

# Costs of EU Accession: The Potential Impact On the Turkish Banking Sector

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# Outline

- Structure of the banking sector and the impact of the crisis
- Restructuring strategy and results
  - Restructuring of the state banks
  - Resolution of the SDIF banks
  - Strengthening of the private banks
  - Improving the regulatory and supervisory framework
- A comparison of the Turkish and EU banks
- Foreign bank entry and impact on competition
- Compliance with the EU Banking Legislation

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# Pre-crisis structural problems

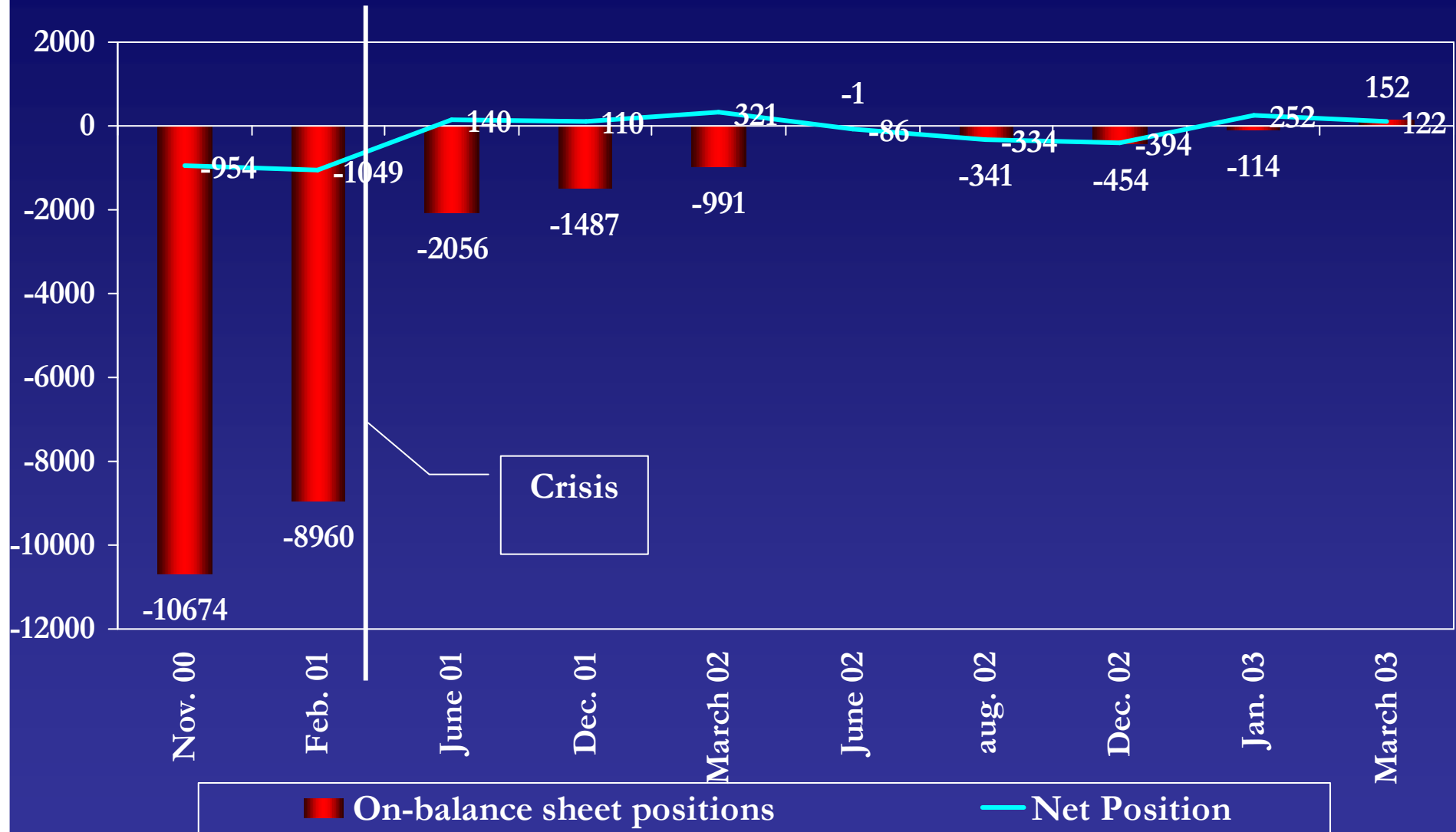
- **Small scale and segmented market structure**

	1980	1990	1999	2000
<b>Commercial Banks</b>	<b>31</b>	<b>54</b>	<b>62</b>	<b>61</b>
State	8	7	4	4
<b>Private</b>	<b>19</b>	<b>25</b>	<b>31</b>	<b>28</b>
Foreign	4	22	19	18
SDIF	-	-	8	11
<b>Invest. &amp; Dev. Banks</b>	<b>6</b>	<b>10</b>	<b>19</b>	<b>18</b>
State	4	3	3	3
Private	2	4	13	12
Foreign	-	3	3	3
<b>TOTAL</b>	<b>37</b>	<b>64</b>	<b>81</b>	<b>79</b>

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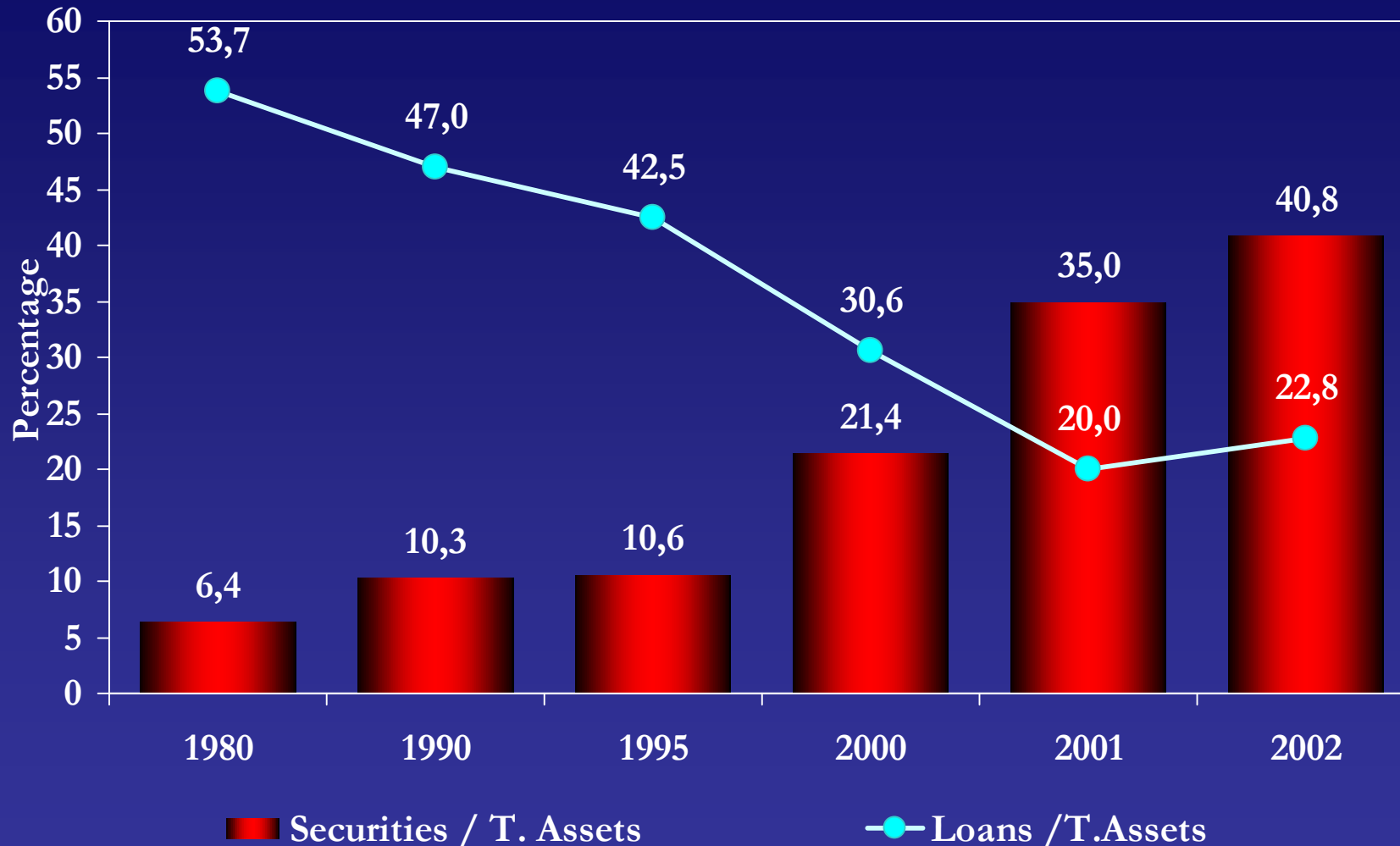
# Large FX open positions of private banks



