

## CORPORATE GOVERNANCE PILLARS IN THE FOUNDATIONS OF THE BLACK SEA TRADE AND DEVELOPMENT BANK – STABILITY AND TRANSPARENCE

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***Annotation:** Located on a strategically focal point in the world business and political scale, the Black Sea region has always attracted the attention of economists, politicians, business leaders, academicians. One of the main institutions in the region that has played a vital role in its recent development and sustainable internationalization is undoubtedly the Black Sea Trade and Development Bank. The way it operates, its management structure and decision-making processes are questions of interest – corporate governance interest. Within the scope of the study, the main corporate governance principles and good practices are briefly presented and a thorough research on how they are implemented in the institution is carried out. The main emphasis falls on the decision-making process that is to be undertaken in order to fulfill the institution's fiduciary duties before its shareholders and stakeholders – the Member States.*

***Key words:** Black Sea Trade and Development Bank, corporate governance, regional financial institution.*

Nowadays the way a company, an organization or an institution of any kind - no matter publically listed or not, private or state-owned, is governed is of high importance for the employees, the stakeholders and the society as a whole. The responsible corporate behavior determines the viability of an organization in a long-run period. The competitive advantages of the international financial institutions that characterize their sustainable development are not only those which are directly related to the profit maximization and to the enlargement of their investment portfolio. The dubious and turbulent market environment also requires greater attention and application of good corporate governance practices which have proven to be the real insurance policy of a corporation against economic and financial crisis. The tough outcomes and the aftermath of the world financial crisis 2007-2009 resulting in the poor financial condition of the large economies and public entities subsequently, put stress on the corporate governance issues on wide international level. However, since one leads to another, the European debt crisis 2009 seemed inevitable at the time. It was the focal point for the European institutions to take immediate and on-point measures to ensure the corporate governance principles are put and encouraged properly in the financial institutions, state-owned enterprises, government bodies, and large public entities, etc. once more. The laws and recommendations (known as 'soft-law' regulations) such as Directives on disclosure of non-financial information, encouragement of long-term shareholder engagement and other Directives on certain elements of corporate governance statement have taken their places alongside the European Company Law, European Action Plan, OECD corporate governance principles, Green and White Papers issues, Basel

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Committee's corporate governance principles, as inseparable means of regulating entities throughout Europe.

The aims of the current paper is to explore at what extent those governing recommendations are embedded in the functioning and the management of the Black Sea Trade and Development Bank (BSTDB). Being a regional financial institution comprising several of the Black Sea countries the latter has manifested its importance for the enhancement of the economic cooperation among the shareholding states and the development of sustainable and social business within the Black Sea Economic Cooperation (BSEC) for the 15 years of its foundation. In the following lines, a brief summary of the corporate governance principles application of BSTDB is made in order to 'disclose' its organizational structure and the nature of its credit operations.

According to the communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions from 12/12/2012 known as the „Action Plan: European company law and corporate governance – a modern legal framework for more engaged shareholders and sustainable companies”, corporate governance (CG) defines relationships between a company's management, its board, its shareholders and its other stakeholders.<sup>3</sup>

CG is traditionally defined as the system by which companies are directed and controlled and as a set of relationships between a company's management, its board, its shareholders and its other stakeholders.<sup>4</sup>

The Organization for Economic Cooperation and development (OECD) states that CG is one key element in improving economic efficiency and growth as well as enhancing investor confidence. CG also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good CG should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring. The presence of an effective CG system, within an individual company and across an economy as a whole, helps to provide a degree of confidence that is necessary for the proper functioning of a market economy. As a result, the cost of capital is lower and firms are encouraged to use resources more efficiently, thereby underpinning growth.<sup>5</sup>

However, the compliance with the codes for corporate governance such as the Bank for International Settlement (BIS) principles for enhancing corporate governance and the OECD Principles of Corporate Governance is not established with the force of the law but it has rather advisable application. These and other recommendations made for applying good corporate governance practices are known as 'soft-law regulations'. Therefore, since they are not compulsory, is BSTDB responsible and transparent enough before its stakeholders and

