

**IS STATE SPONSORED INSURANCE OF
BANK DEPOSITS REQUIRED?
TURKISH EVIDENCE**

Özge İYİTAŞ

105664024

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SOSYAL BİLİMLER ENSTİTÜSÜ
ULUSLARARASI FİNANS
YÜKSEK LİSANS PROGRAMI**

TEZ DANIŞMANI: Prof. Dr. Oral ERDOĞAN

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3) Bank Deposit
4) SDIF
5) BRSA

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ABSTRACT

The thesis consists of four major parts. The first part includes the concept of insurance, its brief definition, features and historical development. Along with detailed description, Turkish evidence of insurance companies is presented, with a thorough analysis in Part III.

The second part of the study is allocated to the economic situation in Turkey. It would be more appropriate to give brief information about the economy itself before explaining a system that works within this economy. Being an emerging market economy, Turkey has had major crises, especially in the banking sector. The Progress Report of the World Bank Group for the Republic of Turkey 2001 is taken as the main reference for this part, since the report summarizes the financial situation in Turkey during the time of a major economic crisis. The impact of political and social developments on economy is analyzed to some relevant extent.

The third part is based on SDIF, the Savings Deposit Insurance Fund. Its definition is made and structure is examined, along with the powers and duties of SDIF, which are described in detail. The official website of SDIF is taken as the major source for this part, as well as some press notes.

The focus of the fourth part is deposit insurance. Examples of New York State's Safety Fund and Oklahoma's Guaranty Fund are taken to explain the reasons for their failure. The present situation of deposit insurance in Turkey is examined. With evidence from insurance companies in Turkey, the necessity of state sponsored insurance of bank deposits is displayed in an attempt to explain the operation of insurance system in our country.

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Introduction

Banks are the intermediary agents which play a crucial role in turning savings into investments. In such a process, any kind of defect undoubtedly threatens economic stability. Flaws in payment system affect social life adversely. In order to avoid such problems, governments have made legal arrangements in banking sector and they intervene should there be crisis symptoms. “Deposit Insurance” is one of the best means to provide an atmosphere of security in the banking sector.

The arrangements concerning deposit insurance in Turkey date back to 1930s, yet the practice of these applications did not start until 1960. The major arrangements were carried out in 1983. As a result of the negative effects of the economic crisis in the year 1994, the scope of deposit insurance was enlarged and in the following years, the application was revised.

The aim of this Study is to provide a detailed explanation of the security of banking system, to analyze the global and domestic applications of deposit insurance, to detect the general features of the system, and to prove their appropriateness for Turkey.

My Thesis is comprised of four parts. In the first part, the concept of insurance, in general, the reasons for its application and history are dealt with. In the second part, the economic situation in Turkey is analyzed and the Progress Report of the World Bank Group for the Republic of Turkey concerning the year 2001 is given special emphasis. In the third part,

detailed information on SDIF and BRSA is presented including the explanation of the duties of each, and specific examples with regard to the deposit insurance. In the fourth part, important articles on the concept and the necessity of deposit insurance are studied and some evaluations are made including the case of Turkey. Special attention is paid to the requirement of state sponsored insurance of bank deposits in Turkey by providing relevant evidence.

PART I

THE CONCEPT OF INSURANCE SYSTEMS IN TURKEY

1.1. The Concept of Insurance

In this chapter information about the concept of insurance and its general frame has been provided. The concept of insurance can be interpreted as an allocation of money so that the damages caused by risks which are not known, but can collectively be anticipated are compensated¹.

Insurance is a concept which stems from Latin. Its accurate counterpart in Turkish is safety and trust. Insurance is a mechanism by means of which one can take measures today against possible future disadvantages. The best safeguard against possible misfortunes is the institution of insurance. Insurance business, which results from the need to aid one another, act with solidarity and to provide security, is a part of the industrial, commercial and social life. In developed countries, the insurance business is an indication of economic and social progress.

One of the reasons for the existence of insurance and the sector of insurance is the need of individuals to take precautions so as to protect themselves from the economic consequences of some events causing damage and expense they may have to face in life. In such situations, precautions taken beforehand may enable to minimize, if not totally eliminate the damages resulting from the situation, although they cannot

¹ Asunakutlu, T., “Sigorta İşletmelerinde Maliyet Unsurları Ve Maliyet Oluşumu”, Dokuz Eylül University, The Periodical of Social Sciences, Vol: 2, Issue: 3, Izmir, 2000, p.1.

eliminate the situation itself. Insurance is on the top of such safeguard mechanisms².

Following elements need to be present in the concept of insurance³.

- The risk, also known as the possibility that a peril might occur in the future,
- A community which is made up of people who are exposed to the risk,
- The equivalence or the resemblance of the risks to which people in a community are exposed,
- The meeting of the needs or the elimination of the disadvantages in case of the realization of the risks,
- The elimination of the economic consequences of the risk, that is, the existence of the worth of protection (premium payments),
- The right of the insurance owner to claim the protection.

The most important precaution resorted by an insurance company in order to curtail financial liabilities is reinsurance. Reinsurance, which means reinsurance, implies the transaction (insurance) of the residue, which comes into existence after an insurer, uses his gross conservation authority in an insurance transaction, to another insurer⁴.

² Keneler, R., Türkiye'de Hususi Sigorta Hukuku, Istanbul, 2001, p.2.

³ Elbeyli, Ü., Sigorta ve Sigorta Pazarlaması, Istanbul, 1996, p.22.

⁴ Genç, Ö., Sigortacılık Sektörü Ve Türkiye'de Sigorta Sektörünün Fon Yaratma Kapasitesi, Ankara: Türkiye Kalkınma Bankası A. Ş., 2002, p.18

1.2. The Definition and Features of Insurance

1.2.1. The Definition of Insurance

Insurance stems from the need to take measures against some risks which may cause certain damages both to individuals and community and the need to protect oneself from the economic consequences of such risks⁵. As the theoretical frame of the concept of insurance is rather broad, there are various definitions of insurance. Some of these definitions are the following:

- Insurance is an enterprise which is based on the distribution of the negative consequences of accidental risks bearing economic consequences between carriers congregating within an organization carried out by an individual known as the insurer⁶.
- Insurance is the gathering of many individuals who are face to face with the same risk in order to determine the possibility of damage, which is indeterminate as an individual, and to compensate the damage together in case of the realization of this possibility by an individual or an institution responsible for risk management⁷.
- Insurance is mentioned in the Fifth Book of the Turkish Commercial Code, which is known as the Law of Insurance. Article 1263 of the said code describes insurance as: “such an agreement that guarantees to pay damages in return for a premium in case of the occurrence of a peril, which jeopardizes one’s pecuniary interests, or to pay money

⁵ Elbeyli, a.g.e., p.17.

⁶ Mertol, C., Sigorta Hukuku Ders Kitabı, Ankara: İmaj Publishing, 2005, p.13.

⁷ Akyol, S., “Hayat Sigorta Şirketlerinde Fonların Oluşumu, Yönetimi ve Kar Payı Olarak Dağıtımı”, İstanbul University The Institute of Social Sciences The Faculty of Economy, Graduate Thesis, İstanbul, 1994, p.11.

and proceed with any proceedings due to certain events in one's lifetime”⁸.

- Insurance is an organization composed so as to compensate the damages of many similar units which can be affected in the same level in case of the accidental occurrence of pecuniary risks⁹.

1.2.2. The Features of Insurance

It is possible to list the main features of insurance as follows: ¹⁰

- An insurance which includes risk transfer structure enables each individual and institution to transfer the risk to a group by means of an insurance policy.
- Insurance can be evaluated as a social instrument. People and organizations help each other with relatively small premiums against possible big damages.
- Insurance is related to the group that is exposed to the risk. Many individuals and institutions need to form a group in order for the system to operate.
- Insurance is a system based on statistical foresight and systematic fund accumulation. Statistical forecasting methods are used in the computation of insurance premiums and funds enable the operation of the system by systematical accumulation.
- Insurance makes compensations to parties in accordance with an insurance policy. It is essential that an insurance policy be made, and damages are met within the framework of written provisions.

⁸ Acıman, H., Sigortanın Temel Prensipleri, İstanbul, February 2005, p.16.