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# Crowding out by government



Note: 2001 and 2002 data reflect the results of the three-stage audit process and are inflation-adjusted.

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# Summing up: Pre-crisis conditions

- Banks
  - Liquidity problems
  - State banks with over-night liabilities of \$14 billion
  - Large open positions of the 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

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# Banking and Currency 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**

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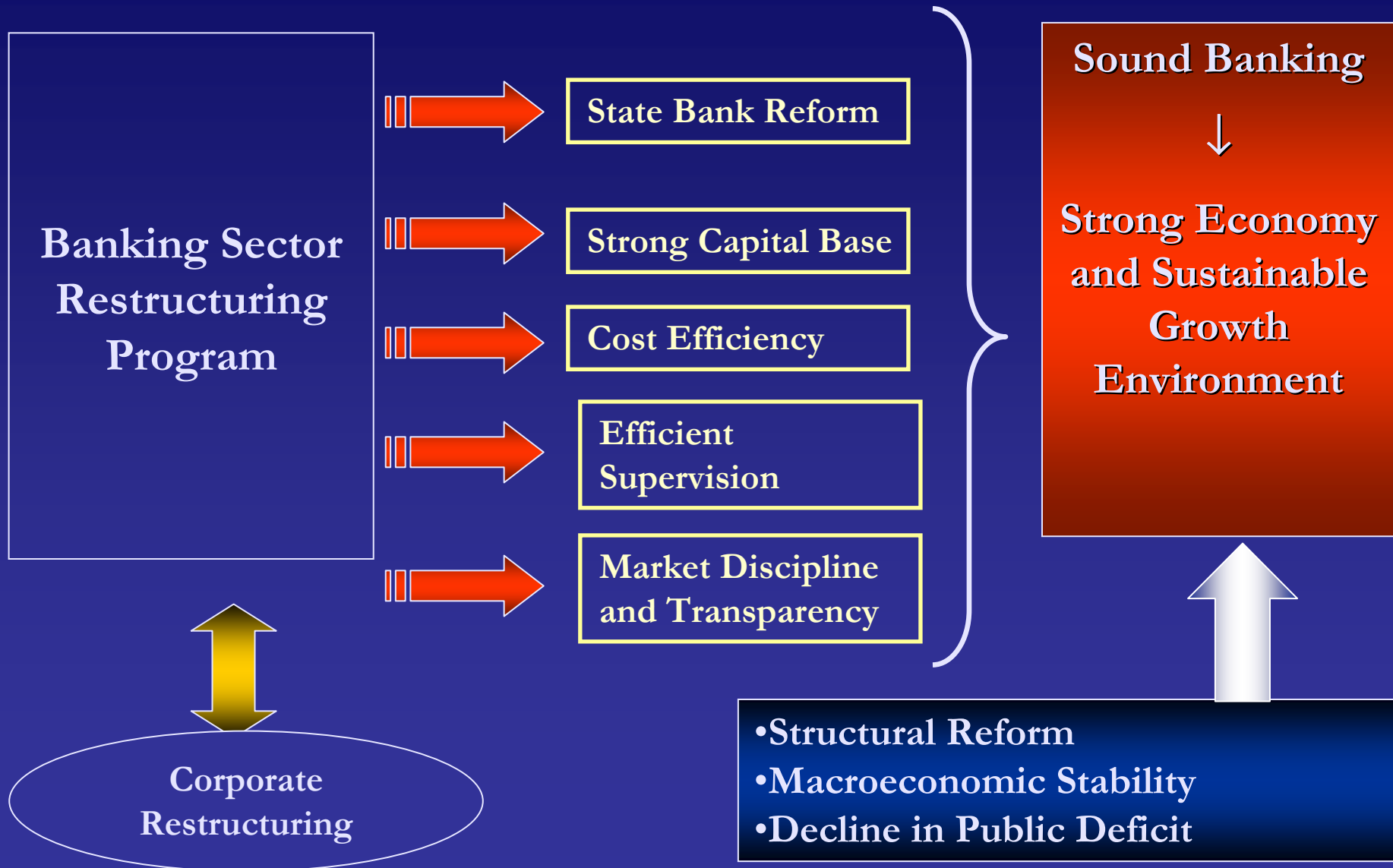
## But crises also provide opportunities for major restructuring

- 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**

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# Goal: Sound banking-strong economy





# Results of operational restructuring

- Consolidation in the banking sector

Number of banks declined from 81 in 1990 to 53 as of April 2003

- Decline in the share of the State and the SDIF banks

During 2000-2002 the share of these banks in total loans and deposits from 34.2% to 18% and 53.3% to 39.3%, respectively.