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<sup>3</sup> European Commission, COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS Action Plan: European company law and corporate governance - a modern legal framework for more engaged shareholders and sustainable companies, Action Plan: European company law and corporate governance - a modern legal framework for more engaged shareholders and sustainable companies, 12/12/12  
<<http://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52012DC0740:EN:NOT>>

<sup>4</sup> EUROPEAN COMMISSION, GREEN PAPER, The EU corporate governance framework, COM(2011) 164 final, Brussels, 5 April 2011, p.2  
<[http://ec.europa.eu/internal\\_market/company/docs/modern/com2011-164\\_en.pdf](http://ec.europa.eu/internal_market/company/docs/modern/com2011-164_en.pdf)>

<sup>5</sup> OECD Principles of Corporate Governance, Paris, 2004, p.11  
<<http://www.oecd.org/daf/ca/corporategovernanceprinciples/31557724.pdf>>

the society as well about its corporate governance practices? How the important decisions are taken and who actually governs the organization? To answer this set of questions first one should review the organizational chart of the Bank, go through its corporate programs and policies, and then analyze its operations.

BSTDB was established by Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Greece, Moldova, Romania, Russia, Turkey, and Ukraine which are the 11 founding countries of the Black Sea Economic Cooperation (BSEC) as a financial pillar of BSEC. As of end 2014, BSTDB cumulative portfolio in its 11 member countries has reached 304 approved operations in the key sectors of infrastructure, energy, transport, manufacturing, telecommunications, financial sector and other important areas amounting to about EUR 3.5 billion.<sup>6</sup>

The Bank pledges that institutionally BSTDB operates in compliance with the principles of effective corporate governance relevant for a multilateral financial institution. The approved set of strategies, policies, regulations, methodologies and procedures governing essentially all Bank activities form the core body of internal legislation ensuring corporate governance in line with best practices.

The Bank follows the traditional continental two-tier management system of corporate governance. It incorporates a Board of Governors as a supervisory body of the company and a Board of Directors – the management body. As it is widely accepted in this type of organizational structure, the BoD conducts the day-to-day operations and the supervisory board – conducts supervisory functions. In addition BSTDB has a President, three Vice Presidents and a Secretary General.

The President is the Chairman of the Board of Directors and the Bank's chief executive. The President conducts the current business of the Bank, under the direction of the Board of Directors. The Vice Presidents and the Secretary General are appointed by the Board of Directors and conduct their activity under the delegated authority from the Board of Directors and the President.

Here a focal point in the current corporate governance practices is strongly hit. It is discussing the role of the Chairman of the BoD and CEO. The two major rivals on the issue are widely named to be the British vs. the US corporate governance models. While the British model is the one proclaiming that the role of the Chairman of the BoD and the CEO should be strictly divided, the US corporate governance model defends the combined role of the two. Nowadays, having seen the fall of many because of the world financial crisis, the US public companies tend to divide the two roles, but still it is only 40% of the companies that do so, or only up 1% since the financial crisis 2008<sup>7</sup>. Many of the world organizations that deal with corporate governance issues are concerned with this problem, and now advise on separating the two responsibilities.

The Bank is structured into four divisions, being supervised by the three Vice Presidents and the Secretary General, and a number of independent offices reporting directly to the President.<sup>8</sup> This throws light on the significance of independent directors' role. It is of extreme importance to dig into this issue especially as the State Member representatives are elected by the regional Ministries of finance or similar<sup>9</sup>. The independent director is a

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<sup>6</sup> Official web page of BSTDB <<http://www.bstdb.org/about-us>>

<sup>7</sup> Goodman, A. *Chairman or lead director: what's in a name?*, Financial Times, April 4, 2011, [Accessed: 01.04.2015]

<sup>8</sup> Official web page of BSTDB <<http://www.bstdb.org/about-us/how-we-are-structured>> - See Appendix 1

