previous researches about corporate governance, and overview of the concept of corporate governance in Lebanon.

Good corporate governance is not just a matter of prescribing particular corporate structures and complying with a number of hard and fast rules. There is a need for broad principles. All concerned people should then apply these, flexibly and with common sense. It implies on the one hand that companies should be prepared to review and explain their governance policies, including any special circumstances which in their view justify departure from generally accepted best practice, and on the other hand that shareholders should show flexibility and listen to directors' explanations and judge them on their merits.

Analyzing the case of Standard Chartered Bank PLC and its subsidiary in Lebanon, by comparing the corporate governance rules applied, with the requirements of BASEL II & the Lebanese Central Bank, will be covered in chapter 3, which will include on top of that, the methodology used and the variables tested.

Standard Chartered Bank is an International Bank with a presence in more than 70 countries. Corporate governance is therefore compulsory, and constitutes a pillar for the success and business continuity of the bank. Noting that these rules might not be applied identically, in all the subsidiaries of the bank, thus creating a need to understand and adapt to the local regulations and standards.

Discussing the outcome of this research, and verifying if the hypothesis is rejected or not, commenting on the findings and analyzing any discrepancy with the regulators' requirements, will be comprised in the fourth chapter of this research.

Finally, the conclusions and recommendations extracted, and the limitations that we faced will be included in the last and fifth chapter. These recommendations will cover the points that we suppose are necessary, and need to be implemented by both Standard Chartered Sal and the Lebanese government, each in its field, in order to guarantee the sound application of these rules, and to implement any amendments needed to reach to a better level of corporate governance.

Chapter 2: Review of Literature

2.1 Corporate Governance at the heart of International Accords

Corporate governance and issues related continue to attract international attention in light of a number of high-profile breakdowns in corporate governance.

As such, the OECD published in 1999 the principles of corporate governance, with the purpose of assisting governments in their efforts to evaluate and improve their frameworks for corporate governance and to provide guidance for regulators and participants in the financial markets.

Given the important financial intermediation role of banks in an economy, their high degree of sensitivity to potential difficulties arising from ineffective corporate governance and the need to safeguard depositors' funds, corporate governance for banking organizations is of great importance to the international financial system and merits targeted supervisory guidance (Bank for International Settlements, 2006).

To assist banking supervisors in promoting the adoption, implementation and the enforcement of sound corporate governance practices in their countries, the Basel Committee on Banking Supervision issued a revised guidance paper in 2005 (The paper was initially issued in 1999).

The paper presents some considerations for corporate governance related to the activities of banking organizations that are conducted through structures that may lack transparency, or in jurisdictions that pose impediments to information flows.

Though it is not intended to establish a new regulatory framework layered on top of existing national legislation, regulation or codes, it is rather intended to assist banking organizations in enhancing their corporate governance frameworks, and to assist supervisors in assessing the quality of those frameworks. The implementation of the principles should be proportionate to the size, complexity, structure, economic significance and risk profile of the bank and the group (if any) to which it belongs.

This guidance paper describes the roles of the board of directors and senior management in managing risk and underscores the need for banks to set strategies for their operations and establishing accountability for executing these strategies.

Some countries have found it appropriate to adopt legal frameworks and standards (e.g. for publicly traded firms), as well as accounting and auditing standards, that are more extensive and prescriptive than the principles set forth in this paper. Such frameworks and standards are particularly relevant for large financial institutions, where financial difficulties resulting from corporate governance failures may potentially lead to major widespread problems in the financial system.

It is important to note that these principles are applicable regardless of whether or not a country chooses to adopt the Basel II Framework (Basel Committee on Banking Supervision, 2006)

In general, good Corporate Governance exploits the profitability and long-term value of the firm for shareholders. As a company rises with the increase of its number of shareholders and the complexity of its activities; the problem of how the owners supervise and organize the management's activities becomes more important. Here lies the importance of sound corporate governance.

Lebanon is a typical emerging economy with partnership agreements with the EU and is in the process of accessing the WTO, and has in minds to become an integral part of the global economy through fulfilling with the underlying principles of Corporate Governance.

Nevertheless corporate governance remains an ambiguous and often misunderstood phrase. For quite some time it was confined only to corporate management. Corporate governance must include a fair, efficient and transparent administration and strive to meet certain well defined, written objectives. It must go well beyond law. The quantity, quality and frequency of financial and managerial disclosure, the degree and extent to which the board of Directors exercises their trustee responsibilities, and the commitment to run a transparent organization, should be always evolving (The Lebanese Transparency Association, 2006)

2.2 Overview of Corporate Governance in Lebanon

For the majority of the Lebanese, corporate governance is regarded at as the attitude and behavior of shareholders, the use of modern management techniques, and the ability to implement the country's laws and regulations. The majority of shareholders rarely applies shareholding rights, and do not focus on to the concepts of governance. There is, therefore, a need for corporate governance reform. Because it implies changing a long history of behavior and tradition, corporate governance reform is bound to be a long-term process. In Lebanon, corporate governance implementation was postponed for about 20 years because of the civil war and political turbulence. An aggressive economic reform program began recently and much attention is being paid to corporate sector development. The economic reform programs, the focus on privatization and the capital inflows (especially from the Gulf region) that resulted from the international high prices of oil and especially namely in the period after the assassination of Prime Minister Rafic Hariri have inspired the development of the domestic capital market, and the potential entrance of new institutions to Beirut's stock exchange market. However, the transition is still in progress.

Lebanon has affirmed its commitment to corporate governance reform and pursuance. The development of its capital market and its improving performance signals credibility of the mechanism through which the governance principles are best pioneered, executed, enforced, and checked. In reality, Lebanon is rated B1 stable according to Moody's country rating and B positive according to S&P's country rating as in 2010. This shows that too much effort was done during the last yeas, yet still many reforms need to be assumed. Of the major issues that we are facing in Lebanon, we will list some facts that are retarding the implementation of corporate governance principles.

- Many companies are closely held and often managed by "family groups" or by individuals. This is measured to be the main barrier to the implementation of corporate governance principles as managers require autonomy, flexibility, and objectivity to supervise company activities and to attain its objectives;
- The dominance of family-owned enterprises (FOEs) and the absence of a system that avoids family members from controlling the decision making process have resulted in the poor protection of minority shareholders' rights;
- The privatization process is almost sterilized in the meantime;
- The free float (shares available for trading) of listed companies on the stock exchanges is small; and most shares are managed by strategic investors; and
- Small and medium sized companies (SMEs), which constitute the majority of the companies in Lebanon, do not have the institutional capacity, making it more costly for them to implement corporate governance principles. There is therefore a need to develop corporate governance standards that can be applicable without difficulty to these types of companies (Center for International Private Enterprise CIPE, 2007)

2.3 Conclusion and Research Questions

Given the importance of the topic, and the obvious need of having a good corporate governance model, in every successful company, without which, the company is doomed to face big difficulties at the short or long run, we will try in this thesis to understand what would happen if no good corporate governance procedures are applied by any institution and we will study the specific case of Standard Chartered Bank Sal to see if it applies the same policies applied in Standard Chartered Bank PLC, and if these rules satisfy the requirements of BASEL II and the Lebanese Central Bank. In addition, we will talk about the main challenges that face the implementation of corporate governance in Lebanon.

Chapter 3: Procedures and Methodology

3.1 Introduction

As stated in the conclusion of chapter 2, this research aims to study the corporate governance policies and procedures applied by Standard Chartered Bank PLC, and to verify if the same rules are applied in its subsidiary in Lebanon, Standard Chartered Bank Sal. Also, we will list the Banque du Liban (the regulator) requirements and those of BASEL II, which are related to subject and check if these rules are applied by the bank in Lebanon.

3.2 Hypotheses

Standard Chartered Bank PLC, is a well known international bank, and is ranked between the top 20 institutions in the FTSE-100 by market capitalization. Obviously, the bank which has realized increased revenues and profits, during the past 10 years, and especially during the turbulent year of 2008, is applying sound corporate governance strategy. Many big banks were either unable to survive the market crash or are still suffering the consequences of this turbulent year, and as per many researchers, this was due to the bad corporate governance rules applied by these banks. Standard Chartered Bank Sal is a subsidiary of Standard Chartered Bank PLC, and as per group policy, should be applying the same policies and procedures applied in the group. At the same time, the bank should make sure to abide by the local rules and regulations. Would this create any conflict? And if it does, how is the bank mitigating it.

3.3 Selected Variables

3.3 1 the requirements of Basel II

Corporate governance mechanisms and controls are designed to reduce the inefficiencies that arise from moral hazard and adverse selection. For example, to monitor managers' behavior, an independent third party (the external auditor) attests the accuracy of information provided by management to investors. An ideal control system should regulate both motivation and ability.

Internal corporate governance controls monitor activities and then take corrective action to accomplish organizational goals. There are different board structures that are optimal for different companies, and usually the board of directors includes executive and non-executive directors. The board has the legal authority to assign the members of the top management and decide about their compensation. The board should be able to identify potential problems and avoid them. In addition, it is the board's responsibility to ensure the implementation of internal control procedures, and the efficiency of these procedures, as well as the compliance with laws and regulations.