- Increase in mergers and acquisitions

Total asset size of the mergers and acquisitions that took place in the sector is around \$26.5 billion

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# Results of financial restructuring

- Reduction of financial risks to manageable levels.
- Improved transparency
- Improved profitability

**In 2002 private banks generated a profit of \$1.5 billion, state banks generated a profit of \$646 million**

- Strengthened capital structure

**CAR rose to 27.1% in December 2002 from 9.3% in December 2000.**

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# Improving the regulatory and supervisory framework

## Moving towards international standards

- **Regulations on capital**
- **Regulations on risk management**
- **Regulations on credit and subsidiaries' limits and loan loss provisioning**
- **Accounting standards and independent auditing**
- **Regulations on facilitating mergers and acquisitions**
- **Regulations on special finance houses**
- **MoUs with other countries supervisory authorities**

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# Turkey is not the first nor the last country to experience a financial crisis

Country	Crisis Period	Total Cost/GDP (%)
Spain	1977-1985	16.8
Japan	1990-	20.0
Indonesia	1997-	50.0
Malaysia	1997-	20.5
S. Korea	1997-	26.5
Mexico	1995	20.0
Argentina	1980-82	55.3
Brazil	1994-96	15.0-20.0
Turkey	1999-2002	13.7-26.5

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

	BillionUSD	Ratio to GDP (%)
State Banks Duty Losses	19.0	12.8
Capital Support to State Banks	2.9	2.0
Resolution of SDIF banks	21.7	14.9
-Public Resources	17.0	11.7
-Private Resources	4.7	3.2

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

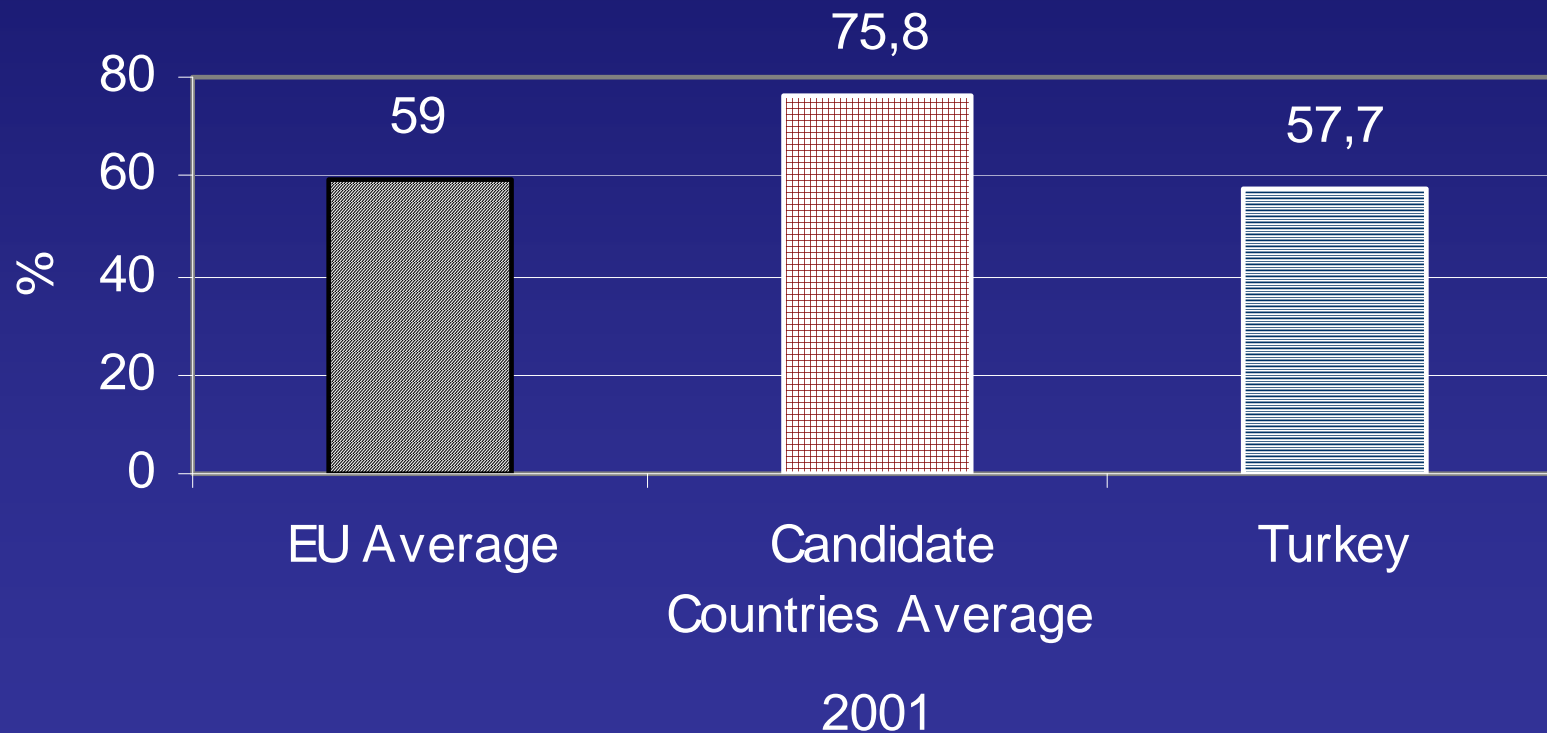
Thus, much of the costs of adopting international standards have already been borne. Annualized costs of \$4bn have been incurred which can be thought of harmonization costs.

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# Turkish banks have similar concentration ratios to EU average

Graph 1: Concentration Ratio of 5 Largest Banks (%)

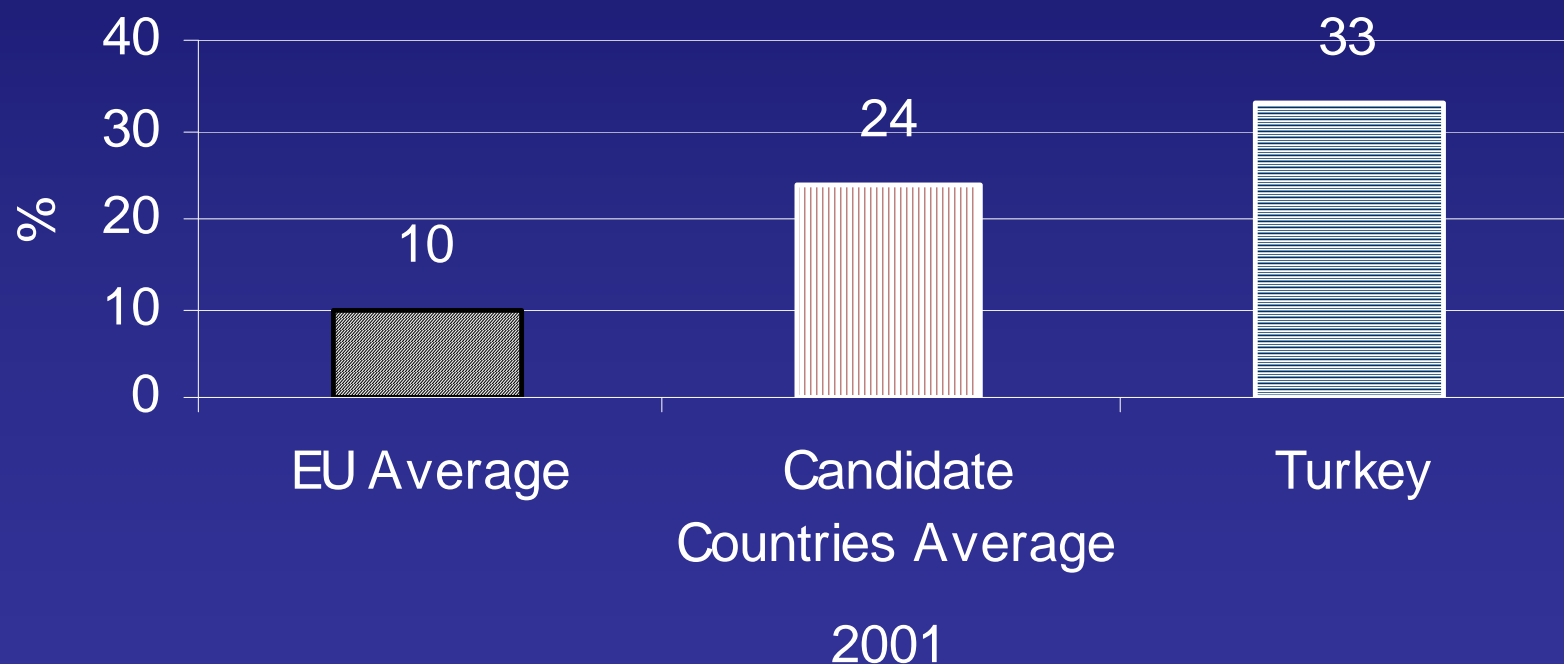


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# While the share of the state banks remain very high in Turkey