<sup>9</sup> Authors' mark – the authors of the paper do not intent to go into details concerning politics and political decisions even though they fully understand the importance of the issue

corporate governance figure that has been significantly appreciated in the recent years because of their highly competent advice and on-point directions concerning organizational, management, financial, other issue. It is said in the corporate governance principles applied in the Bank that the directors in the BoD should discharge their duties only in the interest of the Bank, free from undue staff, senior management or political influence, professionally, etc. Even though they are not appointed as independent directors, the Bank tries to ascribe the independent directors' properties and records concerning their fiduciary duties to its directors.

The Board of Governors is the highest decision making body of the Bank. It is comprised by one Governor and one Alternate Governor appointed from the 11 Member States of the Bank. Each Governor and each Alternate Governor shall serve at the pleasure of the appointing Member. The Board of Governors may delegate to the Board of Directors any or all of its powers, except the power to, among other things, to amend the Agreement Establishing the Bank, to approve the admission of new Members, to authorize any changes in the Bank's capital stock and to terminate the operations of the Bank. The Board of Governors approves the annual report, the audited financial statements and appoints the President of the Bank. At its annual meeting when the countries' interests are to be protected, the Board shall elect one of the Governors as Chairman, who shall hold office until the election of the next Chairman at the next annual meeting of the Board. The Chairmanship rotates amongst the Member States in order for the Bank to stay as far non-political as possible.<sup>10</sup>

Basically, the Bank is structured in four Divisions, under the supervision of three Vice Presidents and the Secretary General. The President is the legal representative of the Bank and conducts the day-to-day business of the Bank under the strategic direction of the Board of Directors in conformity with the Articles Establishing the BSTDB. The Vice Presidents and the Secretary General are appointed by the Board of Directors and conduct their activity under delegated authority from the Board of Directors and the President. The President, the Vice Presidents and the Secretary General form the Management Committee and represent the senior management of the Bank.<sup>11</sup>

The world organizations incorporated in the corporate governance issues have always put a stress on the importance of the committees in the corporate organizational structure. According to the good practices there should be at least three committees mainly divided into remuneration committee, nomination and audit committees. The remuneration committee is recommended so that there is an independent body responsible for the board members and management's remuneration and bonus policies. The nomination committee has the important task to provide qualified and experienced people to fill in places when needed – the so-called 'succession planning'. The succession planning process is of high importance to the contemporary corporate governance practices as it may reduce substantially the risk of appointing and nominating people with relations to the management comprising in complicated nepotism practices, conflict of interests and related party transactions.

However, there are four committees with specific decision-making authorities in BSTDB that have different responsibilities – Management, Credit and Assets, Liabilities Committee and Recruitment Committee. The last one is expected to have an advisory role. Its functions are to be coincided with the ones of the nomination committee explained above. This is slightly misplaced in BSTDB as the recruitment committee is decided by the President. The independence of the decisions may be seen as lost and even delirious.

<sup>10</sup> Official web page of BSTDB <<http://www.bstdb.org/about-us/how-we-are-structured/board-of-governors>> - See Appendix 2

<sup>11</sup> Official web page of BSTDB <<http://www.bstdb.org/about-us/how-we-are-structured/management>>

The Management committee is the main Committee of the Bank and has the mandate to consider and decide on all issues pertaining to key aspects of the Bank's strategy, structure, operation, risk management and performance. All other Committees established by the Bank have a subsidiary role and report to the Management Committee. The Management Committee comprises the President as Chairman, the Vice Presidents and the Secretary General. It makes all possible efforts to take its decisions unanimously, or, if consensus cannot be reached, there are special provisions regarding majority voting.

The Credit Committee<sup>7</sup> considers all matters related to the financing operations of the Bank and expresses opinions with respect to the appropriateness of the due diligence and appraisal process. The Credit Committee rejects financing proposals that do not meet mandate/strategy criteria, are not economically/financially viable and sustainable, and/or are not in conformity with existing Bank regulatory framework.