⁹ Pekiner, K., Sigorta İşletmeciliği Prensipler-Hesap Bünyesi, İstanbul, 1974, p. 3.

¹⁰ Karacan, A., Sigortacılık ve Sigorta Şirketleri, İstanbul: Bağlam Publishing, 1994, pp.33-34.

- Insurance is not gambling. The logic of insurance is based on risk. The risk is always present for each individual and institution. On the other hand, betting is the point at issue in gambling, and the risk is created by people. In gambling it depends on people whether to create the risk or not.

1.3. The Historical Development of Insurance

The desire of people to meet economic damages of possible dangers before they come into existence results in the idea of insurance. People have chosen to meet the damages caused by such perils with their mutual accumulation rather than with their individual accounts. The concept and the sector of insurance came into existence as a result. People feel secure thanks to insurances they have taken out against risks and disasters increasing day by day in the world. Insurance is one of the most developed sectors in the world and, also in Turkey. The sector is developing and gaining more and more importance every day.

1.3.1. The Historical Development of Insurance in the World

The first instances of insurance are seen in places in which sea trade is especially developed. There were people among the first maritime nations who awarded loans to the freight carried by a ship and who entertained the risk that the ship might not reach the harbor. The rate of interests of these loans was not favored by the Church, and was prohibited after a while. It is highly probable that such a prohibition led to taking premiums beforehand against possible perils, and therefore the idea of insurance. According to some resources, ancient Rhodes odes had very similar provisions with sea insurances, which lead to some thoughts that the first application of sea insurance was seen in Rhodes¹¹. According to some resources, insurance

¹¹ Ezerdi, C., Sigortacılığımızın Tarihi, İstanbul: Commercial Union Sigorta A.Ş. Publication, 1998, pp.8-10

began in the 14th century. At first, insurance was developed by private bodies. Genoas, Venetians and merchants in some Hanta cities severally acted as insurers¹². Trade showed significant developments in the 14th century, with changing economic conditions. At that time, there was a need for insurance in Italy, which was the most advanced city in sea trade, and the concept of sea insurance made its appearance in Italy for the first time. The agreement, which was accepted as the first insurance policy was bearing the date of 23rd October, 1347, and was drawn up in order to provide the freight of the ship “Santa Clara”, which was heading from the Harbor of Geneva, Italy to Mallorca. The first insurance company was established in Geneva in 1424, as well. The first law on sea insurance was the Barcelona Edict, issued in 1435. After such a beginning in Italy, sea insurances seemed to develop, especially in England in the 18th century.

Insurance business, which began and developed in seas, later led to the appearance of the idea of life insurance. The insurance of ship and freight gave way to the insurance of the captain, crew and voyagers. In a system known as “Tontines”, developed by an Italian banker named Tontin in the 17th century, a number of people came together and put forth a certain amount of money for a period of time. After the expiration of the period, survivors shared the money among themselves. This system became rather popular, as people tended to believe that they would live longer than other people. In the system, death was considered a pecuniary loss; therefore, another type of premium for people who die before the predicted time against the risk of death was anticipated. The transition to life insurances began in such a way.

After a while, in the 18th century, the development of insurance continued in England, and the first insurance law was enacted in England in 1601. As a consequence, a system which aims to cover trade, capital accumulation, and this capital was developed. The development of

¹² “Sigortanın Doğuşu”, http://www.senturk.com/html/sigortansigorta_nedir_.htm , (25th August, 2007)

insurance in the world was seen especially in two periods, one of them being the Renaissance and the other being the Industrial Revolution¹³.

Insurance business, which is accepted as the fund-creating power of economic activities and important part of industrial, commercial and social life, has become a distinct criterion of the level of the society. At the beginning of the 20th century, insurance companies have reached such a level that they could provide efficient services as institutions that have completed their organization enough to meet every kind of insurance need.

The insurance sector in the world has focused on certain countries, namely North America, Western Europe, Japan and Ocean Countries. The countries in this geographical region have a quite dominant share, namely 90.7 percent in total insurance penetration. The United States of America and Japan are the locomotives of the sector with their share in premium income, which is more than 50 percent. They are followed by four major economies of the Western Europe: England, Germany, France and Italy (The European Union has a share of 29.4 percent in world insurance premium income)¹⁴.

¹³ Oksay, S., “Türk Sigorta Sektörünün Tarihsel Gelişiminin Değerlendirilmesi”, <http://www.tsrsb.org.tr> , (26th August, 2007)

¹⁴ Çipil, M., “Türk Sigortacılık Sektörünün Pazarlama Karması”, Hazine Dergisi, Issue:16, 2003, p.6

Table 1: Developments in the Major Insurance Markets in 2006**Developments in the major insurance markets in 2006**

	Life premiums		Non-life premiums		Total premiums	
	USD bn	Change* vs 2005	USD bn	Change* vs 2005	USD bn	Change* vs 2005
Industrialised countries ¹	2 033	6.6%	1 357	0.6%	3 390	4.0%
United States	534	3.6%	636	1.0%	1 170	2.1%
Japan	363	-2.0%	97	0.3%	460	-1.5%
United Kingdom ²	312	30.2%	107	-2.1%	418	20.1%
Germany	95	2.4%	110	-1.0%	205	0.6%
France	178	15.1%	73	1.1%	251	10.6%
Italy	90	-7.5%	49	0.3%	139	-4.9%
Emerging markets	176	21.1%	157	10.8%	333	16.3%
Latin America and Caribbean	29	14.1%	43	10.0%	71	11.6%
Central and Eastern Europe	13	19.2%	43	9.2%	56	11.4%
South and East Asia ¹	97	23.6%	42	14.5%	138	20.8%
Middle East and Central Asia	5	5.3%	14	5.7%	19	5.6%
Africa	35	21.6%	14	6.2%	50	17.5%
World	2 209	7.7%	1 514	1.5%	3 723	5.0%

Notes: * in real terms, ie adjusted for inflation.

¹ Hong Kong, Singapore, South Korea and Taiwan are no longer considered emerging markets.

² Growth of life business in the UK was driven by a boom in pension sales following the raising of pension contribution limits.

Sources: final and provisional figures released by supervisory authorities and insurance associations, and some estimates.

Source: Insurance- Canada, <http://www.insurance-canada.ca/refstat/canada/2007/SwissRe-World-Insurance-2006-707.php> , 28th November, 2007

1.3.2. The Historical Development of Insurance in Turkey

In the 19th century, with the influence of the great fires in Istanbul, foreign insurance companies began their operations in our country, and for a long time, monopolized insurance transactions. English insurance companies, Sun and Northern British, began the first insurance transactions in Turkey with their representative offices opening in 1872. Since there were no laws requiring government supervision in those days, these two foreign insurance companies acted as they wished, and drew up their insurance policies in English or in French, in accordance with the orders from their headquarters. In 1893, the Ottoman Public Insurance Company (Osmanlı Umum Sigorta Şirketi) began its activities as the first Turkish insurance company. The increasing number of insurance companies led to

increasing competition, and on 12 July, 1900, 44 insurance companies, 43 of which were foreign, got together and implemented fixed tariff application. With the law in 1914, foreign companies were forced to provide guarantee and to pay taxes. There were further developments in insurance business with the establishment of the Republic of Turkey. The insurance policies ceased being drawn up in English and in French.

Foreign insurance companies, which began their activities in 1870, had operated for many years in a free environment, that is, an environment free from any supervision until 1914, when “The Law on Foreign Insurance Companies and Companies Whose Incorporated Capital Is Divided into Stocks” was enacted. Such companies were then forced to provide registration and security, whereupon some foreign insurance companies attempted to establish new companies by collaborating with Turkish equity owners¹⁵.

Insurance companies were connected to the Ministry of Commerce with a law enacted in 1939. The sector of insurance was seriously analyzed with the enactment of the Law on the Inspection of Insurance Companies, No.7397 in 1959. The law No. 3379 was enacted in June 11, 1987. The publication of the first regulations on insurance transactions began hereinafter, as the law foresees the issuing of regulations regarding related bodies and transactions. Foreign insurance companies operating in Turkey were obliged to become Joint Stock Companies, in order to enable the flow of foreign capital. Insurance companies were accepted as a part of the financial structure by being connected to the Under Secretariat of Treasury and Foreign Trade.

