



## **INFORMATION NOTE ON THE AGREEMENT SIGNED WITH CUKUROVA GROUP**

The Banking Regulation and Supervision Agency (BRSA) within its two years of operation, has successfully performed practices considered essential in ensuring a healthy banking sector, in an environment where Turkey has experienced two domestic financial crises. The autonomous structure of the BRSA as regards its operations is considered a key factor in this success.

The BRSA and the Savings Deposit Insurance Fund (SDIF), which *are* conscious of the necessity of being independent institutions in terms of protecting the public interest, have implemented appropriate policies based on authority granted by law, without any domestic and international influence. Within this context, the negotiations between the Cukurova Group and BRSA have been finalized and the agreement, whose principles are set out below, has been drawn up and signed by the parties.

The continuations of the existence of an independent, accountable and transparent regulatory authority, free of any influence, will be the vital guarantee for implementing the contract for the benefit of society. The support and common-sense of all institutions of our country, especially of the neutral and unbiased press, is important to achieve the desired outcome.

Before giving the details of the contract, a brief overview of the circumstances involving Pamukbank, Yapi Kredi Bank (YKB) and the Group is presented.

**Pamukbank:** Given that too little capital was found inadequate as a result of a three-stage audit, Pamukbank was taken over by the SDIF on June 18, 2002. The Cukurova Group started a legal proceeding before the Council of State, and the General Assembly of the Council of State made a decision to suspend the execution of the intervention action on November 22, 2002. Based on this decision, Pamukbank has been returned to its previous majority shareholders on January 24, 2003.

**Yapi Kredi Bank:** 41.8% of YKB is publicly held and almost all remaining shares belong to the Cukurova Group. The financial situation of this large-scale bank, which has a high franchise value, has been negatively affected by Group loans amounting to USD 2.3 billion. As a result of the transfer of Pamukbank to the SDIF, the majority shareholders of Pamukbank have lost their shareholder rights in YKB in accordance with the Banks Act, and 13.1% of YKB shares belonging to Pamukbank were transferred to the SDIF.

**The Cukurova Group:** The Group, having debt amounting to about USD 5 billion to Pamukbank and YKB, has very limited exposure to other banks. The Group is also operating in sectors other than finance, especially the telecommunications. Nevertheless, due to the fact that its assets lost value after the crises, the Group does not have the capacity to fully service its debt within a short period.

## ISSUES TAKEN IN CONSIDERATION IN THE DECISION PROCESS

Our Agency has taken the following issues in consideration during its decision making process:

- Providing a solution in a short period, due to the **potential long-term uncertainty and systemic risk** that could be caused by the absence of a settlement regarding two banks owning 20% of the banking system assets.
- **Removing uncertainties resulting from long-lasting legal proceedings.**
- Mitigating the BRSA's **risk of not being able to take the necessary and timely actions** related with the two banks, due to the otherwise-ongoing legal procedures concerning Parmukbank.
- Avoiding the difficulty of disposing of such large companies in the current economic conjuncture of the bank subsidiaries were transferred to the SDIF, and rather preserving their values in the short term and **avoiding the risk of creating a large State Economic Enterprise (SEE) impossible to be governed** under public sector structures.
- **Increasing the payment capacity of the Group** by allowing the profitable companies with high franchise value to operate, thereby decreasing the ultimate cost to the publicly.
- **Avoiding probable effects in the capital market** due to the high level of publicly-traded shares of Yapi Kredi Bank,

## ALTERNATIVE APPROACHES

When the scope of the problem faced is considered, two solution alternatives arise:

**1. A partial solution:** The partial solution involves waiting for the finalization of the ongoing legal procedures regarding Pamukbank, cancellation of the contract regarding restructuring of YKB's group loans, delay of the necessary actions due to legal uncertainty despite the deterioration of YKB's financial structure, probable liquidity problems of the two banks, the further contagion-impact on the banking, and the bearing of the whole cost by the State.

**2. A comprehensive solution:** The comprehensive solution involves promptly removing the uncertainties engendered by the legal procedure and its negative effects on the banking sector and on the economy in general, and finding a sustainable solution acceptable all. The main principles of this approach are safeguarding the continuity of YKB and ensuring that the majority shareholders bear the financial cost and assume full responsibility to resolve the issue.

## WHY HAS THE BRSA CHOSEN THE COMPREHENSIVE SOLUTION?

Our agency has adopted the comprehensive solution model in order to bring a quick, least-cost and sustainable solution to the issue. The following reasons should be stressed:

- When the cross-ownership relations of the Group are taken in account, the comprehensive approach is the most appropriate to ensure that the majority shareholders assume full responsibility and undertake utmost efforts to repay their debts.
- The collection from the majority shareholders of the public cost arising from the Pamukbank YKB-related issue depends on the general debt-payment capacity of the Group.
- It is expected that Group firma may provide e regular cash flow to ensure that the majority shareholders are able to make their debt repayments.
- Any alternative partial solutions will not provide anything but a temporary solution or postponement of the problem.
- The resolution of the ownership problem of Pamukbank and YKB without considering the Group in general will not contribute to a permanent and sustainable solution. This has led us to choose the comprehensive solution in ensure that the costs to the public are minimized.
- The wide customer range of YKB, its importance in the sector, the fact that it k a publicly-held bank (41.8%) with many small investors, including domestic and foreign mutual funds, were other factors underlying our preference for the comprehensive solution.
- Under the comprehensive solution, the Group has been given the responsibility to pay back its debt by pledging sufficient collaterals and agreeing to necessary covenants.