Assets & Liabilities Committee (ALCO) is responsible for setting strategic direction in asset and liability risk management and establishes specific numerical limits, targets, and guidelines within which tactical and operational decision-making must take place. The Committee is responsible for decisions on issues concerning the relationship between the Bank's assets and liabilities - capital adequacy, liquidity, foreign exchange risk, interest rate sensitivity and off-balance sheet risks. Its composition is recommended by the President and approved by the BoD. It is the key institutional unit in the Bank's financial management process. Although the Bank does not target profit maximization, it seeks at least to recover its operating costs and capital employed.<sup>12</sup>

Another important department of the Bank is the Internal Audit which is an independent, objective, assurance, and consulting activity that examines and evaluates the activities of the Bank as a service to Senior Management and the Board of Directors. The primary objective of the Internal Audit activity is to help Senior Management and the Board of Directors of BSTDB discharge their responsibilities and accomplish the objectives of the Bank by bringing a systematic, disciplined approach to evaluate and improve effectiveness of risk management, control, and governance processes. Central to this approach is the belief that Internal Audit must help to promote a 'control awareness' culture throughout the organization, by working with management on a "real time" basis, leveraging their own control self-assessments, to identify and evaluate risks, anticipate emerging issues and to make recommendations on control mechanisms, in an attempt to prevent problems before they occur as recommended by all good corporate governance practices. Internal Audit reviews the Bank's divisions and business units at appropriate intervals, in accordance with the Bank's Internal Audit Charter and its annual plans, which are reviewed by the Audit Committee to ensure that the Department's work is efficiently and adequately performed. The main objective of such reviews is to determine whether the functions of planning, organizing, directing, and controlling are efficiently and effectively carried out according to best practices, management instructions, policies, and procedures, and in a manner consistent with the objectives of the Bank. Additionally, it performs a consulting role by advising the Management and the Departments on any matter, including recommendations for improvements on policies, procedures, manuals and systems and use of resources. Furthermore, Internal Audit carries out specific audit reviews and investigations upon the request of Management, Audit Committee and the Board of Directors. In order to achieve better results, the Internal Audit Department endeavors to co-ordinate its Annual Plan with that of the External Auditors.<sup>13</sup> Here, strictly following the good corporate governance

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<sup>12</sup> Official web page of BSTDB <<http://www.bstdb.org/about-us/how-we-are-structured/committees>>

<sup>13</sup> Official web page of BSTDB <<http://www.bstdb.org/about-us/how-we-operate/audit>>

practices, the BSTDB has undergone a policy of rotating the external auditor after a one-year term.

Transparency and accountability are integral elements of every organization's good corporate governance practices. The Bank's corporate structure is supported by a system of reporting with information appropriately tailored for and disseminated to each level of responsibility within the Bank to enable the system of checks and balances on the Bank's activities to function effectively. Although it is not clearly stated, the Bank's structure is not organized in a way to support whistle-blowing practices. The main issue is the overall power of the President to appoint high % of the Bank's employees to certain positions. The problem of whistle-blowing is continuously evolving and the world good practices promote this practice by openly discuss the issue to world economic forums and conferences, even trying to incorporate the issue to be formally legalized and to go widely public as Singapore did.

Although the BSTDB strictly discloses financial information including annual financial reports, external audit reports, etc. it is of interest to the corporate governance experts how easy and transparent it would be to disclose non-financial information. The European Parliament's acceptance of the Directive on disclosure of non-financial and diversity information by large companies and groups was welcomed by the EC in 2014. Companies concerned will need to disclose information on policies, risks and results as regards environmental matters, social and employee-related aspects, respect for human rights, anti-corruption and bribery issues, and diversity on boards of directors including qualification, professional background, gender, age, nationality, etc. It is of clear evidence that disclosing of non-financial information would not be an issue to the Bank as it already openly discusses on its environmental and social responsibility policies, evaluation of internal corporate processes, risk management practices, etc.

