

BANKING SECTOR REFORM: PROGRESS REPORT

1. Very important steps have been taken regarding the reform of the Turkish banking sector and various measures have been initiated to strengthen the system. The Banking Regulation and Supervision Agency (BRSA) and the State Banks Joint Management Board have been fully implementing the reform strategy set forth in the context of the economic restructuring program. The progress achieved is summarized below while the annex table contains the details of the time-bound action plan.

I. Progress in the Privatisation and Corporatisation of the State Banks

2. The license of Emlak bank has been revoked on July 9 and its' banking assets and liabilities have been transferred to Ziraat bank. Ziraat bank has been adequately capitalized to absorb the transfer of these assets.
3. A monitoring system has been introduced to monitor profits/losses, liquidity and interest rate margins of the state banks.
4. The independent audit of the state banks has been completed, and outside advisors have been appointed to guide the operational restructuring of state banks.
5. An omnibus law to facilitate the restructuring of the state banks has been passed.

II. Progress Regarding Resolution of Savings Deposit Insurance Fund (SDIF) Banks

6. There are currently 9 banks under the management of the SDIF.
7. HSBC won the bid to further negotiate the sales and purchase agreement of **Demirbank** until September 20th.
8. Five SDIF banks, namely Egebank, Yurtbank, Yasarbank, Bank Kapital and Ulusal Bank, were merged into Sumerbank thereby forming the first transition bank. On July 31, the SDIF approved the start of negotiation process of the equity transfer of **Sumerbank** to the Oyak Group. The negotiations will be finalized by August 10.
9. As there were no bids for the three SDIF banks (Etibank, Interbank, and Esbank) these banks were merged into a second transition bank under **Etibank**.
10. The sale process for **Iktisat Bank** will begin once the Sworn Bank Auditors have completed their financial evaluation.
11. The resolution strategies for the five banks intervened on July 10 will be initiated by the end of the year. These banks include **Milli Aydın Bank (Tarisbank)**, **Sitebank**, **Bayindirbank**, **Kentbank** and **EGS Bank**. Besides, the licences of the two investment banks (Atlas Investment Bank and Okan Investment Bank) have been revoked.

12. The table below summarizes the downsizing process of the banks taken over by the SDIF as of end-July 2001.

Number of Branches and Personnel of the SDIF Banks (*)

Number of branches		Number of personnel	
At transfer date to SDIF	As of July 31, 2001	At transfer date to SDIF	As of July 31, 2001
1,243	824	26,585	15,395

(*) The figures do not cover the 5 banks that were taken over on July 10.

Source: SDIF

13. Among the SDIF banks, Bank Ekspres, was sold to a local group, Tekfen Holding, on June 30, 2001.

14. The banking licence of T. Ticaret Bank was revoked on July 1, 2001.

15. BRSA continues to ensure that the deposit interest rates offered by the SDIF banks are in line with those of private banks.

16. The Collection Department (COD) of the SDIF is fully operational. Already over 70 employees have been hired and the director of the COD has been appointed. A large component of the non-performing loans of Sumerbank, Bank Ekspres and Turk Ticaret Bank have been already transferred to the COD.

17. As of June 30, 2001, The Saving Deposit Insurance Fund has realized loan loss recovery of \$795 million, of which \$276 million is from the previous owners and their firms, and \$519 million is from other distressed loans.

18. The SDIF encourages debt workout schemes by former owners of SDIF banks. In this context, the SDIF-led debt workout arrangement (\$520 million) between Ceylan Group (former owner of Bank Kapital currently under SDIF management) and 24 Turkish Banks was finalized on July 27, 2001. Of these 24 banks, 8 are SDIF banks, 4 are state banks, and 12 are privately owned banks.

19. The resolution strategies for all the remaining banks under the management of the SDIF will be formulated by the end of the year. Different methods are being considered regarding the liquidation procedures, including use of voluntary liquidation and transfer of the deposits and corresponding assets of these banks to another bank.

III. Establishing a Sound Private Banking Sector

20. Time bound commitment letters with plans to raise banks' capital adequacy ratios to 8 percent by end-2001 have been agreed with private banks identified as financially weak.

21. The recapitalization plans of five banks were considered either unacceptable or the banks were not able to comply with their plans. These banks were intervened on July 10 (as mentioned in paragraph 11).