¹⁵ Genç, a.g.e., p.24

Table 2: The General Outlook of the Insurance Sector in Turkey

The Total Number of Companies	: 55
-Insurance	: 52
-Reassurance	: 3
According to Their Capital Structure	
-Public	: 2
-Private	: 45
-Foreign operating in Turkey	: 5
-The Branches of Foreign Companies	: 0
According to Their Operations	
Life	: 21
Non-life	: 19
Life/ Non-life (Mixed)	: 12
The Number of Agencies	: 17.134
The Number of Personnel	: 10.750

Resource: Çipil, M., “Türk Sigortacılık Sektörünün Pazarlama Karması”,
Hazine Dergisi, Issue: 16, 2003, p.3

In the sector, which was entirely under the control of foreign companies, the effects of the nationalization movement, which could be observed in all sectors of the new Turkish Republic, were seen, and thus, domestic companies were established. In the stagnant period, which stretched from the first years of the Turkish Republic until the 1980s, insurance remained as a closed sector in general, although relative increase in premium production has been observed. After the 1980s, there have been significant changes in the sector, both in terms of the services offered, and the general concept¹⁶. As of the last years of 1990, the comeback of foreign insurance companies to Turkey and their gradual enlargement in the sector were monitored. In 2006, the market share of foreign capital companies surpassed 50 %¹⁷.

¹⁶ Çipil, a.g.m., p.2

¹⁷ Şahin, K., “Sigortada yabancı payı % 50'yi geçti”,
<http://www.milliyet.com.tr/2006/10/01/ekonomi/eko02.html>, (27th August, 2007)

As of January 01, 1995, the problem of the collection of insurance premiums was solved by pursuit in terms of insurance policies rather than by the current accounts of the agencies. The law of private pension was not officially published at the beginning of February, 2002. Within the scope of this insurance, 10 Life Insurance Companies will be licensed to Private Pension Insurance¹⁸.

Because of the dilemma put forth by the fact that the increase in the number of new insurance companies did not run parallel with the demand in insurances in the course of time, and with the problems in premium collection, the need for certain arrangements in the Law No: 7397 became obvious, which was achieved with governmental decrees of 1993. As of January 01, 1995, the system of pursuit in terms of insurance policies rather than by the current accounts of the agencies has been put into practice in order to solve the problem of the collection of insurance premiums. In the year 2000, Pool was allocated for the Natural Disaster Insurance Authority (NDIA), an institution allocated so as to execute earthquake insurances, which were made obligatory for domiciles following the 1999 earthquake, and the administration was given to Millî Reasürans T.A.Ş., which gained experience in the area, in the following five years. On the other hand, the age of obligatory reinsurance, which had been embodied with the Law No: 1160, dated July 23, 1927, ended on December 31, 2001? The system of private pension, which was established with “the Law on Private Pension Saving and Investment System”, went into operation on October 23, 2003. As of September 30, 2004, there were 47 active insurance companies in total operation, 40 of which were private, 2 of which were public, and 5 were foreign companies operating in Turkey. 9 of the companies were life insurance, 10 of them were life/ pension companies, 1 was a pension company, 15 of them were non-life insurance companies, and 12 of them

¹⁸ Türkiye Sigorta Sektörü Araştırma Raporu Ağustos 2001-Ocak 2002, Input Araştırma ve İletişim A.Ş., 2002, p.7

were cosmopolite companies. The activities of 15 companies have been ceased at present, and 5 of them have gone bankrupt¹⁹.

In this chapter, basic information regarding the concept of insurance is provided. Having defined insurance and its general properties, its historical framework is outlined, followed by its current situation in Turkey. It is essential to have an idea about the economic situation in a given country, in our case Turkey, in order to correctly understand the insurance system within which it works. To that end, the study proceeds with a discussion on the economic system in Turkey, especially a severe economic crisis she faced in the year 2001.

¹⁹ Kazgan, H., “Osmanlı’dan Günümüze Türk Finans Tarihi”, <http://www.tsrb.org.tr/tsrb/Sigorta/Türkiye+de+sigortacılık/>, (28th August, 2007)

PART II

The Economic Situation in Turkey

Recently, more and more banking crises have been observed, especially in emerging market countries. The reasons for these crises can be summarized as financial liberalization, mobile global capital, and under-regulation. Moreover, banking crises generally affect emerging market countries, that is, the countries in intermediate stages of their development, more severely than developed countries, perhaps because partially developed credit markets magnify effects of exogenous shocks (Aghion, Bacchetta, and Banerjee 2003). The role of deposit insurance in banking crises has not been completely clarified. However, it can be stated that deposit insurance reduces the incentives of the banks as far as managing risks prudently is concerned. In systems where banks are under-regulated, deposit insurance may lead banks to take too much risk, because under these circumstances, banks are aware that the government would compensate for the losses of the depositors, if they are to become insolvent. On the other hand, completely different conditions may occur under different circumstances. Therefore it is not always possible to predict the effects of deposit insurance accurately.

In the case of Turkey, the commercial bank sector, with its problems, has been covered by deposit insurance since 1984. Not only insider lending and under-regulation but also implicit and explicit promises of government cause widespread problems and failure, insolvency and illiquidity in the commercial banking sector.

2.1. The Progress Report of the World Bank Group for the Republic of Turkey, June 7, 2001

As stated in the Progress Report of the World Bank Group, Turkey was in an economic impasse and was suffering from various social problems in the year 2001. Political instability, together with disputes also aggravated this already deteriorated situation. The economy in Turkey; therefore, suffered from a growing current account deficit, a slowdown in policy implementation, the loss of market confidence and an inevitable rapid exit to foreign exchange. The abandonment of the existent regime caused a nominal devaluation. Interest rates soaring above 100 percent largely contributed to the onset of a sharp recession and a wider banking crisis. This economic situation had a negative social impact, as well. Rising prices and negative growth reduced household incomes and constituted a higher risk of poverty. Rising unemployment and widening income disparities were other related problems.

There were many reasons for such deterioration, both internal and external. Rise in oil prices and the weakening of Euro caused depreciation in Turkey's accounts. From an internal aspect, on the other hand, Turkey suffered from a surge in demand due to a sharp drop in interest rates immediately after the implementation of the program.

2.1.1. The Economic Situation of Turkey in the Year 2001

After the financial turmoil in November 2000, an enhanced policy package emerged in December. This package did not happen to be effective; yet, strengthened the fiscal and structural program to help Turkey recover from its existent financial situation. However, the program was not as long-lived as it had been anticipated; the financial program derailed because of political instability stemming from a discussion between the President and

