Strategic Planning and Organizational Structure Standard

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Strategic Planning and Organizational Structure Standard

1. General provisions

The objective of this Standard is to assist banks in achieving the following goals by following efficient principles and methodologies:

- to identify the bank's Vision and develop the Mission Statement;
- to develop a Strategic Plan for implementation of the bank's Vision;
- to monitor the bank's progress against the Strategic Plan, review and update the Strategic Plan given market developments and the bank's performance;
- to establish an organizational structure supporting the implementation of the Strategic Plan and conduct adequate business activities.

Every bank shall apply this Standard in consistency with the scope of their operations and market environment they operate in. Implementation of this Standard will assist banks in laying a foundation for other corporate governance standards.

Grounds for application of the Standard

- Law of Azerbaijan Republic «On banks»;
- Regulations issued by the Central Bank of Azerbaijan Republic (hereinafter referred to as the CBA);
- the Basel Committee for Banking Supervision's «Development of Corporate Governance in Banks» Document;
- OECD's Corporate Governance Principles.

Provisions of the Standard

2. Contents of the Standard

This Standard covers:

- Corporate governance principles;
- Identification of the bank's Vision and development of the Mission Statement;
- Strategic Planning process and the contents of the Strategic Plan;
- Identification of the organizational structure, distribution of powers and identification of procedures within the structure.

3. Corporate Governance Principles

Best corporate governance practices require:

- to identify the bank's strategic goals and corporate values;
- to identify job responsibilities and implement reporting at all levels within the bank;
to ensure that members of the Supervisory Board properly fulfil their duties and have a correct understanding of their role within the governance structure, and are free from any undue influence from other executive bodies or outside;

- to ensure appropriate control on part of the Management Board;
- to ensure effective utilization of internal and external audits, considering the control functions of internal and external auditors;
- to ensure that the remuneration policy is consistent with the bank's strategy, goals, ethical values and regulatory environment;
- to ensure transparency of corporate governance.

Corporate governance principles are based on:

- the primary objective of the bank's operations is to enhance the bank's value for the bank's owners (shareholders);
- the bank must have a vision;
- a Mission Statement must be developed in consistency with the bank's Vision;
- the Strategic Plan must turn the bank's Vision into strategic goals, objectives and activity plans;
- the Strategic Planning process must incorporate strategy development, comparison of the bank's performance against the goals and targets set forth in its strategy, updates of the plan in consistency with the market developments and the bank's performance;
- the bank's organizational structure must be consistent with the application of the Strategic Plan, management and control of the bank's operations;
- an appropriate distribution of authorities and internal procedures must be put in place to ensure that the functions and responsibilities of the organizational structure components are clearly and accurately identified;

4. Identification of the bank's Vision and development of the Mission Statement

The diagram below describes the process of identification of the bank's Vision and development of the Mission Statement. .................................1

4.1. Vision of the bank .......................................................................................................................1
4.2. Development of the bank's Mission Statement .................................................................3

Mission Statement of the bank is a summary of the chief principles of its Vision. The draft Mission Statement is discussed in joint meetings of the Management Board and the Strategic Planning Team. The Mission Statement is a foundation for defining the bank's image and improving its reputation. .........................................................3

Mission Statement has several objectives: the Mission Statement identifies the bank's image and business methods in interactions with outside parties, including prospective customers, business partners, competitors and regulators;.........................3

4.3. Communication of the bank's Vision to internal and external users .................................3

The bank's Mission Statement is the principal instrument of communicating its Vision to internal and external users. The bank's Mission Statement is communicated to two main groups of users: Current and prospective shareholders and other interested parties in the bank. The bank's Vision is communicated to users in detail via the Annual Report. The Vision should be used as a training manual for the bank's existing staff and introductory manual for new staff. .................................3
4.4. Distribution of powers in identification of the Vision and Mission Statement. The Supervisory Board should be responsible for developing the preliminary form of, and annually updating the bank's Vision and Mission Statement in consistency with effectiveness needs and external conditions. The preliminary draft should be developed by the Management Board or the Strategic Planning Team (SPT) and assessed by the Supervisory Board. Once the Vision and Mission Statement are approved by the Supervisory Board, they should be submitted to the General Meeting of Shareholders. Amendments to the Vision and Mission Statement must be accepted by the Supervisory Board and submitted to the General Meeting of Shareholders for review.