22. The private banks have committed to a capital injection of \$1.4 billion, of which \$1.1 billion has already been realized as of the end of July.
23. Measures to reduce financial intermediation costs, to increase the attractiveness of TL deposits, and to lengthen the maturity of savings deposits were announced on July 26. Differential withholding tax rates with lower rates for longer maturity deposits were introduced¹. The Central Bank will start paying market interest rates on required reserves for TRL deposits². Also, to encourage holding of treasury bills by households, the tax exemption on government bonds earnings has been raised from about \$3,750 to about \$38,500.
24. An omnibus law to facilitate the mergers of banks and their subsidiaries has been passed. The law provides tax incentives for corporate mergers and acquisitions. The BRSA also issued a communiqué to define the general principles and procedures regarding mergers and acquisitions of banks on June 27. In this context, the BRSA gave permission for the merger of Osmanlı and Korfez banks on July 26.
25. Regulatory framework has been strengthened with the issuance of an amended regulation on connected lending. Regulatory capital has also been redefined in this regulation.
26. The corporate tax deductibility of loan loss provisions has been clarified in the newly legislated Banking Law. This would remove the uncertainties on tax relief to the banking system.
27. A voluntary debt swap has been done by the Treasury on June 15. The swap was a significant success both in terms of its size and its design. As a result of the swap, TRL 9,335 trillion (\$8 billion) of local currency debt has been converted into foreign currency and TL-denominated instruments. This operation led to an extension of average maturity from 5.3 months to 37.2 months. As can be seen from the below table, the swap operation allowed the private local banks to substantially reduced their open currency position.

Developments in FX Position (Private local banks, excluding SDIF banks)

(Million \$)	April 27	May 25	June 15	June 29
On-balance sheet FX position	-8,177	-8,417	-8,270	-8,300
FX indexed position	1,831	2,157	2,139	6,153
On-balance sheet FX position (*)	-6,346	-6,260	-6,131	-2,147
Future Contracts	5,922	5,992	5,757	2,290
Net FX Open Position	-424	-268	-374	143

(*) FX indexed position included

Source: BRSA daily reporting system

28. The Capital Markets Board of Turkey issued the necessary regulations to establish a derivatives market under the roof of the Istanbul Stock Exchange on July 19. Having a derivatives market will provide the Turkish banking sector with a variety of tools to hedge against risks.

¹ The average effective withholding tax rate on TRL-deposits is reduced to 13.8 percent from the current average level of 15.4 percent, while it is increased from 4.2 percent to 4.7 percent on FX-deposits.

² With the implementation of interest paying policy on reserve requirement, it is estimated that the average funding cost for TRL-deposits stemming from government regulations would decline from 8.5% to 5.3%.

29. Projects and plans are being formulated by the World Bank, the Treasury, and other government entities to enhance the repayment capacity of the corporate sector. These include work on policy alternatives to deal with a potential non-performing loan build-up problem in the banking sector.
30. Foreign participation in the banking sector is expected to further increase over the medium term.

Banking Sector Restructuring Program: Implementation Schedule

I. Financial and Operational Restructuring of Banks

Measures and Regulations	Timing	Current Situation (31.7.2001)
A. State Banks		
Elimination of state banks' overnight liabilities	June 2001	State Banks' overnight liabilities, which were USD 8.7 billion on March 16, 2001, have been eliminated.
Limiting the stock of repurchase agreements of state banks (including SDIF banks) with the CBRT to TL 7 quadrillion	End of May 2001	Done.
Elimination of duty losses and their accrued interests	May 2001	As of May 2, 2001 all duty losses have been securitised
Preventing generation of new duty losses	May 2001	97 previously issued Council of Ministers decrees regarding the current duty losses have been abolished. The bill for the elimination of current duty losses based on legislative arrangements was approved on June 20, 2001 and issued in the Official Gazette dated July 3, 2001.
Allocating the sufficient appropriation within the budget for subsidies through state banks		TL 400 trillion has been allocated within the 2001 Budget.
Appointment of a joint board of management consisting of professional managers for the state banks	April 2001	The joint board of management has been appointed in April 2001 and also the new bank management appointed in May 2001. This board has authority to prepare Ziraat and Halk Bank for privatization within three years.
Setting an upper limit for deposit rates offered by state banks		Deposit rates are being uniformly determined below market interest rates for Treasury securities.
Strengthening capital structure of state banks	May 2001	In 2001, with the purpose of recapitalization Ziraat Bank, Halk Bank and Emlak Bank have been paid TL 217.6 trillion, TL 67.2 trillion and TL 40.8 trillion, respectively. Furthermore, Treasury issued special recapitalization bonds in an amount of TL 624 trillion and TL 900 trillion for Emlak and Halkbank, respectively.
Withdrawal of Emlak Bank's license, and transfer of its liabilities and remaining assets to Ziraat Bank	End of May 2001	Done. The related regulation was published in the Official Gazette dated July 3, 2001.
Privatization of Vakıf Bank		Privatization procedures shall be resumed as soon as the market conditions allow.
Closing of inefficient branches, and downsizing of personnel by providing retirement incentives		As published in Official Gazette dated July 3, 2001, some retirement incentives have already been provided.