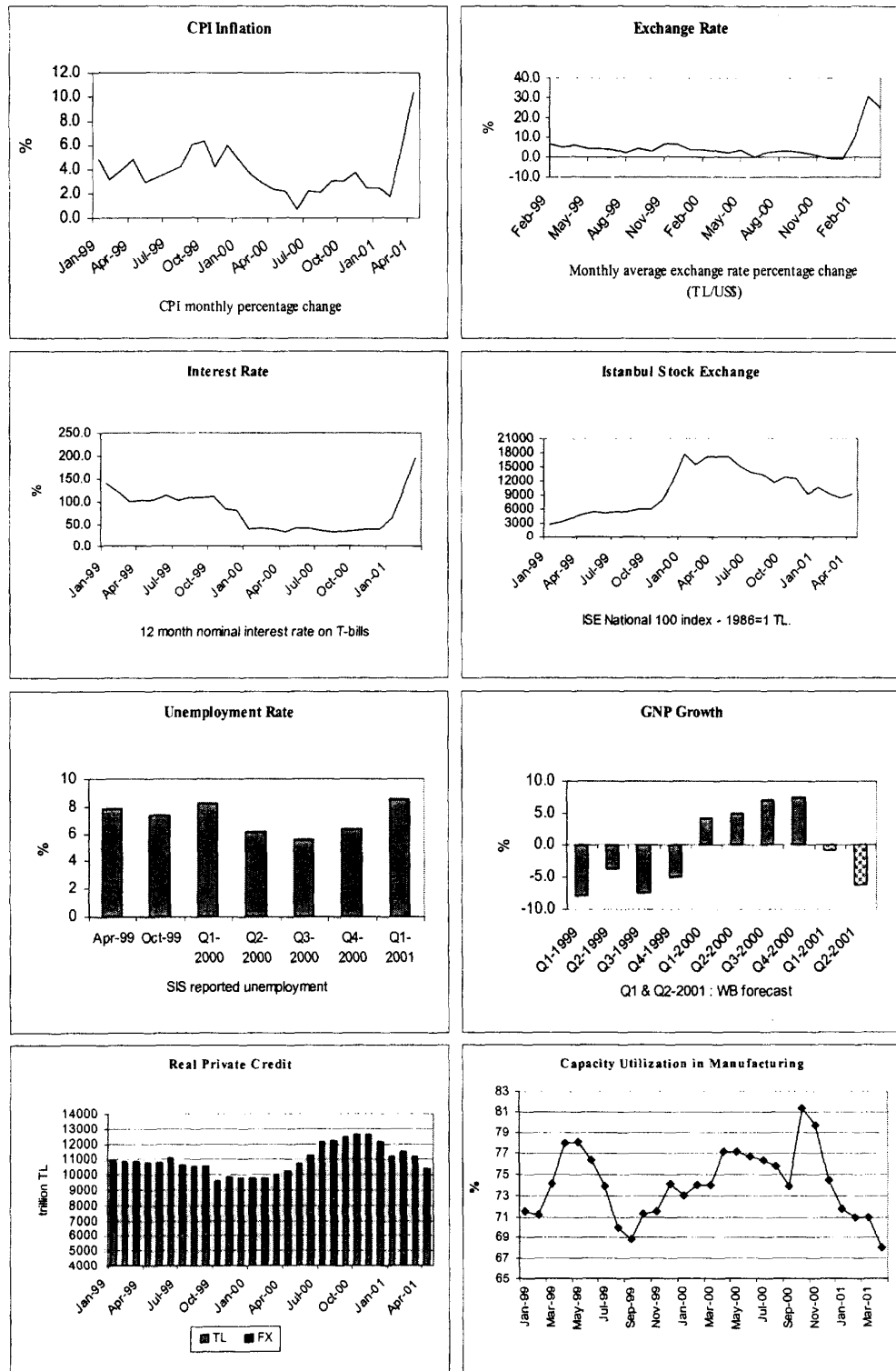
the Prime Minister on February 19, 2001. Overnight interest rates in inter-bank market shut up to 6200 % on February 21, 2001. The economy stalled, and the situation turned into a foreign exchange crisis. The foreign exchange reserves of the Central Bank of the Republic of Turkey, which were 27,94 billion \$ on February 16, 2001 subsided to 22,58 billion \$ on February 23, 2001, resulting in a 5,36 billion \$ reserve loss²⁰ . As a result, Turkey prepared a new economic program, which was more detailed than all the previous ones. This program tried to deal with the structural reasons of the crisis, such as weak public finances and a fragile banking system, rather than the crisis itself. It was a radical yet risky attempt to eliminate inflation and bring down interest rates. The main focus of the program was a rapid restructuring of the banking sector, which inevitably resulted in fiscal costs of the cleaning-up of the state banks and intervened private banks, expected to exceed US \$40 billion. The macroeconomic framework requires a large fiscal adjustment and an additional US \$10 billion of external support in 2001 to close the financing gap²¹ .

²⁰ Uygur, E., “Krizden Krize Türkiye: 2000 Kasım ve 2001 Şubat Krizleri”, Türkiye Ekonomi Kurumu, Ankara, 7th April, 2001.

²¹ Document of the World Bank, Report No. 22282 TU, “Memorandum of the President of the International Bank for Reconstruction and Development and the International Finance Corporation to the Executive Directors on a Country Assistance Strategy Progress Report of the World Bank Group for the Republic of Turkey”, 7th June, 2001.

Figures 1: Crisis Indicators

Box 1: Crisis Indicators



Source: World Bank

2.1.2. The Impacts of Political and Social Developments on Economy

The government lost considerable trust and therefore public support because of the crisis. Opinion polls demonstrated that people could not tolerate another crisis. Therefore, it became more and more obvious for the population, the civil society and the private sector that the economic decision-making of the government should be de-politicized.

Figure 2: Annual CPI and Targets

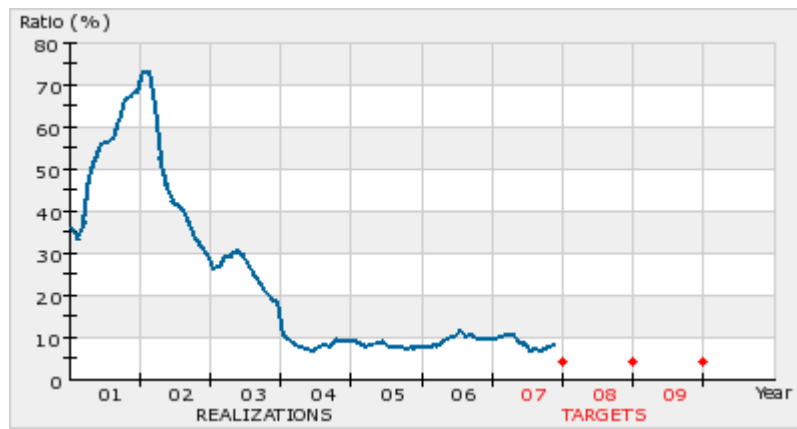


Table 3: Annual CPI and Targets

	2002	2003	2004	2005	2006	2007	2008	2009
Target	35	20	12	8	5	4	4	4
Realization	29,7	18,4	9,3	7,7	9,6	-	-	-

Source: The official website of the Central Bank of the Republic of Turkey, December 10th, 2007

The approach towards the economic situation in Turkey has been briefly analyzed in this part, especially from the point of view of the World Bank. The Progress Report of the World Bank Group for the Republic of Turkey, June 7, 2001 is taken as a reference in this analysis. Eventually, the effects of political and social developments on economy are mentioned. The banking system in Turkey works on the basis of the SDIF, the Savings Deposit Insurance Fund. Therefore in the following part, the SDIF is explained, in detail.

PART III

The Savings Deposit Insurance Fund (SDIF)

3.1. A Brief Definition of SDIF and Its Structure

The system of deposit insurance has been developed in order to safeguard deposits. The main objectives of the system can be summarized as protecting the funds of small depositors, achieving and maintaining the financial stability, and supervising the payment system. The system of deposit insurance operates within the owner of the deposit, the bank receiving the deposit, and the institution insuring the deposit. It takes its authority from legal principles based on the legislation of the country. The institution which insures the deposit collects a certain amount of premium in return for this transaction. The institution steps in if the owner of the deposit cannot pay their deposit back within the precepts of the concerned legislation of the bank which receives the deposit. Under these circumstances, the institution pays the owner or the owners of the deposit the amount it has taken under insurance. As for the bank that could not function, the institution initiates the legal process. According to Article 109, for instance, a preliminary injunction or preliminary attachment may be issued by a court upon the Fund's request in respect of properties, rights and receivables of majority of the shareholders, managers as well as real person shareholders who own more than 10 percent of the capital of corporate bodies that are shareholders of the bank whose operating permission has been revoked or that has been transferred to the Fund, without requiring a security deposit, and such persons may be prohibited from leaving Turkey.²²

²² Bankacılık Kanunu, Madde 109, Fıkra 3

3.1.1. Banking Regulation and Supervision Agency (BRSA)

Two regulatory institutions have had a substantial impact on the stabilization of the banking system in Turkey. These two institutions are the Banking Regulation and Supervision Agency (BRSA) and Savings and Deposits Insurance Fund (SDIF). Each has a specific role to play in the regulation, supervision and stability of the banking system.

