



**BANKING REGULATION AND SUPERVISION  
AGENCY**

**BANKING SECTOR RESTRUCTURING PROGRAM:  
PROGRESS REPORT**

**FEBRUARY 6, 2002**

## **FOREWORD**

The Banking Sector Restructuring Program, announced on May 15, 2001, aims to eliminate distortions in the financial sector and adopt regulations to promote an efficient, globally competitive and sound Turkish banking sector.

The Restructuring program was based on the following main pillars: (1) Restructuring of the state banks (2) Resolution of SDIF banks (3) Strengthening of the private banks and (4) Strengthening of the regulatory framework.

Banking Regulation and Supervision Agency periodically updates and publishes the developments in the restructuring program in the form of “Progress Reports”. This issue of “Progress Report” summarizes developments as of February 5, 2002.

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# BANKING SECTOR RESTRUCTURING PROGRAM: PROGRESS REPORT

## 1. THE RESTRUCTURING OF STATE BANKS

Restructuring program of the state banks targets to improve the financial and operational structures of these banks to prepare them for privatization.

The first step taken in restructuring of the state banks was the transfer of the administration and management of these banks to a Joint Board of Directors in April 2001. The Board was fully authorized to oversee the restructuring program and to prepare these banks for privatization.

Financial restructuring of state banks was completed in 2001, while significant progress has been achieved in the area of operational restructuring.

This section covers information on Ziraat Bank, Halk Bank and Emlak Bank, of which the latter was transferred to Ziraat Bank effective from July 9, 2001.

### 1.1. Financial Restructuring

Financial restructuring of the state banks concentrated on; (1) liquidation of duty losses; (2) elimination of short term liabilities; (3) strengthening capital base; (4) determination of deposits rates in line with the market rates, and (5) efficient management of loan portfolio.

#### *Securitization of the Duty Losses*

- State banks' claims on Treasury arising from the subsidized lending (duty losses) and the interest accrued to these losses were securitized in 2001. The Treasury supplied government bonds of 23 quadrillion TL in 2001 to securitize the state banks' receivables from the government.

**Table 1 Government Securities Issued for the Duty Losses of State Banks**

| (TL Trillion) (*)    | Ziraat        | Halk          | Emlak     | Total         |
|----------------------|---------------|---------------|-----------|---------------|
| <b>2000 Year-end</b> | <b>2,034</b>  | <b>863</b>    | -         | <b>2,897</b>  |
| 2001 January         | 2,333         | 2,167         | -         | 4,500         |
| February             | -             | 1,000         | -         | 1,000         |
| March                | 550           | 1,750         | -         | 2,300         |
| April                | 4,500         | 1,750         | -         | 6,250         |
| May                  | 4,730         | 4,130         | 45        | 8,905         |
| <b>2001 Total</b>    | <b>12,113</b> | <b>10,797</b> | <b>45</b> | <b>22,955</b> |
| <b>TOTAL</b>         | <b>14,148</b> | <b>11,659</b> | <b>45</b> | <b>25,852</b> |

*Source: Treasury*

*(\*) 750 million dollars securities denominated in foreign currencies were converted by the CBRT exchange rate of issuing day, January 3, 2001.*

- Existing regulations (approximately 100 Council of Minister's Decrees and/or Laws) that allowed subsidized lending through state banks (creating duty losses) were annulled in order to prevent the generation of new duty losses.

- Any government support provided through state banks in the future will have to be appropriated in the budget and state banks will have to be provided with the necessary funds.

#### *Elimination of the Short-term Liabilities*

- State banks provided liquidity through out-right sale of government securities or repo transactions made with Central Bank (CBRT) and eliminated their short-term liabilities to the private banks and clients, which was around 8.5 quadrillion TL on March 16, 2001.

- State banks' borrowing through repo transactions with CBRT also declined from 5.5 quadrillion TL in March 2001 to 1.9 quadrillion TL as of January 18, 2002.
- In order to reduce maturity mismatch and liquidity risk, minimum maturity on repo transactions with clients and institutional investors has been extended to a week or longer.
- The Treasury contributed to the stabilization of liquidity position and cash inflow of state banks through early redemption of government securities. This in turn helped to ease the pressure on short term borrowing market arising from the liquidity needs of the state banks.