Measures and Regulations	Timing	Current Situation (30.7.2001)
B. SDIF Banks		
Establishment of joint management for the SDIF Banks	April 2001	All SDIF Banks excluding Demirbank and 4 of newly acquired 5 banks, have been put under the joint board of management.
Merger of some SDIF Banks under Sumerbank	January and May 2001	Egebank, Yurtbank, Yaşarbank and Bank Kapital in January 2001, and Ulusal Bank in May 2001, have been merged under Sumerbank.
Merger of Türk Ticaret Bank, İnterbank, Esbank and Etibank under a second transition bank	May 31, 2001	The Board decision of merger of Interbank and Esbank under Etibank was issued in the Official Gazette dated June 27, 2001. The banking license and the right of accepting deposits of Türk Ticaret Bank have been revoked as of July 1, 2001.
Rationalization of the number of branches and staff		The number of branches of the SDIF banks, which was 1,243 on the date of take over, was reduced to 824 as of July 31, 2001. At the same period the number of staff has been lowered from 26,585 to 15,395. Figures do not cover the 5 banks that were taken over on July 10, 2001.
Sale of financial and non-financial subsidiaries, vehicles and movable assets		30 financial and non-financial subsidiaries of the merged Sumerbank were listed for sale on April 3, 2001. The sale of excess vehicles and movable assets of Sumerbank has also been initiated. As of July 16, 2001, 12 financial and 2 non- financial subsidiaries were sold.
Elimination of SDIF banks' overnight liabilities to the parties other than the Central Bank of Turkey (CBRT)	End of May 2001	SDIF banks' overnight liabilities, which were USD5.2 billion on March 16, 2001, were eliminated.
Limiting the stock of repurchase agreements of SDIF banks (including state banks) with the CBRT to TL 7 quadrillion	End of May 2001	Completed.
Setting an upper limit for deposit rates offered by SDIF banks		Deposit rates are uniformly determined below market interest rates for Treasury securities.

Measures and Regulations	Timing	Current Situation (31.7.2001)
B. SDIF Banks (Continued)		
Recapitalization and strengthening the financial position of SDIF banks	May 2001	TL 19.7 trillion Treasury special issue bonds have been issued for the SDIF banks. In addition, TL 2.2 quadrillion has been provided to these banks in the form of deposit and capital from the SDIF's own sources. The previously owned bonds by the SDIF banks have been exchanged with new bonds in the amount of 3.4 quadrillion that are in line with market conditions. The equivalent of the bonds given to the SDIF banks in December 2000 with a nominal value of USD 1.5 billion have been redeemed in advance by the Treasury and set-off from the SDIF banks's debt.
Transferring the bad assets of SDIF banks to the collection department of SDIF	July 31, 2001	Work on transferring approximately 2.666 files, concerning exposures over TL 75 billion, has been going on. Up to now, 956 files have been transferred to the collection department of SDIF.
Initiating sale of Sumerbank and the second transition bank	July 31, 2001	-Sale and purchase agreement was signed with OYAK on July 31, 2001. -The second transition bank (Etibank) was established on June 27, 2001
Resolution of the two transition banks	December 31, 2001	In case two transition banks cannot be sold, merging the bank(s) with one of the solvent banks or putting them into liquidation by honoring all liabilities and transferring the remaining assets to the collection department of the SDIF
Sale of Demirbank		The Board of Fund has found the proposal of HSBC Bank plc convenient for evaluation on July 19, 2001. It is aimed that the discussions on the shares sale and transfer contract within the framework of "Confidentially Agreement" to be signed with HSCB will be completed within 2 months.
Sale of Bank Ekspres	May 31, 2001	It has been sold to Tekfen Holding A.Ş. and 99.46 percent of its shares as of June 30, 2001 is transferred with the assets and liabilities agreed upon. The rest is transferred to Etibank.
Sale of İktisat Bank		The sale of İktisat Bank will be initiated after completion of its acquisition balance sheet.
Establishing the infrastructure to accelerate collections of the SDIF banks' non-performing loans and legal proceedings		Necessary modifications on the Banking Law have been already done.
C. Private Banks		
Preparation of recapitalization and restructuring plans by the private banks	End of April 2001	The Commitment Letters covering recapitalization plans or provisions of subordinated loan with restructuring strategies have been received from the private banks.
Ensuring capital injection	2001	The BRSA has required banks to add their profits to their capital. The banks have applied to the BRSA to increase their capital by USD 1.4 billion. As of July 31, 2001, USD 1.1 billion capital increase realized.
The implementation of performance criteria set out in the Commitment Letters	2001	The observance of the performance criteria will be strictly enforced. As a matter of fact, 5 banks that were not able to commit to a credible recapitalization plan were taken over by SDIF and 2 investment banks have been closed as they did not comply with performance criteria and became financially weak.