Overall, BSTDB aims to promote environmental and social (E&S) sustainability in its Member States. Therefore the Bank commits to apply sustainability principles to its business management and require its clients to follow these also. These principles relate primarily to: pollution prevention and mitigation, respect for fundamental human rights in the working environment, protection of the Black Sea against pollution, addressing climate change, promoting sustainable use of natural resources, protection and conservation of biodiversity, disclosure of information on E&S performance of its operations etc. BSTDB recognizes that operations it finances may generate E&S risks and negative impacts. These risks and impacts need to be thoroughly identified, assessed, mitigated and monitored. In this respect, the Bank undertakes E&S assessment and monitoring of all its operations commensurable to their potential risks and impacts, and ensures that these are structured and implemented in accordance with the requirements of its Environmental and Social Policy. The E&S issues identified during the assessment process need to be addressed by the Client throughout the life of the BSTDB financing by implementing relevant preventive and mitigation actions. These actions are normally set forth in form of an Environmental and Social Action Plan (ESAP) and its implementation is part of the operations' financing terms and conditions. BSTDB seeks to apply good E&S practices such as the European Union standards, the World Bank/IFC Performance Standards, EBRD's Performance Requirements, International Labor Organizations Core Labor Standards, International Environmental Conventions, as well as the national environmental, labor, health and safety, and public information laws and regulations of its Member States, including national commitments under international law.<sup>14</sup>

Hereford, the Bank is promoting its corporate social and environmental responsibility not only in its daily activity but it also requires that the projects financed and the borrowers

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<sup>14</sup> Official web page of BSTDB <<http://www.bstdb.org/about-us/how-we-operate/environmental-and-social-sustainability>>

should be eligible and take into account these considerations. The rigorous monitoring over the proposals to be financed is another key element of the global citizenship BSTDB.

Evaluation is the process of assessing operations, programs, activities and strategies through systematic and rigorous analysis of their outputs, outcomes and impact against expected results and the overall mission of the Bank. BSTDB, like other development banks, has an independent Evaluation Office, which performs a wide spectrum of evaluations presented in various forms, including Operation Performance Evaluation Reports, Annual Evaluation Overviews, Evaluation Studies, etc. The results of those reports and studies are regularly presented to the Bank's management, Board of Directors and Board of Governors. Various evaluation results are also available to outside partners and the public.

The evaluation function has two basic objectives, serving the overall purpose of assessing mandate fulfillment and drawing lessons for improved future operations: (i) Accountability – to reveal the results of the Bank's operations/activities, both intended and otherwise, and assess their contribution to the Bank's mission; and (ii) Quality Management Improvement – to derive significant lessons learned from past experience and using them for improving future operations.<sup>15</sup>

In order to support its sustainable profitability objective and safeguard its capital base BSTDB is committed to actively identify and manage all risks inherent in its organization and activities, including also compliance and operational risks. BSTDB has defined Compliance Risk as the risk of legal sanctions, material financial loss, or loss to reputation the Bank may suffer as a result of its failure to comply with laws, its own regulations, code of conduct, and standards of best/good practice. Compliance risk is sometimes also referred to as integrity risk, because a bank's reputation is closely connected with its adherence to principles of integrity and fair dealing. Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The definition includes legal risk but excludes strategic and reputational risk.

In accordance with the requirements of the Basel Committee on Banking Supervision the Compliance and Operational Risk Management Office (DCR) has a formal status within the Bank to give it the appropriate standing, authority and independence. DCR is a unit independent of the business activities of the Bank, reporting to the President of the Bank and the Board of Directors, through its Chairman.

The Office is, mainly, responsible for the procedures and the processes in relation to the following activities:

- The Code of Conduct's requirements;
- Integrity and conflicts of interest issues within the Bank as well as within financed operations;
- Combating fraud, corruption, money laundering and terrorist financing;
- The review of the Bank's rules for consistency with each other;
- Performance of Compliance Reviews and testing;
- Conduct of investigation of reported suspicions on fraud, corruption, money laundering, terrorist financing, and unsatisfactory conduct or misconduct on behalf of staff;
- Dealing with the Bank's operational risk.