Applying the principle of separation of power is also important, separate divisions check, where one group may propose company-wide administrative changes, another group reviews and can veto the changes, and a third group checks that the interests of people outside the three groups are being met.

Though it does not provide any mechanism for preventing mistakes, it is advised to adopt the performance-based remuneration, which is designed to relate some proportion of salary to individual performance. It may be in the form of cash or non-cash payments such as shares and share options.

Some of the external corporate governance controls that are exercised by the stakeholders include market competition, media pressure, and government regulations.

Honesty, trust, integrity, performance orientation, responsibility and accountability are all elements of good corporate governance.

Corporate governance model should be evaluated periodically to assess its effectiveness.

There are eight basic principles derived from the Basel II recommendations and these principles are viewed as important elements of an effective corporate governance process.

These principles are shown in the below table, and are elaborated later on, to provide the reader with a better understanding.

Principle 1	Board members should be qualified for their positions, have a clear understanding of their role in corporate governance and be able to exercise sound judgment about the affairs of the bank
Principle 2	The board of directors should approve and oversee the bank's strategic objectives and corporate values that are communicated throughout the banking organization
Principle 3	The board of directors should set and enforce clear lines of responsibility and accountability throughout the organization
Principle 4	The board should ensure that there is appropriate oversight by senior management consistent with board policy
Principle 5	The board and senior management should effectively utilize the work conducted by the internal audit function, external auditors, and internal control functions
Principle 6	The board should ensure that compensation policies and practices are consistent with the bank's corporate culture, long-term objectives and strategy, and control environment
Principle 7	The bank should be governed in a transparent manner
Principle 8	The board and senior management should understand the bank's operational structure, including where the bank operates in jurisdictions, or through structures, that impede transparency (i.e. "know-your-structure")

Table 1: The Eight principles of corporate governance as defined by the Basel Committee on Banking Supervision
Source: Enhancing corporate governance for banking organizations, 2006

The Board of Directors, should understand the bank's risk profile, approve its business strategy, avoid conflicts of interest arising from their individual commitment to other organizations, and when such conflicts are identified, the concerned member should exclude himself from taking decisions. The board should also commit sufficient time and energy to fulfill their duties at the bank, and should maintain an appropriate level of expertise, while structuring themselves in a way that promotes efficiency and strategic advancement.

The board's own governance should be assessed periodically, and necessary changes made whenever weaknesses are spotted.

The board is also responsible for ensuring that appropriate succession plans to replace executives, when necessary, are in place.

Regular meetings should be held with senior management and internal audit to review policies and monitor progress toward corporate objectives. Yet, the board should not be involved in the day to day management of the bank, and should exercise due diligence in hiring the external auditors.

The bank's strategic objectives and corporate values are set and approved by the board, and are communicated within the bank. A recommended corporate culture is the one that mandates and provides appropriate incentives for professional behavior and integrity, and at the same time, implements policies that prohibit or limit activities, relationships or dealings that might negatively influence the quality of corporate governance.

To avoid conflicts of interest within the bank, lending or providing preferential treatment to staff, shareholders, and favored entities, senior management should develop and implement policies that help them in identifying and managing such risks.

Senior management is responsible also, for delegating duties to other staff and establishing a management structure that promotes accountability, while remaining aware of its obligation to oversee the exercise of such delegated responsibility, and its ultimate accountability before the board for the performance of the bank.

In case the bank is part of a group or larger structure, the senior management is charged with setting the general strategy and policies of the group and its subsidiaries and for determining what governance structure for the subsidiary would best contribute to an effective chain of oversight for the whole group. Nevertheless, this should be done while taking into consideration the local rules and regulations applied in the country of the subsidiary, and at the same time, by trying to avoid unnecessary replications of corporate governance structures and activities through adequate integration and co-ordination.

Senior management contributes largely to the sound governance of the bank through overseeing line managers in specific business areas and activities by establishing an effective system of internal controls. Managers should not be assigned to an area or a decision making role unless they are well informed about the business and have the prerequisite skills and knowledge.

In addition, managers should not fear or avoid exercising effective control over employees that are generating good profits for the bank, where supposedly their activity should not generate such a high return.

It is agreed that independent, competent and qualified auditors, as well as internal control functions are vital for corporate governance. That is why, the board should utilize and analyze the work of the internal and external auditors, and communicate the importance of their work throughout the bank. Timely and effective correction of the audit findings, are expected to take place as quickly as identified.

The board should also seek the internal and external auditors' opinion to judge the effectiveness of key internal controls.

External auditors should be rotated periodically, and should always be in compliance with applicable codes and standards of professional practice.

Non executive directors are expected to meet at least annually with the external auditors and the heads of internal audit, compliance and legal functions. This will allow them to oversee management's implementation of the board's policies.

Compensation of the members of the board and senior managers should be linked to the long term business strategy and performance of the bank, failure to which might result in actions that run against the interests of the bank and its stakeholders.

In order to avoid incentives being created for excessive risk taking, salary scales should be set in a way that does not depend heavily on short-term performance.

Transparency in governing a bank is essential, and allows shareholders, and market participants to effectively monitor and properly hold accountable the board of directors and the senior management of a bank.

Appropriate, timely, and accurate disclosure and reporting on aspects of corporate governance, consistent with national law and regulator's requirements, can assist stakeholders in monitoring the safety and soundness of the bank.

The Basel Committee on Banking Supervision (2006) listed some types of information that should be disclosed or reported, and related specifically to the governance of the bank. The list does not contain any reporting information regarding financial data, risk exposures or compliance and internal audit issues. Some of the points listed are the following:

- *Board structure (e.g. bylaws, size, membership, selection process, qualifications, other directorships, criteria for independence, material interests in transactions or matters affecting the bank, and committee* *membership, charters and responsibilities) and senior management structure (e.g. responsibilities, reporting lines, qualifications and experience);*

- *Basic ownership structure (e.g. major share ownership and voting rights, beneficial owners, major shareholder participation on the board or in senior management positions, shareholder meetings);*
- *Organizational structure (e.g. general organizational chart, business lines, subsidiaries and affiliates, management committees);*
- *Information about the incentive structure of the bank (e.g. remuneration policies, director and executive compensation, bonuses, stock options);*
- *The bank's code or policy of business conduct and/or ethics (including any waivers, if applicable), as well as any applicable governance structures and policies (in particular, the content of any corporate governance code or policy and the process by which it is implemented, as well as a self-assessment by the board of its performance relative to this code or policy);*
- *Where a bank is state-owned, an ownership policy that defines the overall objectives of state ownership, the state's role in the corporate governance of the bank, and how it will implement its ownership policy; and*
- *As discussed above, the bank's policies related to conflicts of interest, as well as the nature and extent of transactions with affiliates and related parties (which may be in aggregate form for routine lending to employees), including any bank matters for which members of the board or senior management have material interests either directly, indirectly, or on behalf of third parties (Bank for International Settlements, 2006).*

Banks that operate in different jurisdictions or through a complex structure that lack or impair transparency, pose financial, legal and reputational risks to the banking organization. This is mainly due to the impeded ability of the board and senior management to conduct appropriate business oversight.

Usually this risk is mitigated through following clear policies regarding this type of activities, and by requiring that internal control reviews include regular inspection visits by internal auditors, as well as checking the compliance of these activities with the applicable laws and regulations.

The board should regularly evaluate the need to operate in such jurisdictions or through such structures, and evaluate the risks associated with this operation, while establishing appropriate processes for the approval of transactions and new products, especially related to such activities. Clear corporate governance expectations and responsibilities should be set forth.

3.3.2 Role of the Central Bank

The central Bank should provide guidance to banks on sound corporate governance and the pro-active practices that should be in place. The Central Bank recognizes that banks will adopt different approaches to corporate governance that are proportional to the size, complexity, structure and risk profile of the bank. Yet, there are some basic rules and procedures that should be applied by all the banks.

In addition, the Central Bank should determine whether banks are adopting and effectively implementing sound corporate governance policies and practices.

Information about the expertise and integrity of the proposed managers of a bank, are also required by the regulator. Such information includes the academic and individual skills of a director, as well as a record of criminal activities.

Assessing a bank's audit and control functions, and evaluating the bank's mechanisms that allow senior management to execute their oversight responsibilities, is another duty of the Central Bank. Such assessment could include meetings with bank's internal and external auditors, as well as senior risk managers, and compliance officers.

The Central Bank takes into consideration the effects of the bank's group structure, and requires information about the structure of the group to which the bank belongs. The regulator also cooperates and shares information with other supervisors to enhance supervisory effectiveness and reduce burdens.

The Banque du Liban, and further to the requirements of BASEL II, issued three basic decisions, directly related to corporate governance.

These decisions provide guidance and directions to the banks operating in Lebanon, about the procedures to be followed for Auditor's appointment, and about the establishment of the "Audit Committee", as well as some principles of corporate governance to be applied. Those decisions are listed as appendices at the end of this thesis (Banque du Liban, 2009)

3.3.3 Legal Framework

The foundation of any corporate governance framework is offered by the basic legal framework based on the commercial, civil, and securities laws; the regulations of the stock exchange (especially the listing rules); and the basic accounting standards in place. These laws are the basic rules for board and management behavior and on the long term reveal the values of the underlying business culture.