Graph 2: Public Share (%)

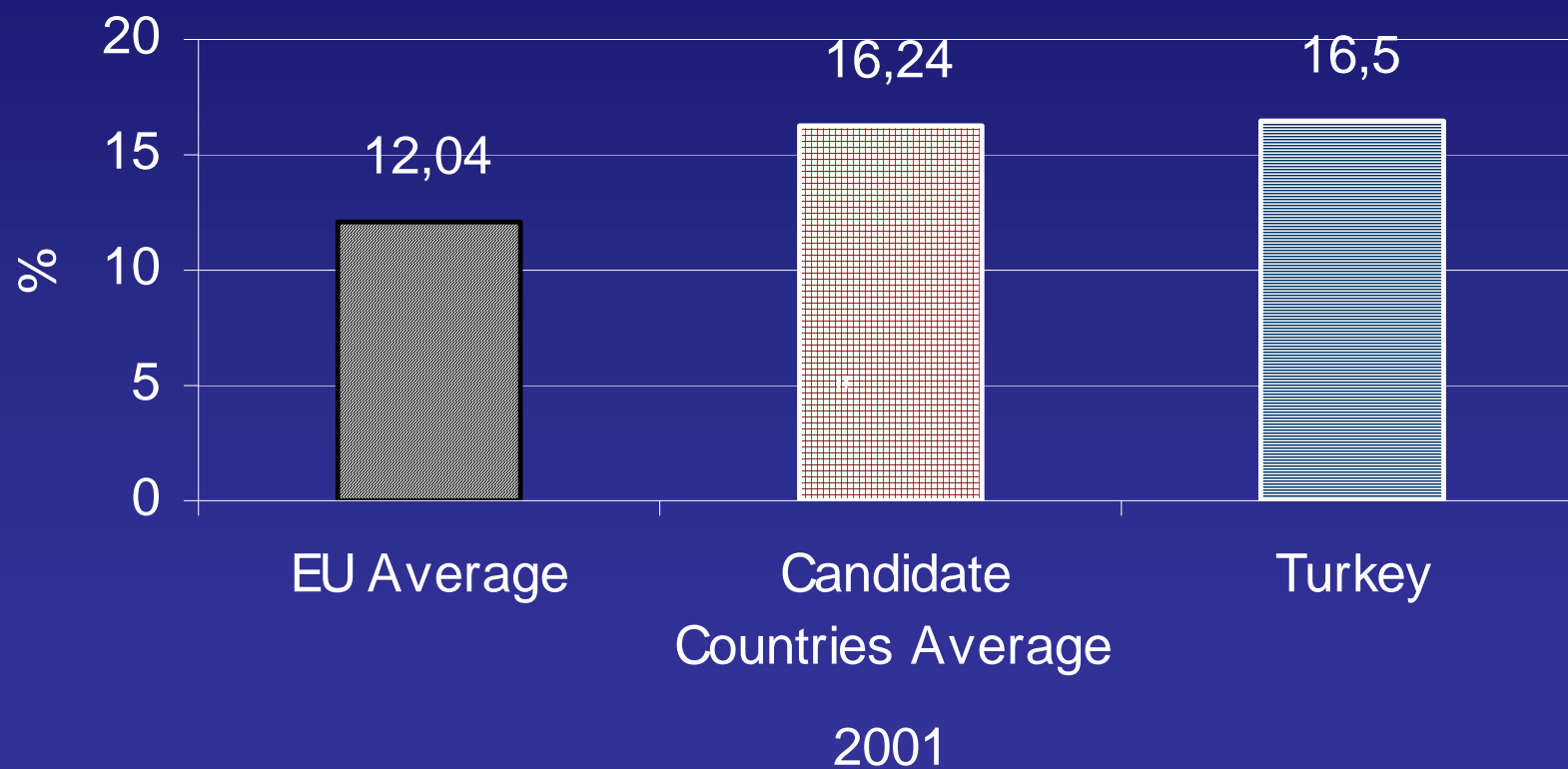


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# Although capital adequacy is high, free capital remains limited