The BRSA is a public legal entity with administrative and financial autonomy. The role of BRSA is mainly to ensure the implementation of the Banks Act; to issue regulations for this purpose; to audit and supervise the implementation of the Banks Act and other relevant regulations; and to ensure that savings are protected. In pursuit of this role, the BRSA is authorized:

1. To take and implement any decision and measures to prevent any transaction/action which might jeopardize the rights of depositors and/or the secure operation of banks or which might lead to substantial damages to the national economy;
2. To take and implement any decision and measures for the efficient function of the Turkish banking system; and
3. To provide opinions and information with respect to the monetary and loan policies to the Under Secretariat of Treasury, Under Secretariat of State Planning Organization and the Central Bank. (Upon demand or where deemed necessary)

The BRSA is entitled to request all kinds of documents and information (including confidential information) from any ministry, public or private entity and person with respect to any issue relating to its responsibilities.²³

Savings Deposit Insurance Fund has access to the jointly agreed databases of BRSA (Banking Regulation and Supervision Agency) and

²³ The official website of Banking Regulation and Supervision Agency, www.bddk.org.tr, accessed on 5th March, 2008

Central Bank within the framework of the principles of confidentiality. As BRSA is entitled to request all kinds of documents and information, including confidential information, from any ministry, public or private entity and person with respect to any issue relating to its responsibilities, SDIF does not impose any burden on banks in the issue of reporting. The accuracy of the system is achieved through cross-checking with these shared databases.

Moreover, there is a coordination committee which includes the Chairman and the Vice Chairman of BRSA, the Chairman and the Vice Chairman of the Fund in the Fund Board of SDIF, which is on top of the organization chart. This committee ensures the establishment of maximum coordination between the Agency and the operation of transactions in the competency of the Fund, when necessary. In accordance with the ideas obtained through the exchange of information on the general status of the banking sector, measures are taken as a result of the supervision of deposit banks.

3.1.2. Savings Deposit Insurance Fund (SDIF)

Savings Deposit Insurance Fund is a public legal entity whose main role is to insure saving deposits at banks. SDIF is also the depository of failed banks and their assets and in this respect seeks to strengthen, restructure and transfer to third parties banks whose shares and/or management and supervision have been transferred to it.

In case of failure or bankruptcy of a bank, Savings Deposit Insurance Fund is authorized:

- to request from the Board to transfer the assets, organization, personnel as well as the savings deposit and participation funds which are subject to insurance together with the

interests accrued to a bank to be newly established or any of the existing banks,

- to terminate the operating permission of the bank, whose assets and liabilities have been transferred partially or completely,
- to provide financial support and take over the losses corresponding to the capital representing the shares transferred, to take ownership of all shares upon assuming the losses; take over the shares in return for the payment of share values to be calculated on the basis of the capital to be calculated upon subtracting the loss from the paid-in capital, to the bank shareholders within the period to be set by the Fund Board,
- to request the Board to revoke its operating permission.

Pursuant to the Banks Act, the SDIF is obliged to pay the savings (at the banks the license to perform banking transactions and accept deposits of which have been revoked) to their depositors. The SDIF then becomes creditor with respect to such amounts.²⁴

3.2. Turkish Evidence Regarding SDIF

In the case of a financial crisis, like the one towards the end of the year 1999, one of the most important points that should be taken into consideration is the restructuring of the banking system, which is known as a rather risky issue. Yet, while attempts to restructure the banking system by adding more and more banks to SDIF, it turned out that the number of wracked banks increased, similar to the Asian Financial Crisis of the year 1997. It has also been understood that certain rules and regulations, which

²⁴ The official website of SDIF, www.tmsf.org.tr, accessed on 5th March, 2008

had been enacted so as to supervise the banking section, were violated in terms of foreign exchange and maturity dates.²⁵

Turkey has conducted new sales which were introduced by the SDIF. Within the past two years, the SDIF has obtained attachments over assets and taken control of a large number of companies from various groups (for example, Uzans, Balkaner, Aksoy) in an effort to collect its public receivables after the collapse of the banks (for example, Imarbank, Yurtbank, Iktisatbank) owned by these groups.

In accordance with its powers, which have been stated in the Banks Act, the SDIF has opted to sell the assets of these companies through forced sales in order to collect its receivables. In these forced sales, the SDIF operates as an Administration and Execution Office that intends to collect its own receivables. SDIF carries out such an operation based on its attachments on the assets of the companies. Thanks to the amendments to the Banks Act and the Regulations issued by the SDIF, the SDIF must sell the assets of the companies as a whole rather than piece-by-piece. It is an approach which maintains the integrity and commercial value of the assets in question.

Based on the requirement stated above, the SDIF has already sold nine cement plants and the assets of five media companies (previously owned by the Uzan Group) to various local and foreign companies via successful tenders. By the sale of these nine cement plants, the FUND gained \$994.5 million income. Furthermore, SDIF's forced sale of Telsim (Turkey's second biggest GSM operator transferred from the Uzan Group) was put out to tender on December 13, 2005. Vodafone became the winning bidder after having submitted a bid of \$4.5 billion. One of the other significant companies of the Uzan Group, Star TV channel, was sold for \$306.5 million to the Doğan Group via tender. Most of the radio channels

²⁵ Uygur, E., “Krizden Krize Türkiye: 2000 Kasım ve 2001 Şubat Krizleri”, Türkiye Ekonomi Kurumu, Ankara, 7th April, 2001.

and newspapers of Uzan Group were also sold. The SDIF intended to continue to force the sale of the remaining companies that it has taken over (for example, Cine-5 TV channel from Aksoy Group) in 2006 . With respect to past and future sales, it is estimated that total collections will reach over \$18 billion. However, the estimated debt of the banks transferred to the Fund is approximately 45 to \$50 billion.

3.3. The Duties and Powers of SDIF

In its official website²⁶, the duties and powers of SDIF has been defined according to the provisions of Law No 5411. The major duties and powers of SDIF can briefly be summarized as:

- Insuring savings deposits which belong to real persons,
- Designating the amount of the savings deposits which would be insured,
- Determining the risk based insurance premiums timetable with the collaboration of BRSA,
- Paying the insured deposits on behalf of credit institutions that are no longer allowed to operate for certain reasons, which have been explained in more detail in Article 63 of the related law,
- Realizing partial or full transfers, and merger of certain banks by completing the necessary procedure, which has been explained in more detail in Article 71 of the related law,
- Fulfilling necessary operations on behalf of banks which have gone bankrupt and are in the stage of liquidation,
- Consummating the voluntary liquidation of a bank, regardless of the provisions of the Turkish Commercial Code when the bankruptcy of the bank has not been issued and the

²⁶ Tasarruf Mevduatı Sigorta Fonu, http://www.tmsf.org.tr/index.cfm?&lang=tr_TR

supervision of the bank has been undertaken by the Fund (in accordance with the Article 106 of the said law),

- Defining and designating the unfavorable conditions which may have adverse effects in the financial system, and coordinating extraordinary precautions decided by Council of Ministers in order to apply in Fund, (Article 72),
- Following the interests of the Fund in case of a disagreement, and taking all of the necessary legal measures so that such a disagreement shall be forborne,
- Holding consultations with the concerned institutions concerning monetary policies and their implementation,
- Providing confidence and stability as far as financial sector is concerned, and supplying different ideas concerning the future policies and situation of the sector,
- Dealing with branches of foreign banks in the case of the annihilation of their permission to operate, and establishing the provisions regarding the transfer of their assets,
- Consummating the sale of all kinds of properties which are owned by the bankrupt without being subject to the provisions of the Execution and Bankruptcy Law No. 2004, the State Tenders Law No. 2886 and the Public Procurement Law No. 4734,
- Using the powers of the banks whose management and supervision have been transferred to Fund, and suspending their activities for a certain period of time by taking the balance sheet as a basis to be prepared as of the transfer date so as to secure and maintain the financial stability in the economy,
- Strengthening and restructuring the financial system, especially in cases where it is regarded as necessary by the Fund Board by increasing the capital in the system, by abolishing fault interests stemming from the obligations of

legal provisions and general liquidity, by taking immovable or other assets as guarantee and giving advance in return, and by carrying out transactions, such as selling these assets to third parties through applying discounts, so as to convert them into cash.²⁷

Many more articles related to powers and duties of SDIF are precisely stated within the related articles of Turkish Commercial Code. In general, however, the main powers of SDIF can be stated as follows:

1. To take over the shareholding rights (excluding dividend) of the subsidiaries of the transferred bank;
2. To take over the shareholding rights (excluding dividend) of the dominant legal entity shareholders of a transferred bank;
3. To appoint members to the boards of the transferred bank.
4. To make dispositions of assets, (whether by way of discount or compromises), and to file lawsuits, enter into agreements with debtors, and apply custody measures; and
5. To prosecute and collect public receivables assigned to it based on the provisions of the Law No. 6183 (Collection of Public Receivables).²⁸

