

From Crisis to Financial Stability: Turkey Experience

April 2009

This article has been prepared by Turkey.

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This article has been prepared by a working group consisting of representatives from the Banking Regulation and Supervision Agency (BRSA), Savings Deposit Insurance Fund (SDIF), Undersecretariat of Treasury (UoT) and Central Bank of the Republic of Turkey (CBRT) within the framework of the G-20 activities.

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Abbreviations

ATM	Automated Teller Machine
BAT	Banks Association of Turkey
BDDK	Banking Regulation and Supervision Agency
CAMELS	Capital, Asset Quality, Management, Earnings, Liquidity, Sensitivity
CAR	Capital Adequacy Ratio
CBRT	Central Bank of the Republic of Turkey
Dollar	USD Dollar
EFT	Electronic Fund Transfer
EU	European Union
FRP	Financial Restructuring Program
FSAP	Financial Sector Assessment Program
FX	Foreign Currency
GDP	Gross Domestic Product
ICC	Investment Counseling Council
IIA	International Investors Association
IICC	Investment Improvement Coordination Committee
IMF	International Monetary Fund
ISE	Istanbul Stock Exchange
MF	Ministry of Finance
MIS	Management Information System
OECD	Organization for Economic Cooperation and Development
POS	Point of Sale
RFA	Risk Focused Audit
RP	Restructuring Program
RUSF	Resource Utilization Support Fund
SDIF	Savings Deposit Insurance Fund
SIGB	Special Issue Government Bond
SIGB	Special Issue Government Bond
SME	Small and Medium-Scale Enterprise
SPO	State Planning Organization
TASB	Turkey Accounting Standards Board
TEA	Turkey Exporters' Association
TIBA	Turkish Industrialists' and Businessmen's Association
TRNC	Turkish Republic of Northern Cyprus
TRY	New Turkish Liras
TUCCE	Turkish Union of Chambers and Commodity Exchange
UFIRS	Uniform Financial Institution Rating System
USA	United States of America
WB	World Bank

EXECUTIVE SUMMARY

Turkish economy had faced increasingly more frequent crises as from the 1990s and economic vulnerabilities increased due to the failure, for various reasons, to complete the stabilization programs initiated. During this period, basic structural problems such as the macroeconomic instability in the banking sector, distorting effect of state-owned banks, the small-scaled and fragmented structure of the sector and deficiencies in risk management have resulted in the deepening of exchange rate crisis experienced in February 2001 and its transformation into a systemic banking crisis.

In order to establish a stronger structure for banks whose financial standings and profitability performance deteriorated with the effect of the fluctuation in financial markets in November 2000 and the crisis in February 2001, the “Banking Sector Restructuring Program” was initiated in May 2001. The program aimed at restructuring state-owned banks, resolution of the banks transferred to the Savings Deposit Insurance Fund (SDIF), rehabilitating the private banking system, strengthening the regulation and supervision framework, and increasing efficiency in the sector.

Within the framework of the program, the capital structures of state-owned banks had been strengthened, their duty loss receivables had been paid and the arrangements enabling the formation of new duty losses had been abolished, a professional staff structure had been established in the management of these banks, and their short-term liabilities had been liquidated. These banks had been operationally restructured and the number of their branches and staff had been reduced to rational levels.

The resolution of the banks transferred to the SDIF had been completed in a short period of time through the methods of merger, sales or direct liquidation. The total amount collected by the SDIF from resolved banks is USD 18 billion as of end-2008 and USD 16 billion thereof which corresponds to about 90% of the collection has been realized as of 2004.

Through the domestic debt swap undertaken to achieve a healthier structure in the private banking system, the foreign currency open positions had been substantially closed, necessary measures were taken for the banks identified to have capital inadequacy through a capitalization program, the balance sheets of private banks have been made more transparent by applying inflation accounting, and their capital structures have been strengthened. Arrangements had been made for the instruction of mechanisms to accelerate the settlement of bad assets.

Legal and institutional arrangements had been introduced to strengthen the regulation, surveillance and supervision framework for the banking sector, furnish the banking system with a more efficient and competitive structure and improve the resilience of the sector and establish a lasting confidence in the sector, and the legal framework was aligned with the international standards. The Banking Law No. 5411, adopted in 2005, envisages a new financial structure for ensuring financial stability, improving the sector, strengthening the regulation, surveillance and supervision framework, protecting the rights and interests of depositors, and strengthening the institutional capacity.

During the crisis and post-crisis period, the supervision mandate of the BRSA was expanded, its organizational structure was revised, a strategic planning approach was adopted, regulation process was made more participatory and transparent, and the supervision system was strengthened through the integration of on-site and off-site audit and

introduction of new approaches, methodologies and practices in order to increase institutional capacity.

The experience of Turkey highlights the importance of **accurately diagnosing the nature and size of problems driving the sector into the crisis** and thus implementing, without compromise, a comprehensive approach for the solution of all conjectural and structural problems through inter-agency coordination. In the transitional period after 2000–2001, the **structural reforms** directed to eliminate the vulnerabilities of banking sector that had played a critical role in the emergency of crisis was the driving force of economic growth and accelerated the process of getting out of the crisis.

It is important to introduce arrangements aimed at eliminating the structural problems that increase vulnerability to crises in the banking sector and taking measures against banking crises. Furthermore, the new structure must focus on detecting the problems in the banking sector in a timely manner and solving them efficiently, expeditiously and permanently, rather than finding temporary solutions for these problems.

The abuses by controlling shareholders in intervened banks demonstrate the **importance of licensing process**. The requirement to carefully evaluate the qualifications and intentions of founders of banks, institutional capacity of managing risks, and compliance with corporate governance principles as well as the competition conditions in the market became clear.

The crisis unveiled the need to implement proactive resolution strategies that will ensure that banks be monitored through early warning systems to be established before they became problematic and will ensure time and cost efficiency in the banks, instead of reactive practices in the resolution process.

The timely introduction of blanket guarantee to give an end to banking sector crises and its abolition after the end of crisis functionalized market discipline.

The fact that the restructuring operations during the crisis and post-crisis processes have been undertaken by BRSA, which enjoys administrative and financial autonomy, helped execute the process with an efficient structure. It was possible to act swiftly during the decision-making process in coordination with the sector representatives, without being impaired by bureaucratic red-tape.

The establishment of **transparency and impartiality** in all practices contributed to the success of Turkish case. Other key success factors were the ability to identify and publicize the actual status of banks, periodically publish financial reports on a sectoral basis and issue of publications to about the program being conducted are recommended to the countries willing to implement similar policies.

Efforts must be exerted to ensure built up of buffers by tightening regulations during the boom periods of economies, and loosening the legislation by gradually releasing the requirements during crisis periods. Thus, the alleviation of problems must be enabled through the easing off rules during times of worsening expectations.

Due to the strong ties between the real sector and the banking sector, any problem experienced in one of these sectors concurrently leads to problems in the other. In the case of Turkey, the fact that get out of the crisis has started with reforms in the banking sector enabled the recovery and growth of real sector in a short period of time. It is obvious that problems in real sector must be perceived as a result rather than a reason and the resolution efforts must be started from the financial sector.