In conclusion, it can be summarized that BSTDB follows the best international practices in adopting its internal documents which provide guidance for its main activities. Its policy framework is based upon the broad guidelines laid out in its statutory documents,

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<sup>15</sup> Official web page of BSTDB <<http://www.bstdb.org/about-us/how-we-operate/evaluation>>

and together with its strategies, form the Bank's most important directional documents for undertaking initiatives and working in various areas. As a regional financial institution, the Bank is in line with the most proclaimed and well-known practices of CG in the financial sector. This fact is comprehensible bearing in mind the scope and the impact of BSTDB activity and its important role of moderator and lender within the boundaries of BSEC. However, there are certain diversions from the straight and internationally prescribed organizational structure that might be considered as opaque and hiding a potential conflict of interest. The empowerment of the President function may pose problems as far as the office assumes more than one function - Chairman of the Board of Directors and the Bank's chief executive. In this respect is the CG consistent with the established international good practices? Deviations are acceptable if the disclosure, the transparency of the manner of the decisions within the organization is taken and the fiduciary duties are respected. The CG principles are open and their reading as soft law should leave room for interpretation.

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Appendix №1

Organizational Structure



Figure 1. BSTDB Organizational Structure (source: www.bstdb.org)

## Appendix №2

<i>Country</i>	<i>Governor</i>	<i>Alternate Governor</i>
<b>Albania</b>	<b>Mr. Erjon LUCI</b> Deputy Minister of Finance	Position Vacant
<b>Armenia</b>	<b>Mr. Arthur JAVADYAN</b> Chairman, Central Bank of Armenia	<b>Mr. Andranik GRIGORYAN</b> Director, Financial System Stability and Development Department, Central Bank of Armenia
<b>Azerbaijan</b>	<b>Mr. Samir SHARIFOV</b> Minister of Finance	<b>Mr. Shahin MUSTAFAYEV</b> Minister of Economy and Industry
<b>Bulgaria</b>	<b>Ms. Karina KARAIVANOVA</b> Deputy Minister of Finance	<b>Ms. Gergana BEREMSKA</b> Director, International Financial Institutions and Cooperation Directorate, Ministry of Finance
<b>Georgia</b>	<b>Mr. Giorgi KADAGIDZE</b> President, National Bank of Georgia	<b>Mr. Nodar KHADURI</b> Minister of Finance
<b>Greece</b>	<b>Mr. Georgios STATHAKIS</b> Minister of Economy, Infrastructure, Shipping & Tourism	Position Vacant
<b>Moldova</b>	<b>Mr. Anatol ARAPU</b> Minister of Finance	Position Vacant
<b>Romania</b>	<b>Mr. Darius-Bogdan VALCOV</b> Minister of Public Finance	<b>Mr. Gyorgy ATTILA</b> Secretary of State, Ministry of Public Finance
<b>Russia</b>	<b>Mr. Sergey STORCHAK</b> Deputy Minister of Finance	<b>Mr. Sergey BELYAKOV</b> Deputy Minister of Economic Development
<b>Turkey</b>	<b>Mr. Cavit DAGDAS</b> Acting Undersecretary of Treasury	<b>Mr. Burhanettin AKTAS</b> Deputy Undersecretary of Treasury
<b>Ukraine</b>	<b>Mr. Aivaras ABROMAVICIUS</b> Minister of Economic Development and Trade	<b>Mr. Sergiy KRUGLYK</b> Director of Foreign Relations Department, National Bank of Ukraine <sup>16</sup>

Table 1. Board of Governors (source: [www.bstdb.org](http://www.bstdb.org))<sup>16</sup> <http://www.bstdb.org/about-us/how-we-are-structured/board-of-governors>