Though the Lebanese government knows that a well-developed corporate governance framework can be an effective way of attracting much-needed foreign capital, it has yet to create significant headway in advancing the legal or institutional frameworks for corporate governance. Existing legal and regulatory requirements lack many important corporate governance protections, especially with respect to the composition and operation of boards of directors. Lebanon has yet to accept a corporate governance code that applies to all publicly listed companies on a mandatory or on a comply-or-explain basis. The basic corporate governance legal framework in Lebanon is contained mainly in:

1. The Commercial Law, which unfortunately, is out-of-date and does not attend to many key corporate governance issues.

2. The Capital or Securities Market Law, which is the principle law regulating the securities markets.

The commercial law requires sufficient and detailed provisions of shareholder protection, which clarify the tendency towards concentrated ownership structures.

Although some provisions are weaker than expected, basic legal protections come out to be in place and support many basic shareholder rights. However, effective protection of basic rights depends on how laws are enforced. Enforcement is a key issue. The promulgation of capital market law has made the legal framework more favorable to corporate governance implementation as it offers the required rules that were missing from commercial laws. A review of the capital market laws and regulations tells that almost all of the legal aspects of corporate governance are well spoken (MENA Regional Corporate Governance Workshop, CIPE, 2003).

1. Basic organization & assignment of responsibilities: A joint stock is the most common type of companies in Lebanon, whereby shareholders have limited liability and shares are freely moveable. The company alternates around two main institutional bodies: the shareholders and the Board of Directors. The Board runs the management of the company, and its members are chosen by shareholders who meet in General Assemblies (GAs). It has a managing director (sometimes referred to as delegated member) who is the Board member responsible for the Board's detailed oversight of the company. The Board can also hire a general manager who is an employee of the company to run the operations.

2. Ownership registration, record keeping and settlement: A modern shareholder record keeping system is essential to the protection of shareholders' rights. The system is able to reassign shares within international norms and is accountable to the securities regulator. Lebanon has well-ordered central depositories which are ready with proper risk management tools such as Settlement Guarantee Funds (SGF) and, in many cases, swift payment systems. While the market is moving towards the dematerialization of securities, central depositories also plan to be a central registration that maintains an updated shareholder database.

3. Equitable protection of all shareholders:

a. One-share/one-vote: the laws are quite clear on the notion that, within a given share class, all shareholders have the same rights. Any intrusion with voting rights within the class is illegal. However, company laws emerge to comply with the basic standard of one-share one vote.

b. Insider trading: Insider trading is, in many laws, explicitly illegal. Such action is heavily reprimanded. The national capacity of securities market regulator must be strengthened in order to detect these activities.

4. Voting of shares: Although shareholders are explicitly given the right to choose and contributing in the general assembly of the company, some practical restrictions are placed on the voting exercise. Shareholders are entitled to attend the general assembly personally or by replacement. Voting by mail or electronically is not allowed or not practiced and in some cases, shares must be blocked before the meeting. With the development of the central depository, international standards propose that procedures should not make it overly difficult or expensive to cast votes. With cumulative voting, shareholders can focus their votes on a single candidate, and elect him or her onto the Board. Cumulative voting addresses several problems as it allows minority shareholders a voice in Board actions and strengthens the principle that directors owe their allegiance to the shareholders.

5. Responsibilities of the Annual General Assembly (GA): By virtue of the governing laws, the GA is supposed to be held once a year, not later than six months after the end of the company's fiscal year. Also, a small group of shareholders (5%) can also call for the meeting to be held. Prior to the GA, the Board must circulate the financial statements of the company, the Board report and the auditors' report. In most of the cases, the information can be send to shareholders before the GA. Minority shareholders are usually confined in this respect by the laws that allow those representing more than a certain percentage of the capital to force a specific topic onto the agenda at the GA and call it to a vote, even if it is not already on the agenda.

6. Takeovers: In Lebanon relatively detailed rules normalize takeovers of listed publicly traded companies. Regulation could be considered excessive, and may discourage future takeovers. The threat of a takeover ensures that companies with widely distributed shareholdings are managed according to the public interest. Takeover restrictions tend to be viewed as anti-shareholder rights, and the threat of a takeover is often observed as critical to the development of a market in corporate control and a positive incentive to corporate governance.

7. Enforcement: In general, enforcement of company and securities laws is an area that needs continuous strengthening and capacity upgrading. The power of the regulator is important to support and complement the court system. Recently developments have been made in the banking sector. Banks now have to comply with the Core Principles of Effective Banking Supervision as issued by the Bank for International Settlements (BIS). Regulatory authorities have established an effective and independent Banking Control Commission and a Special Investigation Committee (for AML).

3.4 The Case of Standard Chartered Bank PLC

In its annual report for corporate governance, standard chartered states its priorities in 2010, as follows:

• *Continue to enhance the focus on key strategic and risk issues.*

• *Ensure the smooth integration of the new Board members.*

• *Embed the corporate governance changes announced in 2009, including:*

- *Enhancing the already strong links that exist between the Board and its committees following the creating of additional board committees*
- *Separating the Audit and Risk Committee*
- *Expanding the remit of and renaming the Sustainability and Responsibility Committee to the Brand and Values Committee*
- *Establishing a Governance Committee*
- *Implementing the Walker Review and Financial Reporting Council Review recommendations*
- *Continuing to create more informal opportunities for the Board to discuss strategic issues*
- *Enhancing further our approach to directors' induction and ongoing development*
- *Using external facilitation to assess the Board's effectiveness.* (Standard Chartered Annual Report 2010).

3.4.1 Core Principles

We will try in this section, to verify if the eight principles recommended by the BASEL Committee on Banking Supervision, already cited above are applied in Standard Chartered PLC.

The aim is to find out if the bank is applying sound corporate governance rules or not.

An effective corporate governance framework comprises many different components. However, complying with corporate governance standards is not enough. Effective governance also requires that culture and values fully support them. That is why corporate governance principles at Standard Chartered Bank are regularly reviewed and practices continuously improved.

To this end, over the past year SCB conducted a full and comprehensive internal review of corporate governance leading to various changes that enabled the Board to spend more time focusing on the key strategic, risk and people issues.

SCB have in place a code of conduct related to securities transactions by directors and in their report, they confirm that the directors were in compliance.

The Board of Standard Chartered Bank PLC's currently has 16 members: the Chairman, six executive directors and nine non-executive directors.

The Board have an adequate level of knowledge and technical understanding of the business, and as a collective body, it has the appropriate skills, knowledge and experience to perform its role effectively. It is the primary decision-making body for all matters considered as material to Standard Chartered. Non-executive directors have unrestricted access to management at all levels, and are encouraged to take advantage of this opportunity both domestically and overseas. Non-executive directors travel widely to engage with local management teams and country leaders, while acting as ambassadors for Standard Chartered in meetings with customers and international regulators.

All the non-executive directors are independent and free of any business relationship or other circumstance that could materially interfere with the exercise of objective, unfettered or independent judgment. Each non-executive director submits an annual confirmation of independence as required under the Hong Kong Listing Rules. The Board also reviews strategic capital, liquidity, cost and risk management and appetite, along with employee engagement and corporate governance.

The Chairman is aware of the other commitments of non-executive directors and is satisfied that these do not conflict with their duties and time commitments as directors of Standard Chartered. Non-executive directors must also give advance notice of any changes to their commitments, and confirm to the Chairman that these will not affect the time devoted to their duties at Standard Chartered.

During the year, a review of the time commitment for the non-executive directors, concluded that this ranged from 30–35 days per annum for a Board member without any committee responsibilities up to 100 days or more for directors who sat on multiple committees. This increased time commitment has been reflected both in directors' letters of appointment and fees payable for the role.

