THE EFFECTS OF TURKISH BANKING SECTOR RESTRUCTURING
ON THE PERFORMANCE OF BANKS

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Anahtar Kelimeler (Türkçe)	Anahtar Kelimeler (İngilizce)
1)Yeniden yapılandırma	1)Bank restructuring
2)Türk Bankacılık Sektörü	2)Turkish Banking Sector
3)Performans Rasyoları	3)Performance Ratios
4)Global Yeniden Yapılandırma	4)Global Restructuring
5)Bankacılık Sektörü Aktif Performansı	5)Assets Performance of Banking Sector

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ÖZET

Bankacılık sektöründe yeniden yapılandırma sektörde son otuz yılın konusunu oluşturmaktadır. Bunun en bilinen nedeni sürekli tekrarlayan finansal krizlerdir. Bu krizlere en fazla maruz kalan sektör bankacılık sektörüdür. Bu nedenle sektör kendini değiştirme ve yapılandırma yolları aramaktadır. Buna kullandığı yöntemler ve kurumsal yapısı da dahildir. Türkiye'deki Bankacılık Sektörü de finansal krizlerden özellikle 1980 sonrasında girdiği liberalizasyon sürecinde yoğun olarak etkilenmiştir. Konuya bakış gereği ise henüz konu hakkında tutarlı bir yöntemin bulunamamış olmasıdır. Bu nedenle bu çalışma konuya yardımcı olması açısından gelecekte konu hakkında yapılabilecekler ile ilgili fikir verebilmesi açısından hazırlanmıştır. Bu çalışma sonucunda Türk Bankacılık Sektörünün yeniden yapılandırılmasının Bankacılık Sektörünün performansını olumlu etkilediği saptanmıştır.

ABSTRACT

Banking sector has been looking for restructuring itself for over last thirty years. Restructuring itself has been an issue for the sector as well. Because of the never ending dynamic of the Financial Crises that has been continuing for over thirty years directed the sector to find new methods to transform itself. Consolidation and structural condition of the sector is included in this. Turkish Banking sector have been subject to Financial Crises especially after the liberalisation process that it started to implement after 1980. The reason behind searching for the issue is that there is an effective method in restructuring has yet to be found. Therefore this study has been prepared in order for being helpful and give opinion about future applications. In this study, it's verified that Turkish Banking Sector restructuring has had a positive impact on the performance of banks.

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LIST OF ABBREVIATIONS

BRSA	:	Banking Regulation and Supervision Authority
BIS	:	Bank for International Settlement
CAR	:	Capital Adequacy Ratio
CBRT	:	Central Bank of the Republic of Turkey
DIA	:	Deposit Insurance Agency
EBRD	:	European Bank for Reconstruction and Development
EFSAL	:	Enterprise & Financial Sector Adjustment Loan
EIB	:	European Investment Bank
EU	:	European Union
HHI	:	Herfindahl-Hirschman Index
GDP	:	Gross Domestic Product
GNP	:	Gross National Product
IASB	:	International Accounting Reporting Standards Board
ICT	:	Information and Communication Technologies
IMF	:	International Monetary Fund
NDA	:	Net Domestic Assets
NDF	:	Net Foreign Assets
OECD	:	Organisation for Economic Co-operation and Development
SDIF	:	Saving Deposits Insurance Fund

INTRODUCTION

Restructuring of banking sector has been an important issue following expecially the economic crises that have been continuing from beginning of the 1970s. Because 1970s were the years economic instabilities started due to the collapse of Bretton Woods system. With the collapse of the system exchange rate in many economies left floating and capital inflows between economies rendered free. With the increasing capital flows risk that used used to be undisclosed had emerged to the space and especially financial sector had become more exposed against the risks and volatility.

Many banking sectors operating in different regions of the globe started restructuring by taking several measures as the financial crises required them to do so. Also operations in banks started changing in while the problems resulted from financial crises were increasing. Therefore the banking sector in different regions of the globe required to put into application of new types of banking while trying to learn to handle up with the difficult conditions.

Though the complex condition has been continuing for over 30 years restructuring in banking sector has been a recent phenomena in academic studies. The approach that has been followed by the academic studies has many aspects. First of all restructuring root cause is evaluated in terms of whether it is being the result or not. Conditioning upon it is resulted from systemic crises, the restructuring should be handled in terms of temporary or permanent problems in nature of the financial structure, the financial system, financial stability and economic structure. Systemic crises caused banking failures are more than those non-systemic based. Based on this premise the banking restructuring should follow a diagnosis process comprised of analyzing the causes of bank losses, applying uniform accounting standarts to measure these losses, assessing the condition of banks, calculating the costs of restoring banks to capital adequacy. Also there are three types of instruments such financial, operational, structural. In financial restructuring process state guarantees might be provided, in operational restructuring new management would be assigned to the banks and in structural restructuring the sector of banking would be handled as a whole and its size maybe downsized.

For the restructuring to be efficient Bolzico, Mascaro and Granata (2007) proposes pillars such as proper legislation, deposit insurance agency, formal procedures, implementation capabilities, bank capitalization fund in order for clear and consistent assignment of roles and responsibilities and legal framework should provide clear and comprehensive assignment of the process during resolution. This resolution should avoid from leaving gaps, duplication and overlapping of functions. For these to be realised there should be basic institutional arrangements, operational autonomy, decision making powers, arrangement for intra-agency coordination, banking supervisors legal protection.

In this thesis Restructuring in Turkish Banking Sector that was held on between 2002 and 2008 has been investigated. Before coming to the restructuring process in Turkey, global restructuring that has been continuing for over 30 years has been investigated. Four countries that went under restructuring in banking sector were selected: Brazil, Russia, Poland and Sweden. These four countries were selected because they give relatively viable example for restructuring in banking sector. Also these four contries were used the methods mentioned in this thesis in their restructuring. It is possible to say that Sweden was the most successful country in handling the restructuring because it has more viable economy and will that was helpful for the restructuring successful. Russia is in the worst condition of which its restructuring is yet to be successful and there is more way to be taken for the banking sector of Russia. Poland is an exceptional example due that it had handled post-communism and restructuring process at the same time.

Bearing in mind the samples from this chapter Turkish Banking Sector structure is given in the third chapter by seperating the process that the sector have been realising since the establishment of the Republic into six periods. Generally this division proposes that the banking in Turkey started as state and profession banking and ended up with the banks mostly held by private sector. Also the mergers with foreign capital banks is the most impacting issue for the current situation in banking sector.

Based on the view that has been put by the study in the third section the road to restructuring in Turkey were mostly paved with the deregulation in 1987, large open exposures of the banks' foreign exchange open position, crawling peg exchange rate

regime implemented in 1999, unsuccessful privatization process, volatile economic condition and interest rates, International Monetary Fund (IMF) agreements that follows all these processes. With the consolidation of the 1980s capital inflows and outflows had largely liberalised and this created liquidity risk for the banks.

Coming to the year 2002 a new agreement was made between Turkey and IMF and one year before this had happened banking regulation authorities such as Saving Deposits Insurance Fund (SDIF) and Banking Regulation and Supervision Authority (BRSA) were established due to the 2001 economic crises. The monitoring and regulating authority that used to be in the hands of Treasury and Central Bank had gradually devolved to these two Institutions.

Also banking sector restructured itself, shrinked by half between 2002 and 2005 and many state banks were either privatized or closed down. Many private banks were bought by foreign banks and currently the sector is operating with 46 banks. Until 2005 the conditions favored the bank to invest in Government Bonds and funds of banking sector had largely used for public sector financing. From 2005 onwards banks directed themselves to private banking and the funds had started mostly in private sector financing. The condition before 2005 was largely explained as “crowding-out” effect. Public sector mostly crowded out private sector by usurping the funds available in the market. Still the same condition prevails but with a decreasing portion. Today the funds directed to private sector comprises %60 of the banking sector assets.

In order to evaluate the effect of restructuring in Turkish Banking Sector performance criterias are used in form of productivity ratios gathered under seven major headings. They are asset quality ratios, profitability ratios, staff productivity ratios, branch productivity ratios, capital adequacy ratios, liquidity risk ratios, currency risk ratios. Based on the figures derived from the banking sector it is possible to say that the performance in banking sector has been improving. Now the loans are now comprised of 50% of total assets with the 20% capital profitability and 20% staff productivity. Also the capital adequacy for the sector as a whole is around 20%.

In the fifth section the target of joining to European Union has to a certain extent been evaluated. It is possible to say that by the end of 2007 banking sector in

Turkey has reached to its European peers in many respects but still have more way to cover.

The thesis starts with the introduction and methods for restructuring are deeply defined in the first chapter. Second chapter gives the example for Global restructuring. Third chapter gives the history of Turkish banking sector, the drawbacks that the sector had suffered and the cost of these drawbacks are given. Fourth section gives the definition perfomance criterias used for the evaluation of the performance resulted from restructuring and chapter five evaluates shortly the condition on the road to European Union. The thesis finalizes with the conclusion.

1. RESTRUCTURING AND BANKING SECTOR

1.1. Restructuring

Banks have a central role in financial system. Banks affect both the composition and level of economic activity in the financial system, because banks promote and canalize savings among competing uses, and facilitate payments among agents. The central role of banking sector makes the economy particularly vulnerable to events in banking system.

Over the past quarter of the century there have been many large bank failures around the world. There have been many episodes of systemic crises and some cases of non-systemic crises in developed and developing countries since the late 1970s. Also, output losses during banking crises have been average over 10% of annual GDP. Moreover increasing bank lending and profitability has taken many years afterwards.[1]

Possibilities of bankruptcy and financial crisis in banking sector would affect credit workflow and credit contraction would cause economic activities to slowdown. When there is a problem in finding adequate credit resources, which is necessary for sustainable industirial growth making investments in trade and services sector, would prevent economic growth. At this point, resolving their problems, in other words, restructuring is very important for the banks that have temporary or permanent problems in nature of the financial structure, the financial system, financial stability and economic structure.

In generally, restructuring for only a single bank means that the improvement of financial structure of bank and increasing the solvency of bank. Goverment and banking sector authorities apply to restructure, if there is no any solution, so governance and the banks are always reluctant about restructuring. The governance is always anxious about high costs and possibilities of lost of trust on banking sector. On the other hand, banks are anxious about bankruptcy and goverment interventionin financial system, and they may prefer to hide their losses.

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[1] G. Hoggarth and V. Saporta 2001, "Costs of Banking System Instability: Some Empirical Evidence", *Bank of England Financial Stability Review* (2001): 16-31.

Purposes of restructuring are enhancing banking sector efficiency and competitiveness, maintaining confidence in the banking sector, minimizing the potential risks to the economy from the banking sector, enhancing the soundness of the banking sector and protecting the rights of the depositors.

1.2. Bank Restructuring Process

1.1.1. Diagnosis

Before taking action about banking sector failure, the true size of bank losses should be measured even though many bank supervisors are unable or unwilling to do it. Many countries also fail to recognize the extent of the problem, whether because of a lack of political wish or because of a perceived inability to deal with such losses. Private banks, state-owed banks and govertments have incentives to hide losses or delay action. While private banks are unwilling to uncover losses because of fearing government intervention and a run on banks, state-owned banks are reluctant to operate profitably because of large stateowned enterprises lending. On the other hand, govertments rely on the banking system as a source of taxation or finance for fiscal deficit, so they resist dealing with bank problems. When banks are controlled by political interest, resolving problem banks is not only tecnical issue but also a political issue.[2]

Loss diagnosis involves four steps:

i. Analyzing the causes of bank losses: The causes of bank losses are as important as their value. Micro economic factors such as low adequacy, broken quality of assets, poor management quality, low profitability, insufficient liquidity, high sensitivity to market risks; macro economic factors such as instability in the growth rate and inflation, variability in interest rates, variability in Exchange rates, variability in capital flows, current account deficit, external shocks, political instability; structural factors such as inadequate accordance to financial liberalization process, insufficient

[2] A. Sheng, "Bank Restructuring Techniques", in *Bank Restructuring*, ed. A. Sheng, (Washington: The International Bank for Reconstruction and Development / The World Bank, 1999), pp. 38-44.

legal regulations, inadequate supervision and control, the size of public banks in the banking system, sensitivity to political intervention, effects of deposit insurance, inadequacy in financial statements reporting, inadequate risk control.

ii. Applying uniform accounting standarts to measure these losses

iii. Assessing the condition of banks

iv. Calculating the costs of restoring banks to capital adequacy

1.1.2. Choosing Bank Restructuring Instruments

Bank restructuring methods affect not only depositors and taxpayers but also bank owners and managers, borrowers and lenders of banks, so choosing proper bank restructuring method is very importantant.

Bank restructuring instruments can be grouped into three broad categories: financial instruments that address immediate problems and generally involve a direct financial transfer to banks; operational instruments that deal with governance, individual bank efficiency, and profitability; and structural instruments that focus on restoring open competition and soundness.[3]

[3] C. Dziobek, "Market-Based Policy Instruments for Systemic Bank Restructuring", *International Monetary Fund Working Paper*, no. 113 (1998): 8.

Table 1. Instruments of Systemic Bank Restructuring	
Type Of Insturements	**Examples**
Financial Immediate financial support to banks	Central bank liquidity support State quarantees State support (bond, grants, loans, etc.) Private equity and bond injections
Operational Improving governance and efficiency	Additional capital New management More efficient staffing Twinning Facililate entry for reputable foreign banks
Structural Restore competition	Closure Merger / spilts and downsizing Asset Management; debt restructuring Privatization Enterprise restructuring

Source: Claudia Dziobek, "Market-Based Policy Instruments for Systemic Bank Restructuring", International Monetary Fund Working Paper, No.113, IMF, August 1998.

Each instrument has advantages and disadvantages. Not only one of these instruments can be implemented, but also a combination of some of the instruments can be applied in a sequence or a counrty can use these instruments in different case of bank losses in different time. Also, sometimes an instrument is chosen and it fails, leading to a second alternative that may work.

1.1.2.1. Instruments of Financial Restructuring

Financial restructuring is complement of urgent measures, which aimed at improving banks' balance sheets and involve direct money transfers. In generally, goverments and central banks can use financial restructuring instruments to overcome the systemic crisis.

i. State financial support: Goverments take an active part in the process of bank restructuring to avoid negative social and political effects of bank insolvency. Also

for having good payment system and public welfare, goverments can give financial support to insolvent banks if the failure covers all banking system.[4]

In the process of bank restructuring governments issue goverment bonds to banks and give subordinated debt to banks for capital support. On the other hand, deposit transfers, low interest loans and grants and equity injections are financial supporting tools of goverments.

In recapitalization, firstly, losses of problem banks are covered by their reserves and then their capital. If there is insufficient capital problem, so additional capital can be injected to banks. Before recapitalization, top management of banks and shareholders accept the process, and in some cases, goverment can make changes in the top management.[5]

Bond instruments are commonly used to improve bank's balance sheet and to improve current income. For instance, replacing bonds with nonperforming assets improves bank asset quality, because goverment bonds are high-quality assets. In addition, the interest, which is paid on the bonds improves income and trading bonds in secondary markets increases liquidity. Non-performing assets-public debt swaps are used in Hungary (1992-93), Ghana (1990) and Sri Lanka.[6] Low interest grants or loans can be used instead of bonds. These have similar effects on the bank's balance sheet but give the bank a more front-loaded liquidity injection. Goverments also engage in deposit transfers whereby state funds are shifted to weak banks. The effect depends on the source of the deposit. Withdrawing funds from strong banks to transfer them to weak banks can produce new problems for those banks that experience outflows of government deposits. Similarly, governments may purchase subordinated debt (bank bonds), and with the help of subordinated debt, the bank has additional loanable funds and credit expansion. Another way which is chosen by the government to transfer cash

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[4] P. Nyberg, "Authorities, Roles and Organizational Issues in Systemic Bank Restructuring", *International Monetary Fund Working Paper*, no. 92 (1997): 9.

[5] C. Denizer and K. Gökay, "Problem Bank Resolution Options and Consequences", *Boğaziçi Journal* 15: 1 (2001).

[6] J.A. Daniel, "Fiscal Aspects of Bank Restructuring", *International Monetary Fund Working Paper*, no. 52 (1997): 15.

to a bank in exchange for ownership is equity injection. Collecting dividens and selling its equity stake for realizing gains are the advantages of getting equity, but on the other hand government has obligations beacuse of being ownership, which may be politically undesirable. Poland, Finland, South Korea, Japan, Norway, Spain and Sweden are countries which use equity injections in the world.[7]

ii. Liquidity Support to Bank by Central Bank: Central bank liquidity support is another financial restructuring instrument which is commonly used when there is problem in goverment funding for weak banks is liquidity support. When liquidity problems arise in the markets, the central bank is commonly the first agency that banks turn to, as lender of last resort. According to properties of the banking sector, emerging needs and opportunities, central banks use various ways to provide liquidity for system. In theory, lender of last last resort loans, which should be fully collateralized and granted at penalty rates, are limited to liquidity support for illiquid but solvent banks. But when systemic problems unfold, the distinction between illiquid and insolvent bank is difficult and also lender of last resort loans are granted with less than full collateral.[8] If this support is continuous, this can be understood that unsuccessful management of insolvent banks is rewarded, and moral collapse arises.[9]

Central banks can use indirest ways of support such as overdraft loans to build up the payment system, reduction of required reserves, broad discounting of eligible paper, or foreing Exchange loans to banks. Moreover, if there is systemic banking crisis, central banks may reschedule short-term liquidity loans into medium and long-term obligations for keeping the liquid system.

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[7] Organisation for Economic Co-operation and Development, 2002, "Experiences with the Resolution of Weak Financial Institutions in the OECD Area", *OECD Journal: Financial Market Trends*, no. 83 (2002):

[8] C. Dziobek, "Market-Based Policy Instruments for Systemic Bank Restructuring", *International Monetary Fund Working Paper*, no. 113 (1998): 9.

[9] A. De Juan, "Restructuring and Resolution Comparative Experiences", *World Bank Working Paper*, (June 2003): 5-8.

In restructuring process, coordination between central banks and banking resturcturing supervision agency must be doughty, because restructuring operations affect liquidity positions and payment systems of banks.[10]

iii. Guarantees and Deposit Insurance: To prevent bank runs and to protect confidence of banking system the goverment may announces guarantees. With the help of guarantees and deposit insurance, small depositors and in some countries all depositors are explicitly protected when the bank is closed. This protection is not only for depositors, but also for specific groups of creditors. On the other hand, guarantees and deposit insurance have significant moral hazard effects on banking system, and authorities try to decrease effects with bounding the extent and period of gurantees.[11] For instance, in Sweden and Hong Kong, goverments gave guaranty for all bank liabilities except equity capital and perpetual debenture.

iv. Private Equity Injections: In supporting process for failing banks, firstly the banks'owners and shareholders should step in to restructuring. But a "wait and see" attitude may arise between shareholders, and it causes postponing necessary action and furthering deterioration in the bank's financial condition. For instance, in France central bank has to hold a right to intervene in weak banks with the intent of raising shareholders' equity without committing any government funds. Similarly, in Spain, the government plays the role as mediator in soliciting new private investments in failure banks and commit some state funds as well.

1.1.2.2. Instruments of Operational Restructuring

Operational restructuring of banks aims at restructuring of these banks in terms of organization, technology, human resources, financial control, planning, risk management and service quality so that they could operate according to the

[10] Nyberg, "Authorities, Roles and Organizational Issues in Systemic Bank Restructuring", p. 10.

[11] C. Dziobek, "Market-Based Policy Instruments for Systemic Bank Restructuring", *International Monetary Fund Working Paper*, no. 113 (1998): 10.

requirements of the modern banking and international competition.[12] Disregarding the importance of operational restructuring delays solving systemic problems, and countries encounter new banking sector problems in short term.

i. .New Management: In order to restructuring in financial system, top management level of banks may exchange or if hiring new management is difficult and expensive, additioal incentives measueres may considered, such as closely monitoring, perfoemance related contract, salary reductions for top management level.[13]

ii. More Efficient Staffing: For successful operational restructuring, not only change in top management level, but also the number of qualified employee should increase. Operational costs affect the pricing of banking services and directly the banks' borrowers and depositors. instead of increasing prices of banking service, banks generally prefer closing or downsizing unprofitable entities or branches and focusing on the banks'comparative strengths.

iii. Twinning: Hiring reputable foreign banks to lead the internal operational restructuring effort of a weak domectic bank is called "twinning". With the help of twinning, efficiency of restructuring increases and operational costs falls.[14]

iv. Facilitate Entry for Reputable Foreign Banks: In order to increase liquidity in banking system and to set up competition, rules for entrance of reputable foreign banks should update, such as relaxing their limitations and facility in tax payments.

1.2.2.3. Instruments of Structural Restructuring

One aspect of restructuring, the structural restructuring has several measures dealing with financial sector. In general these are related with pointing the weaknesses

[12] The Banking Regulation and Supervision Agency, *Banking Sector Restructuring Program: Progress Report* (2002): 16.

[13] C. Dziobek, "Market-Based Policy Instruments for Systemic Bank Restructuring", *International Monetary Fund Working Paper*, no. 113 (1998): 13.

[14] C. Dziobek, "Market-Based Policy Instruments for Systemic Bank Restructuring", *International Monetary Fund Working Paper*, no. 113 (1998): 14.

in the system, measures for open competition strenghtening and forming of system soundness in general. [15]

Financial or banking system may have problems due to too lax or too rigid licencing policies. If the licence issuance too rigid the requirements compliance would favor those have paying the cost of licence capability. Thus, in financial sector a few big players survive and others would always suffer bankruptcy. As a result they become a burden for the system and the system with its rules, regulations and official institutions should deal with financially disabled condition.

