

# From Crisis to Stability: Restructuring of the Turkish Banking Sector

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*“Strong Banking Sector, Strong Economy”*

# Pre-crisis conditions

- Banks
  - Liquidity problems
  - State banks with over-night liabilities of \$14 billion
  - Large open positions of private banks
  - Significant share of holdings of government debt
  - Low asset quality
  - Inadequate risk assessment and management systems
  - Lack of good corporate governance
- Operating Environment
  - Major macroeconomic instability
  - High public sector deficit
  - Systemic distortions created by state and weak banks



# November and February Crises

## Macroeconomic Shocks

- Sharp **increase** in **interest rates**
- **Sharp depreciation** of the Turkish Lira
- **Contraction** in economic activity



## Impact on the Banking Sector

- **Maturity mismatch** → **funding losses**
- **Decline** in the value of **securities portfolio**
- **Short-positions** → **FX losses**
- **Asset Quality** ↓
- **Credit Risk** ↑

**Result:**

**Erosion in Capital Base and Bank Failures**



# But crises also provide opportunities for major restructuring

- BRSA was only set up at the edge of the crises
- Banking System Restructuring Program  
announced on May 15, 2001
- Objective is to **eliminate distortions in the financial sector and adopt regulations to promote an efficient, globally competitive and sound banking sector**
- **4 Main Pillars**
  - **Restructuring of the state banks**
  - **Resolution of the SDIF banks**
  - **Strengthening of the private banks**
  - **Improving the regulatory and supervisory framework**



# State Bank Restructuring

- **Financial Restructuring**
  
  
  
  
  
  
  
  
  
  
- **Operational Restructuring**



# Bank Intervention Strategy

- To avoid,
  - **Bank runs**
  - **Further pressure on interest rates**
  - **Impossibility of sustaining the debt service**
  - **Break down in the payment system**
- Resolution under SDIF strategy was chosen
  - **Legal process shortened vs. direct liquidation**
  - **Resolution process has been facilitated through deposit transfers**
  - **Some employees kept employed through branch/bank sales**



# Resolution Process

- 20 banks were taken over by the SDIF
- Financial Restructuring;
  - Over-night liabilities eliminated
  - FX open positions reduced
  - Deposit rates uniform with market rates
  - Deposits of about \$3bn auctioned to other banks
- With Operational Restructuring, significant reduction in the number of branches and personnel
  - Number of branches and personnel were reduced by 81.3% (1,476) and 80.7% (30,572) respectively, compared respective intervention date figures.
  - With bank and branch sales, a total of 10,337 jobs were kept.



# The initial fiscal costs of the Turkish crisis have been high

	Billion USD	Ratio to GDP (%)
State Banks	21.9	14.8
-Duty Losses	19.0	12.8
-Capital Support	2.9	2.0
Resolution of SDIF banks	21.7	14.9
-Public Resources	17.0	11.7
-Private Resources	4.7	3.2
<b>TOTAL</b>	<b>43.6</b>	<b>29.7</b>

In addition, private banks raised \$2.4 billion of capital from own resources.

Thus, there has been a significant burden-sharing as \$7.1 billion of the restructuring costs were borne by the private sector.



# SDIF Collection Efforts

- Bankruptcy Law has been amended in order to increase efficiency in enforcement.
- A **loan sale project** has been launched aiming at rapid resolution of SDIF assets.
- SDIF has collected a total of **\$2.1 billion** (\$1.8bl. via direct collection, sale of subsidiaries, tangible and intangible assets and bank sales and \$0.3 bl. via time sales)
- Dragging legal procedure and lawsuits are a major impediment to rapid collection.



# Restructuring of Private Banks

- Debt swap operation
  - \$7.5 billion in June 2001.
- Recapitalization scheme (Three-stage audit and first time adoption of inflation accounting)
  - To ensure transparency and enhance confidence in banking sector. Inform the public about the steps.
  - To restore market discipline.
  - To maximize capital contributions by banks' owners. (No contribution, No bank)
  - To encourage mergers and acquisitions.
  - To revise non-performing loans.
- Istanbul Approach
  - As of August 2003, a total of \$5 billion of loans of 220 firms were restructured.