1 OVERVIEW OF TURKISH BANKING SECTOR PRIOR TO THE CRISIS

During the 1990s, Turkish economy had been exposed to crises frequently. Among the main reasons of these crises were the unsustainable domestic debt dynamics and the structural problems, primarily including the ones in the financial markets. In this period, current account had deficit, direct foreign investments were limited, banking sector and private sector increased their foreign borrowing and the Central Bank's reserves grew continuously in general. In order to ensure stability in economy, a stability program based on exchange rate and brings solid limitations to net domestic assets to the CBRT was started to be implemented in December 1999. Implementation results of year 2000 of medium-term program are quite positive in growth, inflation and public financing fields. However, risks occurred in current account balance, capital movements composition, meeting the inflation target, value of TL and in the maturity structure of assets and liabilities of banking sector. These developments led to concerns in international markets. The troubles experienced in the implementation of structural measures, loosening of the implementations pertaining to monetary and fiscal policies and/or loosing of the harmony led to the increase of current risks and the targets expected from the program could not be reached at. Furthermore, the facts that liquidity expansion is sourced from foreign resource inflow, high funding demand, stopping and even reversal of capital movements led to big pressures on domestic interest rates.

In 1999, important steps were taken in the banking sector to harmonize the legal and institutional arrangements with the changing circumstances and developments in the international standards. The Banking Law No. 4389 of June 1999 represents a key turning point. In line with international practices, this Law assigned the role of regulating, overseeing and supervising roles of the banking sector to the Banking Regulation and Supervision Agency, which enjoys administrative and financial autonomy. The public agencies responsible for regulating and supervising the banking sector have been merged under BRSA, and the Agency became operational actually on 31 August 2000, right before the November 2000 crisis.

During the 1990s, the intermediation role of banking sector to support production activities and channel resources to long-term investments has weakened. As a matter of fact, the share of loans in the total assets of the banking sector declined to 32.8 percent in 2000, from 47 percent in 1990. Likewise, the ratio of loans to deposits declined to 51 percent in 2000, from 84 percent in 1990. Concurrently, ratio of loans to GNP in Turkey remained at very low levels as compared with countries in similar category.

The factors that weakened the efficiency of the financial intermediation function of banking sector were:

- **Macroeconomic instability:** High and volatile inflation experienced in 1990s, fluctuations in growth rate and the vulnerable structure of capital movements increased the uncertainties towards future. It led to maturity to shorten for the investor and the savings owner and money substitution to increase in economy.
- **High Public Sector Deficits:** The increase in public sector deficits and financing thereof from high real interest as well as domestic markets caused banks to go far away from obtaining fund to real economy, instead they tended to finance public deficits. Arbitrage opportunity occurred by high real interests made attractive for banking sector to

borrow from abroad and finance public deficits, and resulted with the increase in FX open positions in banking sector.

- ***Distorting Effects of State-Owned Banks:*** Financial structure of public banks distorted significantly since duty losses were not paid in time, interventions which were in contrast to the economic activity, duties assigned other than essential functions and the weaknesses in management. The fact that public banks met their financing requirements from the market with short-term and high-cost caused their losses to increase gradually and made them instability factor in financials sector.
- ***Poor Risk Perception and Risk Management:*** In 1990s, no adequate development is ensured in banking pertaining to risk and corporate management and accordingly banking system became vulnerable against liquidity, exchange rate and interest rate risks. Furthermore, deposit insurance system as well as regulatory and supervisory structure made the said problem more heavier.
- ***Deficiencies and delays in the Adoption and Enforcement of International Standards for Banking Regulation and Supervision:***

Requirements to be met by persons and groups willing to have a bank and the weaknesses relating to granting license as well as the fact that entrance to sector is easy but revoking licenses is difficult led to problems. Delay of the discharge of the insolvent bank from the system with macroeconomic and political concerns made problems get worse.

Issues such as the insufficiency of supervision and surveillance mechanisms in the finance sector, the fact that granting blanket guarantee to deposit leads to moral hazard problems and to abuses made banking sector more vulnerable. The involvement of multiple institutions such as the UoT, CBRT, CMB, Prime Ministry, Court of Auditors, and Ministry of Finance has led to incoherence in the application

As a consequence, Turkish banking system has faced structural weaknesses such as inadequacy of own resources, small-scale and fragmented banking, high share of state-owned banks in the system, poor asset quality, over-sensitivity and vulnerability to market risks, inadequate internal control, and deficiencies risk management and corporate governance and transparency.

2 CRISIS PROCESS AND RESTRUCTURING ACTIVITIES

2.1 Emergence of Crisis and Crisis Management Process

Starting from November 2000, the problems of private and public banks with liquidity deficit started to cause speculations in the markets, eventually leading to the questioning of the sustainability of economic program being implemented. Due to the increased tension in markets, the demand for foreign exchange peaked starting from November 2000, TL liquidity decreased, and with the effect of the decreasing confidence of banks to each other, problems arose in the financial intermediation by the markets, resulting in the increase of overnight interest rates to three-digit levels.

Although the CBRT funded the banks which are in need of liquidity by undertaking the risk of FX reserve loss, stability could not be obtained in markets. Liquidity requirement of a medium-scale bank which took speculative position increased continuously and it had capital loss due to the increasing funding costs and the value loss of the government securities in its portfolio. Together with the additional economic measures, the markets cooled down by the transfer of the said banks to the SDIF in the beginning of December and the reserve losses of the CBRT stopped.

In this process, the following issues were performed by the BRSA; made efforts in order to abstain from behaviors and attitudes which damages the confidence to the sector and stability, leads to dignity risk, being in unity and integrity, brought flexibility to current value implementation of securities, brought the obligation of capital requirement calculation for also market risks comprised of interest rate risk, Exchange rate risk as well as stock risk and determined the principles and procedures relating to risk management system of banks.

Although the effects of liquidity crisis of November 2000 faded in the second week of December, the tension in the markets could not be fully eliminated despite the measures taken. As a matter of fact, triggered by the political tension experienced in February 2001, the confidence in the sustainability of stabilization program vanished, and both foreign and domestic residents started to demand foreign exchange intensively. The CBRT initially tried to limit TL liquidity released to the market in order to defend the exchange rate regime and prevent the loss of reserves, however overnight interest rates exceeded 1000 percent as a result of this practice.

The vulnerabilities in the banking system prevented the efficiency of the CBRT's monetary policy and liquidity management during the crisis. In particular, the payments system had collapsed due to the failure of public banks to fulfill their obligations in the money and capital markets and money markets suspended transactions. Therefore, floating exchange rate regime was introduced on February 2001, and Turkey, faced the most severe economic and financial crisis in its history due to the banking sector and debt roll-over problems.

Following the introduction of floating exchange rate regime, the CBRT reshaped its monetary policy according to the new economic environment. In this regard, a **gradual strategy of three stages** was followed according to order of priority, but rapidly. In the **first stage** of this strategy, the highest priority of the CBRT was to ensure uninterrupted operation of payments system as soon as possible and re-establish stability in money and capital markets the floating exchange rate regime. As a matter of fact, overnight borrowing amounts of public banks and SDIF banks was over USD 15 billion in the said period. The CBRT directly funded public banks and the SDIF banks through reverse repo transactions,

announced the overnight and weekly borrowing and lending interest rates and actively started transactions in the inter-bank money market and in the Istanbul Stock Exchange (ISE) Repo- Reverse Repo Market, which is a secondary money market for Turkey, and did not allow money market interest rates to go beyond the announced band. Thus, at least short-term interest rates were realized at the level of the CBRT policy interest rates. The CBRT also announced to the public that it would take all necessary measures to ensure that each bank fulfills its obligations in the ISE Repo – Reverse Repo Market.

In the second stage of crisis management strategy, the UoT and the CBRT decided to carry out a coordinated operation in order to eliminate the pressure of the said banks on money markets and deposit interest and to find a permanent resolution to the problem. To this end, in April, UoT issued government bonds to the public banks and the SDIF banks to cover the duty losses of public banks and the capital deficits of SDIF banks. A significant portion of bonds were purchased by the CBRT from public banks and SDIF banks, thus the liquidity needs of these banks were eliminated permanently.