3.4. The Development of SDIF in Turkey

The Savings Deposit Insurance Fund (SDIF) was established on July 22, 1983, as a public legal entity with the aim of insuring savings deposits in banks. The duty of administration and representation of the SDIF was given to the Central Bank of Turkey. After a while, the administration of the institution was handed over to the Banking Regulation and Supervision Agency. In addition to insuring savings deposits, SDIF is also responsible

²⁷ Tasarruf Mevduatı Sigorta Fonu, http://www.tmsf.org.tr/index.cfm?&lang=tr_TR

²⁸ http://www.tmsf.org.tr/documents/reports/tr/22102003_nozdemir.ppt, accessed on 5th March, 2008.

for strengthening and restructuring the financial conditions of the banks when necessary. In the official website of the Savings Deposit Insurance Fund, its mission is defined as follows:

“SDIF; insures savings deposits and participation funds in order to protect the rights of depositors and to contribute confidence and stability of the banking system and it resolves the banks and assets transferred to it in the most popular way.”²⁹

The first legal arrangement concerning the protection of savings deposits in the Republic of Turkey was Deposits Protection Law No. 2243, which dated to May 30, 1933. According to this Law, the deposits which the banks have as reserve requirement in the CBRT (the Central Bank of the Republic of Turkey) are accepted as a provision of savings deposit accounts opened in the banks in question and it is provisioned that they are exempted from seizure by third parties. Afterwards, the amount corresponding to 40% of the deposit that the depositors have in banks is accepted as privileged claim over all the securities existing in the assets of the bank accepted the deposit in question and it is provisioned through the Banks Act Nr. 2999 dated 01st June, 1936 amending the Act Nr. 2243 that, in case of bankruptcy it is to be paid to depositors without waiting for the result of the liquidation. This ratio was increased to 50% with the Banks Act Nr. 7129 dated June 23, 1958. A significant amendment was made in the Banks Act Nr. 7129 by the Act Nr. 153 dated 1960 and a “Banks Liquidation Fund” was founded through accepting the gradual liquidation principle in banks. The Savings Deposit Insurance Fund had been founded with the Decree of Law on Banks Nr. 70 dated July 22, 1983, which annulled the Act Nr. 7129. The task of administrating and representing the Fund was given to CBRT (the Central Bank of the Republic of Turkey) with the regulation prepared by the Ministry. Arrangements of the said Decree of Law regarding the SDIF were legalized with the Banks Act Nr. 3182 dated April 25, 1985. With the

²⁹ Tasarruf Mevduatı Sigorta Fonu, http://www.tmsf.org.tr/index.cfm?&lang=tr_TR

Decree of Law Nr. 538 dated June 16, 1994 the Fund was charged in strengthening and the restructuring the financial structure of the banks when necessary besides insuring savings deposits. Banks Act Nr. 4389 dated June 18, 1999 provisions that the Fund is to be administrated and represented by the Banking Regulation and Supervision Agency. BRSA, is established on the date June 23, 1999 with the status of a public legal entity with administrative and financial autonomy, is established in order to ensure application of the said Act and other relevant acts, and to supervise and conclude such application, and to ensure that savings are protected and to carry out other activities and to exercise its authority defined in Banks Act by also issuing regulations within limits of authority granted by the Act in accordance with the article 3/1 of Banks Act Nr. 4389 and initiate to operate on August 31, 2000 . In conclusion, the administration and the representation of the Fund having legal entity as of 1983 was firstly enforced by CBRT and than by BRSA. It was provisioned with the Act Nr. 5020 on “Making Amendments to the Banks Act and Some Acts” on December 26, 2003, that the decision-making body of the Fund is the Fund Board and general directorate and representation, implementation of the resolutions taken by the Fund Board is the duty of the chairman of the Fund.³⁰

It is compulsory for all banks in Turkey, regardless of their origin, to be a member of the SDIF. Since January 2003, SDIF has been using the differential premium system to categorize its member institutions. In doing so, SDIF aims to bring equality into premium determination process, because the level of risk that a member bank poses to the deposit insurance system is not equal. It is therefore important to price the risk fairly within the system. To that end, the results of analyses indicating the financial standing of credit institutions are used in calculating the risk-based insurance premiums, the number of deposit and participation fund accounts, and the total amount of deposits and participation funds in these institutions.

³⁰ The official website of SDIF, http://www.tmsf.org.tr/index.cfm?&lang=tr_TR

The system works by taking the principle of transparency and disclosure as its basis. The basic framework of the deposit insurance is disclosed to the public. The actual premium categories, however, are disclosed only to the Board of Directors and the management of the related banks.

SDIF participates in the committee of bankruptcy as a privileged creditor, and has priority over all privileged creditors specified in Article 206 of the Execution and Bankruptcy Law No. 2004.

Today, Turkey is expected to bring its banking system in line with the EU and international standards by developing new laws and regulatory institutions. The reason for such a harmonization is the desire for integration with international markets. Reshaping and restructuring the banking sector, especially after economic crises, such as that of 2001 is another important factor. To that end, the main Banks Act, which was enacted in 1999 and proved to be inefficient in meeting the needs of the banking system in Turkey, was later modified by Laws 4491, 4672, 4684, 4743, 4842, 5020, 5189 and 5228 the last one dated July 21, 2004. The new Banks Act No. 5411 dating back to November 1, 2005 aimed to comply with the dynamism of the banking sector and with international financial and economic developments.

PART IV

Necessity of State Sponsored Insurance of Bank Deposits

Deposit insurance has been regarded as the most advanced system that has ever been developed for the protection of deposits by a certain group of people. It enables the continuation of the system by maintaining financial stability.

L. William Seidman, thinks that deposit insurance, in many ways, is similar to a nuclear power plant. “If you build it without safety precautions, you know it is going to blow you off the face of the earth. And even if you do, you can’t be sure that it won’t.” ³¹

4.1. Reasons for Failure of Deposit Insurance

Those who consider deposit insurance as a failure put certain historical evidence forth. In their study, Thies and Gerlowski ³² presented a two hundred year of evidence as a result of a thorough examination of the record of state sponsored insurance. The failures of 1985 deposit insurance programs in Maryland and Ohio have been the fuel of heated debates regarding the necessity, and the benefits, if any, of deposit insurance programs. According to Thies *et al.*, the existence of deposit insurance encourages depositors to choose a bank or savings and loan institution without concerning themselves about the business practices of depository managers. This situation frees managers and stockholders to pursue greater

³¹ Seidman, William L., “Full Faith and Credit”, Random House, New York, 1993 .

³² Thies C., Gerlowski D., “Deposit Insurance: A History of Failure”, www.cato.org/pubs/journal/cj8n3/cj8n3-8.pdf (accessed on 29th October, 2007)

profits through assembling portfolios that embody more risk than uninsured depositors would be willing to accept. Because the lost market discipline cannot be fully replaced by government oversight, a federally insured banking system will exhibit more risk taking than one operating without such guarantees. In the insurance industry, this phenomenon is known as “moral hazard”.

In order to prove their argument that deposit insurance has been nothing but a failure, Thies and Gerlowski give examples from New York State’s safety fund in the early 19th century and Oklahoma’s guaranty fund in the early 20th century. Both experiments initiated waves of continuity in this fashion until the time of bank failures associated with the depression of 1921, according to Federal Deposit Insurance Corporation (FDIC)³³.

4.1.1. New York State’s Safety Fund

In the example of New York State’s safety fund, which had been created in 1829, the aim was to protect the bank notes and deposits in chartered banks. The system was considered successful for a certain period of time. During the panic of 1837, however, it turned out that the system “had scarcely been heard of as a means of upholding credit by the New York state legislature. The final blow became the failures of 11 insured banks within a time frame of 3 years. The number of insured banks experienced a dramatic decrease resulting from a loss of confidence in the system of deposit insurance, which proved useless at this specific incident”. As a consequence, “from its peak in 1837 to 1865, the number of banks participating in the New York safety fund fell from 88 (out of a total of 95) banks to only 6 (out of 248). The small number of banks remaining in the safety fund made their bank notes uninsurable”.³⁴ After such a failure emerged other type of banks called “free banks”, which had their own state regulations and did not participate in the safety fund. The upturn of New

³³ Official web site of FDIC: www.fdic.gov , (Accessed on 2nd February, 2008)

³⁴ Thies C., Gerlowski D

York as one of the financial centers of the world owes to the emergence of those free banks, which were regarded as highly competitive and successful.