Too lax licencing would result in abuse in financial sector by allowing many above the required number enter into market and heat up the competition. This would ends up with two conditions. One is the loss in profit. In order to be competitive and survive in the market competitiors would sacrifice from some of their profits and in this sense loose from their operating margins. The other is the harsh competition in the market. This would maket he competitors go to a level that is unsustainable and result in moral hazard. In history this had seen as hiding creditors accounts and declaring erroneous financial statements. Also, the harsh competition makes financial institutions to be competitive and espousing of invention of new unknown financial products that are highly complex and ununderstandable. However, the institutions do not hesitate in marketing such products offering returns over normal ones in order to get more share in the market and be competitive.

The other issue in structural restructuring is considering the market segmentation in financial market. Because mostly financial markets comprised of state and private banks. State have always been have the upper hand as they are supported by government when there is a problem. Therefore, whe restructuring is in consideration this discrepancy should be taken into consideration.

Financial measures in structural restructuring is bank closure, merger, other instruments aimed at insulating nonfunctioning segments of the banking sector and bringing reputable international banks into domestic markets.

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[15] C. Dziobek, “Market-Based Policy Instruments for Systemic Bank Restructuring”, *International Monetary Fund Working Paper*, no. 113 (1998): 14-17.

The problem in restructuring in terms of the structure of the system is to harmonize these instruments with market principles. Because market principles requires to have specific principles implementing these measures should comply with the rules the markets operate under them.

i. Closure: Bank closure due to insolvency requires as an exit rule. Closure due to insolvency reuqires that as the bank could not makes profit managers and owners have incentive to "sack" the bank. In a sense both parties would have view to get rid of such an unprofitable institution with minimum loss in a time period as immediate as possible. Therefore exit policy provides stringent incentives in bank restructuring efforts. Because the bank would end up with as a profitable asset to be sold in its true value. This makes restructuring a better option than closure.

On the other hand, at the end of closure there might be a disrupt payment system for the creditors and depositors of the bank, public opinion would be eroded in terms of reputability of financial sector and savers as they are, they would hesistate in bailing out their savings to financial system. Also, the closure might be impossible due to the legislative difficulties and as legislation for closure does not allow a correct procedure the process would arbitrarily become a random event and makes discrimination an option.

In order not to be discriminated against the track records of banks should have been monitored before hand. In this sense the banks in the financial system would be classified as "first time problem banks" and others. The problem banks near insolvency should first be taken into consideration for the restructuring. In other sense those offering a convincing and a realistic rehabilitation plan would supported along immediate future to get to its resumed condition.

ii. Merger/splits: Market segmentation mentioned in closure item could evaluated within the scope of merger/splits. If specific markets are not efficient with their current structures financial market could be restructured by allocating non-performing divisons of the sector into another ones. This would make institutions concentrate to their core business and reduce inefficiency.

Banking legislation in this sense should be as clear as possible. Huge, complex banking legislation should be minimised and made clear. The rules should be bald and players in the sector should know what to do before hand. This would also pave the way for any voluntary merger that is made intra-players without applying for outside complexion. The system clears up by its own dynamic and routine would continue.

Efficiency gain is key issue in mergers. This is the important precondition in the sense that it necessitates merger among saving banks, cooperative or small commercial banks with similar profile. Inbalance between the parties would create scale economies that makes the bigger scaled one ends up with losses. Scale economies is limited in terms of mergers. Because there institutions in financial sector that are "too big to fail". Therefore merging these with others would bear difficulties and economies of scale could not be obtained. But banks with different competitive advantages could be taken into merger by allocating their capability in different market segments.

Disadvantages of merger is harmonizing different corporate cultures especially between state and private owned banks. Technical structure differences is another issue for two different banks using seperate technical base. Some mergers might be politically forced mergers. For example, politicians may force a state bank to own the assets of another. These fail to improve the stability of the banking system known to be weakening for the bank bigger in size.

Split off could be used in reducing some operations of the bank while maintaining it and the system operative. It maybe done through isolating weak protions of the bank and selling them seperately. Also downsizing is another option in restructuring by narrowing the bank in its operations where profitability is highly a far realisation in some areas of the market.

iii. Privatization: Inefficiently operated banks is an important factor in systemic banking problem. Systemic in the sense that state banks have always been considered as safe heavens because they are under state guarantee as public believes. They are as a result believed far better than private banks.

Privatization is one way in restructuring in the sense that it would abolish priviliges and levels the playing field, increases the profit and business opportunities for all banks. Thus entire system comprised of banks benefits as a whole.

However there are some prior actions before privatization is taken into consideration. Privatization is a long term process. Thus financial and operational restructuring of banks should dispatched before making privatization. If the process is speeded up there is a risk for renationalization because of the new owners could accomplish in operating the bank profitably.

iv. Handling bad assets and loan restructuring: ıf non-performing assets could be siolated (real estate loans) banks could be strenghtened as these assets are isolated. Thus banks could focus on core business.

v. Management and loan resolution: bad assets could be handled by an outside agency. So banks could accept some sort of losses. Agency would be a private company or bank based agency. The problem here is the relation between agency and clients. As clients are depositors to the bank and creditors put their capital into the bank the agency should form a balance between them.

1.2.3. Pillars for Efficient Bank Restructuring

Restructuring necessitates to have a banking supervision. This could be done through an institutional framework that have many aspects such as licencing, standardized supervision with firm actions, intensive supervision with regularisation and resolution.[16]

Bank restructuring is one item of this framework. This item also comprises laws, norms, institutions and procedures. These are not strict pillars rather guidelines for a foundation of a viable bank restructuring.

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[16] J. Bolzico, Y. Mascaro and P. Granata, "Practical Guidelines for Effective Bank Resolution', *World Bank Policy Research Working Paper*, no. 4389 (2007): 4-13

A viable restructuring should be comprised of minimizes financial and economic costs, base level protection for creditor, shareholder protection, adopted in a timely fashion

For such a viable banking restructuring pillars below should exist:

- Proper legislation

- Deposit insurance agency

- Formal procedures

- Implementation capabilities

- Bank capitalization fund

1.2.3.1.Proper Legislation

Financial institutions and banks resolution is different than that of non-financial institutions. Thus bad management of bank failures could generate financial costs. Thus legislative should exist before bank failures ocur because in the middle of the process it would be impossible to prepare for such measures. Also this is risky, in the sense that whole process might ends up with moral hazard.

This is because the market mechanism's “invisible hand” does not allow efficient working of the system. That is why the governmen should be a monitoring institution in the process and the monitoring that it uses is the legislation. This is the only way for depositors interest and welfare of the society.

Following items should be followed in order for the restructuring to be viable:

i. Clear and consistent assignment of roles and responsibilities

ii. Legal framework should provide clear and comprehensive assignment of the process during resoulution. This resolution should avoid from leaving gaps, duplication and overlapping of functions. For these to be realised there should be basic institutional arrangements, operational autonomy, decision making powers, arrangement

for intra-agency coordination, banking supervisors legal protection. These should be particularised among institutions but there is no general consensus regarding how this would be done. As a result this situation bears risky condition for the banks to be restructured viable. But performing all the process through centralization increases the way for accountability. Thus the number of participating institutions should be minimised as possible as it can.

iii. Legal Capabilities of The Supervisor: Supervisors should have all the necessary legal powers to initiate, conduct and supervise failure proceedings. These include asset collection, administration of sources and restructuring the structure of the institutions. Liquidating is the key item for the supervisors perform their task in an efficient manner. Licencing for example one of the core issues in banking restructuring. Because with this in hand management of a bank could be replaced with another and shareholder rights usage are important issues.

iv. Legal Protection for Authorities and Resolution Process: Authorities taking part in the process should have enough protection against penal and civil codes. Apart from negligance their conduct should not be evaluated within criminal code. This should be accomplished by accountability and transparency.

v. Clearly Defined Priority of Claims: The claimants' claims should be ordered according to their priorities. The priority should be given to smaller depositors and than to the more liquid ones.

vi. Liquidation and Pay out of Deposits**:** Liquidation mostly does not favored by government because it might lead to negative externalities. Liquidation in general means paying depositors money because the pre-assingnedly under the protection of government. Paying these means using the money of the tax payers as a source. This is in some sense transferring the sources to the depositors thus resembling favoring one part of the society.

vii. Legal Certainty: Legal and institutional environment must ensure legal certainty and legal certainty requires clear and relatively stable rules.

1.2.3.2.Deposit Insurance Agency

Deposit insurance agency is defined by law and regulation regulatory framework should allow the DIA to participate in bank resolution processes through a "less cost" criteria. Setting a limit for DIA to provide funds for implementation of a BRM maximum coverage established by law.

i. Limited Coverage: Enhance market discipline by providing full coverage of the private account holders that can better monitor back. Covered liabilities should only include deposits and they should be clearly defined in the law. Larger deposits, inter-bank deposits should be excluded.

ii. Appropriate Funding Features: It is convenient to use risk sensitive premiums as they are a very useful mechanism to adequately align incentives while also avoiding cross subsidies from safer to risky banks.

iii. Compulsory Membership: Compulsory membership to DIA increases the size of the insurance pool.

iv. Monitoring Function: Market discipline may also be enhanced when the DIA has supervisory powers.

v. Adaptation to Institutional Environment: DIA as an institution shoud be adopted to legal and regulatory order and when the conditions necessitate could adopt the order by itself.

1.2.3.3.Enhanced Supervision

For the process to be effective supervision enhancement should be ensured by realistic information. If the information is timely and reliable early intervention is possible. International Financial Reporting Standarts (IFRS) details a set of accounting standarts for the information to be timely and reliable.

Cost of not handling bank problems in a timely fashion are large as efforts become more difficult and expensive. Bank restructuring supervisors should step in when banks engage in unsound banking practices or fail to comply with supervisory requirements. It is often said that the correct time for stepping in could be understood by

capital adequacy ratios when banks shows persistent deficiencies in compliance with reserve requirements, repeated lack of compliance with mandates or written requirements.

On the other hand as globalisation and deregulation prevails the risk potential in banking business increases. Therefore risk profile of banks and their risk management potential should be assessed. Basle II accords are thus inspired by assessing the risk records of banks and formed a new capital adequacy framework aiming to make regulatory capital reuqirements more risk sensitive. The framework promotes early intervention when capital fall below minimum levels required

1.2.3.4.Formal Procedures

Clear ex-ante rules and procedures going beyond specifications in the law should be implemented and clearance should be complied with. This will increase speed and transparency of the bank resolution process.

A manual regarding the bank restructuring should be employed as a guide determining trigging time for the resolution begins, mentioning most appropriate process according to circumstances, procedures to be applied during the process, deposits treatment, deposit guarantee fund participation.

The other aspect of the procedures is a forming a contract type. Because as parties such as bank vs. another bank, bank vs. government, bank vs. agencies should sign a contract in restructuring process. A contract completes and complements the relevant legal framework should be prepared before hand.

1.2.3.5.Implementation Capability

Implementation capability is first of all related with enough monetary and technical resources. Second a qualified personal with relevant training and creation of specialized bank resolution unit which is in charge of conducting bank resolution process is required.

1.2.3.6.Bank Capitalization Fund

Bank Capitalization fund is useful when the image of unviable bank have to reshaped in public view. These funds are generally are generally funded by banking sector itself and full of with capital that could be used in strenghtening. Thus during the process the unviable bank could be turned into a profitable institution and its marketing would be easier.

1.2.4. Cost of Bank Restructuring

Banking sector or banks individual restructuring have effects on several areas. This is wide in scope and should be ordered in its prioritization.

Bank restructuring have effects first on the economy proper. As banking sector is the huge part of financial system the flow of capital into this sector often amounts to considerable amounts of the GDP. This amount may goes up to 33 percent as in Chile or 45 percent as in Kuwait. These are fiscal costs to economy. Other costs include externalities. Other sectors as well would be in trouble while financial sector suffering a toruble. These sectors often could not get necessary attention and financial sector gets more share in restructuring processes.

Cost measures in the process has two aspects: the size of the problem which is measured by nonperforming balance sheets of banking system. The other aspect is their effect on the economy. During last 30 years, according to IMF working papers, bank restructuring examples on the effect of the econmy is shown on the below table.

Table2. Bank Restructuring Cost in Percent of GDP

	Substancial Progress Countries
Cote d'ivoire	13
Peru	0,4
Philippines	4
Spain	15
Sweden	4,3
	Modarate Progress Countries
Chile	33
Finland	9,9
Gana	6
Hungary	12,2
Poland	5,7
	Slow Progress Countries
Kuwait	45
Mauritania	15
Tanzania	14
	Countries with restructuring programs after 1994
Argentina	0,3
Indonisia	2
Mexico	12 – 15
Venezuella	17
Zambia	3

Source: Dziobek C., Pazarbaşıoğlu C.(1997) Lessons From Systemic Bank Restructuring: A Survey of 24 Countries 1997 IMF Working Paper avaible on line: -www.imf.org- January 2009.

1.2.5. Assessing the Effects of Bank Restructuring Operations

i Debt Sustainability: One of the measures taken against insolvent banks is debt issuance to compensate against nonperforming loans.[17] The cost to the issuer is the present value of the associated cash flow which has to be met through future income. Thus the sustainability of the government debt will in the abscence of countervailing measures worsen.

[17] J.A. Daniel, "Fiscal Aspects of Bank Restructuring", *International Monetary Fund Working Paper*, no. 52 (1997): 15.

The argument behind this is that as implicit government debt is made explicit and growth of the explicit debt is equal to the implicit debt. However this is viable when governments entirely own insolvent banks. Also insolvent banks are operating under perverse incentives they might lose money faster than the growth of explicit debt. Thus debt sustainability delays restructuring and increases costs.

ii. Aggregate Demand Impact: Aggregate demand for goods and services will be increased to the extent that wealth and income rise and money supply expands. There are various channels through which the demand is affected.

iii. Counterfactual: If the banks are not recapitalised demand will weaken in medium to longer term. As the banks can not make their way out of insolvency, they would go bankrupt. As public confidence declines their demand for deposits will decline. Deposits would be shifted into other financial instruments or currency and availability of credit will reduce. This may result in demonetization.

iv. Interest spreads: Interest rate spreads would have a positive effect on depositors if interest rates decline as this would have a tax reduction effect and aggregate demand will increase.

v. Wealth Effects: Debt based government financial restructuring will transfer net assets from the government to the recipients of the assistance. Recipients' perceived wealth will change as a result provided that lower government wealth is not fully internalised by the private sector and that the financial restructuring is not fully anticipated.

vi. Recurrent Recapitalization: Recapitalization may well recur if it is not accompanied by measures to address the source of bank weakness.

vii. Monetary Impact: Money supply will tend to increase through changing the reserve money and the money mutiplier. Reserve Money will tend to increase when financial restructuring increases the central bank's net domestic assets.

viii. Fiscal Response: Public debt/GDP ratio would grow faster over medium term than that was presumed before banking sector restructuring if the fiscal policies are not tightened. If the debt condition is accepted the sustained incerase in debt

should be overcomed by lowering interest rates. But this is viable when the country have high growth rate and low real interest rates.

Aggregate demand and need for a comprehensive macroeconomic framework. The financing of government financial assistance operations could be adjusted to allow a more gradual fiscal adjustment while ensuring macroeconomic stability through necessary external financinga and public sector share of total restructuring costs could be reduced by imposing greater costs on depositors.

2. GLOBAL RESTRUCTURING

2.2. BRAZIL

2.1.1. Economic condition before restructuring

Economic history of Brazil is defined by volatility and unfulfilled economic conditions. The economy had grown after second world war. This sometimes had gone to extraordinary levels and Brazil experienced budget deficits in the 70s and stagnation in 80s and hyperinflation in 90s. [18]

The magnitude of the hyperinflation had provided banks with an important source of revenue as the real value ofsight deposits fell each day and as time deposits carried interest rates below the rate of inflation. By year 1990 revenue through inflation of the banks had grown to around 4% of GDP. This corresponds to %40 of revenue from financial intermediation.

This levels had down to negligible levels by 1995 due to the end of hyperinflation. This was comprised as huge loss in banking sector returns and in order to compensate this loss they have to make radical changes to adapt to the low inflation environment. On the other hand with the end of hyperinflation it become more attractive to hold bank deposits which grew dramatically following stabilisation. To relend these deposits and compensate for the loss of inflationary revenue the banking system was under pressure to expand lending. Therefore in order to avoid excessive growth of bank deposits authorities increased the reserve requirements to %100. Although this was the case financial sector loans to private sector had grown by %60. This had to a certain extent compensated the loss of the inflationary revenue. The adjustment that should be done in financial sector was postponed due to this. However, the downturn in economic activity during second half of 1995 due to Mexican crisis led interest rate increase led ton non-performing loans.

A low inflation environment with surging bank credits had destabilised financial system again and restructuring had become inevitable.

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[18] J.J. Almagro, *The Political Economy of Financial Reform: Late 90s Bank Restructuring in Brazil and Korea*, Centro de Investigación Latinoamérica Europa (2002), http://www.cilae.org/publicaciones/DTPolEcreform_JJ.pdf.

2.1.2. “Real” plan

Implementation of the real plan in 1994 started a major process of structural changes in Brazilian economy. The evolution of the financial system can be divided into three phases. The first phase was marked by official intervention and liquidation to reduce the number of banks. Second phase was the implementation of Program of Incentives for the restructuring and Strenghtening of the National Financial System and another program for state owned financial institutions. Third phase is marked by entry of foreign banks.

The plan provided all legal mechanisms for intervention when there are cases of insolvency, bad management of infractions of banking laws. Also under a special regime the directors of the financial institution concerned automatically and immediately lose their offices. An Intervenor, a Liquidator and a Board of Directors are appointed by Central Bank and are granted the power to conduct transformation, merger, split or transfer of the shareholding control of the institution.

Since the outset of the Real Plan until 1999, 48 banking institutions have Undergone regime procedures with 31 being liquidated. On the whole financial system 182 financial institutions were submitted to the Regime. However, the difficulties of some private banks considered to big to fail and the recurrent problems with state banks made it necessary to design a new set of policy instruments toprevent risk of systemic banking crisis.

Second phase driven by two programs aimed to help the restructuring of private and state owned banks. These programs wanted to protect the interests of depositors and to transfer the shareholding control of troubled banks. Also normal functioning of payments system and general confidence in banking sector were other considerations to prevent bank runs and keep moral hazard at minimum.

Brazil’s deposit insurance agency (FGC) took part in the program. For larger banks the model was to divide the bank under Regime into two as bad and good bank. Good bank was acquired by another good bank and bad bank was liquidated. For smaller banks the troubled bank was simply taken over by another bank. In both cases credit lines were available. Role of second program regarding state banks was to reduce

the role of state governments in the banking system. These goverments had right to extract credit from their own banks thus undermining the independence. Through the second program state control was changed and the process converted into a state fiscal adjustment and debt restructuring.

2.1.3. Foreign Banks

In fact Brazilian banking industry highly concentrated. Five bank concentration ratio was up to 55% in loans and to %58 in deposits for year 2000. [19] This had been increased by privatization and for the time being major players have significant market power.

Role of overseas institutions in restructuring financial system is important as they could obtained entrance to a huge market with relatively low bank penetration and higher margins owing the presence of a large state-owned banking sector that sometimes allocates credits, thus providing scope for the foreign institutions to do business.

The expectation of a more stable environment created by Real Plan stimulated growing foreign interest in Brazil's financial system. The possibility of acquiring well established institutions with valuable goodwill opened the channel for them to be entered. Moreover, opening of the capital market, the privatization program and the prospects of profits from Project finance for infrastructure investment have been attracting the attention of foreigners.

Even today domestically owned banks stil dominates the market foreign presence is growing rapidly and now amounts to more of a quarter of assets. However, many things remain to be solved. There are four state owned remain to be solved and the economic instability in Americas region (Mexico and Argentina) makes foreigners to hesitate from investing more.

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[19] G. Maia, "Restructuring the Banking System: The Case of Brazil', in Bank Restructuring Practice, *Bank For International Settlements Policy Papers*, no. 6 (1999): 106-124.

Overall, Real Plan has been quite comprehensive and has helped preventing banking crisis runs out. The intervention and closure of numerous instituutions, restructuring of public banks and the entry of foreign competitors have been accompanied by major mergers and acquisitions. But the consolidation is clearly not over.

2.2. POLAND

Along with all countries of Central and Eastern Europe Poland has been undertaking major economic changes. Since 1991, an official attempt has been made to replace former socialist central planning system with a market based capitalist system. With the involvement of IMF, the World Bank and other international financial institutions as well as the assistance of Western governments Poland has embarked upon the process of economic transition. The IMF presciriptions for Poland reform attached to financial aid from that institution are of the usual type. They include the liberalisation of prices and removal of subsidies, the devaluation Plish zloty, a decrease in government expenditures with the goal of decreasing the budget deficit along with a tight monetary policy. The process is quite lenghty and involves not only the overthrowing of old policies of operation and adapting new market based instruments and signals but also the incorporation of a wide range of institutional changes as well as the creation of a new legal framework. The long term goal is to privatize all those economic institutions owned by the state with the hope of creating a market based capitalist system. [20]

Three areas of reform can be identified within the transformation process. The dismantling of controls, adjustment of macroeconomic policy and imbalances and the building of institutions. The reforms could be distinguished within the enterprise sector as the restructuring of fiscal institutions and reform in the financial sector. If macroeconomic stability and a well functioning is desired to be achieved reforming institutional structures should be much concentrated upon.

[20] D.W. Lohrenz, *Reforms of the Banking Sector in Poland 1989-1995*, M.A. Diss., University of Manitoba, Department of Economics, 1997, p 77-97.

i. Financial Strategies: The method in financial liberalisation is to make the government step back and allow market forces to set interest rates at a competitive market clearing level. This requires a deepening for the financial system through

- Savings accessability enhancement

- Investment allocation efficiency

- Financial process allowing moblisation and allocation of savings.