A significant portion of the loans granted to Turkish Treasury by the IMF is started to be used in the financing of domestic debt payments. Thus, TL liquidity is ensured to market via the CBRT operations and Turkish Treasury also ensured liquidity to the market. Extraordinary level of liquidity providing to the market led to pressures on exchange rates.

On the other hand, capital outflow abroad, reverse currency substitution occurred due to the lack of confidence, open FX positions of banking system and real sector also led to additional pressure on exchange rates. Therefore, consistent with the floating exchange rate regime, the CBRT commenced scheduled foreign exchange sales through auction method to meet some of the demand for foreign exchange aiming at avoiding potential over-fluctuations in exchange rates. Foreign exchange sales by the CBRT enabled a more efficient sterilization and supply of foreign exchange liquidity to banks without distorting the functioning of floating exchange rate regime.

The third stage of crisis management consisted of domestic debt swap operation of the UoT. FX open position of banking system both had pressure on exchange rates and held important risks pertaining to banking system and also threatened the financial stability. On the other hand, due to the economic uncertainties, debt maturities of Turkish Treasury shortened quietly and debt roll-over became an important problem. In order to reduce the risks of banking system and extend the maturities of banks debts, the UoT undertook an operation to trade short-term TL-denominated bonds with a package involving long-term USD-indexed and long-term TL-denominated bonds in mid-June 2001. This operation was conducted through auction method to reflect the market conditions.

As a result of these operations, concerns over financial stability reduced remarkably and during the implementation process the CBRT closely cooperated with the UoT and BRSA.

2.2 Reform Studies After the Crisis

2.2.1 Macro Policies

Following the crisis experienced, economic policies determined for the rest of 2001 and for 2002 are submitted to the IMF via a letter of intention on May 03, 2001. The said program has the nature of the continuation of the program supported by the *stand-by* arrangement made with the IMF in end-1999. The fundamental goal of the program is to remove the

insatiability occurred due to the crisis and to establish a framework enabling the sustainable growth by decreasing the inflation in long-term. The targets determined are; to restructure the banking sector in a manner to have a strong relation with real sector, to make public financing have a strong balance in the future and to form the legal framework which will enable the structural reforms.

As regard to the strengthening of finance policy implementations, the most important macro policy target required by the program was to have non-interest surplus amounting to 6,5% of the GDP. In order to achieve it, income should be increased and the expenditures should be made under a discipline. Monetary policy was framed as the implementation of floating exchange rate regime, limiting the inflationist impacts of the rapid depreciation in Turkish Lira, targeting the money base to be consistent with the inflation target and foreseen output growth in the transition period and to achieving net international reserves and net domestic assets targets.

The fundamental features of the period after 2002 are; the structural reforms supporting free market economy and budget discipline, implementations towards a sound banking system, price stability-focused Monetary policies and as a result of these developments the stable and high growth due to rapid-decreasing inflation and real interest as well as the significant diminishing of the fragility against the external shocks. As a matter of fact, while average growth and average inflation were 2,9% and 75,9% respectively in 1991–2001 period, the average growth increased to 6,8% and the average inflation decreased to 13,9% in 2002–2007 period and the fluctuation of these two data diminished significantly.

2.2.2 The Banking Sector Restructuring Program

The Banking Sector Restructuring Program (BSRP) announced on May 15, 2001 **focused on the intermediation function and aimed at transitioning to an internationally competitive banking sector which will be resilient to internal and external shocks**. The priorities of BSRP were identified as recovering the destructions caused by the 2000-2001 crisis in the banking sector and building a strong base for the system by clearing it from weak banks.

The activities undertaken can be classified and summarized as follows:

1. Public banks had been restructured –with the ultimate goal of privatization.¹

• Financial Restructuring

- a. The duty losses which amounted to USD 17.5 billion as of end 2001 was liquidated and the arrangements leading to duty losses were abolished. The practice of budgeting the resources for subsidies to be provided via public banks started and these resources was transferred to banks before actual disbursement. Interest was accrued on duty loss receivables as of December 31, 2000 and Special Issue Government Bond amounting to a total of TL 22,9 billion was issued.
- b. The short-term liabilities of private banks and non-bank sector, which amounted to USD 8.4 billion, were zeroed.
- c. In order to strengthen their capital structures, a capital support of USD 3.5 billion, most of which was formed of securities, was provided to public banks as of end-2001. Therefore, their total paid-up capital increased by TL 2,9 billion when

¹ Includes Ziraat Bankasi, Halk Bankasi and Emlak Bankasi.

compared to December 2000 to TL 3,4 billion in August 2003 and their total equities increased by TL 7,1 billion to TL 7,8 billion in the same period.

- **Operational restructuring**

- a. Since public banks could not fulfill their banking functions in the crisis period, with a new law², the status of Ziraat Bankası, Halk Bankası and Emlak Bankası was converted to corporation and they have been subjected to the provisions of the Banks Act and commercial code. Furthermore, all the laws and decrees which create duty loss for the said banks were provisioned to be revoked by the Act.
- b. Within the structure of operational restructuring, the management of Ziraat Bankası and Halk Bankası were transferred to a joint executive board, and the board was authorized to prepare public banks for restructuring and privatization.
- c. Within the framework of restructuring and privatization preparation plans, the organization, technology, product, human resources, loans, financial control, planning, risk management and service structure of public banks were redesigned for alignment with the requirements of modern banking and international competition.
- d. As of September 30, 2003, about 27% of total personnel of public banks was retired. Besides, 32.5% of the branches closed and about 50% of the personnel was transferred as of September 30, 2003 in order to decrease the number of branches and the transfer of manpower surplus to other public institutions.

2. The banks transferred to the SDIF were resolved quickly through methods such as merger, transfer, sales and liquidation.

Deposit insurance limit which was implemented on various scopes and amounts till 1994, was turned into blanket guarantee as a result of the crisis experienced in 1994 and continued till 2000, and limited guarantee was started to be implemented again in 2000. Together with the crisis experienced, blanket guarantee was implemented and then as of July 2004, limited guarantee was implemented again³.

- **Financial restructuring**

- a. The short-term obligations to the financial institutions other than the CBRT which was TL 5.2 billion as of March 2001 had been zeroed. Short term obligations to the CBRT which amounted to TL 2.6 billion on the same date had been zeroed in 2002⁴.

² Law on Türkiye Cumhuriyeti Ziraat Bankası, Türkiye Halk Bankası Anonim Şirketi and Türkiye Emlak Bankası Anonim Şirketi Nr. 4603 published in the Official Gazette dated November 22, 2000 and Nr. 24238.

³ Full insurance to deposit built up for preventing crisis due to the termination of operating license of 3 banks in 1994 is applied almost 10 years. It is declared that deposit insurance shall be terminated gradually in June 2000 within the scope of harmonization to EU. According to the program, it was foreseen that guarantee up to TRY 100 billion shall be given until the end of 2000 and the upper limit shall be decreased to TRY 50 billion in 2001. However, according to the announcement made in December 6, this practice ended and although there are not any regulations concerning direct deposit insurance, regulations which are indirectly concealed guarantee have been prepared. Concealed guarantee application consists of the entire recorded off-balance sheet transactions of the banks taken over by the SDIF and this application ended in 2004. Savings deposit in Turkish Lira terms opened by natural persons in domestic branches of banks which operate and are authorized to receive deposit in Turkey as of July 2004, participation funds and gold, repos and foreign exchange account in saving deposit quality belonging to natural persons are within the scope of limited deposit insurance up to TRY 50.000 (around USD 32.856). Furthermore, since 2003 banks began to pay insurance premium according to the risk they created within the banking system, risk-based insurance premium tariff practice has been adopted in order to encourage to take risk at low levels and to be in harmony with prudent regulations. As of the end of 2008, 28.3% of total sum of deposit is insured at TRY 128.7 billion (USD 84.6 billion). Total number of depositors are 68 million, 92.4% of this sum is insured.