Graph 3: CAR

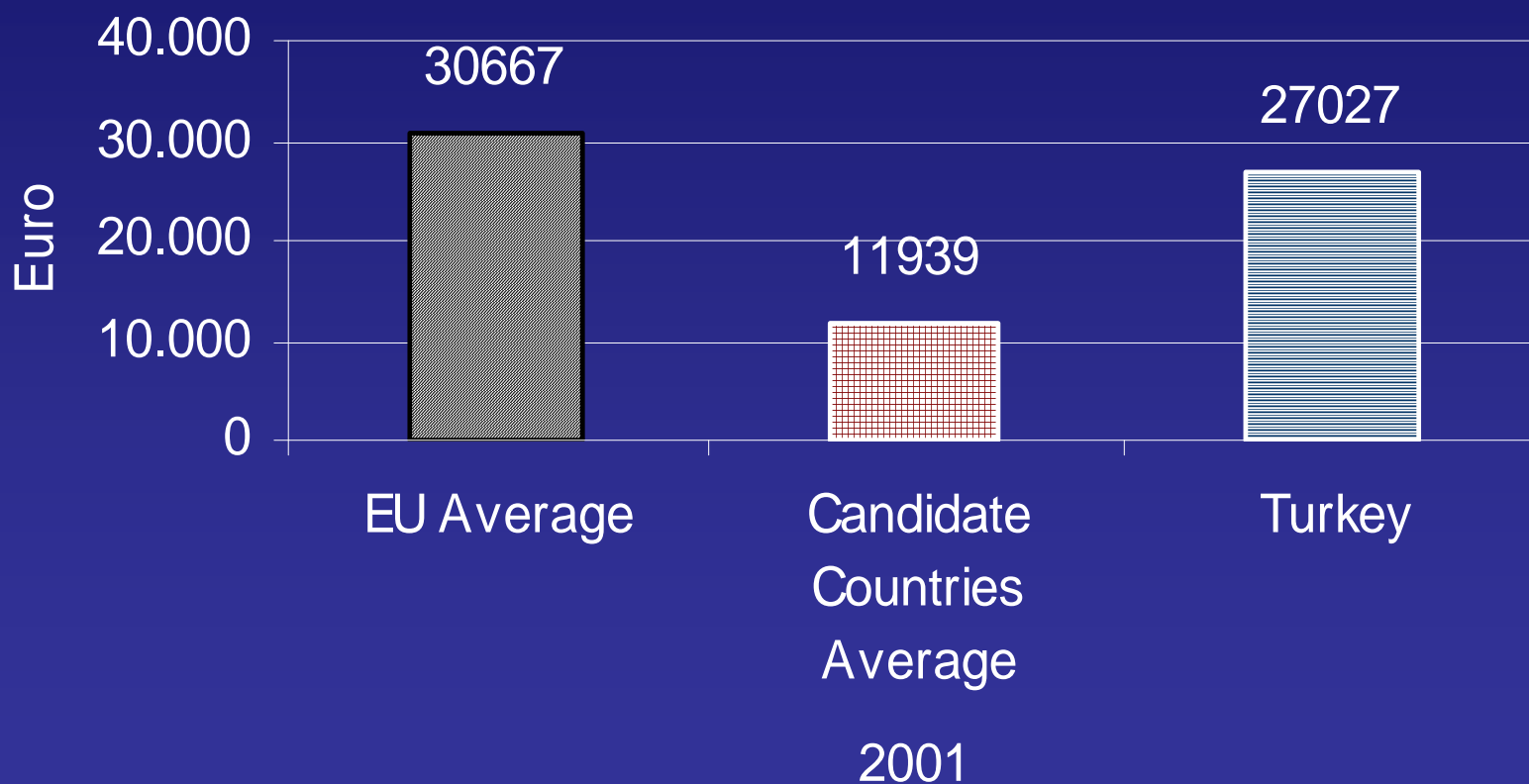


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# Blanket guarantee introduced during the crisis in Turkey

Graph 4: Deposit Insurance

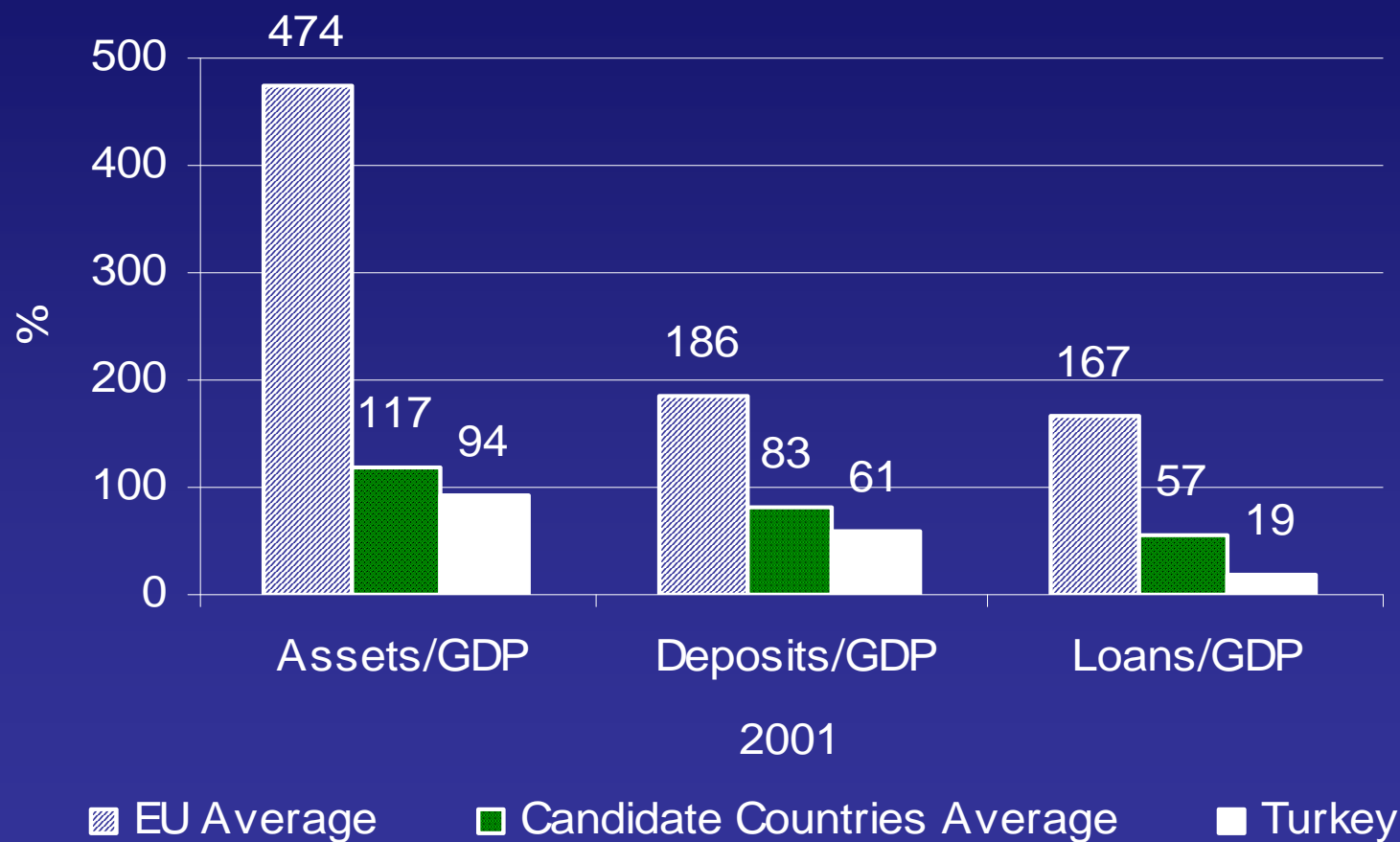


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# Low financial intermediation by Turkish banks

Graph 8: Financial intermediation indicators

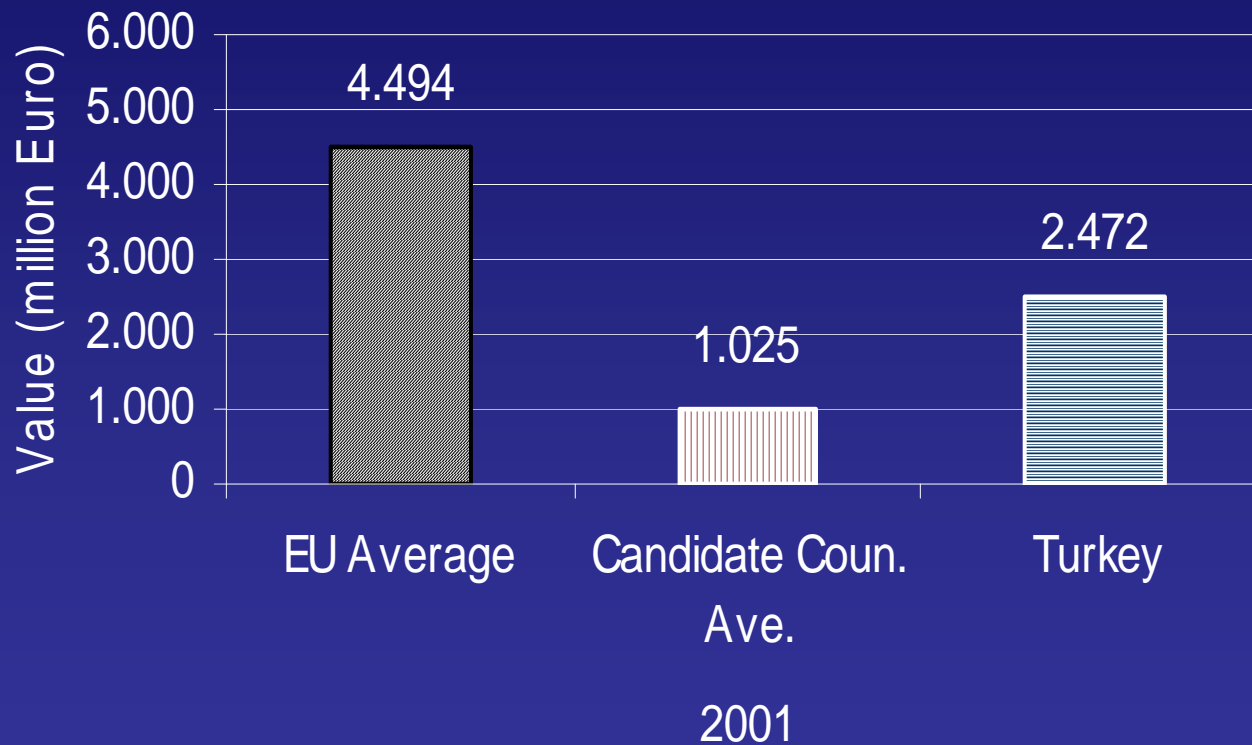


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# Size of the banking sector is small