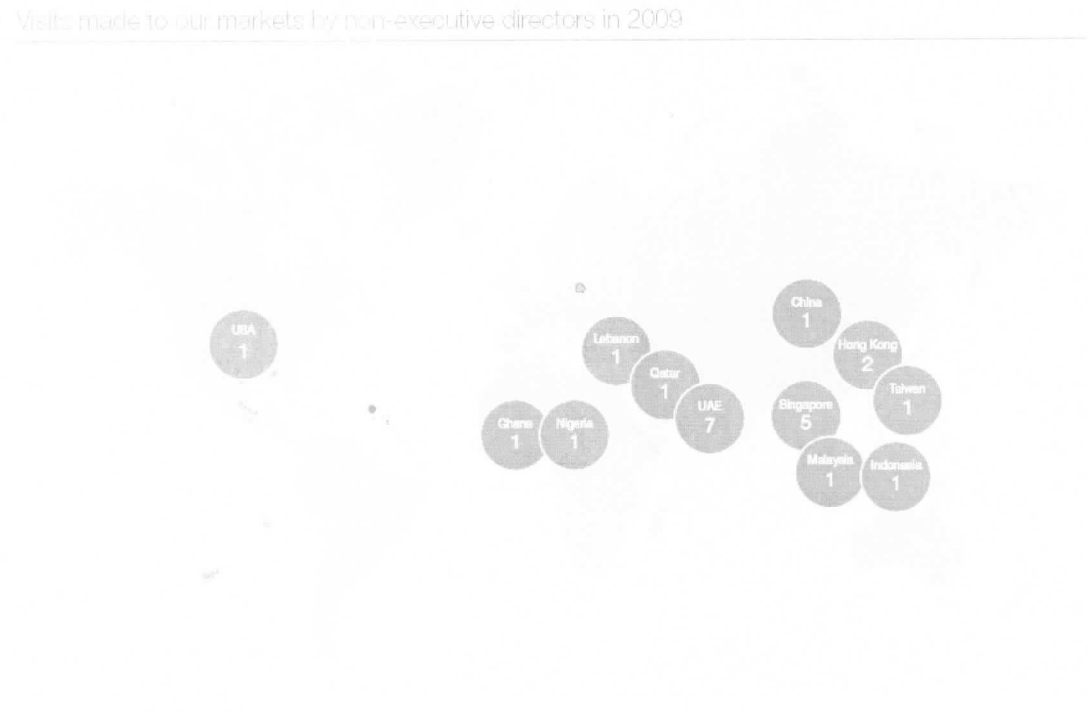
Standard Chartered believes that a highly effective executive team is the single most important factor to ensure successful corporate governance. It does not matter how strong the non-executives may be, either collectively or individually, if the executive team is weak. Non-executive directors perform a vital role in ensuring that the strongest possible executive team is in place and that it operates highly effectively. Board effectiveness reviews go beyond mere performance evaluation, to assess the suitability of the governance processes that support the work of the Board. Non-executive directors demonstrate a high level of engagement and their interaction with the executive directors is both challenging and constructive.

To ensure that directors have the requisite knowledge and understanding to enable them to challenge effectively, a personalised approach to induction, training and development, are provided. On appointment, each director receives a comprehensive and tailored induction covering the Group's business and operations and also the legal regulatory and other obligations of a director of a dual listed company. Each induction programme is tailored to the individual director's specific needs and requirements and further meetings are arranged where a director requires a deeper understanding of a particular area.

Committees play a crucial role in the smooth running of the Board. Where appropriate, topics are delegated to committees to ensure that the Board has time to focus on key strategic issues. It is important that a summary of these committee discussions is provided to the Board so that all directors are aware of any conclusions or actions.

As a result of the internal governance review, and the proactive approach to corporate governance, and although the Board was highly effective, SCB's committees were re-configured with effect from 4 March 2010.

Figure 1: Visits made by SCB non-executive directors to different markets in 2009
Source: Standard Chartered Bank Annual Report 2010



3.4.2 The Committees

The Audit and Risk Committee primarily focuses on the quality and integrity of the external financial reporting, the appropriateness of the accounting policies and the effectiveness of the internal control function and the risk control framework including oversight of risk management.

The Committee meets separately with the external auditor KPMG Audit Plc and the Group Finance Director and Group Head of Internal Audit, allowing members to discuss freely matters relating to the auditor's remit and issues arising from the audit. Its remit also includes the consideration of the appointment, resignation or removal of the Group Head of Internal Audit.

The Committee monitored and assessed the role and effectiveness of the internal audit function. The Committee conducted a review of the performance and effectiveness of the external auditor. The review had many strands. It included an assessment of the independence and objectivity of the external auditor, a survey conducted by the internal audit function and a subjective appraisal of the Committee's own experiences dealing with the external auditor, both in London and at a local level. Committee members met with local external auditors in Abu Dhabi, Dubai, Ghana, Hong Kong, Indonesia, Lebanon, Nigeria, Singapore and Taiwan.

The Nomination Committee primarily focuses on the existing and future composition and balance of the Board and its committees. It seeks to ensure that the individuals in place are those best able to discharge the responsibilities required by Standard Chartered at all times. It also makes recommendations to the Board concerning the ongoing succession plans of both executive and non-executive directors and other senior executives. Taking into account the skills, knowledge and experience required to enhance the existing composition of the Board. The Committee spent a considerable amount of time identifying the nature and criteria of the role of Chairman and the appointment of an external agency to assist in the selection process.

Appropriate plans are in place to facilitate orderly succession to the Board and other senior management positions. The plans are designed to ensure the continued ability to compete effectively in the external marketplace.

During the year, the Sustainability and Responsibility Committee focused on strategic sustainability trends and SCB's response, with renewed emphasis on renewable energy and environmental finance. For a second successive year, Goldman Sachs through their GS SUSTAIN framework, rated Standard Chartered as one of the top seven banks in the world, best positioned to sustain long-term competitive advantage, based on a combination of returns, industry structural positioning and robust management of environmental, social and governance risks. SCB is also included in the FTSE4GOOD index and won the Ability Media International News and Information Media Award for its new portal which was launched to raise young people's awareness to the threat of HIV.

Following internal corporate governance review in 2010, the Committee will be renamed the Brand and Values Committee.

Standard Chartered believe there is merit in forming a Governance Committee to provide a more formal and structured mechanism to considering corporate governance issues (such as industry governance reviews) as well as to drive and oversee the annual board effectiveness review process. The creation of a separate Governance Committee was one of the recommendations from the internal corporate governance review

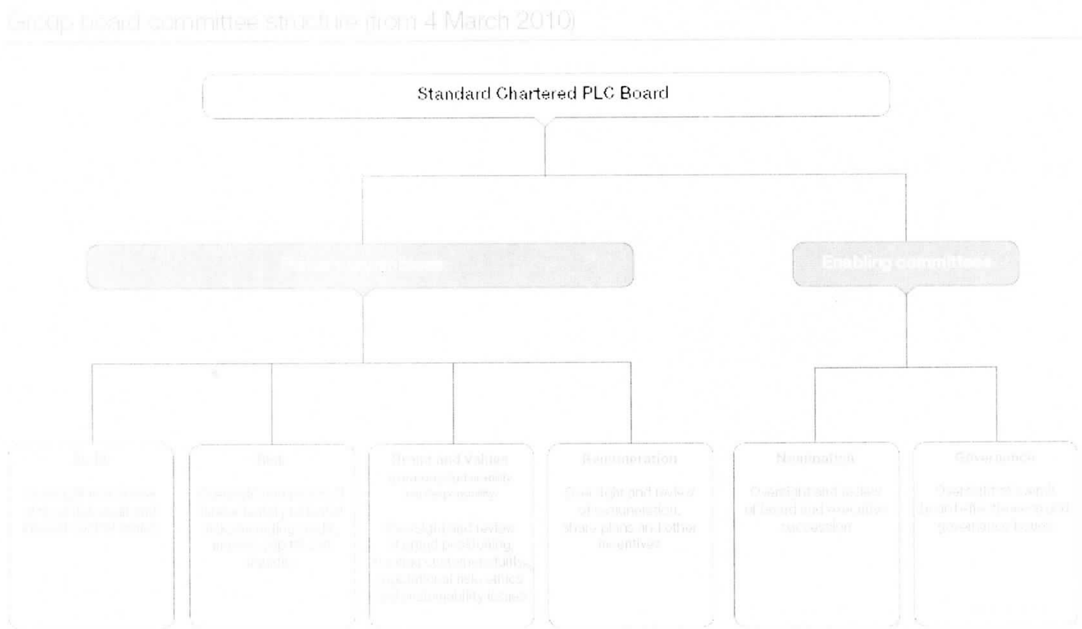
The Board has established a process for the identification, evaluation and management of the risks faced by Standard Chartered. This process is reviewed regularly by the Board. The system of internal control of the Group is subject to regulatory oversight in the UK and overseas.

The Remuneration Committee has oversight of the reward policies for Standard Chartered employees. In particular, the Committee:

• Recommends to the Board the reward policy for Standard Chartered and agrees the reward packages of the Chairman, Group Chief Executive, executive directors and other senior executives as it is designated to consider

• Reviews and approves any major changes in employee reward throughout Standard Chartered, including the continuous review of performance award arrangements to ensure that they remain appropriate, seeking input from the Audit and Risk Committee where necessary.

Figure 2: SCB Group board committee structure
Source: SCB Corporate Governance Report, 2010



Standard Chartered's success depends upon the performance and commitment of talented employees. The reward policy supports and drives business strategy and reinforces values in the context of a clearly articulated risk appetite and effective risk management. The reward policy is designed to:

• Support a strong performance-oriented culture, ensuring that individual rewards and incentives relate directly to the performance of the individual, the operations and functions in which they work or for which they are responsible, Standard Chartered as a whole and shareholders' interests.

• Maintain competitive rewards that reflect the international nature and enable SCB to attract and retain talented executives. Many of the employees bring international experience and expertise, and they are recruited from a global marketplace

The Committee reviews the reward policy on a regular basis against significant regulatory developments, market practice and shareholder expectations.

Standard Chartered's One Bank philosophy, whereby risk management, behaviour and values are rewarded as well as performance, applies to all employees. Reward depends as much on 'how' performance is delivered as 'what' is delivered and this intangible factor is taken into account in every performance assessment and reward decision made within Standard Chartered. Their strong performance-oriented culture ensures that employees are motivated to focus on business and personal objectives and deliver and sustain outstanding performance while acting in accordance with the values.