⁴ Total of special order bonds issued from UoT to SDIF is TRY 24.6 billion as of July 31, 2003..

- b. The foreign currency open positions of the SDIF banks which was about USD 4.5 billion till May 2001 had been reduced through the injection of foreign exchange-indexed government bonds made in May to USD 561 million.
- c. Total losses of the banks whose management and control was transferred to the SDIF was about USD 23.2 billion as of their transfer dates. The Fund follows up receivables of 21 majority shareholders as of end-2008 and repayment contracts (protocols) were signed with 17 of them. 5 of the protocols signed were closed as the receivable was collected from the majority shareholder. Total of the collections made from bank majority shareholders both within the scope of protocols and out of protocols reached to USD 12.618 billion as of end-2008.
- d. An approximately USD 3 billion of the deposit of the SDIF banks had been transferred to other banks through auction, by issuing Government Domestic Borrowing Bonds. This practice is unprecedented in the world, given its size and efficiency.
- e. The non-deposit FX liabilities of the SDIF banks which amounted to USD 2.4 billion had been transferred to public banks.
- f. 10 of 22 banks which were taken over by the SDIF had been regained to the sector through sales in a short period. 8 banks were resolved through merger and transfer. 2 banks are still under bankruptcy and liquidation process and there is 1 transition bank under the structure of the SDIF.
- g. In order to protect viable corporations and enhance the ability to collect SDIF receivables, repayment contracts have been signed with the debtors other than the majority shareholders.

• **The Resolution Activities of the SDIF**

The resolution methods used by the SDIF vary depending on the method by which the bank was transferred to SDIF. For banks transferred to SDIF through abolishing their operating licenses; deposits covered by guarantee were paid and bank liquidation process was conducted through bankruptcy. The banks transferred to the SDIF without abolishing their operating licenses were put up for sale following their rehabilitation by using various methods including augmentation of reserves, capital increase, depositing and abolition of penalty interests originating from legal provisions and general liquidity obligations.

The collections from the resolution of the SDIF banks amounted to USD 18 billion as of end-2008, of which 90% was collected after 2004, which is attributable to the autonomy of the SDIF and regulations introduced.

Table 2-1: Resolution of Banks Transferred to the SDIF

Banks	Type of Transaction	Assets (**)		Personnel (**)		Duty Loss	Resolution Period	
		TL Million	%	Number	%	USD Million	Month	
Banks Merged								
1	Egebank A.Ş. (*)	Merger	795	0,8	1.990	1,2	1.220	13
2	Yurtbank A.Ş. (*)	Merger	332	0,3	563	0,3	656	13
3	Yaşarbank A.Ş. (*)	Merger	823	0,8	1.626	1,0	1.149	13
4	Bank Kapital T.A.Ş. (*)	Merger	89	0,1	538	0,3	393	3
5	Ulusal Bank A.Ş. (*)	Merger	312	0,3	251	0,1	524	2
6	Interbank A.Ş.	Merger	1.112	1,1	1.320	0,8	1.269	29
7	Esbank A.Ş.	Merger	948	0,9	1.898	1,1	1.113	18
8	İktisatBankası T.A.Ş.	Merger	685	0,7	1.339	0,8	1.954	9
9	Kentbank A.Ş.	Merger	899	0,9	1.766	1,0	681	6
10	Etibank A.Ş.	Merger	826	0,8	2.035	1,2	698	14
11	EGS Bank A.Ş.	Merger	510	0,5	1.004	0,6	545	6
12	Toprakbank A.Ş.	Merger	3.541	2,0	2.458	1,7	880	10
Banks Transferred to Public Banks								
13	Pamukbank T.A.Ş.	Transfer	4.942	1,9	4.040	3,2	3.618	29
Transition Banks								
14	Bayındırbank A.Ş.	Transition B.	259	0,2	486	0,3	116	-
Banks Sold								
15	Bank Ekspres A.Ş.	Sales	311	0,3	629	0,4	435	30
16	Demirbank T.A.Ş.	Sales	2.503	2,3	4.225	2,4	648	10
17	Sümerbank A.Ş. (*)	Sales	447	0,4	1.407	0,8	470	20
18	Sitebank A.Ş.	Sales	25	0,0	97	0,1	53	6
19	Tariş Bank A.Ş.	Sales	185	0,1	526	0,4	74	16
Banks under Liquidation								
20	Kıbrıs Kredi İstanbul Şubesi	Bankruptcy	1	0,0	22	0,0	0	-
21	T. İmar Bankası T.A.Ş.	Bankruptcy	1.158	0,5	1.521	1,2	5.933	-
22	Türk Ticaret Bankası A.Ş.	Voluntary Liquidation	677	0,6	3.664	2,1	778	-
Total			21.378	15,5	33.405	21,0	23.205	14

(*) Merged under Sümerbank A.Ş. and sold to Oyak Group in 2001.

(**) Reflects year-end balance-sheet value in the previous year before resolution and the shares in total of the said year. Therefore, amounts belonging to total shows the total of values and ratios belonging to different years.

3. Private banks have been equipped with a sound structure.

- Scheduled letters of guarantee were taken from bank owners and shareholders and capital increase amounting to USD 2.7 billion was provided in 2001–2003 period.
- The fact that the recession in economy continued after the crisis, the inconsistency in global economy increased, negative conditions limited the possibility to turn fixed assets into cash and the increase in inhibition of investors towards the sector increased the capital requirement and limited the new capital increase opportunities. As a result, following measures are taken towards private banks; (1) strengthening of capital structure thereof which had erosion by also providing public support, (2) resolution of bad assets problem in banking sector via Istanbul Approach and asset management companies.⁵
- Triple audits had been performed in 26 private banks, and standard reports laying down their financial position as of December 31, 2001 was prepared. All private capital commercial banks pass that passed the three-step audit were entitled to a support in the form of participation in tier-1 capital or provision of tier-2 capital, for only one time subject to certain conditions, in order to strengthen their capital structure. As a result, 3 banks including one public bank was identified to be in need

⁵ “Law on Restructuring of Debts to Financial Sector and Making Amendments to the Some Laws” Nr. 4743 entered into force in January 31, 2002.

of capital. For one bank with capital deficit, the SDIF has allocated tier-II capital so that its capital adequacy standard ratio reaches 9 percent, and the necessary procedures were completed on 26 August 2002. Capital deficit of the other bank was covered by its shareholders in cash. Time-bound letters of commitment received from bank owners and shareholders, and a capital increase of USD 2.7 billion was ensured during the period 2001–2003.