Graph 5: Average Bank Size (Total Assets / # of banks)

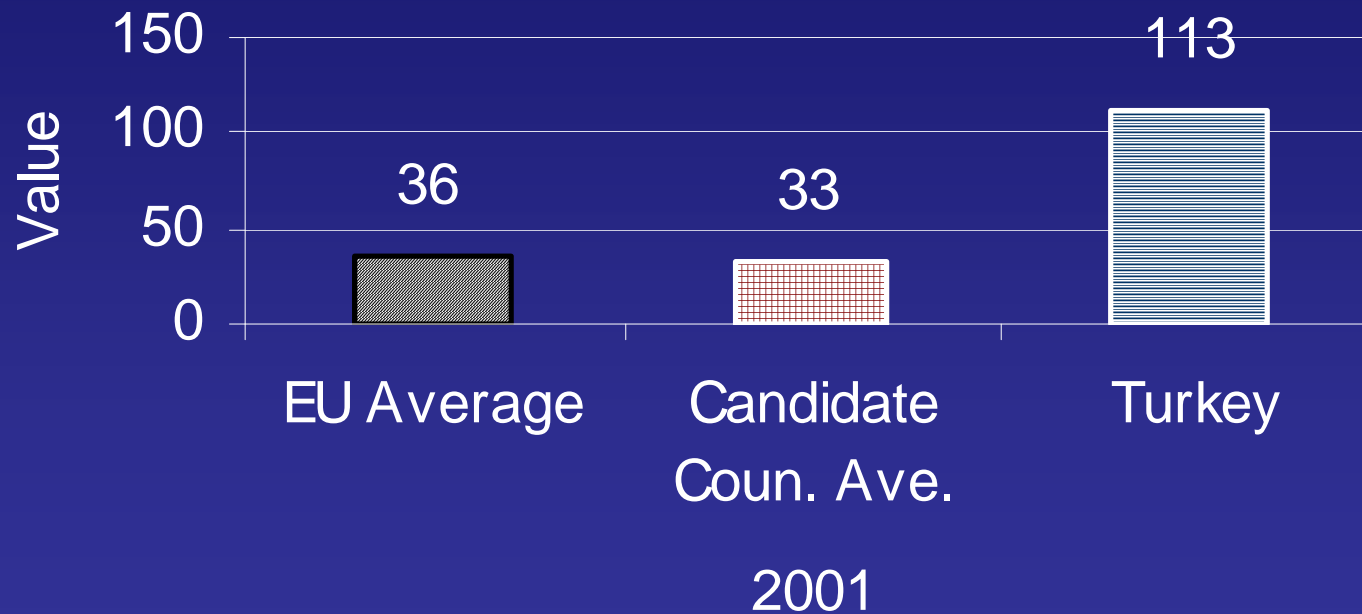


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# Over-branched banking network

Graph 6: Number of Branches per Bank

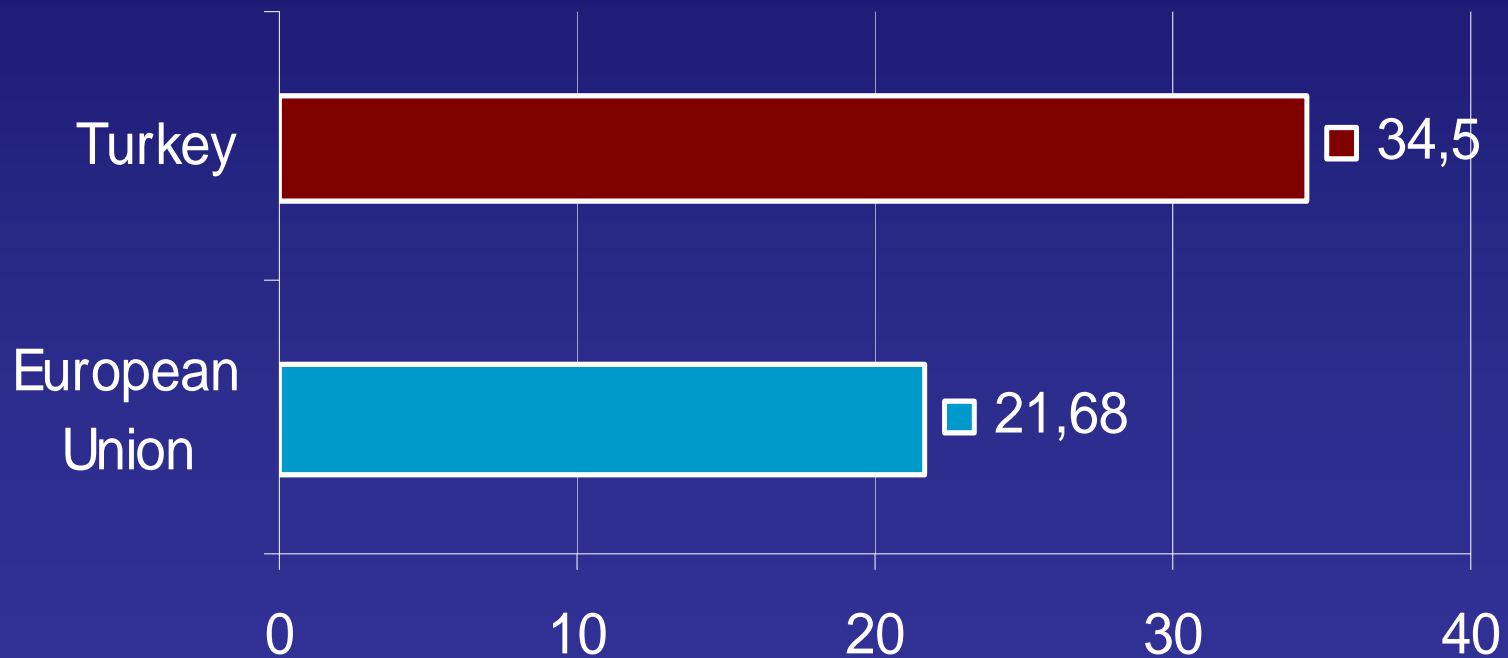


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# Government crowding-out

Graph 16: Debt Securities / Total Assets



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# Literature on foreign bank entry

Features that attract foreign banks:

- liberalization of financial markets
- degree of economic integration between host and parent countries
- support of the client base (“follow the client”) (Konopielko,1999; Clarke *at al*, 2001).
- profit opportunities, low taxes (Claessens *et al.*, 2001; Clarke *at al*, 2001)
- fewer regulatory restrictions for investment (Clarke *at al*, 2001).