- Weaknesses of and amendments to financial liberalisation

Table 3. Deposit Rates, Lending Rates, Spread			
Year	Deposit rate %	lending rate %	difference
1989	104	64	-40,00
1990	42	504	462,60
1991	54	55	1,10
1992	38	39	1,20
1993	34	36	1,50
1994	33	33	-0,60
1995	27	34	6,70

Source: D.W. Lohrenz, *Reforms of the Banking Sector in Poland 1989-1995*, M.A. Diss., University of Manitoba, Department of Economics, 1997.

Table 4. Money Supply Growth and Inflation		
Year	Money growth	CPI inflation
1989	253.6	247.7
1990	401.1	553
1991	39.917	76.7
1992	38.8	45.3
1993	39.903	36.9
1994	39.7	33.3
1995	36.4	40.051

Source: D.W. Lohrenz, *Reforms of the Banking Sector in Poland 1989-1995*, M.A. Diss., University of Manitoba, Department of Economics, 1997.

Table 5. Sources of Money Creation (in %)					
	1992	1993	1994	1995	1996
Total	100	100	100	100	100
Net foreign assets	40.081	39.950	32.9	58.5	33.4
Net budget indebtedness	48.3	47.1	37.2	37	40.035
Credit to non-financial sector	40.050	35.4	40.085	37.8	55.9

Source: D.W. Lohrenz, *Reforms of the Banking Sector in Poland 1989-1995*, M.A. Diss., University of Manitoba, Department of Economics, 1997.

Since financial markets by their unique nature adjust much quicker than do goods and labor markets former's liberalisation must be paced in accordance to the speed of adjustment and of the latter two. Since any policy can work only in the appropriate environment financial liberalisation can be successful only if seen as a credible and consistent policy. Actors in the economy cannot suspect a change or reversal thereof or else they will fail to respond to the new market sginals as they should.

ii. Financial Liberalization in Transitional Economies

In order for the transitional economies to be viable below items should be followed:

- Old problems which have come to light during the transition must be resolved.

- An environment must be created which enables banks to operate under free market conditions effectively

Central banks must be reorganised in order to be able to perform all functions of a central bank in a capitalist economy. Governments must commit themselves to bank reform policy.

iii. The Need for Financial Restructuring: In a market based economic system the financial sector has to perform several important functions. Because the majority of the financial institutions in Poland are banks they had to be restructured so as to execute these functions. Banks must be able to collect newly generated and voluntary savings and to allocate them towards various uses on the basis of risk return

criteria. Savings must be voluntary as opposed to forced. Banks must also be able to monitor and control the existing stock of savings and to implement sanctions whenever risk return criteria are not met.

An efficient system in the economy in transition is necessary in order to provide enterprises with a source of external funds. During the transition process banks has to mobilize the savings. After the state owned enterprises are privatized banks must be available to aid with the restructuring of enterprises.

2.2.1. Banks in Poland

i. Undercapitalization: Banks portfolios and banks in Poland faced with the problem of capital adequacy. Adequate capitalization is stated as %8 in Basel I accords. Old state owned banks are undercapitalised and some small private banks are financially viable during transition.

ii. Insufficient Competition: Although many new small commercial banks were created in Poland and thus the degree of competition in the banking sector may be stronger than in many other transition economies effective competition between banks is stil weaker than it could be. Newly created banks are essentially much too small to rival the large state owned banks.

iii. Post Reform Creation of Bad Assets: In the early stages of the reform a negative net worth due to the collapse of the Soviet Union and collapse of CMAC export market and financial and trade liberalisation of 1989 led banks to less than prudential behavior. Banks often had engaged in activities that only benefited them with the cost of depositors.

iv. Microeconomic Implications of Non-performing Loans: The inherited stock of non-performing loans, the newly created non-performing loans as well as enterprise debt were the obstacles in front of the banking sector in Poland. Banks were preoccupied with staying afloat and as a result problematic loans pose a problem when it comes to privatization of the bank.

v. Inadequate Regulatory and Supervisory Structure: Bank supervision was impeded by several factors. Reliable information about banks could not be obtained and

financial situation of clients were not available. The experience on risk analysis were only limited. Tax regimes were adequate for provisions and prudential regulations.

vi. Lack of Clearing and Payment Settlement System: Even thoough Poland was among those formerly planned economies which had made the most progress in the area of clearing and payment settlements the capability of banks in Poland to process information quickly was still not in line with Western standarts.

2.2.2. The Reform Program in Poland

i. General Economic Reforms in Early Stages: The first goal in the reform of the banking system was to create a two tier banking system with a fully fledged central bank and a second tier or independent proofit oriented commercial banks.

The establishment of a two tier banking system with an independent central bank was designed aid the transformation of Polish economy. Three steps could be identified in this process:

- Divison of the sector with an independent central bank and market based commercial banks

- Development of commercial banks with greater economy

- Providing the central bank with the means to conduct monetary policy and supervise banks.

ii. Regulatory and Supervisory Framework

- Bank Supervision: The supervisory authority were modelled after the standarts of European Union. This was partially because Poland lacked its own experience on the basis of which regulaions could be set and partially because both the World bank and EU required that EU standarts be applied.

- Prudential Regulation: By 1993 prudential regulation in Poland was more restrctive than in many other countries.

iii. Financial Assistance: Poland received financial asistance from international instittutions throughout the development of its reform program. A stand-by was made in 1990 and then in 1994. The World bank extended many loans for specific purposes of which the most of important was EFSAL comprised of $450 mn. Also European Bank for Reconstruction and Development (EBRD) and European Investment Bank (EIB) were two of the other sources. Apart from these Polish bank Privatization bank was a collection of donations from Sweden, Australia, Finland, United Kingdom and Japan. Overall Poland received financial assistance from many sources that were very useful in operating and completing the reforms and restructuring of the banking sector.

2.2.3. Competition in Financial Sector

The spread between deposits and credits shows the competition level. Between 1989 and 1995 the spread changed between 450 and 0%. Thus, this does not give a reliable figure in order for the banks in Poland to be said to be competitive. When the services given is taken into consideration highest number of bank services is catering to the private sector for the general public as well as small and medium sized banks. Activities were concentrated on deposit taking and lending to general public.

Large and predominantly state owned enterprises are serviced by the nine large commercial banks. Ties between them had apparently not been broken and competition in this area has not increased when it is considered that bulk of the business is within nine large bank.

Financial position of banking sector were improved between 1995 and 2006. The banking sector is now the net creditor rather than a debtor compared to the pre-capitalist economy. However, reforms and restructuring have yet to be said that they are proper for Poland.

2.3. RUSSIA

The central bank in Russia has a discount window at which banks can in theory borrow under certain conditions. The interest rate on central bank credits to commercial banks, the discount rate, was raised from 40% to 80% in June 1992 and to 100% in march 1993. With inflation running at over 1000% a discount rate of 80% or 100% cannot be expected to ration the of resources. In practice the discount window serves almost solely as a channel for the directed programs.

In 1992 the central bank disbursed about 2.8 trillion Rubles in directed credits, which represented more than 95% of its credit to commercial banks and more than half of the expansion in the monetary base in that period. Borrowers under these programs negotiated the amounts and the terms of the loans with the government, the central bank and local authorities. In general banks played only a passive role as the conduit for the funds.

The program for agriculture was targeted at activities broadly linked to agriculture, ranging from loans to farmers and procurement agencies, to loans to agro-industry and tractor factories. Disbursements under these programs were approximately R100, R200, R700 and R1800 billion in each of the quarters of 1992. The extensive use of directed credit program delays progress in the reform of the banking sector, since lending under these programs does not require development of activities commonly linked to bank landing.

Raising deposits and credit assesment in channeling the credits, these credits funds to specific enterprises, regions and sub-sectors of the economy in a manner that reflected their recipients' bargaining and political power not economic or financial considerations. Furthermore, directed credit programs as they are currently implemented weaken the Central Banks' ability to control credit expansion, complicate any attempt to stabilize the economy and delay adjustment in the enterprise sector.

One of the main characteristics of the Russian banking system is the split that exists between the role of Sberbank (Savings bank) and all other banks. Sberbank is geared to raising household sector deposits, which untill recently were automatically channeled to financing the government deficit. Other banks raise deposits from and

provide loans to enterprises. Although the legal restrictions that generated this duality have been abolished the situation is changing only gradually. It will take some time before Sberbank becomes important in the enterprise sector or before other banks attract the substantial portion of household deposits. This duality greatly reduces the extent of competition in the banking system.

There are over 1700 independent commercial banks in Russia. While this number may seem relatively high most of these banks are very small (World Bank Country Study, 1993; 13). More than %75 of the banks (1295 banks) have authorised capital of less than R50 million and less than five percent (65 banks) have authorised capital of over R200 million. In august 1992 the central bank raised the requirement on minimum authorised capital to R100 million from the R5 million established in 1991 and ruled that all existing banks will have to increase their capital to that level by July 1993.[21]

2.3.1. Reform in The Banking Sector

The central bank of Russia uses directed credit programs for two purposes: to provide liquidity to the banking system and to support particular enterprises and different sectors of the economy. Directed credits are not an efficient method. For accomplishing either purpose and should be faced out.

As a means for providing liquidity to banks they can be replaced by discount window at an interest rate taht will ration credit or by credit auctions. A combination of these two types of instruments is used by central banks in most developed countries to regulate liquidity in the banking system. While these instruments are utilised in different ways in each country, as a general rule they do not discriminate between bank or sectors in the economy, as is the case with directed credit programs. As mentioned above the central bank uses its discount window as the channel for disbursing directed credit at an interest rate of 100%. Central banks in market economies usually set discount rate, the rate at which banks can borrow at the central bank discount window, high enough to restrict the demand for credit.

[21] K. Schoors, *The Mired Restructuring of Russia's Banking System* (1999), Russian Economic Trends. 4 : 35 -45.

In most countries demand is also restricted by the fact that borrowing has to be collateralised by either government paper or by accounts in the central bank, which usually carry lower interest rates than the discount rate. In some countries, the use of the discount window is limited to distressed bank for other special circumstances, such as seasonal borrowing by banks in rural areas. In other cases the central bank has more than one window, with banks paying interest rates that vary with the amounts borrowed, the circumstances of the bank, or whether the bank has already recently accessed the window.

Deciding on the discount rate is one of the most important aspects of econonmic policy. This rate usually serves as the anchor for other interest rates in the economy, and changes in the rate become a means to indicate changes in government policy. The discount rate is usually kept at about the level of expected inflation and is raised or lowered when the central bank wants to tighten or loosen monetary policy. Once stabilization is achieved in Russia the cost of central bank funds should be kept at a level commensurate with expected inflation.

The appropriate level of the central bank discount rate in the present circumstances has to be determined as part of the comprehensive stabilisation program. The first stages of stabilisation are usually characterised by high real interest rates and by distressed borrowing on th part of enterprises, which often lead to banking crises. This is a clear possibility in Russia where interest rates may move from negative to positive quite rapidly. The central bank should take into account when designing and implementing a stabilisation program.

The central bank is planning to begin auctioning the credit to banks by the end of 1993. Most developed market economies also use credit auctions as an important instrument for controlling market liquidity and setting interest rates, usually in conjunction with a discount window. In many countries, credit auctions are referred to as repurchasing agreements, reflecting the legal structure used to collateralise the credits. The central bank will also have to evaluate the bids and make sure that banks do not collude. On the other hand, auctions have several advantages, incluuding the fact they are market based. This will eventually allow non-banks to participate indirectly in the auctions, which will maket he transmission mechanism more efficient. The central

bank should initially auction only a small portion of its credits to commercial banks. the amounts auctioned will increase as technical problems are solved and the number of participating increases. In any case over the next five years credit auctions are unlikely to replace the discount window as the central bank's main instrument.[22]

2.3.2. Result of Bank Restructuring in Russia

As described above, progress in bank restructuring in Russia has been mixed. There has been progress in establishing the enabling environment for bank restructuring but the authorities have failed to use it with full effectiveness. As a result, the banking system remains weak and does not play a significant role in financial intermediation. [23]

2.4. SWEDEN

The financial deregulation of 1985 affected the behavior of borrowers and lenders in a fundamental way. It gave strong incentives for companies and households to increase their borrowing at prevailing interest rates. It also changed the environment for banks that they are facing more open and aggressive competition. They adjusted to the new situation by expanding credit as borrowers stood in line to increase their debt.

The result of the new structure of incentives was that debt increased dramatically between 1986 and 1988. A large part of the expanding volume of credit was channelled into the asset markets i.e. into property and share markets. The private sector utilized the rising value of its real assets as collateral for further borrowing.

The process was fuelled by a rising rate of inflation that was peaked in 1990. Inflation expectations followed the rise in the inflation rate. The real after tax interest rate was negative for many investors due to the combination of high inflation, high inflation expectations and the rules of the tax system. The low and often negative

[22] K. Schoors, "The Fate of Russia's Former State Banks: Chronicle of a Restructuring Postponed and a Crisis Foretold", *Europa-Asia Studies* 55: 1 (2003): 75-100.

[23] W.E. Alexander, D.S. Hoelscher and M. Fuchs, *Banking System Restructuring in Russia*, Conference on Post Election Strategy, International Monetary Fund, Moscow (2000): 8-11.

real interest rates helped to raise loans for investment and consumption. The final result was the creation of a financial bubble in the Swedish economy, built on excessive indebtness within the private sector and a corresponding over-lending within the financial system.

The expansionary impulse that the deregulation of 1985 created was not countered any contractionary policy measures until 1989-1991. The conduct of fiscal policy in combination with the financial deregulation thus became the prime reason behind the over heating. The cost cirises and financial imbalances that appeared in the form of over-indebtedness and over landing during the latter part of the 1980s.[24]

Monetary policy had, since 1982, been founded on the pegged Exchange rate of Krona. The devaluation in 1982 was declared the last of its kind. The Riksbank did not counter the overheating by revaluating the Krona as its Finnish counter part did. The responsibility for the stabilization policies fell thus solely on the ministry of finance. After the 1988 election a series of restrictive measures were adapted. In february 1990, the government proposed a freze on all wages, prices and dividends for two years and a limitation of the right to strike. The freze package triggered a government crises. In october 1990 as a consequence of the speculative attack on the Krona a new austerity package was introduced. At the same time, the government announced that Sweden would apply for EU membership, a measure that can be viewed as an attempt to shore up the credibility of the Krona. In May 1991 the Riksbank attempted to strenghten the credibility of the Krona by abondining the currency basket and pegging the Krona to the ECU. In September 1991 a major financial institution, the Nyckeln went bankrupt is an event that is commonly regarded as the start of the bust phase.

The responsibility of the creation of over-indebtedness and other financial imbalances did not restrict private individuals or companies within the financial system. It falls squarely with the Riksbank and the ministry of finance as they responsible for the framing of economic policies. They created the incentive structure guiding the actions of the private sector that led first to a boom and later to boost and deep crisis.

[24] L. Jonung, “The Swedish Model for Resolving the Banking Crises of 1991-1993: Seven Reasons Why It was Successful”, *Euroepan Commission, Economic and Financial Affairs, Economic Papers*, no. 360 (2009): 2-6.

The boom in Sweden ended in 1989-1990. The main driving force behind the boost was the strong and unexpected upturn in the real rate of interest adjusted for taxes. The rate of inflation in Sweden decreased markedly after having reached a peak of about 10% in 1990. Inflationary expectations, which followed the actual inflation with a small time lag started to decrease around 1991. A major tax reform dubbed tax reform of the century, carried out in 1990-1991, worsened the condition loan-financed investments and favored savings. In addition, the last parts of the capital account controls were abolished in 1989, inducing an outflow of capital from Sweden.

International factors forced Swedish real interest rates upwards, in particular the German reunification, which induced the Bundesbank to raise German and thus European interest rates. The Krona was subject to several speculative attacks due to falling credibility for the pegged Krona rate policy. The Riksbank had to defend the Krona rate by raising the level of interest rates in Sweden by more than rates in the rest of Europe.

When the real rate of interest rose, the price of assets declined in a downward spiral. The fall in asset prices reduced fortunes, since these had been financed through loans of which the nominal value remained unchanged. The downturn became cumulative through expectations that asset prices would continue to fall and the number of bankruptcies increased dramatically.

Households adjusted their portfolios by increased savings and by reducing consumption, primarily of durable consumer goods. The savings ratio increased from a negative level at the end of the 1980s to about 8% in 1993. This change in private savings was a significant feature of the crisis. At this point it became apparent that the many years of regulated low interest rates had resulted inconsiderable over investment. The rise in the real rate of interest revealed excessive holdings of assets mainly in the form of housing at the beginning of the 1990s. The revaluation of property and other assets brought with it an abrupt freeze on investment within the housing sector-a sector that had previously been considered a major engine of the Swedish economy.

Real interest rate shock created a sharp fall in aggregate demand. Unemployment increased from a level of around 2% to a level close to the OECD

average of over 8%. Employment fell sharply. The number of bankruptcies sky rocketed. In 1990 inflation was 10% per annum; in the mid-1990s it was down to 2%. Available indices or asset prices show deep deflation during the years 1990-1993.

The rapid increase in real interest rates undermined the financial system, creating a banking crisis. The government intervened to prevent a major financial collapse. A bank support authority was set up and two banks Nordbanken and Gotabanken, ended up government control. A growing financial crises, a fall in industrial output and rising unemployment – undermined the credibility of the pegged Krona rate. Stabilization policy was trapped in a situation where external conditions – the currency crises – required contractionary measures, while domestic considerations – the banking crises – demanded expansionary policy. The more the Riksbank tried to defend the pegged Krona rate by raising interest rates, the deeper the domestic crises became.

With the European currency markets facing unrest in September 1992, the Riksbank defended the Krona by significantly raising its overnight rates. For a very short period, the marginal interest rate, the overnight rate amounted to 500%. The government and the opposition party agreed to back up to austerity packages in september to avoid a devaluation of the Krona. However, the defence of the Krona broke down in November 1992 when the Krona came under massive speculative attack. The floating Exchange rate was introduced on November 1992, amounting to a considerable depreciation Swedish currency.

The downturn was halted by the depreciation by the Krona and the swedish economy turned upward during 1993. As had been the case after the devaluations in 1970s and early 1980s exports and thus industrial output increased but the crises left a lasting legacy in the form of high national debt and high unemployment during the rest of the 1990s. Exports were the major driving force behind the Swedish recovery, growing strongly and increasing as a share of GDP. In 1992 exports amounted to %28 of GDP. By the end of the decade the number was over 45%- a remarkable development within less than a decade.

There is no other similar case in swedish economic history. Several factors contributed to this sharp extension in exports – first the large and persistent depreciation of the Krona after November 1992 increased Swedish competitiveness. Actually the Swedish depreciation remained stronger than the Finnish in the mid-1990s. Wage moderation and improvements in productivity facilitated the growth of exports.

The rise in domestic demand during the recovery phase was markedly lower. Both private and public consumption grew slower than GDP during the years following the crises. At the same time, household savings rate remained at a higher level than before the crises, indicating a continued improvement of the balance sheets of the private sector.

The effects of the crises on employment were more prolonged. The low unemployment rate that prevailed during the 1980s was never reached again in the 1990s. Open unemployment started to decline from the high level of around 8-10% by the end of 1997. The high and persistent rate of unemployment contributed to wage moderation in the 1990s and well into the new century. The from the pegged Exchange rate regime to inflation targeting in 1992-1993 had a profound impact on the behavior of the labor market participants.

The fall of Krona in november 1992 allowing the Riksbank to move to lower interest rates meant the end of the pegged Exchange rate for the Krona. Policy makers were not ready to go back to a fixed krona rate again after the events in the fall of 1992. Instead the Riksbank announced unilaterally a policy of inflation targeting in january 1993. The target rate of inflation was set at a 2% yearly increase within a range of plus – minus %1. The Riksbank declared that the new target range was to be binding from January 1995.

The parliament backed inflation target officially in the spring of 1993. Initially there was some uncertainty about the new policy regime of the Riksbank. However, the rate of inflation and inflationary expectation declined surprisingly, quickly towards the level set by the Riskbank, suggesting that the new monetary policy regime gained credibility.

The government loss the election in the fall of 1994 immediately after the crisis. Yielding power to the social democrat opposition. There was initially some uncertainty about the economic policies of the new government about whether it was going to contract or expand fiscal policy. However, uncertainty was dissolved when the new government launched a program of fiscal austerity. As the crises had caused enormous budget deficits large cuts in government expenditures and tax increases were deemed necessary by new minister of finance.

As the economy was recovering after the floating of the Krona, the deficit as a share of GDP decreased quickly and government debt in relation to GDP was brought down significantly during latter part of the 1990s. Expenditure ceilings were introduced and the surplus target of 2% of GDP over the business cycle was established. The crises thus brought about a new framework for monetary and as well as fiscal policy making. Since Sweden decided not to join Euro in 2003 it is likely that the inflation targeting regime will remain in place for the foreseeable future.

The parliament agree on a complete legislation package just after the 1992 crises. Based on this Swedish model for bank restructuring legislation Riksbank was given the option to lend any commercial bank operating in sweden even to those that were on the brink of insolvency. Also the parliament passed the legislation by an overwhelming majority for establishing a bank support authority that became operationable in 1993.

Based on this model established by government and passed by the parliament:

- Government is authorised to decide on guarantee, loans and supply of capital or to take other measures to increase or strenghten the capital base of the banks and of credit institutions with government affiliation.

- All banks, those already affected by Government measures and credit institutions with Government measures and credit institutions with Government affiliation will on voluntary basis and within a given scope be eligible for supporting measures.

- Subsidies will be kept at a minimum and support that will be given repaid and Government would require structural changes.[25]

[25] L. Jonung, J. Kiander and P. Vartia, "The Great Financial Crisis in Finland and Sweden: The Dynamics of Boom, Boost and Recovery, 1985-2000", *Euroepan Commission, Economic and Financial Affairs, Economic Papers*, no. 350 (2008): 36-40.