5. **Strategic Plan**

5.1. Objective of the Strategic Plan converts the bank's Vision and Mission Statement into clearly defined, measurable goals and links such goals with an action plan for implementation. The Strategic Plan should identify the goals the bank wants to achieve and issues to be agreed upon in order to accomplish such goals. The Strategic Plan is primarily a point of reference for the Management Board. It should the activities each member of the Management Board is directly responsible for and their overall efforts to assist in executing the Strategic Plan.

5.2. Development and approval of the Strategic Plan must be developed and updated annually in consistency with the findings of market studies and the overall corporate and individual business unit level strategic goals proposed by the Management Board. The SPT is responsible for drafting the Plan. The draft Plan must be coordinated with the Management Board and submitted to the Supervisory Board for review. The Supervisory Board will thereafter approve the Strategic Plan.

5.3. Coverage of the Strategic Plan. The level of complexity and intensity of the Strategic Plan's analyses should be consistent with the bank's operations and strategic goals. In this view, although the contents of the Strategic Plan of different banks may vary, the following must be incorporated:

5.4. Timeframe covered by the Strategic Plan

5.5. Sources of information

6. **Strategic Planning process**

6.1. Main phases of the Strategic Planning process. Main phases of the Strategic Planning process are executed after the bank's Vision and Mission Statement are prepared, and include:

6.2. Establishment of a Strategic Planning Team for banks with assets over AZN30 billion, a Strategic Planning Team (SPT) may be established, directed by a member of the Management Board and consisting of various bank experts, to be responsible for developing and implementing the bank's Strategic Plan.

6.3. Assessment of development of the market and competitive environment

6.4. Identification of corporate level strategic goals

6.5. Identification of strategic goals and operating strategies for business units. The Strategic Plan converts the corporate level strategic goals and operating strategies into clearly defined and measurable goals for the bank's business units. The Strategic Plan should identify 1-3 key strategic goals for the bank's business units for the first year of the planning period.
6.6. Assessment of the bank’s performance against the Strategic Plan Business unit managers will regularly and closely monitor the progress of their business units against the strategic and operating goals.

7. Division of responsibilities The chairman of the Supervisory Board shall: 

8. Organizational structure

8.1. Management structure of banks

8.2. Organizational structure requirements The organizational structure of the bank groups its operational functions by positions and workplaces, and assigns such workplaces to appropriate interconnected business unit. Following interconnections between units may be: 

8.3. Model organization charts The organizational structure may consider a number of factors affecting the implementation of the business strategy and ensuring optimal efficiency: Management/governance principles and philosophy of the bank; 

8.5. Management and controls Each bank must ensure four principal forms of control within their organizational structure (BCBS’s “Development of Corporate Governance in Banks” Publication): 

8.6. Bank committees The Supervisory Board may assign management decision-making responsibilities to the bank’s committees. The committees shall operate in accordance with the strategy approved by the Supervisory Board and the scope of their competence. The committees may include members of the Management Board and appropriate unit managers. Committees shall be managed by a member of the Management Board. Internal audit staff of the bank may attend Committee meetings, but may not be members of any committee other than the Internal Audit Committee. 

9. Internal control The Management Board shall establish a comprehensive, sound and effective internal control system with the following characteristics:
• Management and control, assignment of functions and authorities granted must cover principles of clear division of responsibilities within the bank.

4 Identification of the bank's Vision and development of the Mission Statement

The diagram below describes the process of identification of the bank's Vision and development of the Mission Statement.