# Expected benefits of foreign bank entry

Claessens *et al.*, 2001; Konopielko, 1999

- increase in efficiency and better resource allocation
- increase in competition
- broad application of modern banking technology
- increased access to international capital markets
- stimulate development of supervisory and regulatory practices



# Potential disadvantages of foreign bank entry

Crystal *et al* (2002) and Stiglitz (1993)

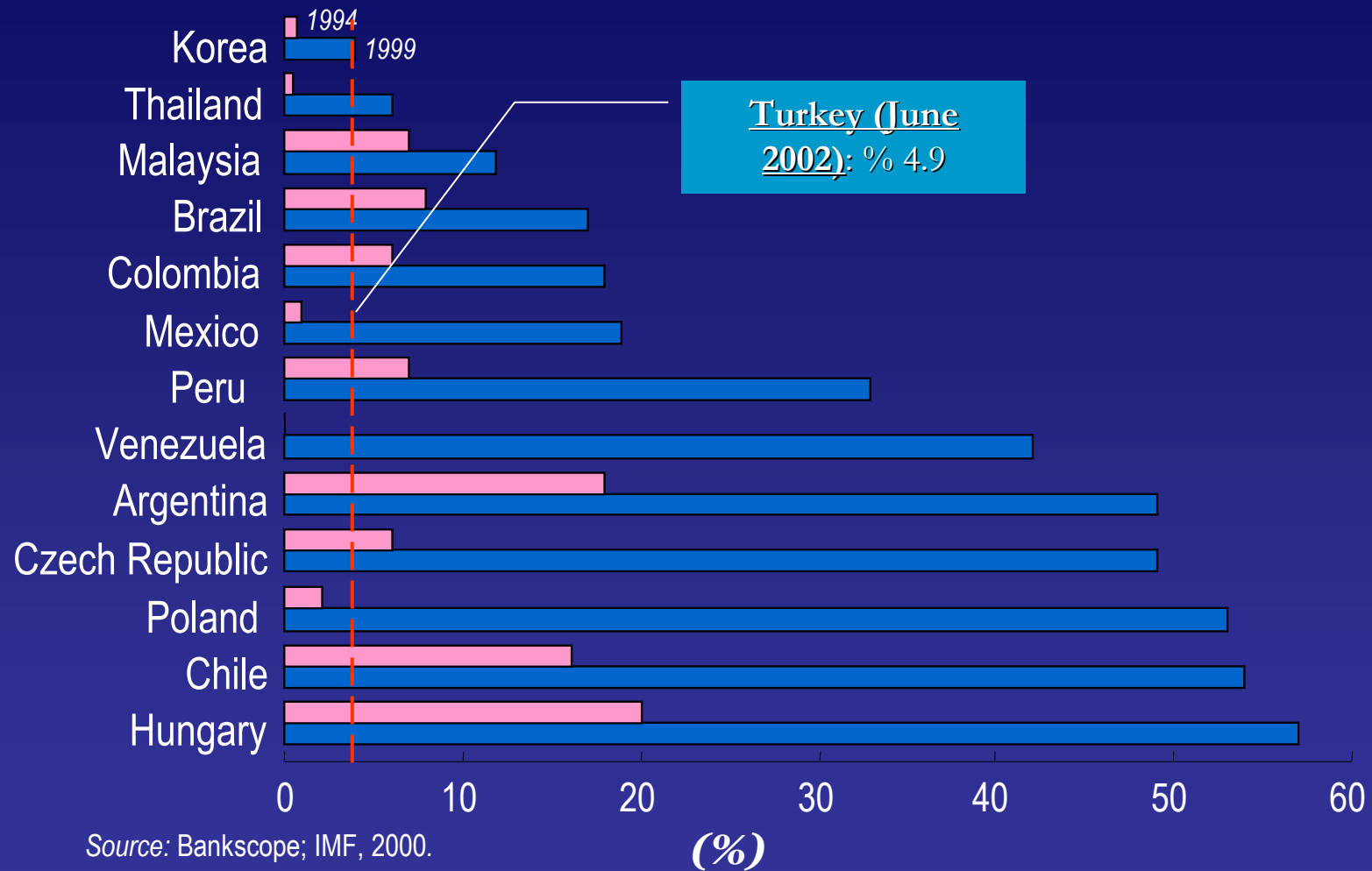
- difficulties to compete with large international banks
- lower access to financial services by domestics as foreign banks generally serve to multinational firms
- less sensitivity to host country's government policies
- vulnerability to economic conditions in the home country

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# Market share of foreign banks



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# Turkish experience

Despite...

- a long history of liberalization policies and practices
- advanced technological facilities
- qualified human capital in banking sector

...foreign bank presence has been limited due to:

- persistent macroeconomic instability (high and volatile inflation)
- low volume of foreign direct investment
- delays in taking necessary steps for financial sector reforms

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## Recent increased interest

- Increased interest in the aftermath of the bank restructuring program

Unicredito 49% of Kocbank shares

HSBC acquired Demirbank

- However further measures are necessary to attract foreign investors

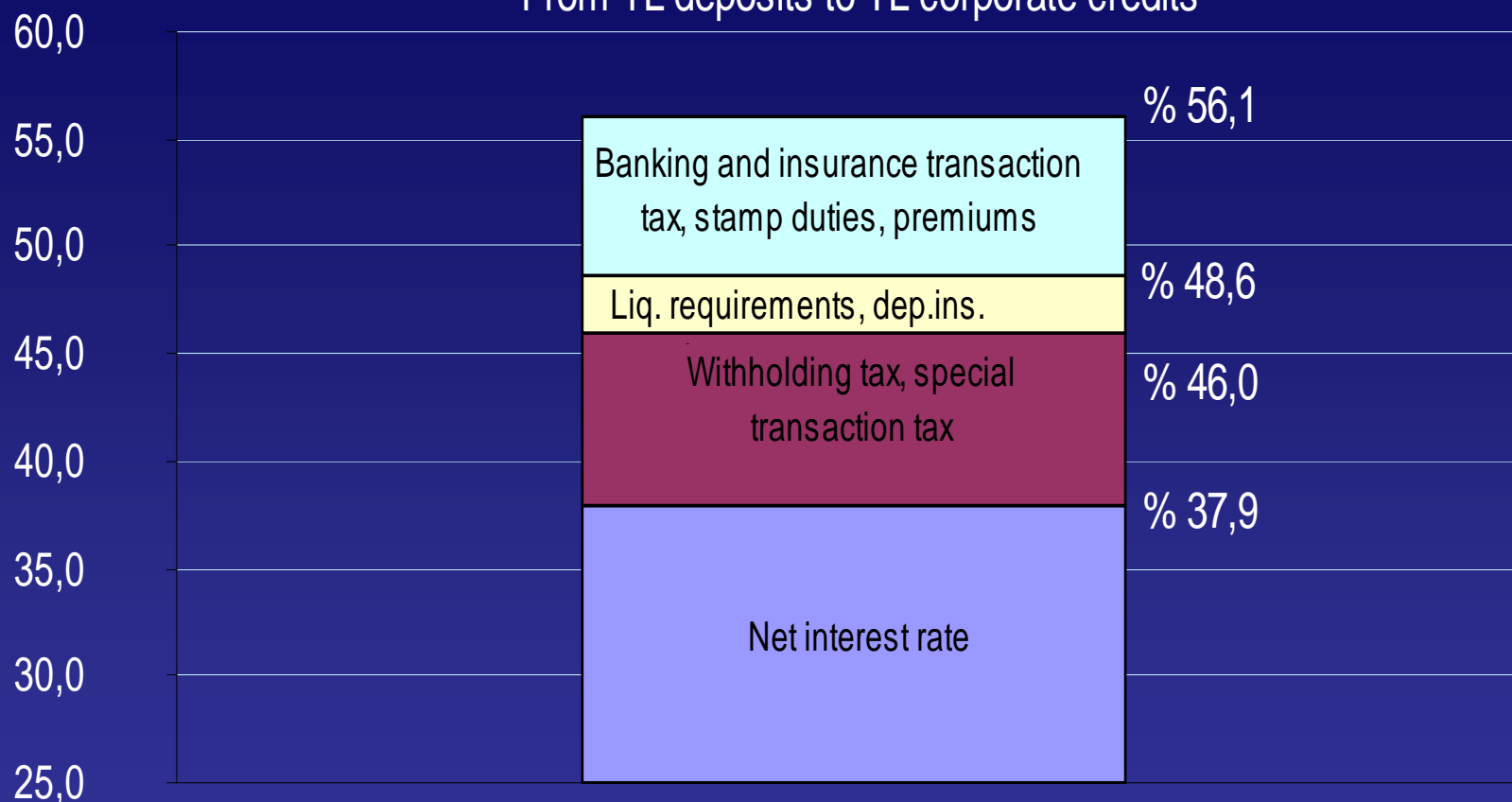
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# Need to reduce intermediation costs