- d. The tax barriers before the growth, through merger, of banks whose own funds have eroded and face difficulties in surviving in an environment of low inflation were removed. Tax incentives were introduced for the transfer and merger of banks and their affiliates, which yielded positive results. The total asset size of bank mergers and acquisitions during that period was around USD 26.5 billion.
 - e. License to carry out banking operations and accept deposit of İmar Bankası was revoked in June 2003 and the management and control of the bank was transferred to the SDIF. It was determined that there were off-the-record transactions in the Bank, there was difference between the actual deposit total and the deposit notified to public authorities, there existed deposit brought from İmar Off –shore to Turkey, unlicensed and open sales of government security, legal cuttings made from deposit interest were notified lower and it was appeared that there existed deposit about ten-fold more than the amount notified by the Bank to public authorities. New resource was allocated with a legal arrangement for the insured deposit payment in such an amount which was impossible to be met by the SDIF's resources. Deposit owners was started to be paid under the scope of insurance in 2004 and a total of **TL 8.6 billion** was paid to **398.632 depositors** as of end-2008. Pursuant to the regulation made in order to remove the grievance occurred due to sales of unsecured government securities of the Bank, a total of TL 902 million has been paid to deposit owners (a total of 21.909 persons).
- 4. Legal and institutional arrangements had been introduced to increase efficiency of regulation and supervision in the banking sector and establish a more efficient and competitive structure for the sector.**
- a. Regulation, oversight and supervision practices were largely aligned with the EU directives, international regulations and recommendations.
 - b. Banks were required to establish and operationalize an efficient internal audit and risk management system, balance sheets became more transparent thanks to inflation accounting, and strong shareholders equity was encouraged instead of weak shareholders equity, the transparency of bank balance sheets was increased, alignment with international accounting and reporting standards was achieved, the scope of off-shore banking activities was expanded, the supervision and regulation of these activities have been made more stringent, the transfer and merger of banks were encouraged, risk concentration in loans and the channeling of bank resources to certain groups were prevented, timely and accurate preparation, reporting and disclosure of financial statements containing consolidated and non-consolidated

information were ensured⁶, and independent audit standards were harmonized with international audit standards.

- c. A single data base was established for banks in 2002, an efficient reporting infrastructure was developed, and the practice of administrative fines for those who make erroneous reporting was introduced.

5. Resolution of Bad Assets: Istanbul Approach

The Law No. 4743 allowed the companies that could not pay their debts to banks and other financial institutions due to the 2001 economic crisis, to restructure their loan debts and obtain additional funding as necessary, to maintain their operation. Istanbul Approach was applied between June 2002 and June 2005, and a total of 318 companies -217 large and 101 small scale companies- were allowed to restructure their loans amounting to USD 5,960 million in total. The amount of loans restructured accounted for approximately 16 percent of the total gross loan volume of banking system as of end-2002.⁷

Total cost of the restructuring of banking sector exceeded 1/3 of the national income and realized as USD 53,6 billion⁸. Turkey overcame the crisis rapidly. Despite the elections and political inconsistencies, the economy grew by 6,2% in 2002. The fundamental reasons for this rapid recovery are; efficient crisis management strategy including maximum inter-agency convergence, restructuring of banking system rapidly and in a determined manner, comprehensive stability program as well as reimplementation of the reliance rapidly.

During and following the implementation of economic programs, cooperation is made with international institutions, primarily with the IMF and World Bank and experiences of equivalent authorities of the USA, Canada and England are enjoyed. Financing facility amounting to USD 9.9 billion obtained from the IMF contributed to the liquidity increase in the market in 2001.

2.3 Sector-originated Activities

In the aftermath of the restructuring process, the concept of mergers and acquisitions, strategic investment, competitive environment, organic growth, financial innovations, technologic infrastructure, access to international financial markets, institutional capacity, expansion of risk management culture, evolution of the culture of doing business and improvement of human capital became the key focus areas.

During this process, the share of global capital was increased, and in addition to the horizontal mergers in the sector, strategic investments were made in medium and large-size local banks. The market dynamics created by restructuring and the search for economies of

⁶ "Accounting Practice Regulation" and eighteen communiqués concerning this, is regulated largely in harmony with the international accounting standards and entered into force as of July 1, 2002. Subsequent to these regulations which are reformative in financial reporting of banking sector, international accounting standards began to be applied in Turkish banking sector.

⁷ Istanbul Approach Practice Results was prepared by the Banks Association of Turkey Financial Restructuring Coordination Secretariat and included in the working report titled as "Istanbul Approach a Restructuring Experience" and dated August 2005.

⁸ Analysis cost of 2001 banking crisis; operation loss of state banks was USD 19 billion, capital support made to state banks was USD 2.9 billion, analysis cost of SDIF banks was USD 22.5billion (USD 17.3 by state, the remaining sum by private sector), quasi-cash credit support was USD 0,1 billion, capital base strengthening cost of private banks was USD 2.7 billion and cost of İmar Bankası was USD 6.4 billion (Ratio of analysis to GDP which is USD 53.6 billion was 34.2%)

scale encouraged the mergers and acquisitions.⁹ The efforts for reaching out more customers led to an increase in the number of branches, staff, ATM and POS machines to levels beyond the EU averages. The sector has strengthened itself in the sense of doing real banking business, by attaching importance to retail customers as much as they do to corporate customers.

The efforts for growing in a competitive environment have brought along the use of technology and thus efficiency and effectiveness gains in the sector. Banks have chosen to outsource some of their services to benefit from flexible solutions in business processes as well as cost-efficiency. The sector comprehended the importance of specialization in banking and searched for capturing relative advantages in certain services through product differentiation. The banks that managed to strengthen their financial stance increased their brand equity and gained easier access to funds in international borrowing markets.

⁹ Accordingly, while there were 10 mergers in Turkish banking sector which created a significant change in capital structure in 2001-2007 periods, there was 14 share transfer transaction. Banks subject to transaction in 4 of merger and transfer transactions were development and investment banks, 20 were deposit banks.

3 NEW FINANCIAL ARCHITECTURE AND STABILITY

3.1 Banking Law and New Regulations

The Banking Law which constitutes a infrastructure of the second structural transformation¹⁰ has formed an important opportunity for ensuring the financial stability, developing the sector, strengthening of supervision, implementation and regulation framework, protecting the rights and interests of depositors, strengthening the corporate ability, and envisaged a new financial structure towards future.

All licensing transactions of banks including establishment and activity permissions have been devised as a part of comprehensive, open and prudential supervision and within the framework of the principles of conformity and honesty. Activities of banks relating to corporate government, internal audit, risk management and internal control have started to be implemented in parallel with the international standards. All prudential regulations, primarily the ones relating to capital adequacy and deposit insurance have been tightened by amendments and updates. Regulations relating to accounting, financial reporting and independent audit have been made fully compatible with international standards.

The practice of installment for credit card receivables by banks has caused excessive increase in credit volume and credit risk in markets, and therefore these receivables have been made subject to higher risk weights (150%/-200%) depending on the installment maturity.

Another structural reform realized after February 2001 crisis has been the amendments made to the CBRT Law. With the legal changes made in May 2001; the CBRT has been forbidden to lend to public starting from November 2001, administrative independency of the CBRT has been guaranteed, the fact that the fundamental goal of the CBRT is price stability has been clearly stated and the CBRT has been furnished with instrumental independency. Following these legal amendments, the fundamental priority of the CBRT is to ensure financial stability in financial markets, and to prevent the liquidity in extraordinary amounts provided to markets with this aim from giving rise to bounces in inflation.

3.2 Enhancing the Corporate Capacity

The regulation, supervision and implementation capacity of the BRSA has been increased in the crisis and following period. Supervision domain of the Agency has been expanded in order to include financial holding companies and financial leasing, factoring and financing companies and **thus consolidated supervision has been furnished with a more integrated structure.**

Strategic management approach has been adopted for agency activities, and the first strategic plan has been started to be implemented¹¹. Organization structure of the Agency has been revised in order to increase the coordination and synergy; **thus a flexible structure necessitated by the expansion in domain of duty and services** is furnished,

¹⁰ Published in the repeated Official Gazete dated November 01, 2005 Nr. 25983.

¹¹ By "The BRSA Strategic Plan 2006-2008" which was announced and started to be implemented in June 2006, the mission and the vision of the Agency have been defined and five strategic goals and related 13 strategic targets were determined for the three year period.

and a more integrated structure in which the same units carry out supervision and off-site surveillance has been established.