4.1 Vision of the bank

The bank's Vision is the coordinated vision of the bank's owners, and is based on the following:

a) target market role and position allowing to add value in the mid- and long run;
b) activities and characteristics necessary to be able to achieve the targeted position;

The bank's targeted market role and position is set by identifying the bank's priorities in some major business areas as discussed below:

• Customer segments: individuals and legal entities or general area customers, etc.;
• Types of financial services offered: maintaining bank accounts, lending to individuals and corporates, exchange operations, brokerage and other services;
• Geographic coverage of bank transactions: identifies the actual locations of the bank, its branch offices, divisions and other units representing the bank (e.g., currency exchange bureaus);

• Acquisitions, mergers, takeovers and alliances: implemented in consideration of attracting new customers and services, as well as potential benefits to the bank;

• Funding sources: combination of individual and corporate deposits, interbank financing, issuance of bonds, etc.;

• Other areas: portfolio management, asset and liability structure, regulatory environment, specific market conditions affecting the bank's operations and position.

In addition to targeting the bank's position, the Vision also incorporates an understanding of **internal and external** factors that enable the bank to achieve that targeted position.

**Internal** factors may include:

• The bank's relative advantage over its peers in terms of competencies in servicing key customer segments;

• The bank's relative advantage over its peers in terms of experience in providing selected financial services;

• Relative advantage of value added to customer services caused by the factors described below:
  - Advantage caused by the scope of transactions;
  - Advantage in terms of experience;

• Other reasons. The bank's advantage over its peers in terms of selecting and attracting candidates for mergers, acquisitions, alliances, etc.;

• Other similar factors.

**External** factors may include:

• The bank is developing in the targeted market segments (service or customers) faster than its peers;

• Market segments defined as important by the bank demonstrate less competition;

• Other factors of external influence.

4.2. Development of the bank's Mission Statement

• Mission Statement of the bank is a summary of the chief principles of its Vision. The draft Mission Statement is discussed in joint meetings of the Management Board
and the Strategic Planning Team. The Mission Statement is a foundation for defining the bank's image and improving its reputation. Mission Statement has several objectives: the Mission Statement identifies the bank's image and business methods in interactions with outside parties, including prospective customers, business partners, competitors and regulators;

- the Mission Statement communicates the bank's key goals and principles to the bank's mid-level management and other employees, and provides guidance for making business decisions, selecting and evaluating a mode of conduct;

- the Mission Statement serves as the basis for developing and supporting the bank's corporate culture.

4.3. Communication of the bank's Vision to internal and external users

The bank's Mission Statement is the principal instrument of communicating its Vision to internal and external users. The bank's Mission Statement is communicated to two main groups of users: Current and prospective shareholders and other interested parties in the bank. The bank's Vision is communicated to users in detail via the Annual Report. The Vision should be used as a training manual for the bank's existing staff and introductory manual for new staff.

1 Market actors and other external parties. Banks should communicate their Vision and promote their image and business methods via brochures and advertisement, where the Mission Statement should be used as a key instrument.

4.4. Distribution of powers in identification of the Vision and Mission Statement. The Supervisory Board should be responsible for developing the preliminary form of, and annually updating the bank's Vision and Mission Statement in consistency with effectiveness needs and external conditions. The preliminary draft should be developed by the Management Board or the Strategic Planning Team (SPT) and assessed by the Supervisory Board. Once the Vision and Mission Statement are approved by the Supervisory Board, they should be submitted to the General Meeting of Shareholders. Amendments to the Vision and Mission Statement must be accepted by the Supervisory Board and submitted to the General Meeting of Shareholders for review.

5. Strategic Plan

5.1. Objective of the Strategic Plan converts the bank's Vision and Mission Statement into clearly defined, measurable goals and links such goals with an action plan for implementation. The Strategic Plan should identify the goals the bank wants to achieve and issues to be agreed upon in order to accomplish such goals. The Strategic Plan is primarily a point of reference for the Management Board. It should the activities each
member of the Management Board is directly responsible for and their overall efforts to assist in executing the Strategic Plan.

The Strategic Plan should be developed through discussions and consultations between the Supervisory Board and Management Board. Various managers should take part in discussions and consultations of the Strategic Plan to coordinate and accept the activities specified therein.