3. RESTRUCTURING IN TURKEY

Banks have an important role in the development of countries. Basic premise of economics, the saving, is an important item in economic development and growth. Saving should be improved in order for the countries develop more. This condition is rendered available through fiscal system, especially by banking sector.

Basic function of banking sector in an economy is to transfer the idle sources to sects requiring capital by collecting from the sects supplying them with minimum cost whereas the goal of the banking sector is to render the return of the shareholders rise to a maximum level as possible. Transfering sources to fiscal sector and investors would be hard unless a secure environment is made available.

Starting from 1980s Turkey started opening to outside and its financial system exposed to structural change in parallel to economic growth. As the number of local banks had started increasing banks with foreign capital started opening branches. This was followed by the establishment of private financial institutions operating based on the profit-loss sharing.

However, structural drawbacks in economy and especially with the procurement of the Decree Law Number 32 increase in foreign exchange transaction and open positions and taking the banking sector into consideration as a source for the financing of public sector made it vulnerable to many structural problems.[26]

Following bankers crisis at the beginning of 1980s the crisis in 1994 caused the banks closures. During the second half of 1990s privatization of several state banks did not end up as expected. Savings Insurance Fund distrained up the administration of 10 banks through the end of 1999. As of 1 September 2000 Banking Regulation and Supervision Institution had established and Treasury and Central Bank devolved supervision and control of the banking sector in terms of specific conditions to this institution. Thereafter several restructuring elements have been implemented and their final effect have yet to be seen. Other complications regarding the structure of financial

[26] M. Günal, *Türk Bankacılık Sektörünün Sorunları ve Geleceği*, (Ankara: Ankara Ticaret Odası Yayınları, 2001), pp. 9-13.

sector and profit making mechanism for the sector have also required to be mentioned in order to understand the restructuring of Turkish Banking Sector.

3.1. General Overview of The Turkish Banking Sector

Banking sector had realised a great breakthrough during the 20th century and in parallel with the technological and financial developments had recorded a very fast development. But until 19th century Banks were used to be the institutions, supplying credits through their own resource utilisation and committing real banking. From the beginning of 20th century started collecting deposits, bill discounts and capital markets issues and corporate finance.

Following the Great Depression after 1930s Post Second World War restructuring of destructed places, need for infrastructure finance has made the development and investment banks come to the fore front.

After the oil crisis at the beginning of 1970s, sources formed by the investment of petroleum exporting countries and also after the collapse of Bretton Woods system several developments have been realised and financial techniques were developed.

1980s were the years of development computer and computerising of the banking system. Computer technologh had been widespread and coming to the beginning of 1990s the private and internet banking started. Years 2000 therefore have been the years the banks had got into severe and harsh competition.

3.1.1. Banking in Ottoman

While Europe was realising welfare and trade development due to the trade and industrial revolution Ottoman Empire was in decadence in terms of economics and politics had prevented the banking sector to develop.

As the Emperor was indebted in tremendous amount keeping the value of the bonds issued for financing of this debt caused the beginning of banking sector structure to be established. Two Galata Bankers, Jack Alleon and T. Baltazzi were attained with holding the establishment of Banking sector. They established İstanbul Bank under the name of Banque de Constantinople. From this time until 1876 Ottoman Russo war 11 banks with foreign capital originated were established. Only one of them had continued operating until 2000s, the Ottoman Bank.

Regarding the banks established with domestic capital Ziraat Bank was established in 1888. From this time until 1923 24 national banks were established out of which 11 were condition their operations during Republican era.

3.1.2. Republican Period

It is possible to divide the Republican Period into 6 sub-periods[27]:

1923-1932: national banking sector establishment period.

1933-1944: Stateness – state banks establishment period.

1945-1960: Private banks development phase.

1961-1979: Planning period

1980-1990: Banking deregulation – opening to abroad.

Post 1990: Holding banking – Treasury financing period.

During the first period the idea was that the development of the economy would be ensured by state banks. Türkiye İş Bankası, Sınai ve Maadin Bankası, Emlak ve Eytam Bankası were established in this period. Many state banks were established between 1933 and 1944 after the Great Depression. Sümerbank, İller Bankası, Etibank,

[27] G. Oksay, *Türkiye'de Kamu Bankalarının Yapılandırılması ve Yapılandırma Sonrası Performanslarının Analizi*, Ph.D. Diss., Marmara University, Institute of Banking and Insurance, 2007, pp. 5-20.

Denizbank and Halk Bankası were established to ensure financial support to commercial private entrepreneurs and small and medium sized firms.

Private Banks had gradually developed after Second World War. With the Economic prosperity both inside and outside the country Yapı Kredi Bank, Garanti Bank, Akbank ve Türk Sınai Bankası were established along with 30 smaller banks.

In parallel to the development in economics and banking sector Turkish Banking Association was established in 1958 in order to support the development of banking profession, prevent unfair competition.

During 1961-1979 period multi-branch banking was developed and with the corporate resuming of the banks Holding Banking and profession banking was started developing. This had generally happened during the planning period in which the economy closed to outside and import substitution directed the sector for establishing development and investment banks. Establishment of Turkish Foreign Trade Bank, Arab Turkish Bank indicated that the banking sector had started opening itself to outside. However, the planning period was the period of profession banking so establishment of trade banks was limited.

During the period between 1980-1990, 24 january 1980 rules allowed financial and economical liberalisation. This effected the banking rendering as that they directed themselves opening to outside. In this framework relieving the credit and deposit account interest rates allowed bankers system and caused 1982 bankers crisis.

Interest rates taken under control again from 1983, gradually relieved from 1987 again. This year was at the same time the year of deregulation and upper limit in interest rates was established again in 1989. Number of foreign banks had increased very fast due to opening to outside and deregulation process. Established number of trade banks were 19 during this period, 8 of them were foreign banks.

As the number of foreign banks were increasing Turkish Banks had opened to outside, established branches or agencies. Deregulation allowed for starting the open market operations, Central Bank mandated interbank TL and foreign exchange market establishment. On the other hand banks had given importance to fund management and

foreign exchange operations. In order to realise development and increase the market share, banks had invested in technological automations. In this sense, computerisation and ATM network establishment, fund management units and “dealing rooms” formation, new products and services rendered important steps to take the development of the banking sector in new areas.

After 1990 banks has been reaching a different path due both from technological improvements and deregulation in financial markets. New technology investments had completed and financial markets stabilised with institutionalisation of capital and money markets establishment was completed.

Law with Decree number 32 allowed for funding capital from abroad and banks started syndication agreements. But liberalisation brought by 32 Law Decree, increase in public sector debt and government bonds with high interest rates directed banks to make profit through this easy way. Interest rate and foreign Exchange gap had increased as a result of this, short term capital inflows reached to tremendous amounts and open positions of banks as a result came to a point that was hardly to be cope up with. This caused foreign exchange risk of the banks to increase.

To the end of 1993, because of the misnomer applied by the government in economical policies, treasury auctions cancellation, grade downgrading by rating agencies prepared the crisis environment. As these developments had come across with overvalued TL, the crises was realised at the beginning of 1994.

The excess TL resided in the market due to the conflict between treasury and Central Bank had directed towards foreign exchange. This condition brought the banks that have large open position into trouble.

5 April 1994 instructions had brought 100% guarantee to the bank accounts and required reserve, disponibility ratios were changed in a dramatic way. In line with instructions or decrees concerning the open positions “capital base / risk weighted assets, non-cash credits and liabilities” standart ratio comprising No.12 Decree and Decree related with “foreign exchange net position/capital base” standart ratio taking into consideration the capital base in this decree was published and put into effect. Aim of these decrees were to diminish the open positions of the Banks.

Between 1996 – 1998 political turmoil and short-lived governments had negatively effected banks. Required structural measures implementation delay had increased the open position of the banks and again financing this position through government bonds buying and this condition also supported the easy profiting.

Table 6. Banking Sector Open Exposure : 1991-2000							
	1994	1995	1996	1997	1998	1999	2000
FX asset	855.699	1.782.681	3.995.052	8.795.231	13.755.739	27.459.529	36.764.586
FX Liabilites	899.351	1.967.864	4.274.182	9.809.852	16.094.542	34.598.942	48.386.470
Net Position	-43.652	-185.183	-279.130	-1.014.621	-2.338.803	-7.139.413	-11.621.884

Source: Günal, M. (2001) Türk Bankacılık Sektörü Sorunları ve Geleceği ,Ankara, 2001, Ankara Ticaret Odası Yayınları.

As it is understood from the table the major problem of the banking sector to the end of 2000 was the open positions of banks that had reached to 19 billion dollar. This condition had played the major part in restructuring of the banking sector after 2000. During Etibank was first privatized. This was first example of privatization in banking sector. Also some banks had established branches at foreign countries and some foreign banks founded establishments in terms of a company and some of the banks merged with others.

The last development of this period was the procurement of Law 4389 Banking Law amended by 4491 Law Concerning the supervision and monitoring of banks after long discussions. After the Constituitional Court cancelled the law authorising the Deposit Savings Fund bank seizure with the Decree regarding the Law of Banking Sector. This Law is important other than foreseeing the regulation of bank seizure by Deposit Savings Insurance Fund due it was foreseeing an Institution taking the authority of monitoring the banking sector on itself.

Between 2000 and to the end of 2001 the Fund seizured 11 banks. The problematic credits of these banks had reached to 10% of total credits which was amounting to 2.262 billion. Until passage to Strong Economic Program these banks were supported by government bonds in order for them to accomodate their open

positions and by supplying overnight requirements. Treasury bonds were given to them in order not to interest rates too much.

3.1.3. Turkish Financial System

Turkish financial system has five main pillars:

- Central bank
- Commercial banks
- Investment companies
- Insurance companies
- Other financial institutions

Banks are investigated under headings as deposit banks and investment banks. These are classified as domestic and foreign or public and private banks among themselves. Other financial institutions are classified as private financial institutions, leasing companies, credit cooperatives and factoring companies and semi-financial institutions

Central Bank of Turkish Rebuplic along with Treasury and BIS, bears importance as a supervisory and monitoring institution. Also, as a “lender of last resort” Central Bank is important both for banking and financial sector in general. Basic task of the Central Bank is to provide price stability. Therefore it determines the monetary policy for providing the price stability, supportsgovernment growth and labor policies.

Tasks determined by Law 1211 are:

- Open market operations
- Provisions in maintaining the value of Money
- Required reserve ratio and general disponibility rules establishment
- Doing rediscounting and advance operations

- Financial markets monitoring

The role of the central bank in this sense is not only maintaining monetary stability but also provide financial stability. In order to realise this central banks should be independent. Especially after 1990s with ever complexing financial markets, in maintaining competitive and open to outside market economy it is vital for the central bank to be independent. Especially during the 1994 the conflict between Treasury and Central Bank had brought the independence of the Central Bank into agenda. With the passage to Strong Economics Program Central bank credit to Treasury and Public Institutions was banned with Law 4561. As these amendements supported the independence, independence of Central Bank would loose basis unless the public sector borrowing requirement problem is resolved. Monetary Board was established in 2001 to solve this problem. However, in a nut shelli structural reforms for decreasing the public sector borrowing requirements should have to be implemented.

3.1.4. Drawbacks Against Banking Sector

-Public Deficits and Inflation: Public sector deficit has largely increased for the last 20 years, Public Sector financing had created "crowding-out" effect. This means the public sector borrowing requirement left no source for the financing of private sector. Therefore banking sector directs these sources to public sector in the form of buying government bonds also. This increases the private sector financing and funding cost, opening credit lines to private sector is not a selectable option. This is called "hot Money" policy as the banks are borrowing from abroad and Exchange it with TL and bought high return public bonds which is the result of low foreign Exchange rate and high interest rate policy.

Also the high inflation, a factor increasing the cost of banks sources. This alienate banks from their basic operations which is seen as 32% return from credit supplies but 68% return from interest earnings.

3.2. November 2000 and February 2001 Crises and The İmpact on Banking

During summer 1999 the real interest rates were around 20% and inflation was about 65%. Long overdue in implementing structural reforms made and required Turkish Government to enter into a full fledged IMF program. Amid this mixed mood things therefore were looking pretty bad on the technical side with low growth and high real interest rates. These had taken their side on Turkey's fragile debt dynamics. Before this time debt to GNP ratio was not too high and could have been rolled over after Russian Crises. [28]

But the debt burden kept growing and rolling over looked increasingly unmanageable. During Russian Crisis professionals in Treasury and Central Bank authorities made a critical decision to extend the maturity of debt to reduce rollover risk. Banks were consulted to use these two years instruments. However the new instruments hardly solve the problem rather postponed it and created a serious hump in debt payments for 2000.

At the time of the August earthquake interest rates rose to 115%. This caused the state professionals consider about comprehensive disinflation program with IMF. The process realised by banks was to borrow from abroad or take foreign exchange deposits and invest in government papers which was seen as open foreign exchange positions. This condition had made the Central Bank to adopt an accomodative monatary policy provide banks the necessary liquidity on demand through open market operations

Exchange rate was predictable by a rough real Exchange rate rule whereby the Exchange rate was depreciated about as much as wholesale price inflation. In the process banks made money, Treasury rolled over the debt and public sector's ever larger borrowing requirement was met.

[28] C.V. Rijckeghem and M. Üçer, *Chronicle of the Turkish Financial Crises of 2000-2001*, (İstanbul, Boğaziçi University Press, 2005), pp. 8-13.

3.2.1. Design of 2000 Program

IMF's principal focus in this program was debt dynamics and disinflation and a wholesale transformation of the supply side economy to promote sustainable growth. The 2000 program was well thought out in its design. It sought to ensure debt sustainability and attack Turkey's high and chronic inflation with the use of the exchange rate as a nominal anchor, a strong fiscal adjustment and several structural reforms. [29]

Exchange rate was the most effective anchor in Turkey's circumstances given the inflationary inertia and turkey's highly dollarised economy. The adoption of a crawling peg economy with a relatively low rate of Exchange rate depreciation was supposed to reduce inflationary expectations.

The program sought to fix the problem banks by a "gradual" strategy whereby an independent supervisory authority would be formed and the regulatory environment tightened. But something more had to be considered in the formation of the program. Central government was part of the story. Public sector borrowing requirements and state banks with their "duty losses", social security institutions, extra budgetary funds and state economic enterprises running with mild deficits all are against the running of the program.

The opaque financial relationship betwen the Treasury and the state banks would evetually strike back in a different form as state banks often short in liquidity would tap the money markets to finance these losses at punitive interest rates. Much of the design of the program was guided by the desire to get interest rates down as soon as possible. Monetary framework or the choice of a "nominal anchor" was of course an essential part of this. However when the exchange rate based programs are chosen the cycle would go as follows: Inertial inflation would be acceptable to low real interest rates and a lending boom which in turn with a few years lag to a large current account deficit and banking sector vulnerabilities.

To assign an extra credibility to the peg the IMF considered a currency board from the beginning of teh program. But this was faced with resistance from

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[29] The Banking Regulation and Supervision Agency, *Towards a Sound Turkish Banking Sector* (2001):6-20.

authorities and a compromise solution was formed as all additional base money would be created through balance of payments inflows and thus foreign exchange purchases of the central bank i.e. increases in net foreign assets (NFA) rather than through domestic credit to the government and the banks i.e net domestic assets (NDA).

As a result at the end a crawling peg with anchor was accepted and implemented thorugh 3 years and at the end of 3 years there would be an "exit" strategy. Specifically in July 2001 the pre-announced rate of crawl (a monthly rate of depreciation of 2.1% in January 2000, gradually falling to 1% in December 2000) was to be replaced by a gradually widening band with a 7.5% band at mid 2001 which would increase a further 7.5% points each half year until the lira left floating at the end of 2002.

Contrary to this formation the condition was that Treasury borrowing in Turkish Lira and local depositors preference for Dollar deposits, Turkish Banks had always maintained sizeable foreign exchange positions.

Of course, interest rates could have been increased to attract depositors to hold lira deposits but this would not be profitable for banks nor desirable for Turkish Treasury preferred to close its eyes to transgressions an open position legislation. As a result banks relied heavily on unhedged open positions, the most profitable sources financiang which was also perceived as relatively risk free under real exchange rate.

Thus, although at the beginning of IMF program conditions were favorable, the open foreign exchange positions of the banking system had reached to 15 billion at the end of 2000. However, this limit was foreseen as 2.3 billion at for the year. This generated a boom in consumer lending which resulted in high consumption and increasing inflation. On the other hand incerase in consumption led to higher current account deficit, this crippled the accountability of the program.

Some of the banks at summer of 2000 had foreseen the drawbacks of such a structure of financial system and started reducing their t-bill protfolio to stand against interest rate risk. However, some of the banks especially one prominent figure Demirbank continued to buy t-bills due to its aggrassive strategy for growth in banking

sector. It hold nearly 3.750 billion T-Bill by the mid-November 2000 that did not have enough resources to finance this.

During September 2000 Savings and Deposit Insurance Fund was established and started operating. 10 banks were got under the administration of Fund following the first two months ot its inception. At the end of the year IMF made its third monitoring and issued a favorable report for the program.

However, starting from the beginning of 2001 political turmoil started among coalition partners especially between MHP and ANAP. Overnight interest rates at this time to some extent had reached 2000 - 5000% on some occasions and coming to the february this was not stabilised. This was beacuse of debt servicing costs. When the 2001 crises striked with a three fold devaluation the country and economics professionals had started to discuss about keaving crawling peg system and let the economy float by enforcement of IMF. This was enforced by the government and currency left floating.

3.2.2. 2002 IMF Agreement

IMF stand by agreement in 2002, 16 billion credit was provided for Turkey. Out of this 16 billion, 6 billion debt redemption was made out and with the rest of the public sector and debt financing operations had been provided. Heavily weighted on 2002, Turkey was used 55 billion $ IMF credit until the end of 2005. Main pillar of this last program was to regulate and arrange public sector financing, providing efficiency in the economy and reducing the inflation. Thus supervision of banking sector was on the other hand formed on its part formed Monetary Policy Board and monetary policy was strictly applied in the direction of fighting against inflation. In order to provide accountability for this last program, the consumption should be crippled as possible public sector financing should be continued with the increasing taxes in order to prevent the treasury to apply for borrowing. [30]

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[30] C.V. Rijckeghem and M. Üçer, *Chronicle of the Turkish Financial Crises of 2000-2001*, (İstanbul, Boğaziçi University Press, 2005), pp. 14-20.

As the credibility increased in international markets banks borrowing capacity abroad led to growth in banking sector. Total asset size of banking sector was 47 billion dollar. Total number of banks in the system dropped to 46 in 2006 from a number of 79 in 2001. Loan protfolios increased from 26% to 46% as of the end of 2007. Shareholders equity is now at 41.3 billion USD. All these positive economic and regulatory environment increased foreigners' interest on banking sector during 2005 and 2006.

Banking sector restructuring program the financial risk and strenghtened the capital structure of Turkish banking which gave potential rise to profits and growth. Since 2004, Turkey attracted an historical amount of investments from foreigners in total around 33 billion USD and significant amount of this flow is directed to the banking sector. Most of the deals were between large and medium sized banks and leading banks in the global.

Between 2001 and 2006 twelve foreign banks entered the market typically throug acquiring majority shares in locally established banks, invested almost 14 billion USD for a presence in Turkish Banking market.

3.3. Banking Sector Restructuring and Rehabilitation Program

The main goal of the banking sector restructuring and rehabilitation program is to eliminate the distortions in the financial sector and to adopt regulations to promote an efficient, competitive and sound banking sector. The strategy under this program rests on four main pillars; financial operational restructuring of banks, the resolution of SDIF banks, the strenghtening of private banking, the strenghtening legal environment.

i. State Banks: The overnight exposure of the state banks reached unprecedented proportions exposing these banks to interest rate and liquidity shocks. The sharp increase in interest rate during November 2000 and February 2001 crises

amplified the funding needs of the state banks and thus the losses incurred by these banks.

The first step to restructure the state banks was to adopt a program to eliminate the short term funding needs of these banks. The treasury provided floating rate notes (23 TL quadrillion) thus securitized the losses incurred by banks (the duty losses). The securitization operation provides the interest income (yielding cash receipts) and allows the banks to borrow directly from the Central Bank using securities as collateral. The latter eliminates the need to borrow heavily from markets at very high interest rates.

State banks' overnight liabilities to the markets have declined from USD 8 billion on march 16 2001 to USD 1.1 billion by may 2001. The Central Bank of Turkey provides liquidity to the state banks by acquiring these securities through repurchase agreements. The bulk of these repos will be converted to outright purchases by the end of June 2001.

The securities given to the state banks by the treasury not only limits the overnight funding needs of these banks but also allows these banks to reach regulatory capital adequacy ratio. Treasury paid 326 trillion TL in cash to strenghten the capital base of State banks. Simultaneously with the financial of the state banks important measures are also being taken in order to allow for an operational restructuring of these banks. State banks will no longer be forced to run duty losses. In the future any support provided via the state banks will be budgedet and will not lead to loss by state banks.

The management of the largest state banks Ziraat and Halk is strenghtened through the establishment of a common and politically independent governing board, reporting to the Treasury. The new management will apply commercial criteria to operations and pricing policies that ensure profitability.

To reduce the operating costs of state banks the inefficient branches of these state banks will be closed and timely retirement will be encouraged. Once financial restructuring is completed the state banks will be required to fully comply with all BRSA regulations applicable to commercial banks.

ii. Private Banks: The BRSA has conducted a series of extensive discussions with individual bank basis, comprehensive Letters of Commitment regarding the business plan, projections and if necessary the restructuring/rehabilitation strategy. The BRSA will actively follow up on the implementation of such plans through time bound commitment letters. BRSA has introduced an enhanced monitoring system for the liquidity position and interest rates all banks to make sure that unviable banks are not allowed to engage in unsound practices and that prompt corrective action is taken.