As regard to improvement of regulation process; **taking views of all related parties and publicizing the regulation drafts** have been made institutional within the process, **economic and social impacts of regulations have started to be analyzed**, and special attention has been paid to informing the public on the process and ensuring transparency.

In order to enhance the supervision and monitoring capacity of the Agency; first of all organization and functioning of **audit** have been revised and on-site audit teams have been strengthened by the participation of all professional staff besides sworn bank auditors. Furthermore, reports, evaluations and products prepared within the scope of off-site monitoring and other activities have started to be shared with audit units more effectively.

Supervision process has been enriched with the risk-focused supervision approach (RFS). RFS is carried out by taking as basis the supervision type, scope, time, intensity, resource allocation and supervision procedures, risk profile as per each bank's scale and complexity level as well as the existence of internal audit and risk management systems, sufficiency and efficiency thereof; new, flexible and proactive audit techniques are used.

The UFIRS (Uniform Financial Institutions Rating System) which is also known as **CAMELS** and subjects each bank to a rating compound with the parameters such as capital adequacy, asset quality, management ability, income/expense balance, profitability, liquidity and sensitivity to market risk **has been launched**.

In the field of information systems audit; legislation infrastructure has been formed, audits through independent audit companies have been started, principles relating to information systems infrastructure and management have been published, and audit teams formed within the structure of the BRSA have been functionalized. A **comprehensive data base comprised of data collected through a single channel from the institutions** was formed in 2002 and as of 2007 administrative fines started to be applied to banks which make defective reporting.

Human resource of the Agency was strengthened, publications has been enriched in terms of frequency, content and type, new internet site has been opened for use, information resources, primarily electronic data bases and periodical publications have been enriched, and uninterrupted access to them has been ensured.

3.3 Policies Towards the Implementation of Financial and Economic Stability

Three fundamental factors for the permanent price stability are financial discipline, continuation of structural reform process and ensuring financial stability in financial markets. Furthermore, an efficient and sound banking system increases the financial sector – real sector interaction and strengthens money policy transfer mechanism, thus enhances the efficiency of money policy.

Strategies implemented by the CBRT may be listed as; (a) Providing unlimited liquidity facility to the banks in need of end-day liquidity requirement provided that it is collateralized, as being last resort of the liquidity in Inter-bank Money Market, (b) Providing liquidity facility to primary dealer banks up to 10% of the portion they took from the UoT, (c) Interest payment to their required reserves, (d) Warning the markets against inflation and exchange rate risk continuously, enhancing the use of hedging instruments, (e)

Measures for the prevention of fluctuations stemming from external shocks such as war and terrorist attacks and providing liquidity support.

Banks have been warned for not dealing with bad derivative products except hedging transactions. Efforts have been made to build up buffers by tightening regulations during the boom periods of economies, and to loose the legislation by gradually releasing the requirements during crisis periods. Accordingly;

- Target ratio has started to be implemented to all banks under current circumstances in November 2006¹².
- In case that dividend to be obtained in 2008 is planned to be subject to distribution, the banks are notified about the fact that dividend shall be subject to distribution in the case that application is made to the BRSA with the reasons and if permission is given. Dividend distribution of banks whose capital adequacy ratio decreased significantly and which grew rapidly are not allowed.
- In order to develop the lending opportunities of banking sector by also considering the household's ability to pay, provisions to be set aside by Banks were loosened by the amendment made to the Regulation on Provisions.

Financial Sector Commission¹³ which was **formed** in order to ensure the confidence and stability in financial markets, information exchange, inter-agency cooperation and coordination, making common policy recommendations and to declare its views on the issues relating to the future of finance sector. A Coordination Committee¹⁴ was formed in order to increase the cooperation between the BRSA and SDIF. Furthermore, the work for updating the protocol regarding the cooperation and information share between the BRSA, SDIF, UoT and CBRT is in final stage.¹⁵ **Memorandum of understandings have been signed with equivalent supervision authorities of 16 countries**¹⁶ until today for cross-border cooperation and information exchange. **FSAP-Turkey studies** have been carried with the cooperation of the WB and IMF. Consumer Complaints Arbitration Panel within the Banks Association of Turkey in order to resolve the problems between banks and customers.

General provisioning ratios which were as 0,5% for cash loans and 0,1% for non-cash loans in the abolished regulations have been tightened in the Regulation on Provisions by being determined as 1% for Group 1 cash loans, 0,2% for non-cash loans; 2% for Group 2 cash loans and 0,4% for non-cash loans.

¹² The said target ratio has been determined as 12% by adding reserve interval by +4% to 8% which is the legal ratio, banks are decided to be warned about the fact that the banks which do not meet the target ratio will not be able to open new branches.

¹³ Financial Sector Commission which is formed under the structure of the Agency pursuant to Article 99 of the Banking Law Nr. 5411 and comprised of the representatives of the Agency, Ministry of Finance, Undersecretariat of the Treasury, CBRT, Capital Market Board, SDIF, Competition Board, Undersecretariat of State Planning Organization, İstanbul Gold Exchange, Securities Exchanges, Derivatives Exchange and associations of institutions makes meetings for at least one in six-months and submit information to Council of Ministers about the meeting results.

¹⁴ Pursuant to Article 100 of the Banking Law Nr. 5411, Coordination Committee was formed in order to share the required information general position of the banking system, measures to be taken as a result of the audits to be made by credit institutions, analysis results showing financial structure of credit institutions in order to be used in the calculation of risk-based insurance premiums and furthermore the information on number of accounts of deposit and participation funds of those banks, insured deposit and participation funds as well as total deposit and participation fund amounts; in order to ensure maximum cooperation between the Agency and the SDIF in the case that any transaction is required in the fields fall under the SDIF. The Committee meets, in the frequency determined by the parties to be for at least one in three months.

¹⁵ Relating to cooperation, information exchange and systemic risk, work is carried out for a new memorandum of understanding including the SDIF besides the said institutions and the draft prepared is under signing process.

¹⁶ Turkish Republic of North Cyprus, Albania, Romania, Bahrain, Indonesia, Kazakhstan, Pakistan, Malta, Greece, Kyrgyzstan, Azerbaijan, Bulgaria, China, Dubai, Georgia and Kosovo.

3.4 Structural Indicators of Banking Sector

During and after the restructuring program, the banking sector has entered a high and stable growth period, and the total assets of the sector, which was TL 104 billion in 2000, grew by seven-fold in 8 years and reached TL 733 billion. There has been a consolidation in the sector, and concentration has increased. With the success of the program, the weight of public banks in the system has decreased. The capital structure of the sector has strengthened; and the capital adequacy ratio which was 9.3 percent in 2000 rose to 18 percent as of end-2008. The profitability performance of the sector has improved and its asset quality has stably improved; while one fourth of loans were non-performing in 2001, the rate of non-performing loans fell below 4 percent in 2008. The financial intermediation has started to operate effectively, and the share of loans in the total assets of the sector rose to 50 percent in 2008, from 23 percent in 2001.