Individual rewards and incentives therefore relate directly to an individual employee's performance, to that of the business unit in which they operate and also to the overall performance. Target total compensation is benchmarked to the relevant market in which each individual is employed, while the potential total compensation is set at upper quartile or higher for excellent individual and business performance. All employees have the potential to receive an element of performance-related compensation. Typically, the higher the total compensation is, the greater the proportion delivered in variable form (either through a cash award, deferred shares and/or performance shares). The balanced set of reward structures reflects the risk profile of particular businesses. The methods by which variable compensation pools are determined vary according to the nature of the business.

3.5 Exemplary Corporate Governance

When looking at the components that contribute to exemplary corporate governance, it is believed that it is vital for companies to have an underlying culture with behaviours and values that support effective corporate governance. Without such an embracing culture there is a higher risk that corporate governance principles will be applied with a strict compliance mentality rather than following the spirit of the principles that underpin strong corporate governance. In this context, Standard Chartered's open, challenging yet cohesive and collaborative culture has been instrumental in supporting their holistic approach to corporate governance. Standard Chartered has an ethos of continuous improvement which facilitates review and improvement of practices and creates an environment where constructive challenge and collaboration is expected and welcomed. It is regarded as the responsibility of all employees to be responsive and vigilant to the environment in which they operate.

It is certain from all the measures, policies and procedures described above, that Standard Chartered Group applies the best practices related to corporate governance and that they comply with Basel II requirements to the utmost.

The next step is to find out if Standard Chartered bank in Lebanon, applies the same policies of Standard Chartered Bank PLC, and whether these policies and procedures comply with local regulations.

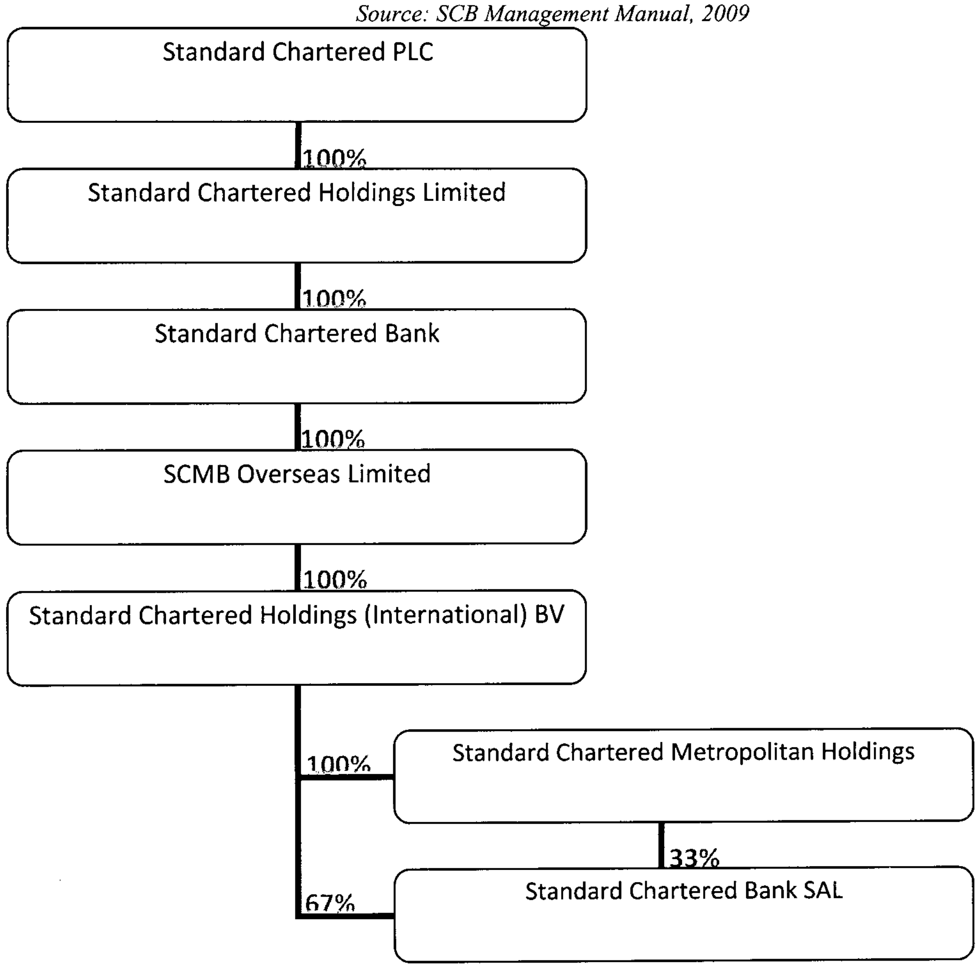
For that reason, we will highlight the nuance in the requirements of the Central Bank, Basel II and Standard Chartered PLC, and will show how the bank is mitigating these mismatches, if any.

Chapter 4: The Case of Standard Chartered Bank S.A.L. – Lebanon

4.1 Introduction

Standard Chartered Bank SAL, is totally owned by Standard Chartered PLC, this ownership is not direct, but rather through a number of companies and holdings as clarified in the chart below:

Figure 3: Standard Chartered Bank Sal Ownership
Source: SCB Management Manual, 2009



Standard Chartered Bank SAL, is celebrating this year its tenth anniversary. In Lebanon, the bank offers an extensive range of products and services for personal, priority, and private customers, local companies, multinational corporate and financial institutions.

The bank's main objective is to offer outstanding value to their customers by providing a knowledgeable, efficient and reliable service in a personal, helpful and responsive manner.

Central to this service philosophy is the professional consultative approach they take with each customer. By getting to know you better, they can identify your needs and match them with quality products which suit you best.

To simplify, Standard Chartered Bank SAL is seriously committed to helping you manage your money in the best possible way.

4.2 Analysis of the Corporate Governance Responsibility

The bank in Lebanon is managed by a Management Committee (MANCO), responsible for the communication and the implementation of the strategic objectives and corporate values of the bank across all levels.

MANCO members are experts in their jobs. Over the years, they have accumulated their experience, to the know-how and the practice. They are all well informed about their functions and they constantly receive necessary trainings.

MANCO members also delegate duties and authorities to other staff, and establish a management structure that allows accountability. Across all the departments in the bank, you will find the DOA (Delegation of Authority) documents, the DOI (Departmental Operating Instructions) documents and the succession plan in place. This allows the senior management to oversee the exercise of such delegated responsibilities.

Another Committee responsible for corporate governance is the Assets & Liabilities Committee (ALCO), which will ensure that the country balance sheet is managed in accordance with Group Policy and any other applicable regulatory requirements.

ALCO function is to ensure the efficient implementation of balance sheet management policies as directed by GALCO (Group ALCO). It receives and review reports on liquidity, market risk and capital management. It identifies balance sheet management issues that are leading to under-performance and refer those that cannot be resolved locally to LMC (Liquidity Management Committee – part of GALCO). It also reviews deposit pricing strategy for the local market.

In carrying out its duties, ALCO pays particular attention to the following points:

- Ensure compliance with Group policy and regulatory requirements.
- Where appropriate, to set local targets within Group policy and guidelines and to review assumptions used for forecasting cash flows on an annual basis.
- Review and approve contingency plans for liquidity at least annually.
- Review and manage concentration risk arising from both borrowers and depositors.
- Ensure business activity is consistent with the structural integrity of the balance sheet, including capital consumption.
- Ensure that risks inherent in local payment systems are evaluated, quantified and managed.
- Review requirements set by external regulators both locally and on a Group basis.
- Establish a rate setting mechanism for all published rates on assets and liabilities with the objective of ensuring that rate risk is effectively transferred to Global Markets wherever possible.
- Review Price risk profiles of the balance sheet, especially exposures relating to nil rate or administered rate products that give rise to basis risk.

Operational risk is also a major key element of the corporate governance strategy of a company. That is why, each branch of Standard Chartered Group has a committee responsible for the management of Country Operational Risk (CORG).

Operational risk is the risk of direct or indirect loss due to an event or action resulting from the failure of internal processes, people and systems, or from external events.

Effective operational risk management directly supports the Bank's strategic intent. It underpins the approach of management discipline, especially the balance of growth with firm control of risk. It protects the bank's reputation, and so reinforces the brand, and strengthens the bank's "Right Partner" relationships, particularly with the regulators, which reflects in the trust and the confidence of the Central Bank in the internal processes and auditing systems applied by the bank.

While The CEO is accountable for the effective management of operational risk in a country, business heads are accountable for the management of operational risk in their business.

The bank's external auditors are KPMG since SCB's opening in Lebanon. During those ten years, KPMG provided non-audit services to SCB for only one single time. It was during 2006, when the group acquired American Express Bank.

As part of the group requirements, the bank also conducts on a yearly basis an employee engagement survey, using the services of an independent company. This survey measures the aspects that link employees' engagement to business outcomes and compares these scores to other teams' results from other companies. This is essential to ensure that the employees are satisfied from the work environment and that they are committed to the bank values and brand promise, and willing to develop their skills and outperform their job.