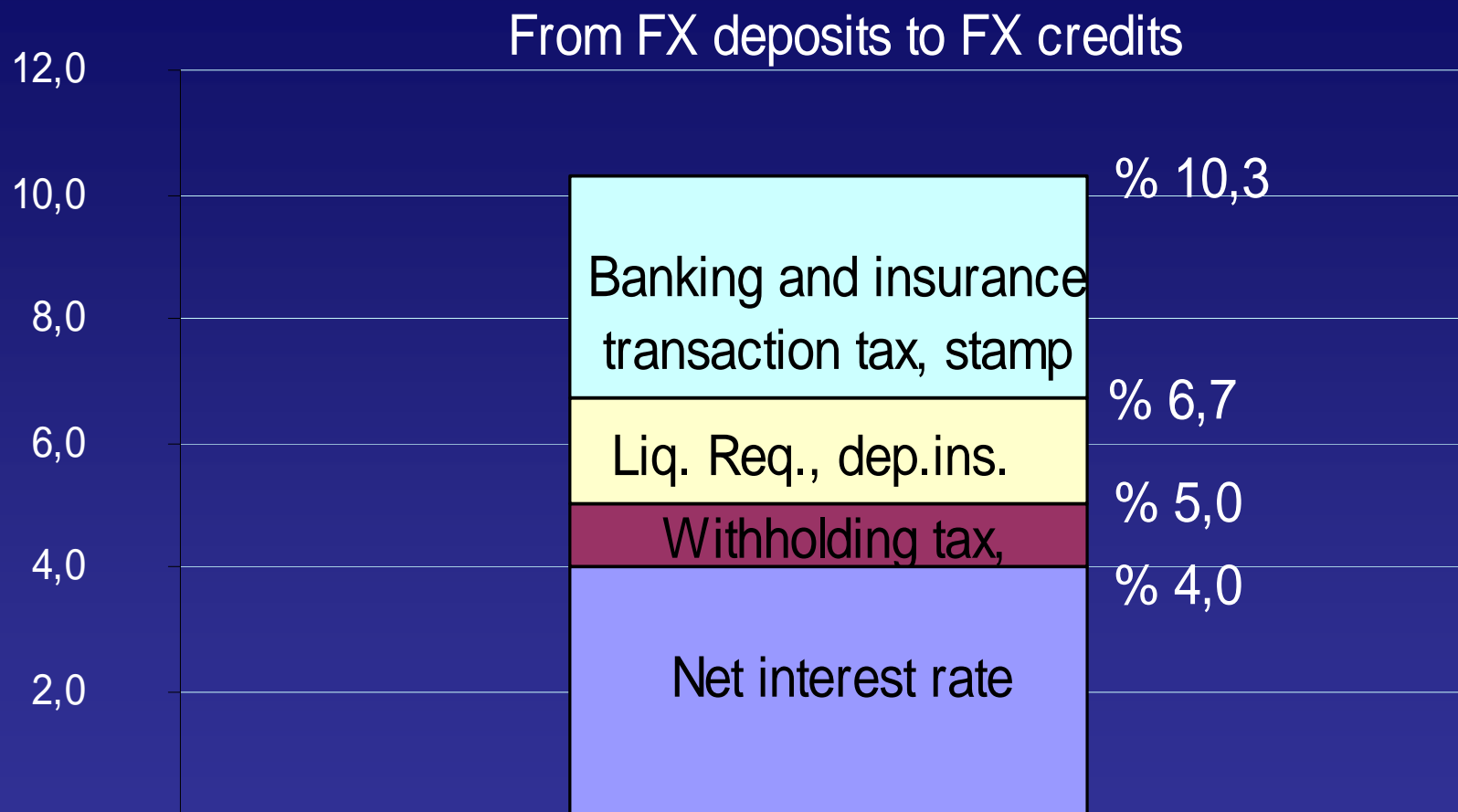
From TL deposits to TL corporate credits



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# Need to reduce intermediation costs



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# Need to overhaul blanket guarantee

- BRSA/SDIF is working on a deposit insurance scheme
  - Elimination of blanket guarantee
  - Adoption of a limited guarantee scheme in accordance with EU standards (20,000 Euro) with a one-year transition period
  - Redefining protection coverage in favor of domestic currency.
  - Transition to a risk based premium structure in which risk is fairly priced.
  - Application of co-insurance in order to limit potential claims on the insurance system.

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# Quantitative Impact Study (QIS)

	<b>Date of exercise</b>	<b>No. of banks participating</b>	<b>No. of countries participating</b>	<b>Scope</b>
<b>QIS 1</b>	<b>Autumn 2000</b>	<b>78</b>	<b>10</b>	<b>Standardised Foundation Advanced</b>
<b>QIS 2</b>	<b>Summer 2001</b>	<b>138</b>	<b>25</b>	<b>Standardised Foundation Advanced</b>
<b>QIS 2.5</b>	<b>Autumn 2001</b>	<b>37</b>	<b>12</b>	<b>Foundation</b>
<b>QIS 3</b>	<b>Autumn 2002</b>	<b>Almost 300</b>	<b>Almost 50</b>	<b>Standardised Foundation Advanced All portfolios including securitisation</b>

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# Summary QIS-2 Results

	Standardised		IRB Foundation		IRB Advanced	
	Credit	Overall	Credit	Overall	Credit	Overall
G10 Group 1	6%	18%	14%	24%	-5%	5%
Group 2	1%	13%				
EU Group 1	6%	18%	10%	20%	-1%	9%
Group 2	-1%	11%				
Other (non-G10, non-EU)	5%	17%				

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