Letters of commitment which differ across banks depending on each bank's financial condition incorporate the implementation plan for a combinaation of the below listed measures within a specified time table:

- Capital injection

- Utilisation of subordinated debt

- Mergers and acquisitions

- Rationalization of branches and personel

- Cost reduction

- Restructuring of concentrated credits

- Sale of subsidiaries and real estate

- Sale of partial or all of shares to foreign and domestic partners.

According to Banking Law (Nr. 5411), the responsibilities of BRSA[31] are determined as;

- To take necessary decisions and measures in order to protect the rights of depositors and ensure sound operating of the credit system and to implement them

- To regulate, enforce and ensure the enforcement thereof, to monitor and supervise the implementation of establishment and activities, management and organizational structure, merger, disintegration, change of shares and liquidation of

[31] Available online - www.bddk.org – May 2009.

banks and financial holding companies as well as leasing, factoring and financing companies without prejudice to the provisions of other laws and related legislation

- To become members of international financial, economic and professional organizations in which domestic and foreign equivalent agencies participate, to sign memorandum of understanding with the authorized bodies of foreign countries regarding the issues that fall under the Agency's duty field

- To fulfil other duties assigned by the Law.

According to Banks Act Nr (Nr. 4389), the responsibilities of SDIF[32] are determined as

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. 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.

[32] Available online – www.tmsf.gov.tr – May 2009.

4. PERFORMANCE MANAGEMENT IN BANKING SECTOR

4.1. Performance Criterias

As mentioned in the previous chapter the banking sector restructuring has benevolent effects for Turkish Banking Sector. This effect could be monitored by selecting some criteria ratios that have been in banking sector. These ratios are called as "performance criterias" and could be classified into seven sub headings as

- Asset quality ratios
- Profitability ratios
- Staff productivity ratios
- Branch productivity ratios
- Capital adequacy ratios
- Liquidity risk ratios
- Currency risk ratios

Although depending on the investigation type on banking sector selection type of these ratios could made according to the generally accepted monitoring figures used in the banking sector. Based on this premise for asset quality ratios:

- Total Loans / Total Asset
- Total Loans / Total Deposits
- Non performing Loans / Total loans are used.

Total loans / total assets ratio is used for financial analyses. In the framework of financial analyses this ratio is used for evaluating the productivity of the assets. An institution or a corpotate bank might be in such a situation that the relativity of the performance of the assets in regarding the loans of a bank demonstrates the viability or capability of the bank satisfying its liabilities. A liable bank should have a productivity ratio smaller than one. Because as this ratio goes further than this ratio the bank as a corporation would suffer inefficiency in satisfying liabilities.

Total loans / total deposits ratio is again a performance criterion in monitoring the availability of liquidity not only in the bank as a corporation but also in the banking sector as a whole. This liquidity ratio demonstrates the available loans that the bank of the sector have. It is the ideal position that this ratio is equal to one. Because total deposits collected is generated as loans if this ratio is equal to one. This means the conditions in the economy are favorable and cost of investment is low relative to other alternative financial means in the economy.

Non-performing loans to loans ratio is the last performance criteria in the monitoring of the return of the loans provided as credits to the borrowers. This ratio is to a certain extent is important for the banking sector but in another sense it is very important for the economy as whole. If this ratio is high the economy is in trouble in the sense that the borrowers cannot pay their debts back.

The profitability ratios on the other hand indicates the corporate profitability of an institution or the sector as a whole. These in a sense shows the capability of a sector or an institution to stay capable and profitable in a given time period. Based on this premise:

- Net profit / total assets

- Net profit / total shareholder's equity

- Net interest income / total loans

- Net interest income / (total loans + securities portfolio)

Net profit to assets ratio indicates the performance of the assets generating the corporate profit for the given period. Thus for the assets to be productive this ratio could be close to one as possible. It cannot go beyond one because none of the assets could generate a profit equal to itself. Therefore this ratio should be smaller than one but closer it is to one profitable is the corporation or the sector.

Net profit to shareholder's equity indicates profitability of the capital that has been put at the beginning of an accounting term. Capital is assumed to be capable of providing profit if the ratio of net profit to shareholder's equity is between zero and one.

But the required condition is that the capital should provide profit above the risk free interest rate. Otherwise there is an opportunity cost for the capital to be invested in other options providing the occasion for the capital to provide the gain equal to that created by operation of the corporation.

Net interest income to loans ratio indicates the real performance of the loans given by the bank. As the basic premise says that a role of a bank is to transfer funds from lenders to borrowers, this transfer is made in the form providing loans to those required for the loans. This ratio has both positive and negative meanings. If this ratio is above a certain level, the cost of borrowing becomes higher. If it is lower, there is problem of performance for the bank. Thus this ratio should be kept at a balanced level.

Net interest income to loans plus the securities portfolio is the same as interest to loans ratio. This is different in a sense that it is including the securities of which the bank holding in its portfolio. The securities could be in the form of many intangible assets such as funds of capital markets or government bonds. Government bonds in particular generates interest income. Part of this income according to this ratio is generated through intangible assets apart from loans given to those required for them. The performance criterion is equal to the interest income to loans ratio. If the ratio is higher the bank provided most of its income through operations other than banking. Also if the ratio gets higher the bank has provided its through the securities. This means the sources in the hand of the bank is directed to the assets rather than directing them to the real sector.

Staff productivity ratios are measuring the inside operations of the bank or the sector. It is possible to say that the operations of the bank or the sector is productive and contributes to the profitability of the bank by looking at these ratios.

- Personnel expenses / total assets

- Deposit / number of personnel

- Net profit / number of personnel

- Net interest income / number of personnel

Personnel expenses to assets is the ratio indicating the capability of the assets in regarding the expenses of the personnel. This in a sense is the labor cost of the bank or banking sector as a whole. All the expenses could not be comprised only of personnel expenses. A general precondition is that the bank should render the most productivity from its personnel. That is to say a bank in this condition is an efficiency maximiser in the case of personnel. The whole operation of the bank should be provided at a minimum cost possible. That means unit asset per personnel should be maximum as possible. Therefore personnel expenses to totatl assets should be close to zero as possible although it could not be close to zero. Zero personnel expenses total assets means the bank does not employ any personnel which means in no case is possible.

Deposit to number of personnel ratio indicates the performance of the personnel in providing or creating the deposit. This ratio is important as it is indicating the productiveness of the bank or the sector as a whole. Smaller the ratio higher the number of employees. So the institution or the sector is working with excess employee that do not viable in number to carry on the operations. Higher the ratio means the deposit per personnel increases. So the productivity of the bank or the sector increases as well. If this ratio shows an increasing trend the bank or the sector could hire more employee because as the level of deposits increases increasing the number of personel beneficial for the productivity of the sector. Sometimes it is possible to experience negative relation between number of personel and deposit. Number of personnel may decreases while the level of deposits are increasing. This is typical in the case of crises times.

Net profit to number of personel is another performance criteria for the operations of the sector. Although the bank or the sector could create excess capital it may not be productive if it does generate profit. So this ratio is a more robust indicator than deposit to number of personnel. Higher the ratio the operations of the bank or the productivity of employee is high.

Interest income to number of personnel is a performance criteria close to profit to number of personnel. However, profit to number of personnel indicates the productivity from the real activities of the bank or the sector. Interest income on the other hand is income other than normal activities of the bank. Therefore higher the ratio

means the bank or the banking sector generates its income from the activities other than normal. In a sense the bank or the sector does not operate but rather generates income out of non-performing functions.

Branch productivity ratios as the name suggests indicates the productivity of the branches of a bank or total of the branches in the sector. If these ratios generates positive figures the sector generates its income from the operations of the branches. Otherwise, the operations are gathered in the center and there is no need to widen the operations other than capital exchange. The ratios are

- Total assets / number of branches

- Deposit / number of branches

- Number of personel / number of branches

Assets to number of branches is indicates the performance of the branches in creating the assets. Because it is a general precondition that the level of the assets per branch should be as high as possible. If the ratio is high the branch is overperforming, creating the productive assets.

Deposit to number of branch is the same as assets to branch number but creating the deposits is the real activity of branches. Therefore this ratio should high as possible. Because higher the deposit to number of branches ratio gets the bank or the sector closer to its real activity. Number of personel to number of branches is the productivity of the branches in terms of its employees.

Capital adequacy ratios are the ratios used in the assessment of the capital in the bank or the banking sector as a whole. In order for the bank or banking sector continue its life in the future. These ratios should always be as high as possible in order for the bank or the sector not only maintain its capital but also increase it. Currently for standart capital ad equacy ratio Basel I is in application in Turkey. Aimed to standardized the computation of riskbased capital across banks and across countries.

- Issued in 1988 by the Basel Committee on Banking Supervision, a group of banking supervisors which secretariat is based at the Bank for International

Settlements in Basel, Switzerland. Market risk was incorporated into Basel 1 in 1996. Basel I allows both a standardized and an internal model Approach Circular No. 280 issued in 29 March 2001 and Circular No. 360, which incorporated market risk, was issued in 3 December 2002. Assignment of credit risk weights under Basel I is crude – Basel 2 aims to make capital requirements more risk sensitive. Because Basel I only accounts for credit risk and market risk, on the other hand Basel II includes operational risk and other risks.

Banks should have capital appropriate for their risktaking activities (Pillar 1). Banks should be able to properly assess the risk they are taking, and supervisors should be able to evaluate the soundness of these assessments (Pillar 2). Banks should be disclosing pertinent information necessary to enable market mechanism to complement the supervisory oversight function (Pillar 3)[33].

In calculating standart CAR, Shareholders' equity/total risk weighted items is used. Equity to risk weighted items shows the capability of the bank or the sector in satisfying the drawbacks that would likely be generated by the risky items in the balance sheet.

Other Capital adequacy ratios are

- Shareholder’s equity to deposit
- Shareholder’s equity to total loans
- Shareholder’s equity to total assets

Shareholder’s equity ratio is a two tier correspondant ratio. In a sense both the equity and deposit have effect on each other. If both increase at the same time the equity has a positive effect on deposits. Whereas if the equity increases faster than deposits the equity is more productive than the deposits. In a sense the profitability of the bank or the sector is generated not from deposits but also other items such as assets.

[33] Available online – www.bddk.org.tr – May 2009.

Equity to loans ratio indicates the capability of the capital satisfying the loans of the bank or the sector. In a sense, if the conditions required the bank or the sector as a whole could satisfy the loan requirements of those demanding for the loans.

Equity to total assets is the ratio indicating the amount of assets corresponding to the equity. If the ratio is close to one, the bank or the banking sector does not bears too much liability. If the ratio gets closer to 1/2, half of the liabilities of the bank or the banking sector is satisfied with the assets.

Liquidity ratios are,

- Liquid assets / total assets

- Interest sensitive assets with maturity of three months / interest sensitive liabilities with maturity of three months

Liquid assets to total assets shows the weight of liquid assets in the total assets. If the ratio is greater than one the bank or the sector is highly liquid. That means an excess supply of capital in the market. In contrary if the ratio is smaller than one the sector is illiquid and there is need for the liquidity. This is the risky position for the banks because the conditions may require the banks to apply for more liquidity to satisfy their daily operations.

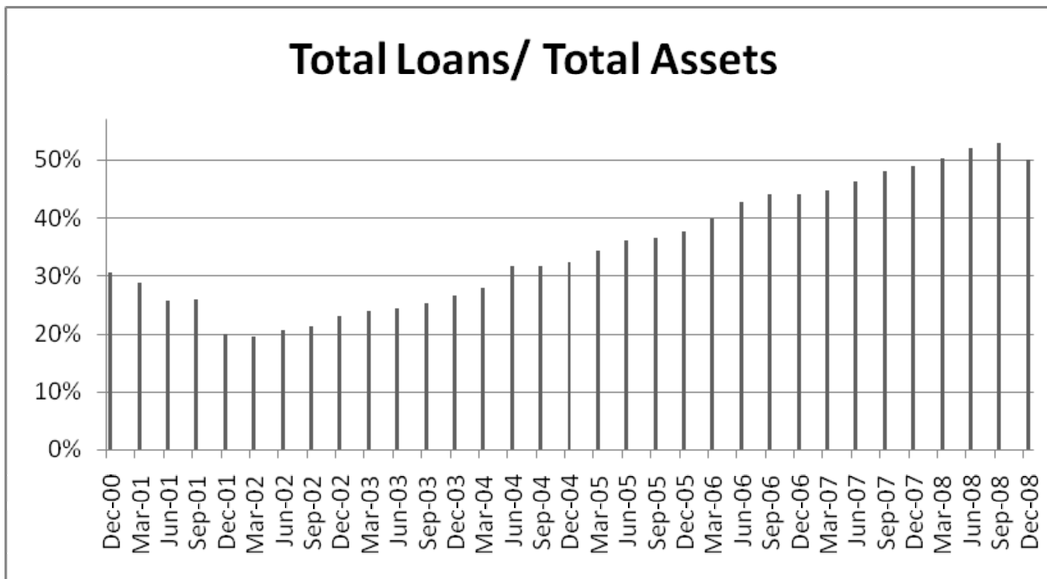
The second ratio indicates the short term performance of the banks both in terms of assest and the liabilities. If short term liabilities is higher than the assets the bank or the banking sector would suffer difficulty or go bankrupt.

Last performance ratio is Currency risk ratio.It is calculated with Foreign Exchange Net General Position / Shareholders' Equity Standart Ratio. This ratio shows the net position of foreign exchange in terms of the capital of the bank or the banking sector. If the ratio is greater than one the bank or the sector as a whole could not satisfy its foreign exchange holdings and have an exposure of exchange rate risk.

4.2. Changes in Banks' Performance with Restructuring Program

The ratios mentioned in the last section are evaluated for the performance of the banking sector in Turkey. These are also important in monitoring the performance and effect of the restructuring program of 2002 and its aftermath. The graphs of the ratios are as follows:

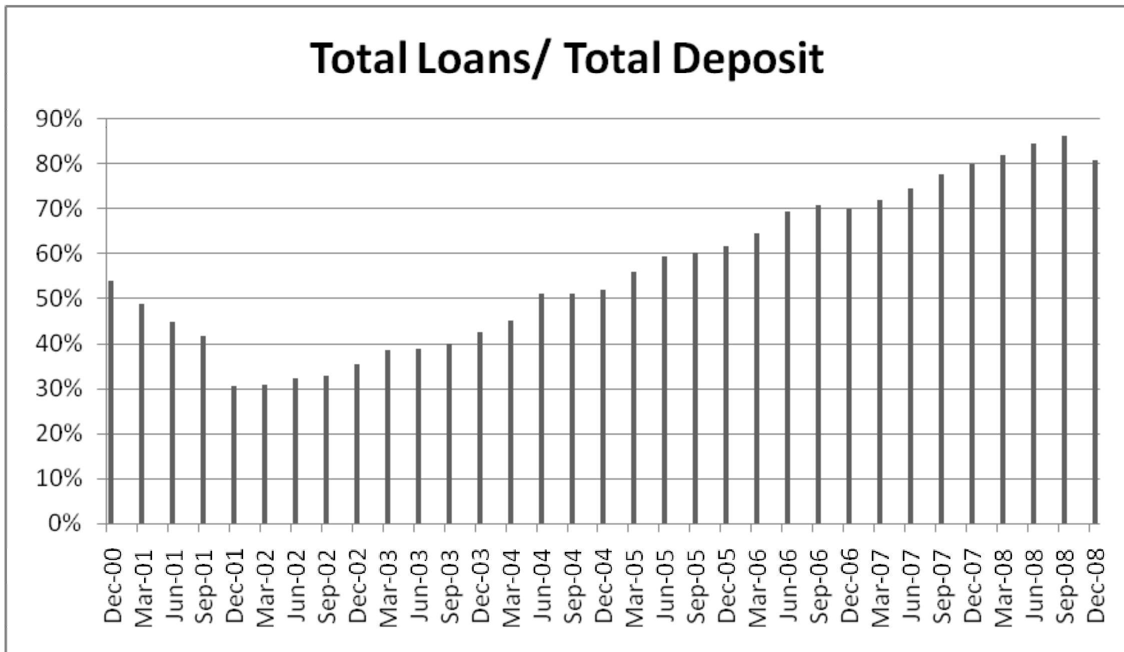
Figure 1: Total Loans / Total Assets



Source:BRSA Monthly Bulletin – available on line
http://www.bddk.org.tr/websitesi/english/Statistical_Data/Statistical_Data.aspx- April 2009

Loans to assets ratio has been in an increasing trend for the last five years. As mentioned above loans assets ratio indicates the capability of the assets in satisfying the loans of the banking sector. The banking sector in Turkey has generated half of its assets as loans to the real sector. This in a sense is positive because the sector had created additional funds and sources for the real sector. But also its negative because the area left to the banking sector other than funding the real sector has narrowed. It is possible to say that this trend has been occuring because of the constantly decreasing interest rates for the last five years. Because the cost of borrowing had decreased the demand for loanable funds has increased.

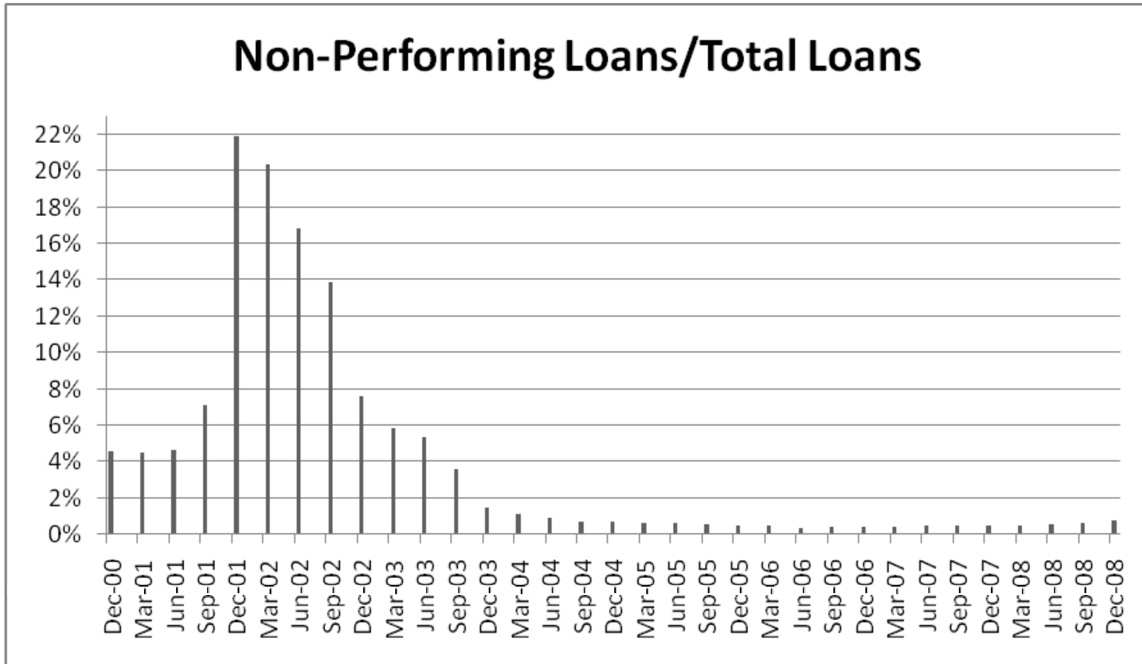
Figure 2: Total Loans / Total Deposit



Source: BRSA Monthly Bulletin – available on line
http://www.bddk.org.tr/websitesi/english/Statistical_Data/Statistical_Data.aspx- April 2009

There is an increasing trend again. This figure indicates that loans to deposit ratio nearly close to one. That means approximately whole of the deposits has been using in generating the loans for real sector. This is the result of the decreasing trend in interest rates as well. However, it is not possible to say that all the deposits are used in generating real funds to real sector. Consumer banking for the last five years had generated loans for individuals in order for them to fund their consumptions. This is why this ratio indicates a high ratio.

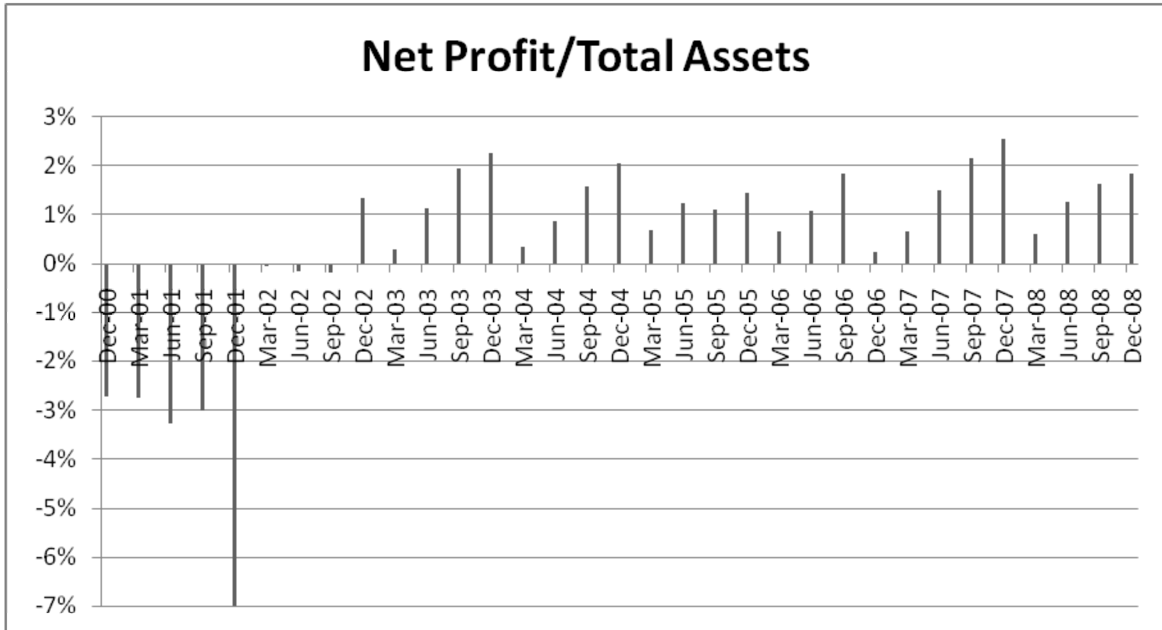
Figure 3: Non-Performing Loans / Total Loans



Source:BRSA Monthly Bulletin – available on line
http://www.bddk.org.tr/websitesi/english/Statistical_Data/Statistical_Data.aspx- April 2009

Crises years of 2001 and 2002 demonstrates the negative effect of non-performing loans. The not be paid back ratio were as high as 22% but after this time it went into a sharp declining process and during mid 2007 it nearly makes a 0% level. So the conditions seen for the above ratios is also correct for non performing loans ratio.