**Table 2 Short Term Borrowing of State Banks**

|  | TL Quadrillion   |                    | Percentage Share |                    |
|--|------------------|--------------------|------------------|--------------------|
|  | 16 March<br>2001 | 18 January<br>2002 | 16 March<br>2001 | 18 January<br>2002 |
| <b>1. Central Bank</b>                               | <b>5.5</b>       | <b>1.9</b>         | <b>39.3</b>      | <b>100.0</b>       |
| - Open Market Operations                             | 5.5              | 1.9                | 39.3             | 100.0              |
| Repo   | 5.5              | 2.1                | 39.3             | 110.5              |
| -O/N   | 0.2              | 0.0                | 1.4              | 0.0                |
| -Longer  | 5.3              | 2.1                | 37.9             | 110.5              |
| - Interbank (O/N)                                    | 0.0              | -0.2               | 0.0              | -10.5              |
| <b>2. Private Banks+Customer Repos &amp; Deposit</b> | <b>8.5</b>       | <b>0.0</b>         | <b>60.7</b>      | <b>0.0</b>         |
| <b>Private Banks (O/N)</b>                           | <b>4.2</b>       | <b>0.0</b>         | <b>30.0</b>      | <b>0.0</b>         |
| - Interbank within CBRT                              | 0.4              | 0.0                | 2.9              | 0.0                |
| - OTC  | 1.9              | 0.0                | 13.6             | 0.0                |
| - ISE Repo Market                                    | 1.9              | 0.0                | 13.6             | 0.0                |
| <b>Customer Repos &amp; Deposit</b>                  | <b>4.3</b>       | <b>0.0</b>         | <b>30.7</b>      | <b>0.0</b>         |
| <b>Total (1+2)</b>                                   | <b>14.0</b>      | <b>1.9</b>         | <b>100.0</b>     | <b>100.0</b>       |

Source: CBRT

### *Strengthening the Capital Base*

- Since March 2001, Treasury injected securities and cash to state banks in order to strengthen their capital base. Hence, paid-in capital of the state banks rose from 477 trillion TL in December 2000 to 3.4 quadrillion TL in December 2001, while shareholders' equity rose from 712 trillion TL to 4.1 quadrillion TL during the same period.

**Table 3 Shareholder's Equity of State Banks**

| TL Trillion                | December 2000 | December 2001 (*) | Change (%) |
|----------------------------|---------------|-------------------|------------|
| <b>Ziraat Bank</b>         |               |                   |            |
| -Paid-in capital           | 261           | 2,222             | 751.3      |
| -Reserves+FARF+SRF         | 180           | 470               | 161.1      |
| -Profit/Loss               | 65            | 543               | 735.4      |
| Total Equity               | 506           | 3,235             | 539.3      |
| <b>Halk Bank</b>           |               |                   |            |
| -Paid-in capital           | 145           | 1,150             | 693.1      |
| -Reserves+FARF+SRF         | 171           | 249               | 45.6       |
| -Profit/Loss               | 5             | -570              | -          |
| Total Equity               | 321           | 829               | 158.3      |
| <b>Emlak Bank</b>          |               |                   |            |
| -Paid-in capital           | 70            | -                 | -          |
| -Reserves+FARF+SRF         | 121           | -                 | -          |
| -Profit/Loss               | -305          | -                 | -          |
| Total Equity               | -114          | -                 | -          |
| <b>STATE BANKS (Total)</b> |               |                   |            |
| -Paid-in capital           | 477           | 3,372             | 606.9      |
| -Reserves+FARF+SRF         | 470           | 719               | 53.0       |
| -Profit/Loss               | -235          | -27               | -          |
| Total Equity               | 712           | 4,064             | 470.8      |

Source: BRSA, Joint Board of Directors of State Banks (JBDSB)

FARF: Fixed Assets Revaluation Fund, SRF: Securities Revaluation Fund

(\*) Preliminary Figures.