# Improving the Regulatory and Supervisory Framework

Moving towards international standards, introduced new and revised regulations on;

- **Capital**
- **Risk management**
- **Lending limits and loan loss provisioning**
- **Related party exposure**
- **Accounting standards and independent auditing**
- **Facilitating mergers and acquisitions**

And signed

- **MoUs with other countries' supervisory authorities to improve cross-border supervision.**
- **Aiming at introducing risk based supervision and tighter prudential supervision.**



# Results of Restucturing Efforts

- Consolidation in the banking sector  
Number of banks down to 51 from 81 in 1999.
- Decline in the share of the State and the SDIF banks
- Reduction of financial risks to manageable levels
- Improved transparency
- Improved profitability
- Strengthened capital structure
- Increased credit extension



Although risks have been decreased to more manageable levels some still remain..

- Despite Istanbul Approach share of NPLs are still high
- Short-term maturity structure of deposits
- High share of Government bonds in the balance sheet
- Improved but low level of free capital



# Recommendations based on Lessons Learned by BRSA

## I. Preventive Measures:

- The most important phase is licensing.

Make sure you have clear, strong, healthy rules for licencing.

- Make sure your audits on-site include financial detective techniques.

Three level audit was OK for one bank. But a year later we found out that it was running two sets of books.

- Pay more attention on IT audits.

It is a powerful platform for all: The Good, The Bad and The Ugly.

Consider outsourcing this function.



# Recommendations based on Lessons Learned by BRSA

## II. Immediate Crisis Management Lessons:

- Introduce blanket guarantee.

But also be ready to announce the rules, conditions and timing of returning to normal.

- Work in-coordination with other Public Authorities.

Prepare an “Emergency Action Plan” with Central Bank, Treasury, Ministry of Finance and Capital Markets Board etc..  
Make sure “Lender of Last Resort” facility functions.

- Provide information to public.

An efficient public relations unit would calm public reaction.

“Keep Your Settlement System Intact”



# Recommendations based on Lessons Learned by BRSA

## III. Lessons for resolution of intervened banks:

- Merge and then resolve (sell or liquidate) strategy.

Worth applying since you immediately start cost cutting.

- Sell deposits / loans via auctions.

If you cannot sell the bank in a short period of time immediately start selling the B/S in pieces via auctions.

- You will end up closing branches and laying – off personnel.

Do it on time. Waiting will increase your costs and their expectations.

“Wholesale vs. Retail Strategy”



# Recommendations based on Lessons Learned

by BRSA

## IV. Lessons for Collection:

- Get superpowers to accelerate collection.

**Without hurting the rest of the banking system which will already have receivables from the same borrowers.**

- Agree on repayment protocols with borrowers to accelerate collection process and to minimise costs.

**Create principles/guidelines for settlement and protocols.**

- The Collection Agency and the Banks you own (together with the other Banks in the system) will have piles of NEA's on their B/S's. (NPL's, Real Estates, Companies etc.)

**Organize immediate sale of these at market prices. Don't expect them to get back to their original prices. Funding them will always cost more.**

**“Consensus Supported by Superpower”**



# Recommendations based on Lessons Learned by BRSA

## V. Restoring Profitability and Risk Mitigation:

### ■ Do voluntary debt swaps

Avoid moral hazards but do it when needed. You do not have the luxury of waiting.

### ■ Encourage mergers and acquisitions. Give incentives.

There will always be enough number of bureaucrats to prevent you from doing so. Don't listen them. Do more than what you think is sufficient.

### ■ Tax incentives to lengthen maturity of deposits.

Sole legal incentives are not effective; macroeconomic stability matters.

### ■ Re-capitalization scheme and providing Tier-II capital.

Three level audits. Third being yours. Be tough. This is the last train.

### ■ Voluntary corporate debt restructuring (Istanbul Approach).

Voluntary does not work. Have stand-still rules for justified cases.

**“Reward the Effort Without Forbearance”**



# Recommendations based on Lessons Learned by BRSA

## VI. Other Lessons:

- Coordinate with other Government Agencies to set up training programmes for self employment of laid – off personnel.  
**Or even set it up yourself and fund it thru the World Bank if possible.**
- Make sure you have a high quality Legal Department.
- To accomplish all of these you need an “independent” agency.

**“Be Bold, But Also Compassionate”**