4.1.2. Oklahoma's Guaranty Fund

As for the example of Oklahoma, which passed the first of the guaranty fund laws and pioneered to Kansas, Nebraska, Texas, Mississippi, North Dakota, South Dakota as well as Washington, it can be noted that the system of deposit guaranty legislation proved unsuccessful when all eight guaranty funds failed during the 1920s. The system immediately turned out to be fragile when Columbia Bank and Trust Company failed in September, 1909 and revealed the sore point of the system. The future of deposit guaranty has not been different in other states, either.

4.2. Present Situation of Deposit Insurance

Current problems proved that the pattern of deposit insurance has not changed at all. History demonstrates that legislatures do not act during the gathering crisis in deposit insurance to prevent the crisis through reform. Deposit insurance programs are doomed to fail.

To sum up, deposit insurance seems applicable and reasonable in theory. In practice, however, it suffers from a number of insolvable problems. The requirement of sponsored insurance of bank deposits is therefore questionable. Turkey has gone through almost the same steps during the times of crisis, especially in 2001.

4.3. State Sponsored Insurance of Bank Deposits in Turkey

Systematic Banking Crises has a tremendous cost to pay due to its impact on GNP for each country. In order to avoid further banking crises, modifications are made in Bank Law so that a milieu of trust is created in the financial sector.

Table 4: Systematic Banking Crises and their Costs

Sistemik Bankacılık Krizleri ve Maliyeti		
Ülke	Kriz Dönemi	Toplam Maliyet /GSYİH (Yüzde)
Türkiye	2000-2001	19,3
-Kamu Bankaları		7,4 (*)
-TMSF Bankaları		11,9
İspanya	1977-1985	16,8
Japonya	1990-	20,0
Endonezya	1997-	50,0
Malezya	1997-	20,5
Güney Kore	1997-	26,5
Meksika	1995	20,0
Arjantin	1980-82	55,3
Brezilya	1994-96	15,0-20,0
Çek Cumhuriyeti	1994-95	12,0

(*) 2000 yılı sonu itibarıyla gerçekleşmekle birlikte menkul kıymete bağlanmamış görev zararları karşılığında verilen DİBS'ler ilave edildiğinde yüzde 15,8 olmaktadır.

Source: Pazarbaşıoğlu, C. (2002). "Türk Bankacılık Sektöründeki Son Gelismeler: BDDK'nın Rolü" *Pamukkale Üniversitesi, Ekonomi Yaz Seminerleri*.

One of the key actions for 2001 concerning the new economic program of the World Bank for the Republic of Turkey was the restructuring of SDIF by eliminating overnight borrowing of state and SDIF banks and shrinking their balance sheets, and implementing a clear, time-bound action for resolving the SDIF banks. These articles imply the inefficient administration of SDIF in Turkey, similar to deposit insurance systems in other countries.

On the other hand, Turkey has plenty of models, existent both in theory and practice concerning similar applications in countries all around the world. Certain aspects of these models can be appropriate for application in our country, whereas others can not. It is important to determine the most convenient of these models for Turkey, to make necessary adjustments and to establish a solidly built system of state sponsored insurance because state sponsored insurance in Turkey might yield beneficial results.

As mentioned above, the deposit insurance fund in Turkey is named as the Savings and Deposit Insurance Fund. The Fund is managed by the Central Bank of the Republic of Turkey in accordance with the regulations issued by the related Ministry.

The Savings and Deposit Insurance Fund (SDIF) provides the safety and stability of the financial sector. Safe financial institutions are unlikely to fail. From the viewpoint of public policy, the failures of financial institutions should be prevented, lest they cause individuals' deposits to be lost and a portion of their wealth and the nation's money supply to disappear. Sudden changes in the money supply could disrupt the overall financial stability of the economy.

Regarding the structure of deposit insurance in Turkey, it is compulsory for all banks, notwithstanding their origin, to have their savings deposits insured. Government deposit insurance serves as an insulator in differentiating between effectively functioning banks and failing banks through guaranteeing depositors that they will receive the full amount of their insured deposits regardless of the success of a depository institution, that is, whether or not it fails. That surely reflects on the choices of depositors within a financial system, thus minimizing bank runs, which are likely to occur when many depositors want to withdraw their deposits at the same time. Although the reasons for bank runs may differ, one common outcome is the lack of liquidity.

The situation presents a certain conundrum for banks that have gone into the business of substituting their own liquidity risk for the liquidity risk of non-financial firms in an attempt to earn profits. Yet, the situation may result in individual depositors who do not have sufficient information on the risks and the liquidity of the depository institution's asset portfolio and on the preferences of other depositors in terms of money withdrawal.

From an individual point of view, these bank runs are natural to occur, because depositors are aware that not all of them would be able to get their deposits back. From a more general perspective, however, bank runs may adversely affect the flow of economic activity in a country.

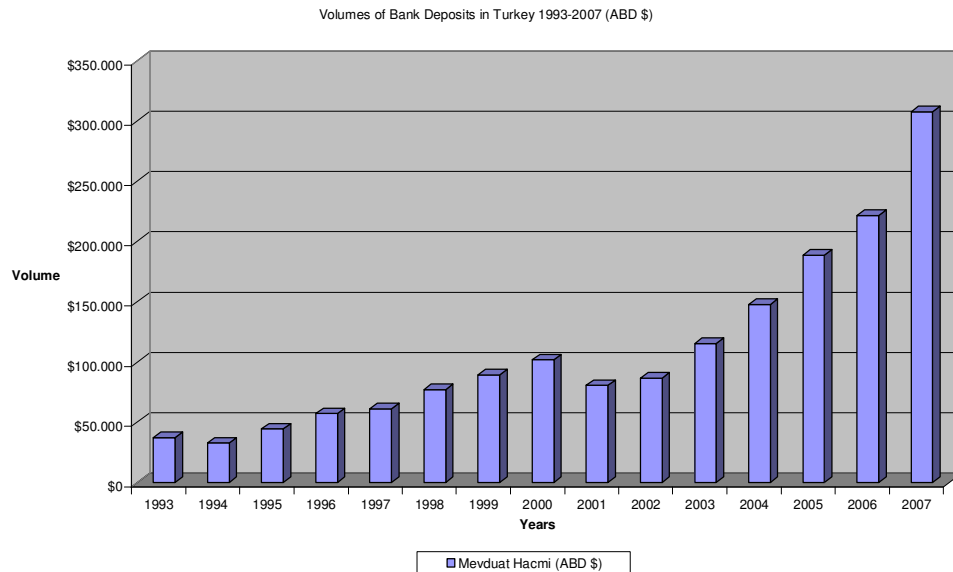
Before the 1994 economic crisis, saving deposits were insured up to 150 million TL. After the failure of the TYT Bank, Impexbank, and Marmara Bank, the Council of Ministers decided to extend the limit of coverage in order to prevent the liquidity crisis and to provide the safety of the banking system. The decision taken by the Council of Ministers caused a lot of discussions; the reason of which is that the new regulation was not valid for the depositors of the three failed banks, since the regulation was issued after the event had occurred³⁵.

³⁵ Çelikçi, E, Benefits and Successes of Deposit Insurance in Turkey, MBA Thesis, Koc University, 1995, Istanbul.

4.4. Volumes of Bank Deposits in Turkey

As shown in the table below, in 2001 deposits volume decreased because of the economic crisis and unsecured environment in the financial markets. To change this situation, the bank act enacted in 1999 was modified. Regulation had been made in order to increase the trust of the investors to the banking sector. Improvements in economy coupled with the appropriate regulations led to increase the deposits volume after the crisis and in 2007 it reached the highest level (307.697\$). In my opinion, one of the major factors affecting this increase was the insurance of bank deposits. If the deposit insurance had not existed, depositors would not have regained the trust to the banking sector and have invested their savings differently.