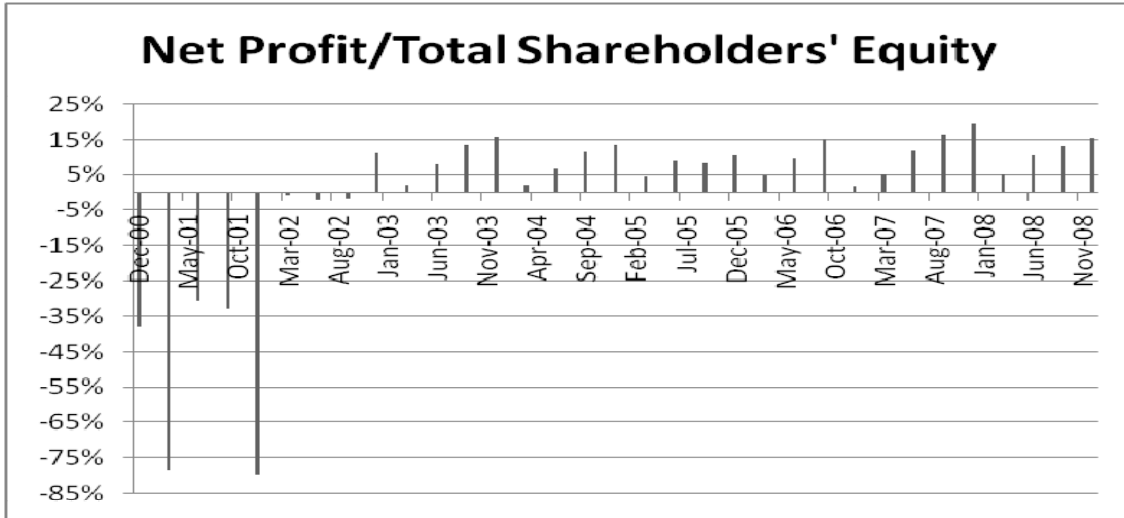
Figure 4: Net Profit / Total Assets



Source:BRSA Monthly Bulletin – available on line
http://www.bddk.org.tr/websitesi/english/Statistical_Data/Statistical_Data.aspx- April 2009

Apart from crises period profit to total assets indicates a volatile trend because of the decreasing trend in interest rates and public sector borrowing requirements. Especially, before the year of 2003, the banking sector was making its profit through funding the public sector borrowing requirement. But after this requirement is crippled in tremendous amounts the banks directed themselves towards other assets other than government bonds. This has why the banking sector not been succesful in profitability.

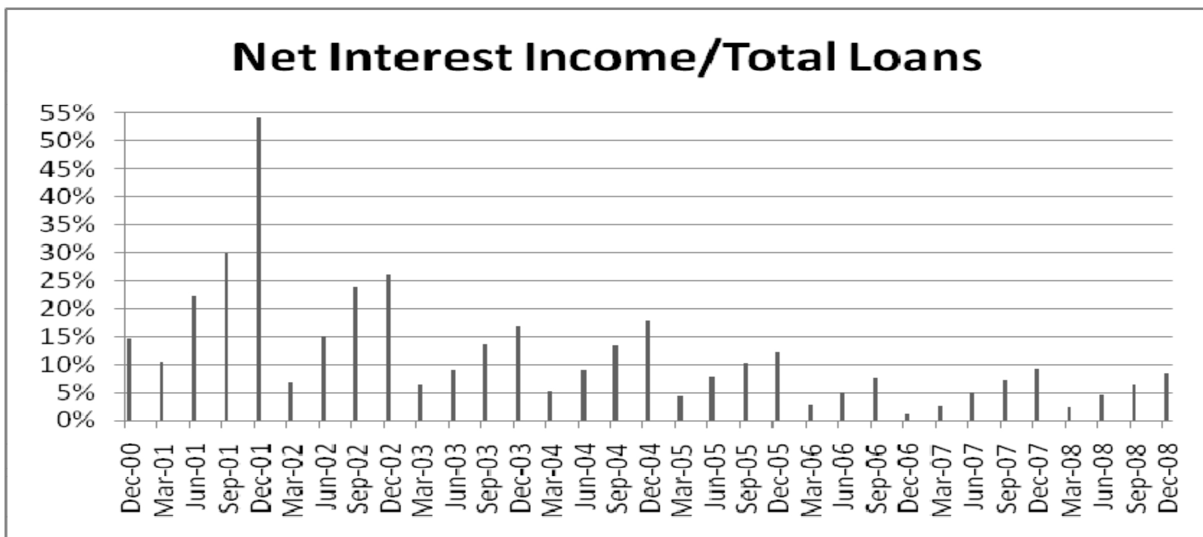
Figure 5: Net Profit / Total Shareholders' Equity



Source:BRSA Monthly Bulletin – available on line
http://www.bddk.org.tr/websitesi/english/Statistical_Data/Statistical_Data.aspx- April 2009

Capital of the banking sector is seen to have been operating with 10% operating margin for the last five years. This is not productive enough if the level of the interest is taken into account for the last five years. Interest rates were approximately 20% throughout the period and the banking sector had stayed much lower than this level.

Figure 6: Net Interest Income / Total Loans



Source:BRSA Monthly Bulletin – available on line

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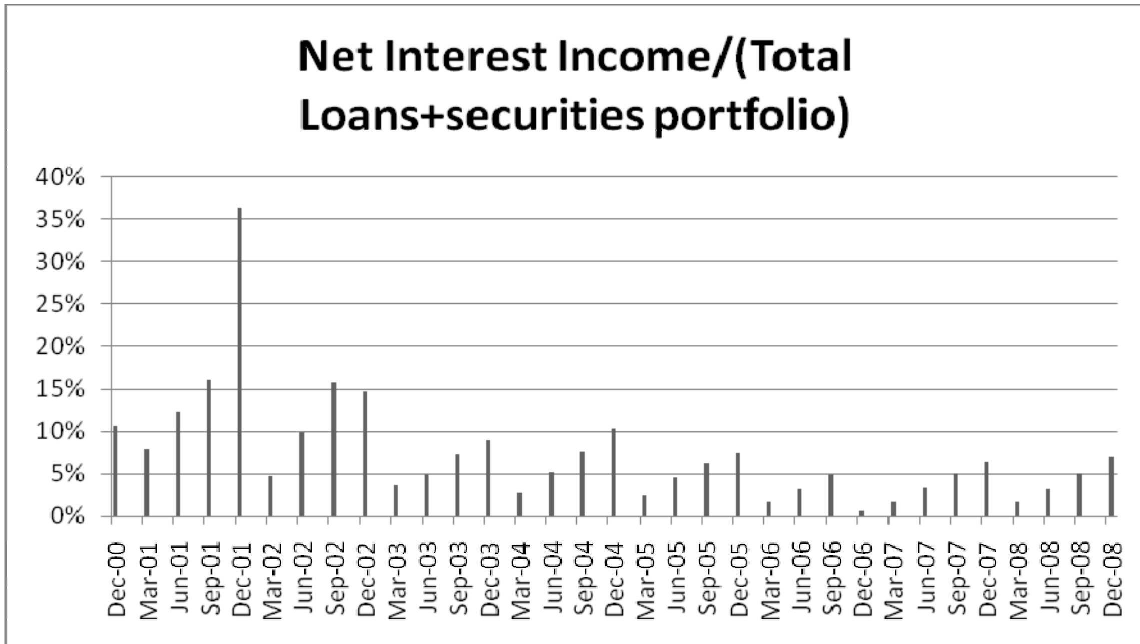
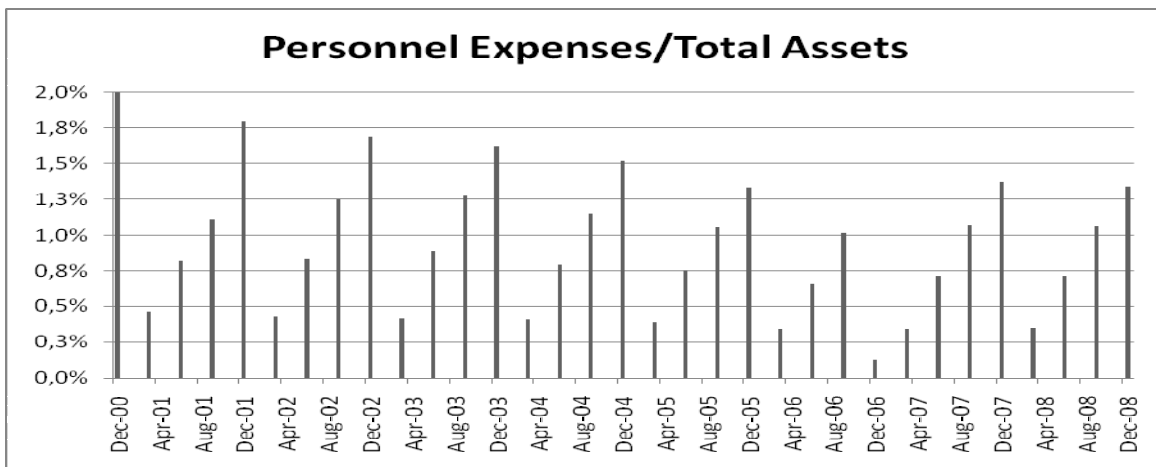
Figure 7: Net Interest Income / (Total Loans + Securities Portfolio)



Source:BRSA Monthly Bulletin – available on line
http://www.bddk.org.tr/websitesi/english/Statistical_Data/Statistical_Data.aspx- April 2009

As the crises years suggest the interest income were higher in these years because the public sector borrowing requirement was high during this period. However, for the other periods, it is sharply going down. As a result income generation from interest rates is not likely for the banks any more as the figure suggests.

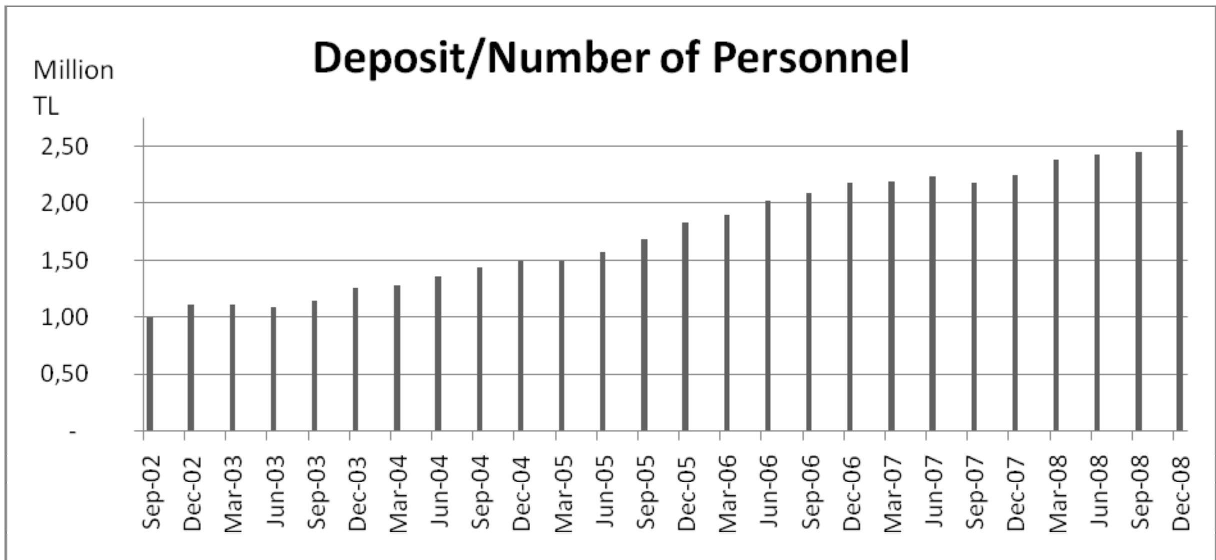
Figure 8: Personnel Expenses / Total Assets



Source:BRSA Monthly Bulletin – available on line
http://www.bddk.org.tr/websitesi/english/Statistical_Data/Statistical_Data.aspx- April 2009

This graph renders a seasonality in the personnel expenses other than 2006 for December of each year. This is because each year generates a full scope for the banking sector to increase its operations and hire more personel.

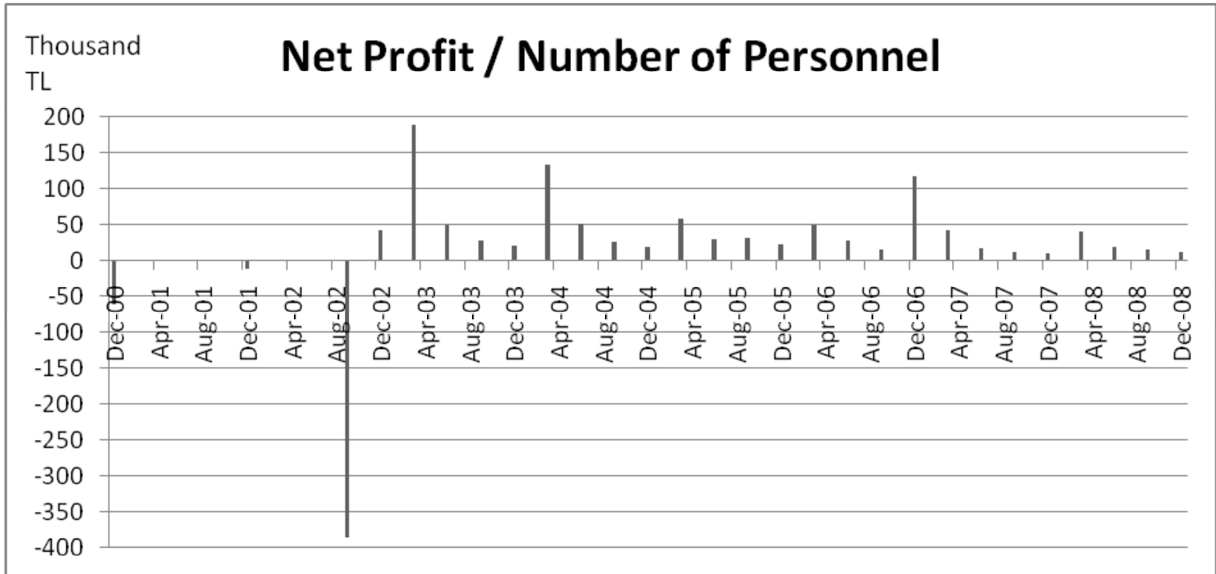
Figure 9: Deposit / Number of Personnel



Source:BRSA Monthly Bulletin – available on line
http://www.bddk.org.tr/websitesi/english/Statistical_Data/Statistical_Data.aspx- April 2009

A paralel indicator with personnel expenses. This indicates that the personnel in the banking sector over-performing in terms of generating deposits. This complies with the premise that the banks have been attaining for concentrating on their real activities throughout the last five years.

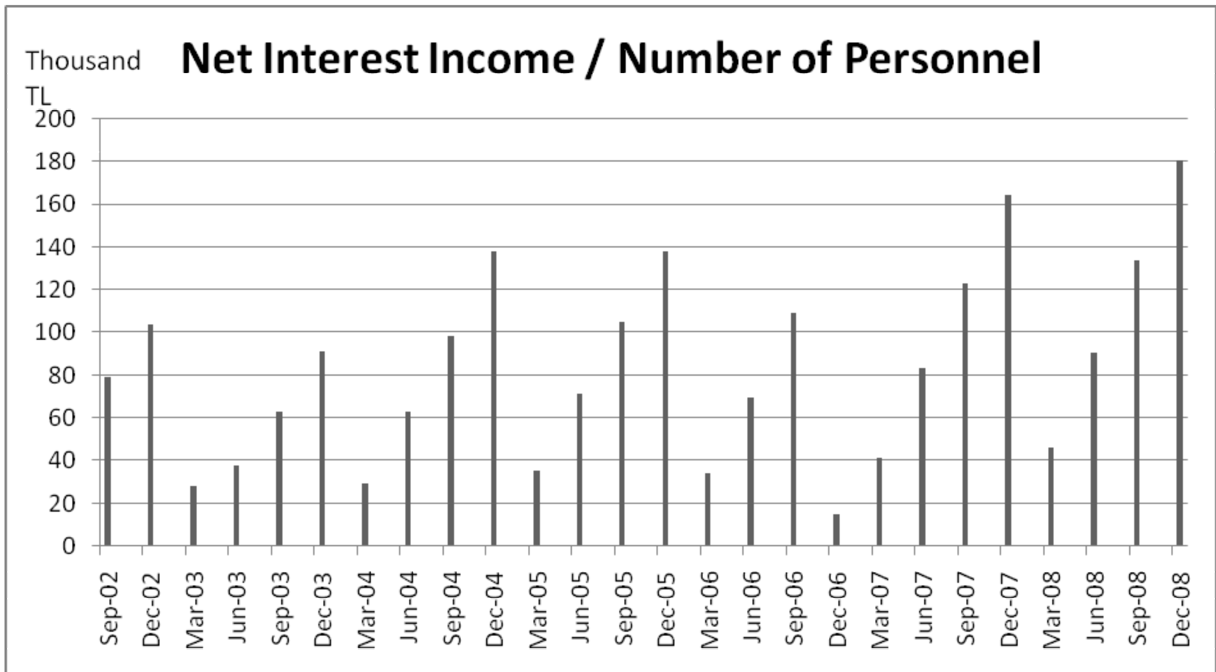
Figure 10: Net Profit / Number of Personnel



Source:BRSA Monthly Bulletin – available on line
http://www.bddk.org.tr/websitesi/english/Statistical_Data/Statistical_Data.aspx- April 2009

In paralel with the being not successful in generating profit the personnel of the banking sector is also not successful in generating profit.

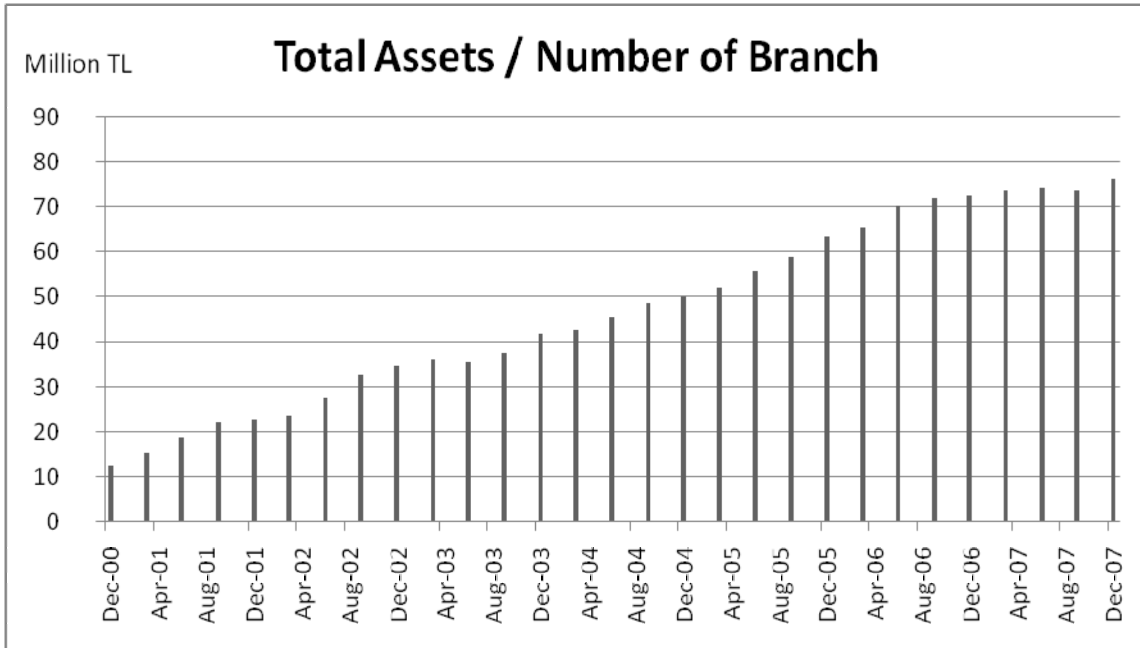
Figure 11: Net Interest Income / Number of Personnel



Source:BRSA Monthly Bulletin – available on line
http://www.bddk.org.tr/websitesi/english/Statistical_Data/Statistical_Data.aspx- April 2009

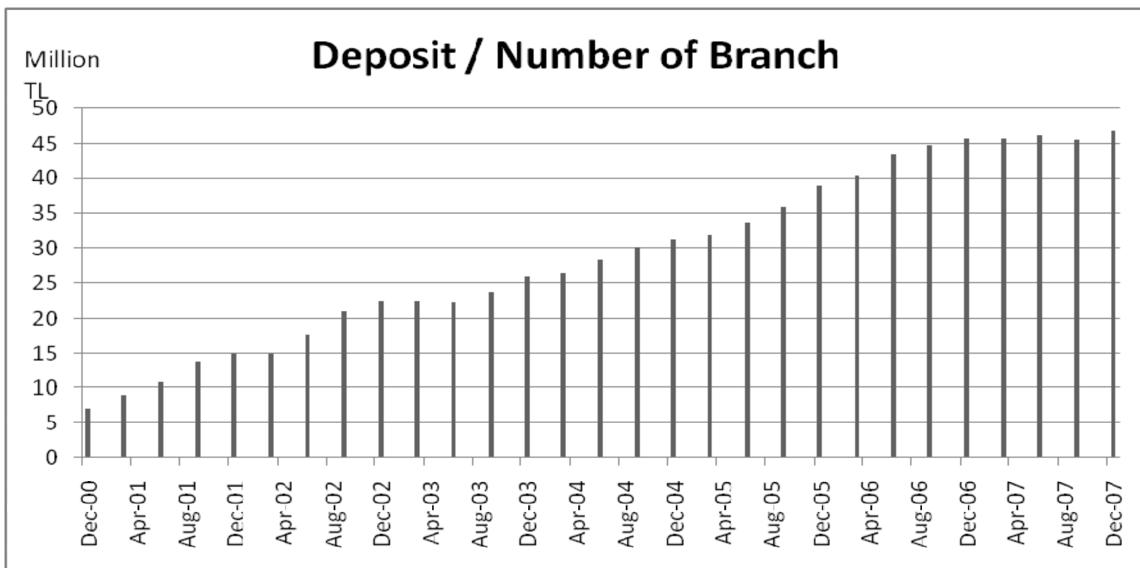
A trend for year end indicator because as the year ends required the banks to direct their operations other than real activities interest income generated by the employee increases at each year end.