Banking Sector Restructuring Program: Implementation Schedule

II. Legal and Institutional Arrangements

Measures and Regulations	Timing	Current Situation (31.7.2001)
A. Strengthening the Supervisory Framework		
Defining consolidated own funds consistent with the EU Directives	May 2001	With the change in Banking Law, “consolidated own funds” is defined, and this definition will be used in calculation of consolidated credit limits and standard ratios.
Limiting the banks’ participations in non-financial institutions	May 2001	Banks’ non-financial subsidiaries are limited to 15% of total net worth and the total sum of all such subsidiaries are limited to 60% of total net worth with a transition period until 2009.
Broadening the definition of credit, and inclusion of forwards, options and other similar derivative products into the definition of credit	May 2001	Necessary modifications in Banking Law have been done.
Clarifying the deductibility of loan loss provisioning in calculation of corporate income tax base	May 2001	Necessary modifications in Banking Law have been done.
Ensuring transparency in financial statements and that all transactions are properly recorded	January 1, 2002	The Regulation of Accounting Practices will be effective as of January 1, 2002. The studies on the issue have been still going on.
Inclusion of repo transactions on balance sheet	January 1, 2002	To be included in the context of The Regulation of Accounting Practices.
Adopting the basic principles of International Accounting Standards together with the Standard No: 39 including valuation and classification of financial tools and the financial transactions against risk	January 1, 2002	To be included in the context of The Regulation of Accounting Practices.
Adoption of connected lending regulation	June 30, 2001	The Communique on the establishment and operations of banks was issued on the Official Gazette dated June 27, 2001. The regulation covers organizational structure of banks, lending principles and procedures, definitions of indirect shareholding, indirect credit and indirect participation, and ratios of non-cash credits taken into account in calculation of credit limits.

Measures and Regulations	Timing	Current Situation (31.7.2001)
A. Strengthening Supervisory Framework (Continued)		
To maintain a close monitoring of open positions of banks.		Recent swap operation has enabled banks to reduce their open positions to a great extent. The compliance of the banks with regulations related to open position has been closely monitored on daily basis.
Monitoring the establishment process of internal control and risk management systems	January 1, 2002	The related regulation will be effective on January 1, 2002.
Incorporation of the market risks on consolidated basis in the calculation of capital adequacy ratio	2002	Banks will be obliged to take into account market risks in capital adequacy calculations on a solo basis by January 1, 2002, and on a consolidated basis by July 1, 2002.
Encouraging banks to give importance to internal and external supervision, and ensuring examinations on internal control and risk management systems and lending portfolio and market risks during independent supervision activities		
The revision of the establishment and operation principles for independent auditing firms	September 2001	Studies on this issue have already been initiated. The auditing license of one independent auditing firm was cancelled as of June 2001.
Close monitoring of the off-shore banks established by Turkish banks or their dominant shareholders		BRSA is in the process of finalizing Memorandum of Understanding (MoUs) with host country supervisory authorities.
Ensuring on-site supervision of branches in foreign countries		BRSA is in the process of finalizing Memorandum of Understanding (MoUs) with host country supervisory authorities.
B. Other Measures to Enhance Efficiency and Competitive Power of the Sector		
Review of the withholding income tax rates and reserve requirement practices to promote long term savings and reduce financial intermediation costs.	July 2001	Done. The measures include increasing taxes on repo and FX deposits, reducing tax rates on long term deposits and paying interest on reserve requirements for TL deposits.
Eliminating the remaining obstacles for bank mergers and acquisitions	July 2001	The regulation that enables the tax advantages in Law No: 4605 to be apply also to the merger of bank subsidiaries was issued on Official Gazette dated July 7, 2001. Also BRSA issued a new regulation on bank mergers and acquisitions and it is published in the Official Gazette dated June 27, 2001.
Encouraging the increase in own funds	July 2001	The regulation stipulating that 'the requirement of two year holding period for property and subsidiaries to be eligible for corporate tax exemption shall be abolished' was issued on the Official Gazette dated July 7, 2001. The regulation also enables the reduction of withholding tax rate on income that is generated from real estate and subsidiary sales.