Table 5: Volumes of Bank Deposits in Turkey 1993-2007



4.5. Requirements of a Successful Deposit Insurance System

It is obvious from the data presented in this study that there are certain successes and failures that deposit insurance leads to. In order to avoid these failures and make the system as effective as possible Financial Stability Forum (2001) prepared a report which aims to give suggestions about the settings and structures of a successful deposit insurance system. I think that these suggestions can also be beneficial for Turkey. Some of these suggestions are summarized below.

4.5.1. Contextual issues

Explicit, limited-coverage deposit insurance, “a deposit insurance system”, is preferable to implicit protection if it clarifies the authorities’ obligations to depositors and limits the scope for discretionary decisions that may result in arbitrary actions. However, such a system needs to be properly designed, well implemented and understood by the public in order to be credible. It also needs to be supported by strong prudential regulation and supervision, sound accounting and disclosure regimes, and the enforcement of effective laws.

It is important to keep in mind that a deposit insurance system can deal with a limited number of simultaneous bank failures, but cannot be expected to deal with a systemic banking crisis by itself.

4.5.2. Moral hazard

A well-designed financial safety net contributes to the stability of the financial system; however, if poorly designed, it may increase risks, notably, moral hazard. Good corporate governance and sound risk management of individual banks, effective market discipline, and frameworks for strong prudential regulation, supervision and laws, can

mitigate moral hazard and these elements are most effective when used in consent.

Good corporate governance and sound risk management of individual banks help to ensure that business strategies are consistent with safe-and-sound operations, and thus can act as the first line of defense against excessive risk taking. Such management includes standards, processes, and systems for ensuring appropriate direction and oversight by directors and senior managers; adequate internal controls and audits; management of risks and the evaluation of bank performance; the alignment of remuneration with appropriate business objectives; and management of capital and liquidity positions. Effective market discipline requires sound accounting and disclosure regimes and the ongoing attention to a bank's soundness by rating agencies, market analysts, financial commentators and other professionals. Regulatory discipline can be exercised through effective regulation covering the establishment of new banks, the imposition of minimum capital requirements, the qualifications of directors and managers, sound business activities, a fit-and-proper test for controlling shareholders, standards for risk management, strong internal controls and external audits. Supervisory discipline can be exercised by ensuring that banks are monitored for safety and soundness as well as compliance issues and that corrective actions are taken promptly when problems surface, including the closure of banks when necessary.

Ensuring that a deposit insurance system contains certain design features can also mitigate moral hazard. These features may include: placing limits on the amounts insured; excluding certain categories of depositors from coverage; using certain forms of coinsurance; implementing differential or risk-adjusted premium assessment systems; minimizing the risk of loss through early closure of troubled banks;

and demonstrating a willingness to take legal action, where warranted, against directors and others for improper acts.

4.5.3. Public-policy Objectives

The first step in designing a deposit insurance system is to identify the public-policy objectives which are expected to be achieved and well understood. The principal objectives for deposit insurance systems are to contribute to the stability of the financial system and to protect less-financially-sophisticated depositors. The choice of how a deposit insurance system is to be operated depends on many factors that are unique to each country and its governmental and financial systems. A continuous-improvement process should exist to review the extent to which a deposit insurance system is meeting its public-policy objectives and its mandate.

4.5.4. Situational Analysis

Policymakers should conduct a situational analysis when adopting or reforming a deposit insurance system. This analysis should examine conditions and factors such as: the level of economic activity; current monetary and fiscal policies; the state and structure of the banking system; public attitudes and expectations; the legal framework; prudential regulatory, supervisory, accounting and disclosure regimes. Deposit insurance systems cannot be effective if relevant laws do not exist or if the legal regime is characterized by inconsistencies.

4.5.5. Mandate and Powers

There is no single mandate or set of mandates suitable for all deposit insurers. Existing deposit insurers have mandates ranging from narrow, so-called “pay box” systems to those with broader powers and responsibilities, such as risk minimizations with a variety of combinations in between. Whatever the mandate selected, it is critical that there be consistency between the stated objectives and the powers and responsibilities given to the deposit insurer.

As a general principle, a deposit insurer should have all powers necessary to fulfill its mandate. All deposit insurers require the ability to enter into contracts, set appropriate requirements, and access timely and accurate information to ensure that they can meet their obligations to depositors promptly.

4.5.6. Coverage

Policymakers should define clearly in law or by private contract what is an insurable deposit. In doing so, they should consider the relative importance of different deposit instruments, including foreign-currency deposits and the deposits of non-residents, in relation to the public-policy objectives of the system.

The level of coverage can be set through an examination of relevant data, such as statistical information describing the size distribution of deposits held in banks. Whatever coverage level is selected, it must be credible and internally consistent with other design features, and meet the public-policy objectives of the system.

Given the importance of effectively limiting coverage and contributing to financial system stability, as well as keeping the

requirement for information reasonable, it is preferable to apply deposit insurance on a per depositor per bank basis.

One approach to foster market discipline and to reduce somewhat the costs of deposit insurance is the use of coinsurance. If coinsurance is adopted, it should be applied above a certain amount. This will provide individuals holding small account balances full protection against the risk of loss, while maintaining the incentive for depositors holding larger account balances to monitor banks. In order for coinsurance to be effective, extensive information needs to be provided to the public regarding the financial condition of banks.

Coverage limits may need to be adjusted periodically because of inflation, the growth of real income, the development of new financial instruments, and the way in which these factors influence the composition and size of deposits.

The decision whether to cover deposits denominated in foreign currencies depends heavily on a country's usage of foreign currency. When usage is high, it would be of little value to institute a deposit insurance system without covering these deposits. An important decision is whether to reimburse insured deposits in local or in foreign currency when a bank fails. Policymakers should ensure that banks have sound foreign-exchange risk-management systems and controls in place. Furthermore, the deposit insurer should develop sound policies and procedures to manage prudently any foreign-exchange risk it faces. In designing such policies and procedures, the deposit insurer may wish to draw on the expertise residing in banks.

4.5.7. Public Awareness

In order for a deposit insurance system to be effective, it is essential that the public be informed about its benefits and limitations. Experience has shown that the characteristics of a deposit insurance system need to be publicized regularly so that its credibility can be maintained and strengthened.

In short, deposit insurance in Turkey has a considerable number of shortcomings. However, when the above suggestions are taken into consideration, the system can be eliminated from its disadvantages. Appropriate regulations and control mechanism should be implemented in a transparent way by the Council of Ministers. Only after these changes have been made SDIF can reach its purpose and be beneficial for the stability of Turkish financial system. Bearing in mind these criteria, State Sponsored Insurance of Bank Deposits is required in Turkey.

CONCLUSION

Some developments in 1990s led to considerable malfunctions in the financial structure of the banking system, and, therefore, banks had to work within a very high risk atmosphere which not only required an effective management on the part of the banking sector but also increased the importance of institutional management. Universally accepted problem-solving methods in terms of banking applications should be made effective by taking country specific economic, legal, social/ethic and managerial structures into account. Another important aspect is the necessity of on time updates concerning the regulation of current banking applications. Moreover, management structure and relations should make the continuity of effective structural management operation in banks possible.

It has been suggested that deposit insurances are not insurances in any real way. According to this idea, it is not possible to regard the SDIF as an insurer because firstly, it is not a corporation. Secondly, when deposit insurance is accepted as a kind of private insurance it should be qualified as an insurance in someone else's account. Therefore, when the risk is realized, SDIF would be responsible for compensating the clients for their loss. That is why deposit insurance should be considered as a "guarantee mechanism".

Although the idea of structural management in terms of principles is universal, its applications may vary from country to country. That is why the banking system in our country should be analyzed, in detail, by considering the economic and conjectural structure. Deposit insurance in Turkey is under the control of SDIF, which helps investors to build trust to

the banking system. It is one of the factors which help to keep a prospective economic crisis from taking place. Nevertheless it has a considerable number of shortcomings. If appropriate regulations and control mechanism are implemented in a transparent way by the Council of Ministers, SDIF can achieve its aim and help to maintain the stability of Turkish financial system. In addition, should small investors be aware of the banks with high and low risks, they will be able to better make their risk management and invest accordingly. The facts mentioned above make one realize that State Sponsored Insurance of Bank Deposit is a requirement for Turkey.

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