## **THE MAIN ISSUES OF THE CONTRACT**

The main features of the coritract are as follows:

- The Group waives the legal proceedings.
- The SDIF, based on the authority granted to it by law, waives the legal proceedings, though penal proceedings can be implemented through the provisions of the related articles of the Banks Act.
- The SDIF will continue to exercise the ownership and management rights, of Pamukbank.
- The SDIF will continue to exercise the partnership rights, except dividend rights. of Pamukbank's majority shareholders in YKB.

- The management of YKB will be appointed from the nominees determined by a mutually-selected advisory firm having an international reputation, with appointments conditional on *the* final approval of the SDIF.
- Shares in YKB of the Group (which no longer satisfy the “fit and proper” conditions stipulated for establishing a bank pursuant to the Banks Act) will be sold within two years. In case the sale cannot be realized within this period, the sale will be conducted by an investment bank having an international reputation in the third year. If the shares cannot be sold through the afore-mentioned method, the SDIF will take the initiative for sale.
- Under the existing Banks Act, the majority Shareholders in Pamukbank can no longer hold shares equal to or over 10% in any bank.
- The Debt Restructuring Agreement (Istanbul Approach) between YKB and the Cukurova Group will continue to be effective.
- The parties have agreed to take all measures required to avoid the capital adequacy ratio (CAR) of YKB falling below 10%. If the CAR falls below 10% and the Group fails to increase its capital, the capital increase will be performed by the SDIF and therefore the Group’s share in the bank will decrease.
- Group debts in Pamukbank have been restructured according to a fifteen year payment plan, based upon the provision of necessary and sufficient collaterals, in the first three years of the payment plan, interest payments will be made, and during the remaining time both interest and principal will be paid. In determining the payment schedule, the amount of the debt and the feasibility results performed within the scope of Istanbul Approach principles, including the payment capacity of the Group, will be taken in account.
- The sale of Turkcell shares in Pamukbank to the Group is intended to increase the payment capacity of the Group. The transaction was conducted by taking in account the average stock exchange price for the thirty days prior to January 30, 2003. These shares are pledged to the SDIF.
- In case the Group sells all or a part of its assets to third parties, a minimum 55% of the sale value will be used for the payments of debts to YKB and the SDIF. In the case of the sale of assets pledged to the SDIF, sales revenues would be transferred to the SDIF.
- Of the majority shareholders who have participated in negotiations with the SDIF to-date, the Cukurova Group has the largest exposure. Payment plans similar to those granted to this particular group are available to all majority shareholders who accept the BRSA/SDIF-determined value of their debt and are willing to service it.
- Debts of the Group to the other SDIF banks are also included under the restructuring agreement.

## **TO WHAT EXTENT ARE PUBLIC RIGHTS SECURED?**

The agreement protects public rights against risks that may arise if the Group does not fulfill the provisions of the agreement. These measures can be summarized as follows:

- Partnership rights except dividend rights of Pamukbank shareholders in YKB will be exercised by the SDIF.
- Professional bank managers for Yapi Kredi Bank selected by an advisory firm having an international reputation will be appointed, conditional on the final approval of the SDIF.
- Almost all of the Group's assets have been taken as collateral for the Group's debts.
- YKB will have a minimum 10% CAR, otherwise the SDIF will have the authority to increase capital and to ensure that Yapi Kredi Bank operates in a sound financial structure. Furthermore, dividends of the majority shareholders of YKB will be kept in the bank.
- In the case of default on payments, the relevant provisions of the procedures for the recovery of public receivables (Act No. 6183) will be enforced. In case two consecutive installments are not paid, the agreement will become null and void and all debt will be followed up as public receivables.

## **WHAT DOES THIS AGREEMENT PROVIDE FOR THE BANKING SECTOR AND THE ECONOMY?**

- Elimination of systemic risk, through removing the uncertainties regarding Pamukbank and YKB.
- Pamukbank will be available for sale after being restructured under the SDIF, making it possible to reduce costs to the public.
- YKB's position in the system will be preserved through the removal of uncertainties related to non-performing loans and the ownership problems.
- In accordance with international practice, production, employment and export losses are to be minimized by ensuring a viable environment for the Group's financial and non-financial firms.
- This agreement does not lead to any additional fiscal costs.

## **CONSEOUENTLY**

All parties have mutual responsibilities to implement the results of this contract.

Accordingly:

- The Cukurova Group shall make all efforts to ensure the sustainability of the agreement under existing circumstances.
- The BRSA/SDIF will undertake tight enforcement of the contract conditions and share its findings with the public under the principle of transparency. Accordingly, it will be the biggest guarantor of the gains that the Turkish Banking Sector has achieved through the reforms realized in recent years.
- It is important that the media monitor related parties regularly and accurately inform the public.

Under the principle of transparency, the BRSA/SDIF will publicize detailed information on the contract signed with the Group on its Internet site.