Table 3-1: Fundamental Indicators

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Total Assets*	36.8	72.1	104.1	173.4	212.7	249.7	306.4	406.9	499.7	581.6	732.5
Loans*	13.1	19.9	31.8	38.0	49.0	66.2	99.3	156.4	219.0	285.6	367.4
Securities Portfolio*	5.2	12.4	12.0	17.5	86.1	106.8	123.7	143.0	158.9	164.7	194.0
Deposit	21.8	43.4	58.9	110.4	138.0	155.3	191.1	251.5	307.6	356.9	454.6
Equities*	3.3	4.2	7.2	18.3	25.7	35.5	46.0	54.7	59.5	75.8	86.4
Number of Banks	75	81	79	63	54	50	48	51	50	50	50
Number of Branches	7,740	8,104	8,298	7,386	6,160	6,029	6,440	6,240	6,911	7,700	8,768
CAR (%)	13.00	8.24	9.29	20.78	25.34	30.93	28.24	23.73	21.91	18.94	17.98
Retail Loans / Loans	5.3	4.9	14.5	6.3	4.5	9.7	12.8	18.8	21.7	23.8	22.6
NPLs /Gross Loans	7.2	10.5	11.1	25.2	17.6	11.5	6.0	4.8	3.8	3.5	3.7
Loans /Deposit	60.3	45.9	54.1	34.4	35.5	42.6	52.0	62.2	71.2	80.0	80.8
Term Profit*	0.8	-0.3	-3.1	-10.5	2.9	5.6	6.5	6.0	11.4	14.9	13.4
ROA¹	2.1	-0.4	-3.0	-6.1	1.4	2.5	2.3	1.7	2.5	2.8	2.0
ROE	23.1	-7.2	-43.7	-57.5	11.2	18.1	15.8	12.1	21.0	24.8	18.3
FXNGP/Equities (%)²	N/A	N/A	N/A	N/A	N/A	1.1	-0.5	-0.6	1.0	0.3	-0.6
Tot. Ass.Share of First 10 B.	67.6	67.5	69.2	79.5	80.8	82.3	84.0	82.9	83.5	82.5	82.8
Share of Global Capital³	5.6	7.1	3.4	3.0	3.3	3.0	3.5	6.3	13.1	14.0	17.0
Funds from Abroad (\$ Bl.)	2.5	3.2	3.8	2.8	11.0	17.0	22.0	36.2	49.4	60.6	61.6

*Billion TL. Participation banks are included as of 2005 period.

¹ In ROA and ROE ratios, assets and equities are included in the calculation averagely.

² Foreign development and investment banks before 2002 are not included.

In ROA and ROE ratios, assets and equities are included in the calculation averagely.

³ The calculation in which 50% or more, bank's assets are controlled.

3.5 Strengthening the Real Sector

Various regulations were implemented towards increasing the role of private sector in economy and improving the investment environment within the scope of reform program¹⁷.

By the “**Anatolian Approach**” which started to be implemented in April 2007, insolvent SMEs are aimed to be regained to economy by restructuring their debts to financial sector¹⁸.

¹⁷ In order to increase international investments coming to Turkey and to rationalize the regulations in the field of international direct investments, the Law on Direct Foreign Investments Nr. 4875 was put into force. Law on Company Establishment which minimizes the required phases to establish a company and diminishing registration and company establishment transactions to one day was issued. By the regulations making important developments to opening company and working licenses, 52 documents required in licensing of constitutional working place decreased to 6 documents, and 43 documents required for non-constitutional working places decreased to 7 documents. Turkey Investment Support and Introduction Agency which will meet the corporate capacity requirement for introducing the investment environment and investment opportunities in Turkey was established. YOİKK (Investment Improvement Coordination Committee) Technique Committee Action Plans was formed in 2007 in order to furnish performance criteria to studies of YOİKK (Investment Improvement Coordination Committee) Technique Committee. Action Plans are updated each year pursuant to requirements and priorities of private sector and announced to public

105 of 120 companies which were taken under the scope are subject to FRS and restructured debt amount was TL 200.904 thousand as of February 2009.

3.6 Reflections of Global Crisis

Thanks to strong Turkish financial structure and the efficient and timely measures of the CBRT towards effective operating of money markets, the impact of global crisis on financial markets in Turkey was limited. The CBRT announced the measures it will take against the crisis as of October 2008. The measures taken are as follows:

- It is announced that the liquidity to be needed by the market will be provided effectively by 1-week repo auctions and volatility in O/N time secondary market interest rates will not be allowed.
- It is announced that, in case of liquidity shortage, maturity of repo auctions shall be lengthen to 3 months in order not to lead to problems in credit mechanisms, and if needed, government securities direct purchase transactions shall be realized.
- The CBRT started to perform intermediary transactions in the markets under its structure in order to prevent lack of confidence in FX depo market and increased FX-denominated lending to banks over the lending interest rates it announced.
- In case that excessive volatility is observed in exchange rates, floating exchange rate regime as well as FX sales auctions whose rules are announced in advance are started.
- Required reserve ratios were decreased in order to strengthen FX liquidity of banks.
- In case that a bank has liquidity problems due to fund withdrawals, the conditions for Emergency Liquidity Support credits to be obtained by the CBRT in addition to Standard liquidity opportunities are announced to public.

In order to ensure to transfer more resource to exportation sector, current exportation rediscount credit limit granted to banks by the CBRT was increased to USD 1 billion on December 05, 2008, and ease-of-use was brought to these credits. In addition, in order to minimize the negative impacts of the problems to be experienced in FX liquidity, FX required reserve ratio was decreased by 2 points to 9% from 11%. By this decrease made in FX required reserve ratio, additional FX liquidity amounting to USD 2,5 billion is provided to our banking system on December 12, 2008.

In order to limit the impacts of global crisis to sector, 2008 dividend distribution of banks was made subject to permission by the BRSA, flexibility is ensured in regulation on restructuring of loans and other receivables, financial assets were allowed to be classified under a different category, cash-flows sourced from FX-indexed financial instruments are considered in the calculation of FX liquidity adequacy, minimum liquidity level so as to meet sudden deposit withdrawals was implemented.

¹⁸ The Law on Restructuring of the Debts of Small and Medium-Scale Enterprises to Financial Sector dated 27/12/2006 Nr. 5569.

4 LESSONS TAKEN FROM THE CRISIS

As in the crisis experienced in Turkey in 2001, management of crisis arose especially in emerging countries due to the rapid changes in expectations and decisions of domestic and foreign investors requires the rather fast and resolute decisions are taken both in money and finance policies. Hence, policy decisions taken in crisis management created significant advantages in respect of their results.

Crisis experience in Turkey emphasizes the supplementary relation between macroeconomic and financial stability and satisfactory improvement procured by structural reforms. One of the most important reasons why the effects of global crisis on Turkey are limited and especially financial structure of the banking sector experienced no significant deterioration as yet are the new regulations introduced after the crisis in 2001. Accordingly, very tight limitations are brought to FX open positions, liquidity and capital adequacy ratios of the banking system. Although the achieved stable growth environment brought along a rapid credit growth, excessive risk-taking of the bank is prevented owing to the legal regulations and ratios of no-performing loans are rather low even in period where effects of the global crisis on or country became clear.

Crisis in 2000–2001 years states that an economy having structural problems in financial sector cannot steadily maintain fixed exchange rate regime. Twin crisis which appeared in Turkey as banking and money crisis stated that the structural problems in banking sector provided a basis for the constitution of the crisis.

Crowding out the high public borrowing requirement created caused the banking sector alienated from its main function, financial mediation, and a balance-sheet structure predominantly funding Treasury. Banks in this structure alienated from market discipline, could not perceive risk, policies increasing activity and competition became absurd. In this respect, imbalances in public finance created negative results on the sector.

Supporting liquidity management and the activity and flexibility of payments system of banks is critically important in avoiding problems in money markets. Because, in case there are problems in payment system, negative effects grow like snowball and it becomes hard to prevent speculations. Crisis and post-crisis stated the significance of market maker role of the CBRT in money markets. It is important that the CBRT to have high credibility to fulfill this role.