4.3 Non Compliance with Banque du Liban Basic Desicions

As we already mentioned in the Chapter 2 of this thesis, corporate governance in Lebanon is still in the process of creating a well developed legal framework. With regards to the banking sector, The Banque Du Liban, recently started the implementation of new decisions related to corporate governance and the implementation of the Basel Committee on Banking Supervision recommendations, in the Banking sector.

In that context, The Banque du Liban issued in July 2006, the basic circular No.106, relating to "Corporate Governance". This Circular comprised the basic decision No.9382, which stated that pursuant to the Code of Money and Credit, particularly Articles 70 and 174, and in accordance with the document on enhancing corporate governance for banking institutions, issued by the international Basel Committee in February 2006, the Central Bank requested that all banks operating in Lebanon must seek to apply the principles stated in the said document.

The Central bank also issued in July 2008, the basic circular No. 118, consisting of the basic decision No. 9956, relating to the "Establishment of the Audit Committee", its tasks, role and activities. The decision stated that the Board of Directors of each Lebanese bank must, by June 30, 2009 at the latest, establish the above Committee.

Finally, The Banque Du Liban issued in August 2009, the basic circular No. 122, covering the basic decision No 10224, specifying "The Procedures of Auditors' Appointment". The decision requested that starting with fiscal year 2010, each bank operating in Lebanon, must appoint two audit firms for auditing its accounts jointly and severally (Banque du Liban, 2009)

While it is obvious that Standard Chartered Bank, whether at group level or In-Country, applies all the principles of corporate governance required by Basel II, a broader study shows that Standard Chartered Bank SAL has not applied, till date, all the required actions, requested by the Banque du Liban, and related to corporate governance. But, does that mean that Standard Chartered Bank SAL is breaching the local regulations of the Central Bank? And if so, what would be the consequences.

4.4 Analysis of the Findings

To discuss the Central Bank's decisions, as well as the bank's corporate governance framework, its application in Lebanon / the Group, and the relation with the Central Bank, I interviewed Mr. Fouad Nakfour, Head of Legal, Compliance and Assurance and Mr. Michel Choueiry, Chief Finance Officer (CFO), at Standard Chartered Bank SAL.

When asked whose responsibility it is to ensure the application of corporate governance policies and procedures in Lebanon, Mr. Nakfour pointed out that it is the responsibility of the Chairman, the CEO and the CFO (i.e. The Board of Directors) to guarantee the appropriate level of corporate governance.

Ultimately the CEO should raise to the Board any matter of significance affecting the bank which requires the Board's attention, including any matters which exceed the delegated authority of the executive management. It is the duty of the CEO to ensure the adherence by all functions and businesses to the policy on subsidiary control and governance.

According to Mr. Nakfour the bank applies the same policies and procedures related to corporate governance as the ones applied in the Group. On the other side, he added that the Group's corporate governance strategy, covers the requirements of BASEL II, and is even more demanding and challenging.

On how the bank mitigates the risk arising from using KPMG's services for the last ten years, Mr. Choueiry replied that every two years, partners from KPMG are rotated to ensure the independence and objectivity of the auditors, and that the external auditor is appointed by the shareholders during the Annual General Meeting to ensure its independence and its objectivity.

Whether the bank uses any non-audit services from KPMG or not, Mr. Choueiry pointed out that in 2006, the bank got the approval and the required dispensation of the group, to use KPMG's services for matters related to tax advisory and regulatory issues. Mr. Choueiry added that during 2006, the bank had acquired American Express Bank, and the management decided to use KPMG's services because it was cost effective.

While we mentioned before that the Central Bank requires from each bank to have two separate audit firms, it is worth noting that an exemption was granted by the Central Bank to Standard Chartered Bank Sal (Among other international banks). According to Mr. Nakfour, KPMG's audit report on Standard Chartered Bank Sal constitutes a part of KPMG's Group audit report on Standard Chartered Bank PLC. Therefore, all the audit reports of KPMG covering the subsidiaries of Standard Chartered Bank around the world are re-audited at KPMG's group level, which satisfies the Central Bank requirements, ensures the transparency and the independence of the audit report and guarantees the required level of comfort.

According to Mr. Choueiry, KPMG's annual report is first sent as a draft to the coordinator inside the bank, who in his turn sends it to each business unit, asking for their comments and feedback relating to any possible audit finding. After each unit responds to the queries, the answers are sent back to KPMG, and the final report of KPMG is presented to the shareholders at the Annual General Meeting.

Another regulator's requirement, that should have been implemented in each Lebanese bank, before June 30, 2009 at the latest, was the establishment of an "Audit Committee".

The role of an internal audit committee, as described by the Central Bank, is mainly to review the internal control regulations and procedures, including procedures relating to fighting money laundering and terrorist financing, in order to ascertain their efficiency and effectiveness. In addition to that, the committee plays a major role in coordinating work between the audit units and the auditors, particularly when each of them is reviewing the internal control regulations and procedures.

The committee also gives its opinion about auditors and evaluates their performance, independence and objectivity. It also discusses the main remarks and recommendations included in the auditors' reports, and report them to the Board of Directors.

Yet, while Standard Chartered Bank PLC has the Audit and Risk Committee established and performing all the duties and roles mentioned above, it is worth noting that till date, Standard Chartered Bank Sal has not established one, and talks are currently underwent with the central bank to get a dispensation.

Both Mr. Nakfour and Mr. Choueiry, agreed that when it comes to Internal Audit, Standard Chartered Bank relies on business checks, followed by second and third level checks, and abides by the group controls and systems, like budgets and delegations of authorities and product development documents.

Self-assessment by the business unit of the controls put in place, which include the performance of KCSA (Key Control Self Assessment), escalating issues as identified to the management of the business unit, and recording the issues identified in the appropriate system are all examples of what the first line of audit and assurance do. These assessments are performed through embedded controls that are part of a process flow or through periodic controls and checks within the business unit.

Second line of Assurance are executed by the audit and assurance unit in the bank, this unit does independent checks that the self-assessment activities in the first line of assurance are being done and are of satisfactory quality, it also checks that the controls embedded in the processes are working as prescribed, and carry out the in-country audits stipulated by local regulator. These checks take the form of checking the effectiveness of the self assessments done by the business (done at the right time, and in the right way) and the underlying compliance with the control being tested.

They might also be more wide-ranging and addressing a subject (E.g. Anti Money Laundering) rather than a business, it will cover several businesses and will use several types of inputs (audit points, interviews, and customer complaints).

As for the third line of Assurance, Mr. Choueiry added that the Group Internal Audit are there to review independently the effectiveness of all aspects of audit and assurance framework, and they will address whether the risks being addressed are the right risks and whether the controls in place are appropriate.

The Group Internal Audit is concentrated on strategic and thematic audit work, and where audit activities relate to compliance with internal policies, these activities will pass to the risk assurance team.

Mr. Nakfour called my attention to the fact that all these layers of risk assessment and assurance, and the different controls that the group adopts and incorporates in all its subsidiaries guarantee the same results that the Central Bank expects from the Internal Audit Committee, and that creating such a committee at the country level for Standard Chartered Bank would be a redundancy and will have no added value on the processes and the controls of the bank, since this committee exists but at a group level. Yet, he added that the bank's management is always seeking to incorporate the Central Bank's requirements in the processes adopted, and that whenever there is a necessity to add a certain audit procedure, it is being immediately implemented, even if it is mitigated by another existing process.

When asked if the bank had in place some specific documents, related to corporate governance Mr. Nakfour replied as follows:

Document	Available	Not Available
Compliance Manual	X	
Bank Charter/By-laws	X	
By-laws on Internal Control	X	
By-laws on the Board	X	
Risk Management Manual	X	
By-laws on GSM	X	
By-laws on Audit Committee	X	
Code of Ethics	X	
By-laws on Board Committees	X	

By-laws on the Conduct of Business	X	
By-laws on Information Policy	X	
Corporate Values	X	
By-laws on Corporate Officials	X	
By-laws on Dividend Policy	X	
By-laws on Corporate Conflict	X	
Corporate Governance Code/Principles	X	
By-laws on Takeovers	X	

Table 2: Availability of documents related to corporate governance

Other documents mentioned included anti-money laundering manuals, credit policies and procedures, internal audit manual, treasury policies and procedures, and customer relations policies and procedures.

Finally Mr. Nakfour and Mr. Choueiry, ended by saying that the talks with the Central Bank are at the closing stages, and that the bank will get the required dispensation.

Chapter 5 Conclusions and Recommendations

5.1 Conclusion

Standard Chartered Bank SAL is obviously doing very well in terms of corporate governance. In addition to applying the entire group related policies and procedures, it is also satisfying the local regulator's requirements. There might be some local requirements that are not implemented in its processes, but these are certainly alleviated by other group requirements, policies and procedures. It is also important to look at Standard Chartered Bank PLC's corporate governance model as an example to be followed, since it proved its success through the continuous and rapid expansion of the bank and the increasing revenues and profits during the last ten years, especially throughout the turbulent crisis of 2008.