The Strategic Plan is a point of reference for internal evaluations and outside promotion. References to the Strategic Plan ensure that comments given outside the bank are the same, while internally their provide grounds for analyzing the bank's current performance against the Strategic Plan.

5.2. Development and approval of the Strategic Plan

Strategic Plan must be developed and updated annually in consistency with the findings of market studies and the overall corporate and individual business unit level strategic goals proposed by the Management Board. The SPT is responsible for drafting the Plan. The draft Plan must be coordinated with the Management Board and submitted to the Supervisory Board for review. The Supervisory Board will thereafter approve the Strategic Plan.

5.3. Coverage of the Strategic Plan.

The level of complexity and intensity of the Strategic Plan's analyses should be consistent with the bank's operations and strategic goals. In this view, although the contents of the Strategic Plan of different banks may vary, the following must be incorporated:

- Vision and Mission Statement;
- Assessment of the bank's performance against the strategic goals set for the previous financial year;
- Assessment of market developments and the bank's market position:
  - Environment and competition at the market the bank operates in (should specify the events that took place during the year reviewed);
  - Assessment of the bank's market position, factoring in total assets, customer base, trade mark, profitability and other performance evaluation criteria;
  - Alliance, merger, consolidation, investment and acquisition opportunities;
  - An overview of market development and the bank's position (a SWOT analysis (strengths and weaknesses, market opportunities and risks of the bank) must be provided);
- Strategic goal, operating target and action plan updates for the entire bank and individual business units.

The Management Board or the SPT must develop and update annually the Strategic Plan in consistency with the above stated areas. As part of this process, the SPT or the Management Board will hold meetings and discussions with the Supervisory Board.
5.4. Timeframe covered by the Strategic Plan

A Strategic Plan typically covers a 3-5 year period and all required amendments to the Financial Plan along with the Strategic Plan will be approved by the Supervisory Board on an annual basis.

5.5. Sources of information

Available sources of information on financial market performance and economic information must be used fully when developing the Strategic Plan. Such sources include:

- Analytical and statistical data published on the CBA's web-site (www.nba.az);
- Statistics published on the web-site of the State Statistics Committee of Azerbaijan Republic (www.statcom.baku-az.com) or other channels;
- Financial statements and other published disclosures of other market actors (web-site or other channels);

Credibility of information sources picked by the bank and information used is very important. Thus, such information must be obtained from official sources, published in official information channels and accepted by other market actors.

Information should be collected by an appropriate service unit of the bank and used in assessment of market developments and the bank's related market position by the persons responsible for developing the Strategic Plan.

6. Strategic Planning process

6.1. Main phases of the Strategic Planning process. Main phases of the Strategic Planning process are executed after the bank's Vision and Mission Statement are prepared, and include:

- Establishment of an SPT, if required;
- Assessment of the market and competitive environment the bank operates in;
- Identification of corporate level strategic goals;
- Identification of unit level strategic goals and operating strategies;
- Development and approval of the Strategic Plan;
- Assessment of the bank's performance against the Strategic Plan;

All phases of the process must be supervised by the Management Board.
Control by appropriate executive officers is one of the most important instruments of executing the Strategic Plan. This control is achieved by regular checks of relevant documents of the bank and meetings with individual business units.

6.2. Establishment of a Strategic Planning Team

For banks with assets over AZN30 billion, a Strategic Planning Team (SPT) may be established, directed by a member of the Management Board and consisting of various bank experts, to be responsible for developing and implementing the bank's Strategic Plan.

The SPT may include a secretary responsible for keeping minutes of each meeting and coordinating the SPT's activities, individual business unit managers responsible for controlling the bank's operations and market assessments, and strategy planning, and specifically appointed executive officers.

6.3. Assessment of development of the market and competitive environment

Development trends of the market and competitive environment the bank operates in must be regularly monitored for the following purposes:

- to identify the bank's current competitive position;
- to identify the key development trends of the market the bank operates in and the bank's associated prospects and hazards;
- to check the general information about the strategic goals and operating measures of competitor banks;
- to identify and evaluate potential alliance and merger (acquisition) candidates, targeted investment areas and acquisitions of other banks;
- to obtain clear and comparable information about the main characteristics of the domestic financial markets enabling the bank to accomplish its strategic goals.