Turkey experience indicated the importance of the implementation of a comprehensive approach, without compromising, which aims to solve all the current and structural problems by **determining the quality and the dimensions of the problems that lead the sector to crisis**. Primary priority during crisis should be establishing the trust suffered erosion as soon as possible by means of the measures to be taken. Total consideration of the process was effective in the achievement of the systematic and totalitarian approach program. Crisis experience indicates the importance of agility and coordination in political decision-taking period is increased to the highest level possible, executing exclusive economy management, maintaining prestige and benefiting from the cooperation among international institutions during crisis. Financing and technical support of international institutions is important and it helps the establishment of international trust.

As understood from the **strong banking, strong economy** introduction definition of overcoming the crisis program introduced to the public, stability and soundness of the banking sector is as fundamentally important in preventing and managing the crisis as at least financial discipline, sustainable borrowing, manageable external deficit and correct foreign exchange system. Accordingly, during the transition period following 2000–2001, **structural reforms** which ensure overcoming the fragilities for banking sector that plays an important role in constitution of crisis became the engine of the economic growth and accelerated the overcoming the crisis process.

New financial architecture developed for maintaining the stability supported by structural reforms, is the primary factor in protecting economic stability and the economy to become more flexible and resistant against external fluctuations after 2006.

It is important that structural problems which increase fragility against crisis in banking are resolved and the regulations regarding the necessary measures are prepared. Furthermore, regulations should resolve the problems in banking sector permanently, not temporarily. It is critically important that authorities in sub-regulations are abided by the Law in order to increase the exercise power of the regulations. Regulations should not cause regulation arbitrage. Practicality of regulations should be based on impact analysis.

Intensive majority shareholder abuses in banks submitted to the SDIF displayed **the importance licensing process bears**. During the analysis of license applications, it is required that; quality and purposes of the entrepreneurs as well as the competition conditions in the market, risk management capacity of the applicant institution, internal processes and corporate management principles are evaluated fastidiously. Establishing a sound legal infrastructure in post-crisis period and reflecting the experienced learned from the crisis to this structure increased the power of the sector against possible crisis.

Crisis revealed that it is essential to monitor banks by means of early warning systems before they became problem banks instead of reactive practices during problem bank analysis process and proactive analysis strategies are practiced in the problem banks in a way providing maturity and cost activity. Delays cause the losses of problem banks and the problems to be reflected to other banks, consequently the costs the public shall undertake. It is deemed important that **analysis process is conducted rapidly and by assessing every single analysis alternative**. Delay in analysis may erode the market values of problem institutions and assets and increase the analysis costs in respect of tax payers. Rapid and determined procedure of the process contributed the ownership of the SDIF on the banks is finished in a little while and industry based solutions are formed.

It is deemed significant that **new solutions are developed in respect of conditions; creative solutions** not limited with only old experimented applications are produced. Concerning the analysis process, it is observed that current **political, geopolitical and macroeconomic ambiguities** influenced resolution attempts especially for the problem assets negatively and caused delays. Modeling when or under what conditions public cost shall be used, and these models are established in a way that they signal before crisis periods and consider all internal and external conditions are important. Thus, analysis is less costly, recovery is faster and effective.

Unlimited guarantee given at the appropriate time in order to end banking sector crisis and abolishing it when the crisis ends brought in operability to the market discipline. It is important that the balance between protection function deposit insurance brought and ethic risk it may create is established soundly. Having realized largely its target of collection of revenues concerning the banks taken over by the Fund, the SDIF focused more on the deposit insurance institution functions. Deposit insurance system is activated by credit institutions paying insurance premium according to the risk they created within banking system and taking risk at lower levels and practice of risk-based insurance premium tariff encouraging the adaptation to prudent regulations.

The importance of a **sound public finance structure** in overcoming the crisis is understood. While budget discipline and low public borrowing requirement ensures the collection of public resources, on the other hand it prevents the reactions in public and increases the success chance of the practice.

The BRSA, an administratively and financially autonomous institution, conducting the restructuring during crisis or after the crisis assisted the process is executed in an effective way. During resolution period, in cooperation with sector representatives, no bureaucratic obstacles were experienced. It is deemed significant for the financial stability that effective surveillance and supervision activities are conducted by an independent institution with extensive authorities. Extent and effect of the supervision activities are increased, information processing audit has begun. Establishing a risk management understanding adaptable to the international banking regulations and which ethical banking principles are adopted and establishing a more effective banking surveillance and supervision mechanism are required. Effective internal supervision, internal control and risk management systems are considered important.

Providing transparency and impartiality in all practices enabled the Turkey model becomes successful. Countries which want to adopt similar policies are advised to ensure they determine and announce the real conditions of their banks, publish financial reports periodically in sectoral basis and prepare publications informing the public about the program being carried on. Lack of information and rumors generally in crisis periods prevents the sound operation of financial markets. Therefore, the BRSA publishes the detailed data concerning banking system daily, weekly and monthly and brings the real information into use of those related and contributes to the transparency. Being at an equal distance to all banks, not favoring any bank are the rules of the game which all the banks realized. Three step audit in the re-capitalization period is in a stress test for the sector, being an important experience for transparency of balance-sheets of banks.

In order to prevent the repetition of crisis, **financial and operational re-structuring of banks** should be emphasized. The **problems experienced** in the financial structure of banks becoming systematic are an important factor for crisis to arise. Thus, it is significant that these problems are treated at the truly, at the right time and sufficiently. Public, if necessary, in order to prevent the problems in financial sector increase, should change securities in way to reflect market conditions, in case there are FX open-position in banking system balance-sheet or securities risky for balance-sheet. It is possible to decrease the speculations in markets by means of these measures.

Foreign exchange rate risk the private banks in the Turkish banking sector bear due to their open positions and own-funds of state banks which wasted away due to operation losses and daily high liquidity needs were effective in crisis to arise. These problems are removed by developing rapid policies against the problems of these banks concerning the termination of crisis. State and private banks are made strong by various capital increase policies; operation losses of state banks are liquidated, legal regulations are made to avoid new operation losses, number of branches and personnel of these banks became rational and they are ensured to operate in a similar structure as of private banks under market discipline.

In order to analyze the banks taken over by the SDIF effectively and as soon as possible, new organizational structuring within SDIF is adopted and non-performing loans, subsidiaries and real estates are analyzed under this structuring. Establishing **flexible organizational structures** increased the success in bank analysis.

Soundness of the activities Turkish banks perform by means of their abroad subsidiaries, abroad branches and representatives, effects the stability and reliability of financial systems of both our country and other host countries. Accordingly, it is important to be able to receive the right information in respect of evaluate, regulate and supervise the structure of abroad activities, connections with main the institution and to establish a corporate structure in international scope to facilitate cooperation in supervision and surveillance among countries.

Regulations on preventing economic units with no foreign exchange incomes to get into debt in foreign currencies prevented this sector to have open-position and problems Middle and East European Countries experience at the present day are not experienced in our country.

Sunny days in which risk appetite increased, expectations improved, surveillance and supervision activities and regulations should be tighten, legislation should be loosened in crisis. Aggregation should be made by tightening the regulations in boom periods in economies, while in crisis periods legislation should be loosed by slowly discharging the aggregations. Thus, to enable to decrease the problems rules should be loosened in periods in which expectations are failed.

Due to the strong connection with the real sector and banking sector, a problem experienced in one of them cause it is experienced simultaneously in the latter. Reforms having initiated to overcome the crisis in Turkey model enabled the real sector improve and grow in a little while. It is foreseen that the problems in real sector should be perceived as a result rather than a reason and the resolution should began in the financial sector. Furthermore, in a policy on banking sector, it is important to develop policies considering **the significant effects of real sector and banking sector one another** and willingness principle. It is important to develop simultaneous resolutions for problems in banking sector and real sector. Accordingly Istanbul Approach and Anatolian Approach were executed successfully.

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