With the banking sector in Lebanon, being probably the most reliable sector in the Lebanese economy, and with the wise strategies Lebanese banks are adopting, and the increasing number of expansions of these banks across the region, it is certainly a must that these banks exchange the knowledge and experiences they have, and that the Central Bank adopts most of the corporate governance models that international banks and BASEL II have set. This certainly does not imply that local regulators or local banks lack the knowledge and skills to design their own models, but the extended experience of International banks and the speed at which they adapt to international standards and recommendations, is evident and requires from us to acknowledge its success and extract its best practices to embed it in our systems.

Banks are the backbone of the local and global economy, providing capital for innovation, infrastructure, job creation and overall prosperity. Banks also play an integral role in society, affecting not only spending by individual customers, but also the growth of entire industries.

To conclude, corporate governance in Lebanon is still a new concept and is not yet widely spread in the country. However, Lebanese banks are the leaders in adopting corporate governance and the Central Bank is playing a major role in implementing it. Standard Chartered Bank Sal is an international bank operating in Lebanon, and applying all the policies and procedures required by the central bank and related to corporate governance. But in addition to that, the bank applies further measures required by the Standard Chartered group and resulting from the complex structure of the bank on the global scale.

5.2 Implementation Challenges

The implementation of Corporate Governance in Lebanon features the following main challenges:

- Laws prevent separation between board and management (no separation of interests and accountability);
- No incentives for public listing;
- No access to information;
- Negative perception and relationship between public and private sectors;
- Spread of corruption hindering competitiveness;
- The nature of Lebanese companies:
  1) Up to 85% of Lebanese firms have less than 10 employees.
  2) Around 95% of Lebanese firms are family owned; and
- Lack of enforcement or incentives for the adoption of international accounting or auditing standards.

5.3 Recommendations

Since the end of the country's civil war in 1990, the Lebanese government has been under rising pressure to reclaim the country's position as the region's trading and financial capital. Despite economic and political reforms, Lebanon has been unable to protect significant foreign and domestic capital flows. While the macroeconomic situation has certainly been central to the problem of low capital mobilization, the general weakness in the country's corporate governance framework also has been an concern. There are indications, however, of some improvement in the corporate governance environment. There is growing public and private awareness of the importance of corporate governance, and efforts have been made toward reform. The government has given high priority to developing the legal and institutional framework for corporate governance. The private sector has also revealed a commitment to improve corporate governance. Representatives from both the public and private sectors in Lebanon have worked together to organize an action plan to develop corporate governance. Areas that need strengthening were identified and there was a recommendation to adopt a Corporate Governance Code (The Lebanese Transparency Association, 2006). The following specific actions on governance are recommended to be implemented:

- Provide minority shareholders the right to sell stock at appraised value in the event of a merger or takeover;
- Develop a plan to reduce multiple voting powers of founders' shares;
- Require the establishment of compensation, nomination, and audit committees;
- Require that at least one-third of board members be non-executive;
- Require that a majority of non-executive members be independent;
- Require that independent directors chair audit and nomination committees;
- Create a separate, independent securities' enforcement agency;
- Take steps to establish a system for arbitration for shareholders' disputes.

The following additional broad-based measures would also reinforce the governance framework:

- Sustain training for independent directors;
- Consider the creation of a separate commercial court;
- Provide additional training for judges hearing commercial cases.
- The Corporate Governance principles should comprise a number of changes, including possible amendments to the existing commercial law:
- Amendments to commercial law:
- Fortify minority and foreign shareholder protection;
- Recognize the responsibilities of the Board of Directors and individual directors;
- Accounting and auditing;
- Transparency and ownership and control.

Amendments in laws such as:

- Establish a modern securities law;
- Renovate and reform Insolvency and Bankruptcy law;
- Launch a comprehensive Capital Markets Law.

- Streamlining corporate governance into the securities and financial markets, emphasizing the role of the banking sector, which is the strongest in Lebanon is also recommended.
- Encouraging the set-up of local rating agencies to ease compliance with Basel II banking standards.
- Develop incentives for information disclosure and corporate governance.
- Set-up national websites for good corporate governance companies.
- Necessity of awareness raising about corporate governance and related local and international tools.
- Ensuring access to information and disclosure.

All these recommendations could be reached through joining forces, building coalitions, creating alliances with the media and academia; designing an action plan, activating resources, and ensuring international cooperation and support.

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APPENDIX I

BANQUE DU LIBAN

Basic Circular No 122 to Banks

Attached is a copy of Basic Decision No 10224 of August 13, 2009, on the procedures ofauditors' appointment.

Beirut, August 13, 2009

The Governor of the Banque du Liban

Riad Toufic Salamé

Basic Decision No 10224

Procedures of Auditors' Appointment

The Governor of the Banque du Liban,

Pursuant to the Code of Money and Credit, notably Articles 70 and 174 thereof; andPursuant to the Decision of the Central Council of the Banque du Liban, taken in its meeting of August 12, 2009,

Decides the following:

Article 1:

Auditors are appointed for a renewable, three-year period, provided that the principle of partner rotation is adopted by the audit firm, by changing the auditor in charge every five years.

Article 2:

Starting with fiscal year 2010, each bank operating in Lebanon must appoint two audit firms for auditing its accounts jointly and severally.

Article3:

This Decision shall be effective upon its issuance.

Article 4:

This Decision shall be published in the Official Gazette

Beirut, August 13, 2009

The Governor of the Banque du Liban

Riad Toufic Salamé

APPENDIX II

BANQUE DU LIBAN

Basic Circular No 118

Addressed to Banks

Attached is a copy of Basic Decision No 9956 of July 21, 2008, relating to the establishment of the "Audit Committee".

Beirut, July 21, 2008

The Governor of the Banque du Liban

Riad Toufic Salamé

BANQUE DU LIBAN

Basic Decision No 9956

Article 1:

The Board of Directors of each Lebanese bank must, by June 30, 2009 at the latest, establish an "Audit Committee" (hereafter "the Committee"). This Committee shall be composed at least of three of the Board's non executive members having no administrative functions in the bank, with one of these members, at least, being competent in accounting, financial administration, or auditing.

The Board of Directors shall appoint the chairman and members of the Committee Establishment of the "Audit Committee"

The Governor of the Banque du Liban,

Pursuant to the Code of Money and Credit, notably Articles 70 and 174 thereof; and Pursuant to the Decision of the Central Council of the Banque du Liban, taken in its meeting of July 17, 2008,

Decides the following:

and shall determine their remunerations.

Article 2:

The Committee shall convene on a quarterly basis at least and when necessary. It may request to meet with any of the bank's directors to enquire about the department's work and shall directly submit to the Board of Directors the reports on its work results.

Article3:

The Committee shall assist the Board of Directors in fulfilling its tasks and supervisory role, particularly as regards the following matters:

1. Competence and independence of the auditors and of the Internal Audit Unit, specified in Basic Decision No 7737 of December 15, 2000 (hereafter "the Unit").
2. Control of financial statements' soundness, and review of the disclosure standards adopted by the bank.
3. Efficiency and effectiveness of internal control regulations and procedures.
4. Follow-up the implementation of remedial measures proposed in the reports of the Unit and those of the auditors.
5. Monitoring the bank's compliance with the Banque du Liban's Circulars, and with the Banking Control Commission's Circulars and Reports.

Article 4:

The committee shall, for indicative purposes but not restrictively, perform the following tasks:

1. **Regarding Internal Control regulations and procedures:**

    (a) Reviewing internal control regulations and procedures, including procedures relating to fighting money laundering and terrorist financing, in order to ascertain their efficiency and effectiveness.

    (b) Discussing the main financial and administrative reports prepared by the Executive Management, the Unit, the auditors, or the control authorities, about any weakness in the internal control regulations and procedures.

    (c) Coordinating work between the Unit and the auditors, particularly when each of them is reviewing these regulations and procedures.

2. **Regarding the supervision of the Internal Audit's activities:**

   (a) Directly overseeing the Unit to ascertain its independence from the Executive Management and the objective performance if its tasks.

   (b) Approving the Unit's remunerations.

   (c) Proposing the Unit Chief's appointment or dismissal.

   (d) Meeting on a quarterly basis and when necessary with the Unit Chief for discussing the Unit's activities, and also once a year, at least, without the attendance of any member of the Executive Management.

   (e) Approving the Unit's Manual of Procedures and, when necessary, proposing its amendment, in addition to ensuring all the human and material resources needed for its application.

   (f) Reviewing all the Unit's reports.

   (g) Giving its opinion about any agreement the bank would like to conclude with any specialized institution for performing all internal control tasks (outsourcing) or part thereof (co-sourcing).

3. **Regarding the appointment of auditors and follow-up their activities:**

   (a) Giving its opinion about auditors before their appointment, and determining the conditions of their appointment, including annual remunerations.

   (b) Evaluating the auditors' performance, independence and objectivity.

   (c) Discussing with the Management and the auditors the financial statements to be published.

   (d) Discussing the main remarks and recommendations included in the auditors' reports, and reporting about them to the Board of Directors.

   (e) Meeting with the auditors once a year at least, and when necessary, for enquiring about their activities and discussing their results.

Article 5:

Lebanese banks must communicate to the Banking Control Commission the names of the incumbent chairman and members of the Committee, and any subsequent change.