Figure 12: Total Assets / Number of Branch



Source:BRSA Monthly Bulletin – available on line
http://www.bddk.org.tr/websitesi/english/Statistical_Data/Statistical_Data.aspx- April 2009

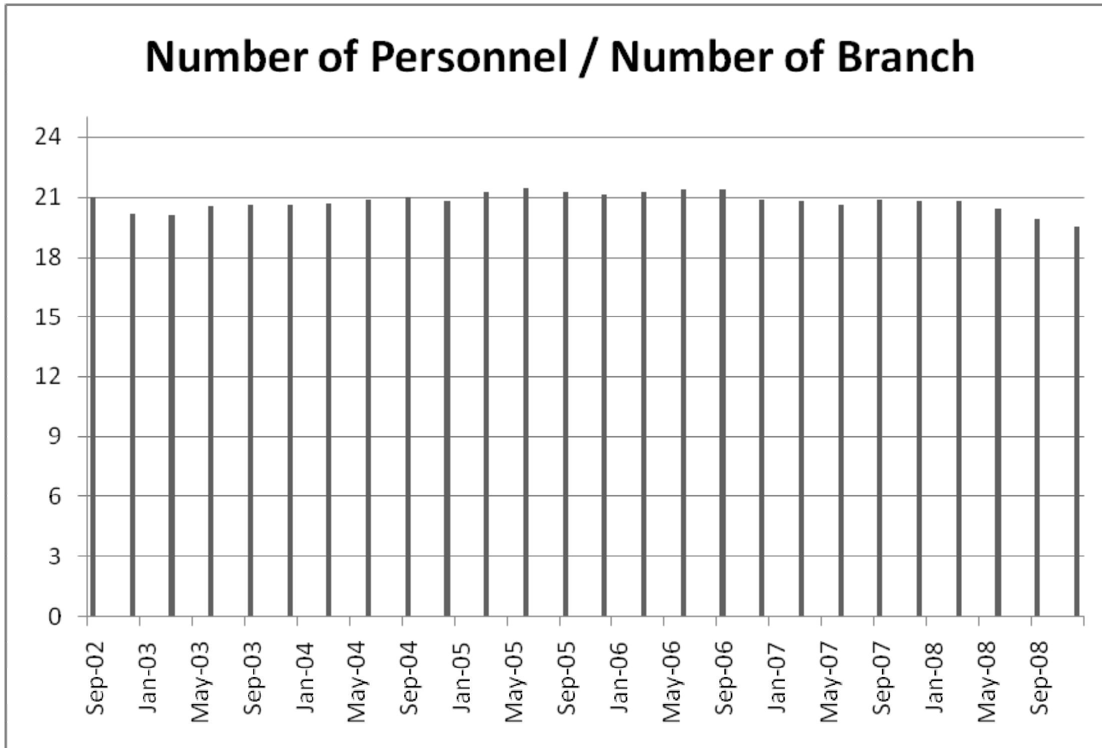
Figure 13: Deposit / Number of Branch



Source:BRSA Monthly Bulletin – available on line
http://www.bddk.org.tr/websitesi/english/Statistical_Data/Statistical_Data.aspx- April 2009

Assets and deposits to branch ratio has been in an increasing trend due that the banking sector had directed their activities towards the real banking sector activities. That is why the assets and deposits per branch has increased.

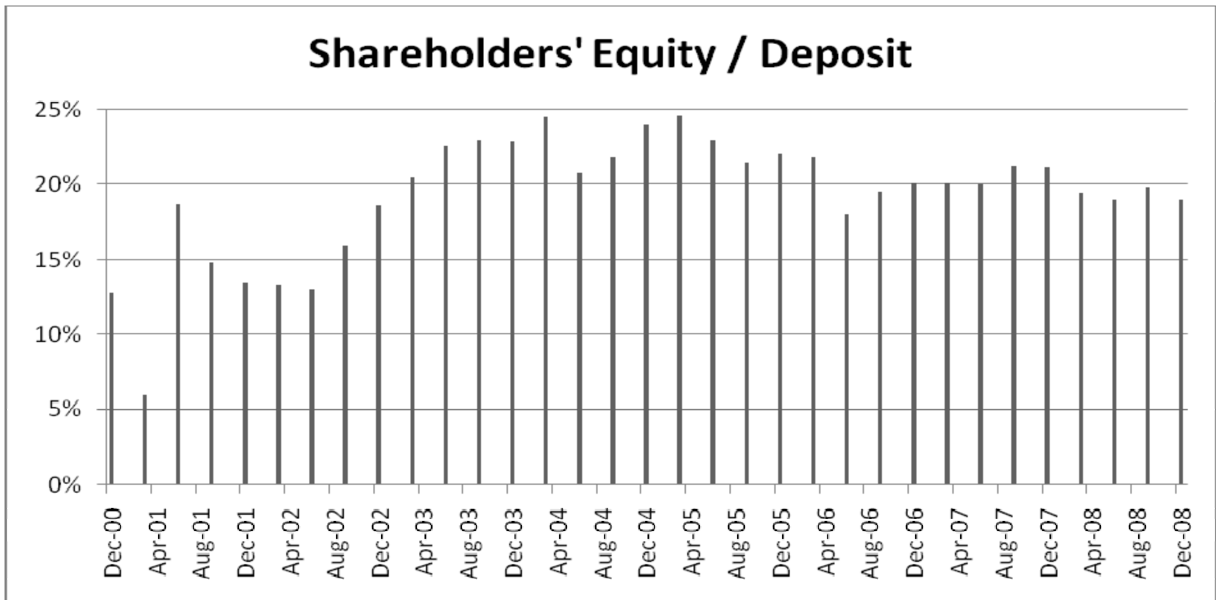
Figure 14: Number of Personnel / Number of Branch



Source:BRSA Monthly Bulletin – available on line
http://www.bddk.org.tr/websitesi/english/Statistical_Data/Statistical_Data.aspx- April 2009

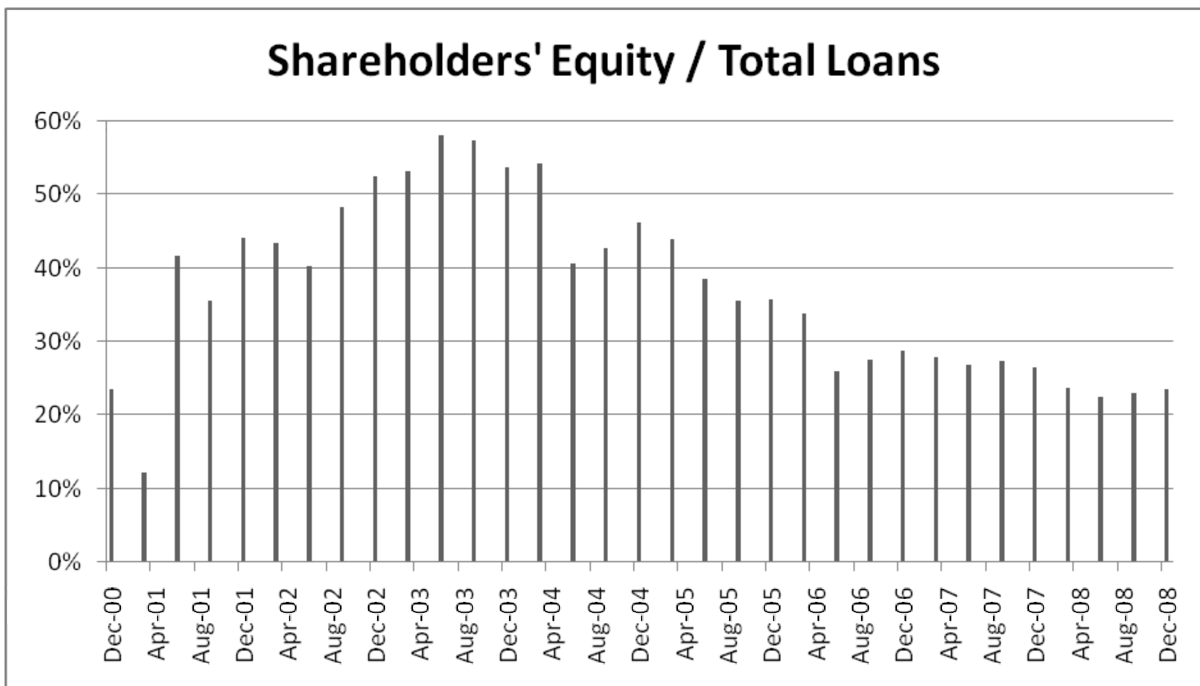
Personnel number for the banking sector has been in a steady state. That means the banking sector in Turkey has made a cost minimisation and a utility maximisation. The real banking and consumer banking has been increasing for the last five years however number of personnel has kept as stable as possible.

Figure 15: Shareholders‘ Equity / Deposit



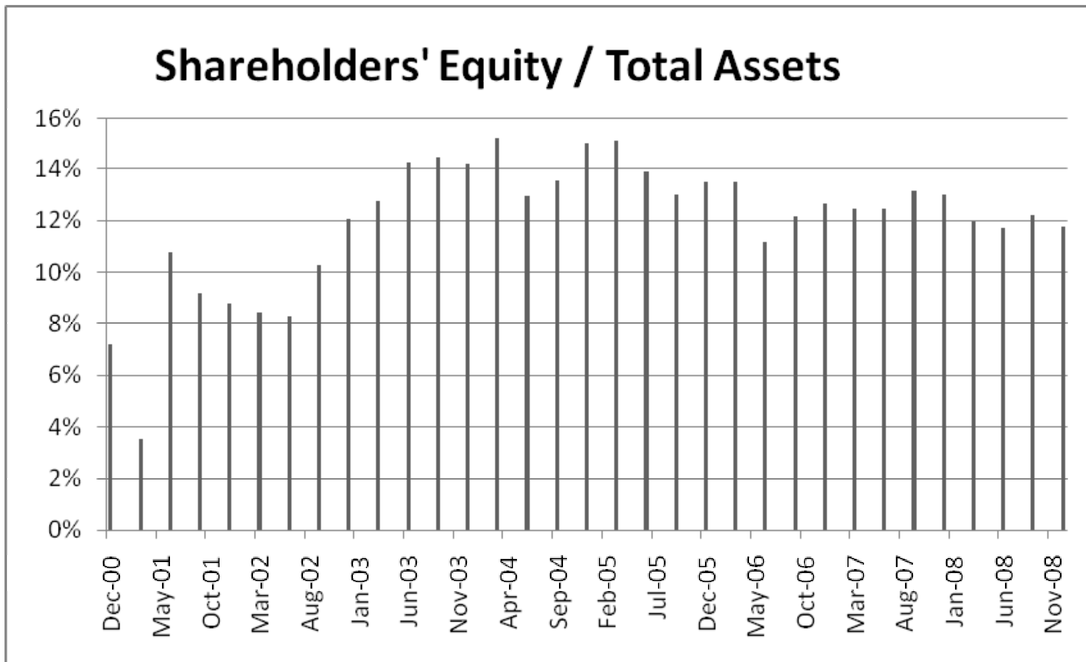
Source:BRSA Monthly Bulletin – available on line
http://www.bddk.org.tr/websitesi/english/Statistical_Data/Statistical_Data.aspx- April 2009

Figure 16: Shareholders‘ Equity / Total Loans



Source:BRSA Monthly Bulletin – available on line
http://www.bddk.org.tr/websitesi/english/Statistical_Data/Statistical_Data.aspx- April 2009

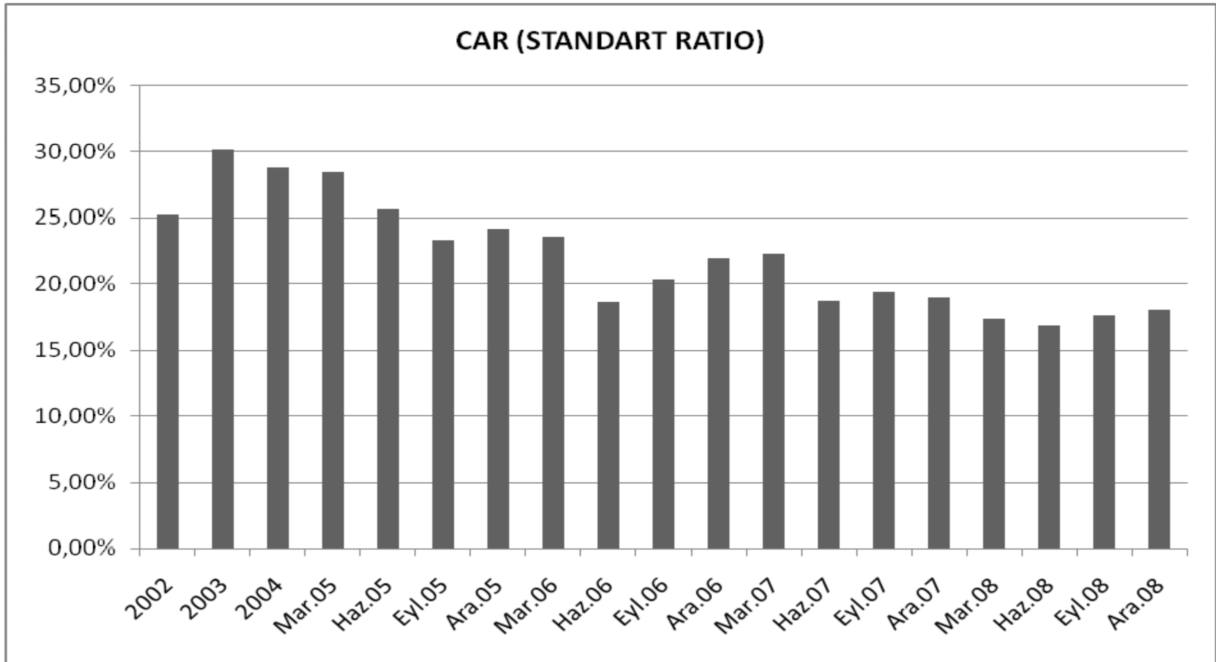
Figure 17: Shareholders‘ Equity / Total Assets



Source:BRSA Monthly Bulletin – available on line
http://www.bddk.org.tr/websitesi/english/Statistical_Data/Statistical_Data.aspx- April 2009

Concerning the performance of the equity it is possible to say that the equity was successfil against assets and deposits. It has a decreasing trend in loans. That means loans throughout last five have been satisfied through the assets not from equity.

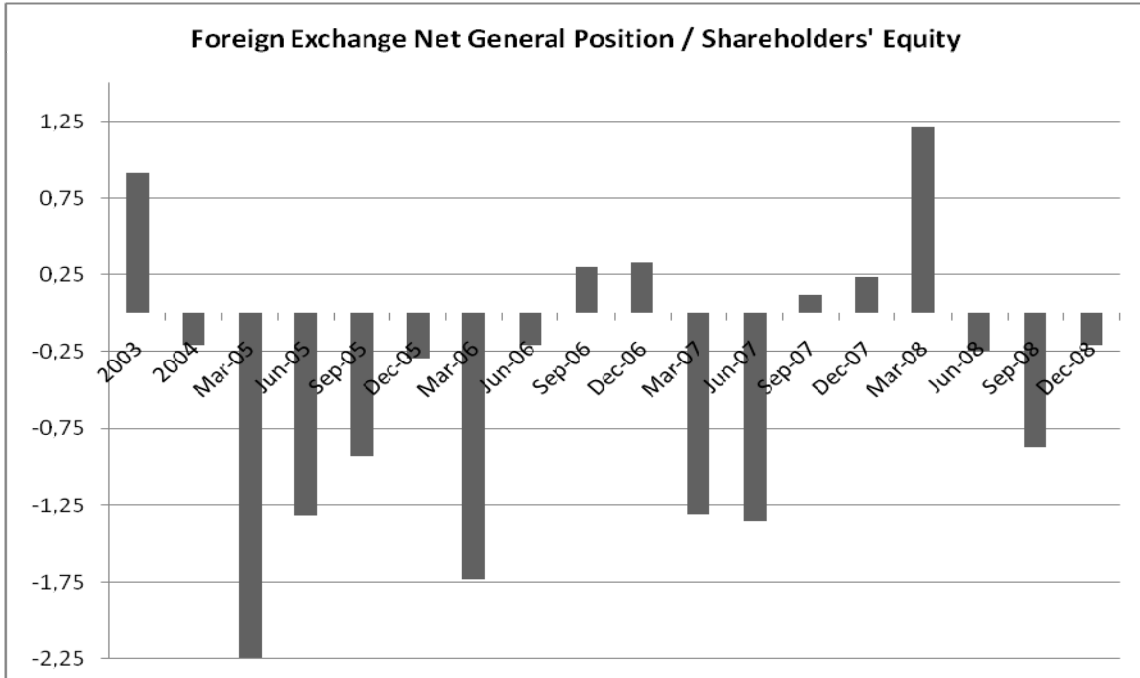
Figure 18: CAR (Standart Ratio)



Source:BRSA Monthly Bulletin – available on line
http://www.bddk.org.tr/websitesi/english/Statistical_Data/Statistical_Data.aspx- April 2009

The standart ratio indicates that the equity is not suffered from risky assets too much during post crises period. This was mainly because the measures taken against risky assets and lesson derived by the sector to stand away from risky positions.

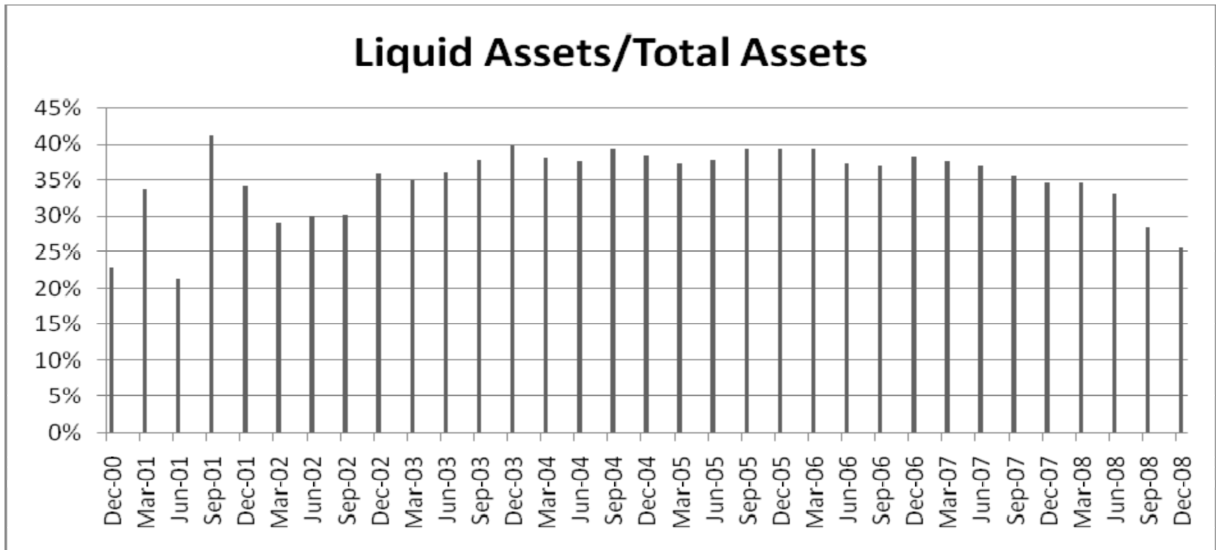
Figure 19: Foreign Exchange Net General Position / Shareholders' Equity



Source:BRSA Monthly Bulletin – available on line
http://www.bddk.org.tr/websitesi/english/Statistical_Data/Statistical_Data.aspx- April 2009

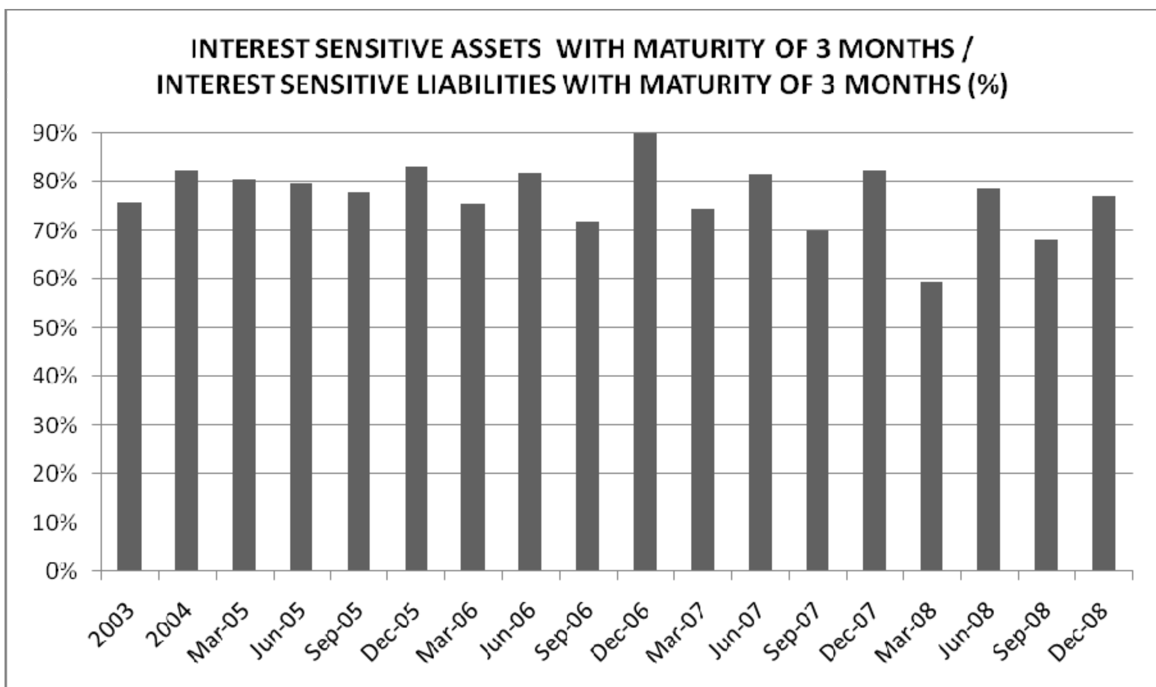
This is the most appropriate indicator for monitoring the banking sector in its open position. Banking has not been generating open position against its capital on the post crises period. Before this time when the real interest rates were indicating 30% the banking sector was borrowing from abroad and invest in Treasury Bonds for the interest generation. In a sense banking sector was doing a "carry trade". It has continued its carry trade during the last five years but not in a way generating risky open position.