Studies and assessments provide grounds for application of the market development and competitive environment sections of the Strategic Plan.

6.4. Identification of corporate level strategic goals

The Management Board should be responsible for identifying clear, measurable and assessable corporate level strategic goals arising from the bank's Vision.

Corporate level strategic goals represent a part of the Strategic Plan.

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1 These goals are set for the bank's operations as a whole.
6.5. Identification of strategic goals and operating strategies for business units
The Strategic Plan converts the corporate level strategic goals and operating strategies into clearly defined and measurable goals for the bank's business units. The Strategic Plan should identify 1-3 key strategic goals for the bank's business units for the first year of the planning period.

Based on the proposed strategic goals, each business unit manager will develop an annual plan for his unit, incorporating the scope and quality of operations, utilization of resources and profitability details. The plan will be divided into monthly sections. Following consultations with business unit management, the strategic and operating plans of business units will be submitted to the Management Board for approval. This typically includes:

- high level budget plans for financing and operating needs of the bank's business units;
- preliminary resource requirements, necessary competencies and expertise;
- criteria for analysis of deviations from financial information and budget by business units;
- criteria for performance evaluation for individual business units.

The Management Board will be responsible for approving strategic and operating plans for each business unit.

6.6. Assessment of the bank's performance against the Strategic Plan
Business unit managers will regularly and closely monitor the progress of their business units against the strategic and operating goals.

The Management Board or the SPT will assess the performance of business units against the monthly goals, as well as the entire bank's progress against the corporate level goals on a monthly basis. The SPT manager will report the assessment findings to the Management Board.

The Chairman of the Management Board will report the bank's progress against the corporate level goals to the Supervisory Board on a quarterly basis.

The Supervisory Board will evaluate the Management Board's performance in terms of planning and addressing the causes of deviation of actual performance against the plans. The Strategic Plan and planned future activities will be amended and revised in consistency with the changes occurring in the current operating conditions as compared to the current experiences and the approved Strategic Plan. The Management Board and SPT will be responsible for reflecting the amendments to the corporate level goals in individual business unit strategic and operating goals.

7. Division of responsibilities. The chairman of the Supervisory Board shall:

- ensure that the bank's Vision is clearly defined and its key principles are coordinated with the bank's major shareholders;
ensure that the bank's Vision is submitted to the General Meeting of Shareholders for review;

ensure that a Strategic Plan is developed and approved in consistency with the Vision and Mission Statement;

ensure that the bank's performance is regularly assessed against the Strategic Plan and the Strategic Plan is updated in consistency with the bank's actual performance and market developments.

The chairman of the Management Board shall:

ensure that the corporate level strategic and operating goals are submitted to the Supervisory Board for identification and approval;

ensure that business unit level operating goals are clearly defined and consistent with the corporate level strategic goals;

ensure that performance of business units is regularly assessed against the goals defined;

to ensure that strategic plans and operating strategies of business units are updated in consistency with the amendments to the corporate level Strategic Plan;

ensure that significant business decisions made by business units are consistent with the corporate level strategic goals, strategic plans and operating strategies of business units.

8. Organizational structure

8.1. Management structure of banks

Each bank is managed by the following management/executive bodies:

- General Meeting of Shareholders, the high/supreme executive body of the bank;
- Supervisory Board, a body appointed by, and reporting to the shareholders, and responsible for managing and controlling the bank's operations;
- Management Board, the executive managerial body responsible for management of the bank's everyday operations;
- Audit Committee, responsible for the bank's accounting procedures, control and internal audit of the bank.

8.2. Organizational structure requirements. The organizational structure of the bank groups its operational functions by positions and workplaces, and assigns such workplaces to appropriate interconnected business unit. Following interconnections between units may be:

- both vertical (hierarchic connection or reporting),
• and horizontal (several business units are involved in a business process without mutual reporting requirements).