Article 6:

This Decision shall be effective upon its issuance.

Article 7:

This Decision shall be published in the Official Gazette

Beirut, July 21, 2008

The Governor of the Banque du Liban

Riad Toufic Salameh

APPENDIX III

BANQUE DU LIBAN

Basic Circular No 106 to Banks

Attached is a copy of Basic Decision No. 9382 of July 26, 2006, relating to Corporate Governance.

Beirut, July 26, 2006

The Governor of the Banque du Liban

Riad Toufic Salamé

Basic Decision No 9382

Corporate Governance

The Governor of the Banque du Liban,

Pursuant to the Code of Money and Credit, particularly Articles 70 and 174 thereof, and Pursuant to the Decision of the Central Council of the Banque du Liban, taken in its meeting of July 12, 2006,

Decides the following:

<u>**Article 1:**</u>

For the purpose of implementing the provisions of this Decision, the expression "Senior Management" shall mean the persons responsible for supervising the daily business management, such as the Chairman of the Board/General Manager, the assistant general managers, the heads of the main divisions, and the officers in charge of the specialized committees.

<u>**Article 2:**</u>

In accordance with the document on Enhancing Corporate Governance for Banking Institutions, issued by the International Basel Committee in February 2006, and in accordance with relevant texts to be subsequently issued, all banks operating in Lebanon must seek to apply the following principles stated in the said document:

<u>Principle 1:</u> Members of the Board must be qualified for their positions, have a clear understanding of their role in corporate governance, and be able to express pertinent opinions on the bank's activities.

<u>Principle 2:</u> The Board must determine the strategic objectives and corporate values, communicate them to the staff, and supervise their implementation at all the bank's levels.

<u>Principle 3:</u> The Board must clearly define responsibilities and accountability rules, and impose them at all the bank's levels.

<u>Principle 4:</u> The Board must ensure that Senior Management is firmly supervising the bank, in accordance with the established policy.

Principle 5: Each of the Board and Senior Management must efficiently use the results reached by the internal audit unit, the internal control bodies and the auditors.

Principle 6: The Board must ensure that the policies followed in determining and implementing remunerations and allowances are consistent with the bank's institutional culture, long-term objectives, strategy, and control framework.

Principle 7: The bank's business must be conducted in a transparent manner.

Principle 8: Each of the Board and Senior Management must, in conducting its activities, be aware of the bank's operational structure, especially when organizational structures lack transparency (which means "know your structure").

Article 3:

The banks' internal audit units must take the following actions:

1. Verify at all the bank's levels, that all services are implementing the policies and procedures that complement corporate governance regulations adopted by Senior Management, including the above-mentioned principles.
2. Assess properly the corporate governance regulations, with their complementary policies and procedures, and formulate opinions about their adequacy, efficiency and effectiveness.
3. Give the required priority to the implementation of corporate governance regulations, especially when the bank has expanded outside Lebanon and when it undertakes acquisition and merger operations, so as to avoid divergence in organizational structure within the group.

Article 4:

This Decision shall enter into force upon its issuance.

Article 5:

This Decision shall be published in the Official Gazette
Beirut, July 26, 2006
The Governor of the Banque du Liban
Riad Toufic Salameh

APPENDIX IV

Standard Chartered Bank PLC

Profile:

Standard Chartered was formed in 1969 through a merger of two banks: The Standard Bank of British South Africa, founded in 1863, and the Chartered Bank of India, Australia and China, founded in 1853.

Both companies were keen to capitalize on the huge expansion of trade and to earn the handsome profits to be made from financing the movement of goods between Europe, Asia and Africa.

The Chartered Bank

Founded by James Wilson following the grant of a Royal Charter by Queen Victoria in 1853.

Chartered opened its first branches in Mumbai (Bombay), Kolkata and Shanghai in 1858, followed by Hong Kong and Singapore in 1859.

Traditional trade was in cotton from Mumbai (Bombay), indigo and tea from Kolkata, rice from Burma, sugar from Java, tobacco from Sumatra, hemp from Manila and silk from Yokohama.

Played a major role in the development of trade with the East which followed the opening of the Suez Canal in 1869 and the extension of the telegraph to China in 1871.

In 1957 Chartered Bank bought the Eastern Bank together with the Ionian Bank's Cyprus Branches. This established a presence in the Gulf.

The Standard Bank

Founded in the Cape Province of South Africa in 1862 by John Paterson. Commenced business in Port Elizabeth, in January 1863.

Was prominent in financing the development of the diamond fields of Kimberley from 1867 and later extended its network further north to the new town of Johannesburg when gold was discovered there in 1885.

Expanded in Southern, Central and Eastern Africa and, by 1953, had 600 offices.

In 1965, it merged with the Bank of West Africa, expanding its operations into Cameroon, Gambia, Ghana, Nigeria and Sierra Leone.

From the early 1990s, Standard Chartered has focused on developing its strong franchises in Asia, Africa and the Middle East. It has concentrated on consumer, corporate and institutional banking and on the provision of treasury services - areas in which the Group had particular strength and expertise.

Since 2000 the Bank has achieved several milestones with a number of strategic alliances and acquisitions, which have extended the customer and geographic reach and broadened the product range that Standard Chartered offers.

Business & Strategy

Standard Chartered PLC, Listed on both the London Stock Exchange and the Hong Kong Stock Exchange, ranks among the top 20 companies in the FTSE-100 by market capitalization. The London-headquartered Group has operated for over 150 years in some of the world's most dynamic markets, leading the way in Asia, Africa and the Middle East. Its income and profits have more than doubled over the last few years primarily as a result of organic growth, supplemented by acquisitions.

- **Consumer Banking**

Consumer Banking offers a broad range of products and services to meet the borrowing, wealth management and transaction needs of individuals.

- **Wholesale Banking**

Wholesale Banking has a client-focused strategy, providing trade finance, cash management, securities services, foreign exchange and risk management, capital raising and corporate finance solutions.

- **SME Banking**

SME Banking division offers products and services to help small and medium enterprises manage the demands of a growing business, including the support of the international network and trade expertise.

- **Islamic Banking**

Standard Chartered Saadiq's dedicated team provides comprehensive international banking services and a wide range of Shariah-compliant financial products based on Islamic values.

- **The Standard Chartered Private Bank**

Private Bank advisors and investment specialists provide customized solutions to meet the unique needs and aspirations of high net worth clients.

- **Global Network**

Standard Chartered has a network of over 1,700 branches and outlets and 5,600 ATMs in more than 70 countries and territories across the globe, making it one of the world's most international banks.

Principles

Leading by example to be the right partner for its stakeholders, the Group is committed to building a sustainable business over the long term that is trusted worldwide for upholding high standards of corporate governance, social responsibility, environmental protection and employee diversity. It employs over 75,000 people, nearly half of whom are women; The Group's employees are of 125 nationalities, of which about 70 are represented among senior management.

- **Strategic intent:** To be the world's best international bank, leading the way in Asia, Africa and the Middle East
- **Brand promise:** Here for Good
- **Values:** Courageous – Responsive – International – Creative - Trustworthy
- **Approach:** Focusing on attractive, growing markets where they can leverage their relationships and expertise
- **Competitive positioning:** Combining global capability, deep local knowledge and creativity to outperform their competitors
- **Management Discipline:** Continuously improving the way they work, balancing the pursuit of growth with firm control of costs and risks
- **Communities:** Trusted and caring, dedicated to making a difference
- **Investors:** A distinctive investment delivering outstanding performance and superior returns
- **Regulators:** Exemplary governance and ethics
- **Sponsorship:** Committed to the long-term development of the communities in which we operate, Standard Chartered sponsors a wide range of inspirational people, projects and events. (Liverpool FC, Marathons…)

Appendix V

The Lebanese Transparency Association

The Lebanese Transparency Association (LTA), established in May 1999, is Transparency International (TI)'s national chapter in Lebanon. It is the first Lebanese Non Governmental Organization (NGO) that aims at curbing corruption in its various forms and promoting the principles of good governance. Its main objective is to establish the rule of law, thus advancing the concepts of transparency and accountability. Moreover, LTA aspires at strengthening the respect of basic Human Rights as declared in both the Lebanese Constitution and in International Charters.

LTA resorts to any necessary means to fight corruption; improve the quality of life and encourage civil society to take measures.

To achieve these goals, LTA uses methods that include – and are not restricted to:

- Raising citizens' awareness about their rights
- Shedding light on corruption, its causes, consequences and costs at all levels within society
- Empowering youth to reject corruption and participate in promoting transparency and accountability
- Improving the Lebanese legislation related to transparency, accountability and corruption
- Coalition building with similar national, regional and international organizations
- Cooperation with the media in order to encourage it to unveil truths, strengthen integrity and promote transparency in the practices of public and private institutions

Throughout the years, LTA, as part of its mission to promote democracy and advance the principles of good governance, associated itself with many organizations amongst which Transparency International (TI), the Arab Region Parliamentarians Against Corruption (ARPAC), the Global Integrity Alliance (GIA), the Friedrich Naumann Foundation, the Center for International Private Enterprise (CIPE) and the International Finance Corporation (IFC).