Figure 20: Liquid Assets / Total Assets



Source:BRSA Monthly Bulletin – available on line
http://www.bddk.org.tr/websitesi/english/Statistical_Data/Statistical_Data.aspx- April 2009.

Figure 21: Interest Sensitive Asests With Maturity of 3 Months / Interest Sensitive Liabilities With Maturity of 3 Months (%)



Source:BRSA Monthly Bulletin – available on line
http://www.bddk.org.tr/websitesi/english/Statistical_Data/Statistical_Data.aspx- April 2009

These two liquidity figures shows an opposite trend against each other. Liquid assets in the whole assets has been increasing. This generates enough funds for the real sector however, the banking sector is doing this for a very short period from where it is seen on the second graph that short term assets in short term liabilities in approximately equal to one.

With the restructuring program as it is seen from the graphs the banking sector has entered a high and stable growth period and the total assets of the sector reached TL 733 billion at the end of 2008. The capital structıre of the sector has not yet strenghtened especially against the loans portfolio but the capital adequacy ratio has reached to 18%. The financial intermediation has started to operate effectively and the share of the loans to assets rose to 50%. Share of the public banks has decreased.[34]

Besides the improvements in the banking sector developments seen in the many areas such as growth, inflation and capital inflows rendered the banking sector help in its stabilization.

[34] Banking Regulation and Supervision Agency (2009) Financial Sector Restructuring:Turkish Experience , March 2009, Working Group paper

5. COMPARISON TURKISH BANKING SECTOR PERFORMANCE WITH EU

When it is said as banking sector in European Union it is not possible talk about a unified banking sector. Rather it is comprised of individual banking sectors of 27 countries that are trying to be unified as possible as it can.

As a general view for Euro area, it is possible to talk about an annual GDP growth of 1%, approximately 8% of unemployment, 22% of fixed capital formation against GDP of 27 countries. The cost of financing is nearly 4% and a tremendous ratio of 180% debt to GDP ratio. Inflation in general is 4% for the whole area and the bond yields i.e. the risk free interest rate is 4%. Therefore net gains in the area is generally close to zero.

For the banking sector there is a 7.87% of return on equity. Return on net interest income in total assets is only 0.73% with a solvency of 11.40% whereas the net income out of trading is 3.4%. The cost incurred out of this income is 30% of the capital.

Therefore the comparison of the performance of the banking sector of Turkey with EU requires the comparison of the indicators with the indicators of 27 countries published by European Union itself in Financial Stability Review Reports. This report indicates many performance criterias similar to that were used in the Performance management in Turkish Banking sector chapter. These are;

- Loans / assets
- Deposits / loans
- Deposit / number of personnel
- Deposit / number of branch
- Number of personnel / number of branch
- Concentration ratio
- Capital adequacy ratio

These performance criterias are useful for comparing the banking sector in Euro area and in Turkey in terms of operational productivity. However, figures for Euro area are in Euro and in Turkey in Turkish Lira. Therefore the difference bewteen Exchange rates should be taken into account.

*i.*Total loans / Total Assets

Table 7: Total Loans / Total Assets					
%	2003	2004	2005	2006	2007
Turkey	28%	33%	39%	45%	49%
EU 27	48%	47%	47%	46%	47%

Source:Available online:-www.bddk.org.tr and
http://www.ecb.int/pub/pdf/other/eubankingstructures2008en.pdf-

Loans to assets ratio as mentioned in the performance of Turkish Banking sector indicates the portion of the assets directed to real sector in the form of loans. It has been long time that the public sector borrowing requirement crowd-out real sector in terms of their credit needs. For many years public sector usurped the credits in financial markets and the banks always have funded public sector. As this situation had considered as no more sustainable and the level of interest rate has downed more reasonable levels credit institutions started opening their funds to real sector both in terms of manufacturing credits and consumer credits. As it is seen from the table Turkey reached the and gone beyond the level of Euro area in loans to asset ratio.

ii. Total Loans / Total Deposits

Table 8: Total Loans / Total Deposits					
%	2003	2004	2005	2006	2007
Turkey	40%	51%	61%	70%	80%
EU 27	117%	116%	115%	115%	116%

Source: Available online:-www.bddk.org.tr and
http://www.ecb.int/pub/pdf/other/eubankingstructures2008en.pdf-

The condition in loans to deposits is similar to loans to assets. Throughout five years loans has increased two fold for the Turkish Banking Sector. However it is yet lagged behind Euro area banking sector because banking sector in Euro area is overfunding the real sector with its over 100% ratio of loans to deposits. This means the banking sector and the real sector has a complete mutual dependability. But it seems that the ratio is satiated. Because it seems that going beyond this level might create a risky condition for European Banking as has recently been the case for the last one year. The banking sector in Turkey has not effected much from financial crises as the banks in Euro area. Therefore this performance criteria indicates that the productivity increase in Turkish banking sector is much faster than the Euro area bank seven though it is far from being satiated.

iii. Deposit / Number of Personnel

Table 9: Deposit / Number of Personnel

(Million)	2003	2004	2005	2006	2007
Turkey(TL)	1,20	1,50	1,70	2,20	2,60
EU 27 (€)	3,45	3,78	4,31	4,67	5,98

Source: Available online:-www.bddk.org.tr and
http://www.ecb.int/pub/pdf/other/eubankingstructures2008en.pdf-

This is the figure with which the Turkish Banking sector is far lagged behind relative to Euro area banking sector. When the exchange rate is taken into consideration the personnel in Turkish Banking Sector is not that productive as the personnel in Euro Area Banking Sector. The performance increase of the personnel on both sides is the same because they have increased by two fold throughout the whole period taken into consideration. Therefore it is possible to say that personnel in Euro area is more successful in deposit creation.

iv. Deposit / Number of Branch

Table 10: Deposit / Number of Branch					
Million	2003	2004	2005	2006	2007
Turkey(TL)	26	32	38	45	47
EU 27 (€)	52	56	63	65	71

Source: Available online:-www.bddk.org.tr and
http://www.ecb.int/pub/pdf/other/eubankingstructures2008en.pdf-

Deposit creation per branch in Euro Area Banking Sector is three times the size of the Turkish Banking Sector when the Exchange rate is taken into consideration. Also brances in Turkey are far more performer than the peers in Euro area. Because the increase in the deposits per branch is nearly two fold more than the branches in Euro area. But this is because the saturation in Euro area banking. This is again the result of the decrease in public sector borrowing requirement. Banks in Turkey directed themselves towards consumer banking for the last five years. By the help of this they achieved to have much more productivity level.

v. Number of personnel / Number of Branch

Table 11: Number of Personnel / Number of Branch					
Number	2003	2004	2005	2006	2007
Turkey	20	21	21	21	20
EU 27	15	15	15	14	12

Source: Available online:-www.bddk.org.tr and
http://www.ecb.int/pub/pdf/other/eubankingstructures2008en.pdf-

This ratio shows that the banks in Euro area have much comparative advantage. Because they are operating with the minimum cost. Thus the cost per personnel much more lower than Turkish banking sector. As a result productivity of each employee in Europe is higher than in Turkey.

Vi. Concentration ratios

Herfindahl-Hirschman Index (HHI) is commonly used for calculating market concentration. HHI is calculated by squaring the market share of each firm competing in a market, and then summing the resulting numbers. The Herfindahl-Hirschman Index number can range from zero to 10,000. The HHI is expressed as: $HHI = S1^2 + S2^2 + S3^2 + ... + Si^2$ (where Si is the market share of the ith firm).

The closer a market is to being a monopoly, the higher the market's concentration ratio. If, for example, there were only one firm in an industry, that firm would have 100% market share, and the HHI would equal 10,000 (100^2), indicating a monopoly. Or, if there were thousands of firms competing, each would have nearly 0% market share, and the HHI would be close to zero, indicating nearly perfect competition. The U.S. Department of Justice considers a market with a result of

- less than 1,000: a competitive marketplace

-1,000-1,800: a moderately concentrated marketplace

- 1,800 or greater to be a highly concentrated marketplace.[35]

Tablo 12: HHI

	2003	2004	2005	2006	2007
HHI Turkey	941.2	948.8	980.5	959.5	938.5
HHI EU	545.0	567.0	642.0	630.0	654.0

Source : avaible online – www.tbb.org.tr,
http://www.ecb.int/pub/pdf/other/eubankingstructures2008en.pdf-

In Turkey, according to calculation of HHI the values are usually between 930 -1000, so Turkish Banking Sector is a competitive marketplace. But this value is very closed to moderately concentrated marketplace. If precautions are not taken to providing concentration with the help of competition rules, Turkish Banking Sector may become a strong oligopolistic market. On the other hand, European Banking Sector is a competitive marketplace, too. The decline in the number of credit institution and the dynamic growth of certain banking groups (result of their mergers) are reasons of increasing in European Union. But risk of becoming strong oligopolistic market is very low.

[35] Avaible online -http://www.economypedia.com/wiki/index.php?title=Herfindahl-Hirschman_Index-

Vii Capital Adequacy Ratio

Table 11: Capital Adequacy Ratio (CAR)			
	2005	2006	2007
CAR Turkey	21.9	18.9	18.0
CAR EU	12.0	11.0	11.3

Source: avaible online – www.bddk.org.tr and www.ecb.int-

Another performance ratio is capital adequacy ratio. In Euro Area, the ratio of banks` capitals to their risks is lower then Turkish banking sector. In Turkey, after 2000 and 2001 crisis and restructuring the importance of capital adequacy has increased and banks are trying to increase their capital adequacy ratios so the CAR of all banking sector has increased.

It is clear that the restructuring in Turkey has rendered the banks in Turkey renovate themselves in a very short time period. In terms of productivity in operations, Turkish Banking Sector performed effectively for the last five years. Therefore the restructuring made the Banks in Turkey perform better for the last years. Especially in terms of loan performances today half of the assets of the banks is directed towards real sector. The deposits in the banks also are started much used in real sector financing.

But it is not possible to say that this has only achieved by banking sector restructuring. Especially after 2001 crises number of banks had decreased. The increase in the deposits to number of branches is resulted from this. Also the number of employees got out of the sector is the same as the number of employees today working in the sector. Therefore the increase in the productivity in the sector is the result of diminishing cost and concentrating the banking sector in the hand of few strong banks. For the last three years mergers in the banking sector and foreign direct investment rendered the banking sector increase its productivity.

Also decrease in public sector borrowing requirement and the decrease in interest rates to more reasonable levels. Nearly half of the public sector requirements used to funded by financial sector funds. This unsustatinable condition directed banks towards much consumer banking and more funds are directed towards real sector.

When looking to adaptation capability of Turkish Financial System into European Financial Integration, the financial sector remains relatively weak and EU standarts are not entirely adopted but there is progress towards a more transparent and efficient legal framework in Turkey according to the EU management.

In recent years Turkish commercial banking industry is undergoing numerous changes in laws and regulations. The aim is to bring the banking sector operations in line with the EU standarts. By the banking act renewal of the former act in accordance with the banking sector's dynamic structure and forming of an effective regulation and supervision structure which is compatible with EU norms and international standarts are aimed.

As of 2005 with the regulations adopted by Capital Markets Board Turkey has succeeded in many field to integrate into EU. In the financial system integration country succeded many structural reforms. Based on this adaptations real interest rates should be kept as low as possible. The assets of the banking sector should be increased as much as possible. Therefore throughout the restructuring process banks are entitled to increase their assets and the operations had to be made based on these premises.

CONCLUSION

As mentioned throughout the thesis banking sector is important for the financial and economic condition of a given economy. The funds are regulated and given an order through banking sector. Therefore efficiently operating banking sector is vital for the economy.

Banking sectors throughout the globe has gotten under several crises for over 30 years due to the liberalisation of flow of capital throughout different economies. This is because as the capital moves freely the assets held in terms of the currencies of individual countries were subject to risk of loosing their value. Therefore the banking sectors were in the effort to find ways to cope up with these risks. However, the financial and economic conditions globally had increasingly become more global and the problems had widened in their scope. This made the banks not only tried to cope up with the risks but also restructure themselves.

As mentioned in chapter one there are many methods to perform bank restructuring depending on the economic condition is subject against systemic or non-systemic crises.

In chapter two examples of restructuring is given from the globe that used the methods largely mentioned in this thesis. Based on the evaluation done in this chapter Sweden is the most successful country in banking sector restructuring given that it has a viable economic and financial situation. Russia is the worst country in the success due to its defective banking sector operating with over 1500 banks and 90% of funds are gathered in the hands of one state bank.

The main theme of the thesis is to examine whether the banking sector restructuring in Turkey is successful or not. Performance criterias gathered under seven headings were used for the evaluation of the productivity in the banking sector. And it is seen that the condition in banking sector is improving given that the capital productivity of the banking sector is 20% and loans to total assets of the banking sector is 50% as of 2008. By looking through seven general performance ratios it is possible to say that loans has been increased approximately 100% in terms of asset quality ratios. The banking sector has been profitable throughout the restructuring period. Overall the

profitability ratio according to net profit/ total assets is 1% on average and in net profit/ shareholders' equity 9% on average. Concerning the productivity of the staff the banking sector in Turkey the personnel in the banking sector over-performing in terms of generating deposits. Concerning the capital adequacy ratio, banking sector has always been above the capital requirement ratio. Based on BASEL I criteria it should be 8%, and it is 12% in condition that BASEL II would be implemented in the future. Turkish Banking Sector has a 15% on average. About net foreign open position the sector had recorded negative figures other than two years. This is favourable in terms of the sector would not expose to large instabilities that it has largely faced during 1990s. The covarage capability of short term assets against liabilities is currently 77%. For the evaluation of the performance in its road to European Union, banking sector today has positive figures to be compatible with its European peers. Turkish Banking Sector could be competitive in capital requirement and loans performance. However there are certain points that Turkish Banking Sector has to improve itself. The operational cost in Europe is twelve persons per branch whereas in Turkey it is twenty persons. Turkish Banking Sector is a more oligopolistic market than European finacial market. Concerning the capability of funding condition banks in Europe could provide excess funds their loans are more than their deposits. Because they are capable of finding other resources than deposits in order to funding themselves.

In conclusion, it is possible to say that the restructuring act in Banking sector in Turkey started in 2002 is successful to a certain extent however, it is not possible to reach a conclusion that this is enough for the sector to consolidate completely itself.

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APPENDIX 1: BANKS TRANSFERRED TO SDIF

1.BANKS TRANSFERRED TO FUND		
Banks	**Date of Transfer to SDIF**	**Current Status**
Egebank	Dec 21,1999	It was merged with Sümerbank on January 26, 2001.
Yurtbank	Dec 21,1999	It was merged with Sümerbank on January 26, 2001.
Yaşarbank	Dec 21,1999	It was merged with Sümerbank on January 26, 2001.
Bank Kapital	27-Oct-00	It was merged with Sümerbank on January 26, 2001.
Ulusalbank	28-Feb-01	It was merged with Sümerbank on April 17, 2001.
Interbank	7-Jan-99	It was merged with Etibank on June 15, 2001.
Esbank	21-Dec-99	It was merged with Etibank on June 15, 2001.
Iktisat Bankası	15-Mar-01	Its banking license was revoked as of December 7, 2001 and the liquidation process was initiated. Upon the resolution adopted in the General Assembly Meeting on April 4, 2002 the liquidation decision was revoked and the Bank was merged under Bayındırbank.
Kentbank	9-Jul-01	Its banking license was revoked as of December 28, 2001 and the liquidation process was initiated. Upon the resolution adopted in the General Assembly Meeting on April 4, 2002 the liquidation decision was revoked and the Bank was merged under Bayındırbank.
Etibank	27-Oct-00	Its banking license was revoked as of December 28, 2001 and the liquidation process was initiated. Upon the resolution adopted in the General Assembly Meeting on April 4, 2002 the liquidation decision was revoked and the Bank was merged under Bayındırbank.
EGSBank	9-Jul-01	Its banking license was revoked as of January 18, 2002 and merged with Bayındırbank as of the same date.
Toprakbank	30-Nov-01	Its banking license was revoked as of September 30, 2002 and merged with Bayındırbank on the same date.
Pamukbank	19-Jun-02	In accordance with the Act No. 5230 regarding "Transfer of Pamukbank Turk Anonim Sirketi to Türkiye Halk Bankasi Anonim Sirketi and the Act Concerning Making Changes in Some Acts" it was transfered to Türkiye Halk Bankasi A.§. on November 12, 2004.
2. BANKS SOLD		
Bank Ekspres	Dec. 12,1998	It was sold to Tekfen Group on June 30, 2001. Merger of Bank Ekspres A.S. with Tekfenbank A.S. was approved by BRSA on October 18, 2001. It carries on its activities as Tekfenbank A.S.
Demirbank	Dec. 6,2000	A share transfer agreement was signed with HSBC Bank Pic. on September 20, 2001 and actual share transfer was realized on October 30, 2001.
Sümerbank	Dec. 21,1999	Merged Sümerbank was sold to Oyak Group on August 9, 2001, the transfer of Sümerbank to Oyakbank A.S. was registered on January 11, 2002. It carries on its activities as Oyakbank A.S.

Sitebank	July 9,2001	A share transfer agreement was signed with Novabank SA on December 20, 2001 and share transfer was realized on January 25, 2002.
Tarişbank	July 9,2001	A share transfer agreement regarding its transfer to Denizbank A.S. was signed on October 21, 2002 and actual share transfer was completed on October 25, 2002. Merger of Denizbank A.S. with Tarişbank was approved by BRSA on December 19, 2002 and merger was completed on December 27, 2002.
3. BANKS UNDER LIQUIDATION		
Türkbank	Jan. 6,1997 (*)	Pursuant to the Resolution No. 346 dated June 15, 2001 of BRSA, license of Turkbank to perform banking activities and accept deposits was revoked as of July 1, 2001 and within the scope of the Articles concerning dissolution and transfer of the Turkish Code and the Article 18 of the Abolished Bank Acts and the articles of the Bank master agreement, the liquidation of the bank was decided to be realized. Upon the Resolution dated August 9, 2002 of the Extraordinary General Meeting and registered on August 14, 2002, the liquidation transactions of the bank are continuing.
Bayindir Bank (Birlesik Fon Bankasi)	July 9,2001	It is determined as a bridge bank to carry out the function of asset management and bank's tide designated in main contract was changed as "Birlesik Fon Bankasi A.S." in accordance with the Article No. 109 of the Banking Law No. 5411 and the Resolution No. 515 dated December 7, 2005 of the Fund Board.
4. BANKS WHOSE OPERATING PERMISSION HAS BEEN REVOKED AND A BANKRUPTCY DECISION HAS BEEN ADOPTED		
Banks	**Date on which the Operating Permission Revoked**	**Current Status**
Kıbrıs Kredi Bankasi	Sep. 27, 2000	Bankruptcy of the bank has been judged pursuant to the Decree No. 2002/590 of the Istanbul Commercial Court of First Instance as of August 23, 2004. Its liquidation is going on.
Imar Bankasi	3-Jul-03	Bankruptcy of the bank has been judged pursuant to the Decree adjudicated with the File No. 2004/132 of the Istanbul Commercial Court of First Instance, on August 8, 2005. Liquidation is going on.
5. BANKS WHOSE OPERATING PERMISSION HAS BEEN REVOKED ACCORDING TO BANKS ACT 3182		
Marmara Bank	April 20,1994	Bankruptcy of the bank has been judged pursuant to the Decree No: 94/1425 of the Istanbul Commercial Court of the Fifth Instance.
TYT Bank	April 11,1994	Bankruptcy of the bank has been judged pursuant to the Decree No: 94/1402 of the Istanbul Commercial Court of the Seventh Instance.
Impex Bank	April 23,1994	Bankruptcy of the bank has been judged pursuant to the Decree No: 94/1395 of the Istanbul Commercial Court of the Eighth Instance.

(*) Take Over of the bank's majority shares by the Fund

Source: Available online –www.tmsf.org.tr-