The following general issues are instrumental in establishing an effective organizational structure of the bank:

• Nature of the bank's operations and specific business strategy of the bank;
• Business processes are optimally effective (high quality results are achieved within estimated timeframes and with appropriate costs);
• Possibilities exist for separation of functions and appropriate implementation of other forms of internal control (risk management, compliance).

In addition to regulatory requirements all banks must comply with, an efficient organizational structure usually requires all of the above described aspects to be balanced. For example, a “comprehensive customer care and service” strategy at a branch office servicing individual customers may result in a need for more cost-consuming personnel. However, this “comprehensive customer care and service” strategy will be in conflict with the bank's operating strategy when a highly automated and minimal cost-intensive service process is a priority. Another example is the control requirement with respect to payment transactions where this process must not be a single person's responsibility. In this view, a well-devised organizational structure of the bank should be consistent with the bank's area of business and size. Important factors of organizational structure include services provided by the bank, customer segments and the geographic coverage of operations. A bank that conducts its business via various branch offices (divisions, bureaus) needs to balance centralized of decision-making and back-office operations at the head office with the bank's infrastructure (communication channels, information technologies (IT) system).

Once an appropriate organizational structure has been established, it may require certain time to start functioning for a number of reasons:
• appropriately qualified and skilled employees must be hired or appropriate staff must be trained;
• operating procedures must be developed and checked to support the organizational structure;
• investments must be made in IT systems and equipment.

Availability of appropriately qualified personnel in the organizational structure is a practical factor important for proper performance of their functions. The organizational structure is established not to provide employees with work, but to enable the bank to achieve its business goals and meet regulatory and internal control requirements.

Each unit within the organizational structure must have their own regulations/by-laws identifying their goals, functions, duties, relations with other units of the bank and other information. The regulations must be developed by business units in accordance with the bank's strategy and approved by the Management Board.

Every employee's job description must identify his/her functions, duties, responsibilities, input in the reporting process and, if applicable, limitations. Job descriptions must be signed by employees, approved by the relevant unit managers and kept at the bank’s Human Resources Department (see the HR Standard). Once the bank's organizational structure has been approved, persons (supervisors) responsible for the
structure and its main components (functional units), their duties and reporting process must be fully and clearly identified.

Each bank must have at least four functional units. Such functional units vary by the nature of banks’ operations and control interconnections:

- Direct customer work: customer transactions, branch office operations and other retail activities;
- Risk management: internal controls and risk management infrastructure, regular identification, measurement and control of various types of risk inherent in the bank's operations;
- Bank transactions: lending, treasury, interbank operations, settlement and clearing operations;
- Administrative and support services: back-office and accounting, Legal Service, Human Resources, Information Technologies, Procurement, etc.

These functional units are equally significant and closely interconnected. Pursuant to the principle of division of functions and duties, functional units must report to their individually appointed supervisors – individual deputies of the Management Board Chairman.

Organizational structure established by the bank:

- Must assist in achieving the bank's strategic goals;
- Clearly defined functions, rights and responsibilities, the reporting structure must assist in ensuring high effectiveness of all business processes;
- Must meet all regulatory requirements and comply with internal control principles.

8.3. Model organization charts. The organizational structure may consider a number of factors affecting the implementation of the business strategy and ensuring optimal efficiency: Management/governance principles and philosophy of the bank;

- Period of the bank's operation, asset size, scope of operations, number of staff, geographic area and other significant parameters;
- Nature of bank products and services offered to customers;
- Nature of competitive environment of the market the bank operates in;
- Level of automation of the bank's key business processes.

There are three major types of organizational structure for banks. Also, experience suggests that many banks establish an organizational structure combining elements of all three types.
Type 1: Functional structure

The functional organization clearly describes the activities (“services”) of each unit. Advantages and benefits of this structure are increased cost-effectiveness of the bank's operations and prevention of duplication/overlapping of efforts due to specialization of employees in specific areas.

Downsides of this structure include an inability to take account of key differences between various operating processes, delivery channels of customer services and customer groups. The centralization implied in this system does not fully satisfy the development needs of business activities in the country (for example, small branch office network in this type of structure).
**Type 2: Service-based structure**

In the service-based structure units are defined by the types of services offered to customers.

For example, the bank offers each of various types of services at individual service centers. In some cases, each service unit is responsible for the full scope of all operating processes relating to the service (including, back-office, administrative and support services). In other cases, back-office work is centralized in addition to the support services, as indicated in the chart above.

A service-based structure is most appropriate for large banks, because this type of structure allows for easier management of the institution and enables each business unit to focus on its products and services. This approach requires banks to hire appropriately specialized experts to deliver services to customers because such structure mostly have a decentralized decision-making process. On the other hand, although some services are offered jointly in a service-based structure, some operating processes are duplicated in each business unit, resulting in high cost intensity.

Furthermore, business units may start competing for customers, which reduces cross-sales cooperation between units and leads to operations incorporating complex elements.
Type 3: Market-based structure

A market-based structure is defined by various “customer groups” or segments serviced by business units.

For example, customer segments may be represented with big companies, small and medium enterprises, individual customers with a high level net capital. Different “markets” may be different geographic regions where the bank operates.

In a market-based structure all necessary services may be concentrated in each business unit, which results in duplication of services.

Strengths of the market-based approach is that a single business unit provides services necessary to maintain connections with customer groups with varying needs or geographically divided, and meet the needs of each customer group. Operation and management of a market-based structure may be difficult. For example, when customers demand the same services, it may require duplication of services in different business units.
8.4. **The most appropriate structure.** As indicated above, banks must balance the following criteria when selecting the most appropriate structure:

- Most cost-effective solution;
- Use of expert knowledge in most needed areas due to high cost intensity.

As a functional, centralized structure is low cost-consuming, banks may incorporate some elements of a service-based and market-based structure in the functional structure in order to ensure that customer needs are satisfied and expert knowledge and skills are used properly.

As performance evaluation is very important for implementation of the bank's strategy, banks may identify income and cost units in their organizational structures.

Evaluation and comparison of performance of various business units may result in de facto competition between the units. This competition, besides creating efficient business activities, must not prevent business units from working together in areas considered important for implementation of the strategy.

Under best banking practices, banks must ensure that four functional units (direct work with customers, bank transactions, risk management, administrative and support services) are put in place when identifying their organizational structure. These functional units must be distinctive for the nature of their operations and mutual control relationships.

The model organizational structure presented in the chart is a functional structure with four functional units. Each functional unit must be under direction and charge of individual members of the Management Board. Banks must focus on a number of factors specified herein when establishing their organizational structures.

In addition, a brief overview of the main functional units presented in the model is provided below:

- **Bank business** – may be divided by individual and corporate customers. Individual business units are responsible for various activity areas, considering risk management and internal control issues, depending on customer needs;

- **Treasury** – includes management of the bank's assets and liabilities, securities transactions;

- **Risk management** – includes identification of a risk management policy, risk analysis, control of the bank's risk resistance and risk limit compliance;

- **IT, accounting, human resources, security, legal and other services** – key internal services providing administrative support to the above described functional units.
8.5. Management and controls Each bank must ensure four principal forms of control within their organizational structure (BCBS's “Development of Corporate Governance in Banks” Publication):

- control provided by the Supervisory Board and Management Board;
- control provided by employees not involved in everyday activities of various business units/areas;
- control provided by persons directly responsible for various business units/areas;
- independent risk management and internal audit service.

In addition, key personnel must be “fit and proper”.

Under best corporate governance practices, the Supervisory Board is fully responsible for the following in line with the management and control of the bank's operations:

- approve and regularly review the bank's overall business strategy and key internal documents;
- understand key risks encountered by the bank and set appropriate/acceptable limits for such risks;
- consider and act upon recommendations provided by the Audit Committee and external auditors of the bank.

8.6. Bank committees. The Supervisory Board may assign management decision-making responsibilities to the bank's committees. The committees shall operate in accordance with the strategy approved by the Supervisory Board and the scope of their competence. The committees may include members of the Management Board and appropriate unit managers. Committees shall be managed by a member of the Management Board. Internal audit staff of the bank may attend Committee meetings, but may not be members of any committee other than the Internal Audit Committee.

The following bank committees may be established:

- **Risk Management Committee;**
  
  Banks may establish two risk management committees as banks in Azerbaijan typically encounter two major risks such as credit and liquidity risks (see Risk Management Standard):
  - Credit Committee;
  - Assets and Liabilities Management Committee.

- **Information Technologies (IT) Committee;**

- **Other committees, as necessary.**
\textbf{1.1.1 Credit Committee.} \textit{The principal objective of the Credit Committee is to ensure compliance with the bank's lending policy, control the quality of the loan portfolio, improve problem and past due loan management. The Credit Committee will analyze and recommend decisions on the following:}

- breakdown of the loan portfolio by economic sectors and regions;
- lending, guarantee (warranty) issuance, loan and guarantee (warranty) roll-over procedures;
- setting credit limits for banks and other corporate customers;
- principles, methods and forms of problem loan management;
- problem loan restructuring programs;
- insider lending and limit policy.

\textbf{1.1.2 Assets and Liabilities Management Committee (ALCO) The ALCO is responsible for defining the bank's policy for liquidity and financing, asset and liability management (ALM) in risk structure and capital adequacy areas. ALCO's main asset and liability management duties and responsibilities include:}

- For expansion and management of assets and liabilities, in accordance with the bank's Strategic Plan:
  - to assess the bank's overall balance sheet in terms of amount of capital, deposit base, quality of assets and off-balance sheet liabilities;
  - to determine changes in current and projected interest rates, market conditions and types of asset and liability management operations as per risk management procedures;
  - to ensure that capital and liquidity levels are provided and controlled as planned in order to provide compliance with regulatory and internal requirements.

- Oversee the following for identification and management of the bank's liquidity and funding policy:
  - asset and liability maturity structure and regulation of balance sheet amounts to be allocated to illiquid assets (for example, investments in real estate and subsidiary enterprises);
  - adequacy of required liquidity ratios;
  - asset and liability maturity mismatch limits;
  - plan of actions to be taken by the management in liquidity crises.

- Ensure the following for management of the bank's capital:
  - return on equity rates are identified, considering liquidity and capital requirements;
  - capital “distributed” among business units and services offered;
  - recommendations provided on raising additional capital/funds (amount and types) for the bank (for example, issuing new shares or subordinated debt);
9. Internal control. The Management Board shall establish a comprehensive, sound and effective internal control system with the following characteristics:

- reliable and continuous operation;
- capable of identifying the risks inherent in the bank's balance sheet and off-balance sheet operations and their complexity;
- capable of appropriately responding to changes in the bank's market and business environment.

9.1. Division of responsibilities. The bank's organizational structure must have a correct distribution of responsibilities. The same person should not be appointed to different positions in conflict with the control policy. For example, a person responsible for front and back-office sales services. This person may have an opportunity to misuse information or conceal losses for personal gain when using the bank's assets. In this view, in order to minimize the risk of financial data distortion or illegal appropriation of assets, certain positions must be distributed among different employees to the extent possible. Control over the same employee holding positions in both front and back-offices is not limited to distribution/division of responsibilities. If an employee is responsible for the following positions, adequate internal procedures must be put in place to enable adequate control:

- Disbursement of funds and confirmation of disbursements;
- Customer accounts and treasury;
- Execution and recording of operations in accounting books/ledgers;
- Evaluation of adequacy of loan documents and post-lending borrower monitoring;
- Potential areas of conflicts of interests and mitigation of such conflicts using other factors.

Potential areas of conflict of interests must be identified, minimized and carefully monitored by an independent third party. To prevent key personnel from hiding non-compliant activities, their rights and responsibilities must be regularly reviewed (Basel Committee's “Structure of Internal Control Systems in Banks” Document, No.40, September 1998).

9.2. Internal audit service

9.1.5 Banks must have an effective and comprehensive internal audit service. As part of the internal controls system, the internal audit service must consist of operationally independent, appropriately trained and skilled employees. The internal audit service shall report directly to the Audit Committee and the