- Despite the sharp increase in non-performing loans, the capital adequacy ratio of state banks improved considerably in 2001. This improvement was due to the capital injections as well as the increase in the share of government securities, which has zero risk weight in the calculation of CAR, in the total assets of the state banks.

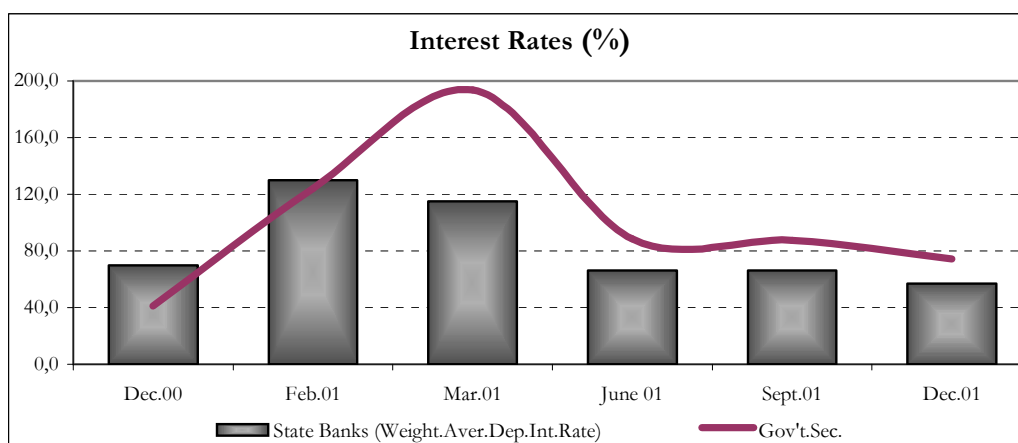
**Table 4 Capital Adequacy Ratio of State Banks**

| Percentage  | December 2000 | March 2001 | June 2001 | September 2001 |
|-------------|---------------|------------|-----------|----------------|
| State Banks | 7.1           | 11.6       | 25.5      | 36.5           |

Source: BRSA

### ***Determination of Deposit Rates in Line with the Market Rates and Efficient Management of Loan Portfolio***

- State banks' deposit interest rates have been determined uniformly and below the interest rates of the government securities.
- Significant reduction in the short term liabilities and strengthening of capital base have contributed to the elimination of distortions created by the state banks in the deposit market. In fact, state banks have been able to reduce average deposit rates to 57 percent in December 2001 from 70 percent in end-2000. During the same period interest rates on FX deposits diminished considerably as well.



Note: As there is no auction in December 2000, November auction rates used instead.

- State banks have been determining interest rates on specialized credits by taking into account their funding costs.
- State banks have become more prudent about identifying problem loans and reserving appropriate provisions for such loans, which in turn resulted in a more transparent balance sheet. With a more adequate classification, non-performing loans of state banks rose to 3,365 trillion TL in December 2001 from 1,017 trillion TL in end-2000, while provisions for NPLs reached to 2,301 trillion TL from 296 trillion TL during the same period.

## **1.2. Operational Restructuring**

Operational restructuring of state 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 will operate according to the requirements of the modern banking and international competition. Developments regarding these issues are summarized below:

- State banks are organized in a pyramid structure where the board of directors are at the top with 5 sub-departments including non-branch profit centers, marketing, operations, loans and risk management, and control under this board.

- The banking and deposit taking licenses of Emlak Bank were revoked and the bank was transferred to Ziraat Bank.

- Significant improvements have been realized towards the rationalization of the number of branches and staff. In this respect, about 100 branches were closed, while the number of staff was reduced by 13,616 during 2001.

- A detailed strategic and organizational implementation plan regarding the operational restructuring of Ziraat Bank and Halk Bank has been adopted and approved by General Assemblies of these banks, the principles of which were approved by the Council of Ministers. The Council of Ministers' Decree, published on February 1, 2001, envisages that the number of branches and employees of state banks will be reduced by 897 and 16,000 respectively by end-June 2002.

**Table 5 Number of Branches and Employees**

|                            | December<br>2000 | March<br>2001 | June<br>2001  | September<br>2001 | December<br>2001 |
|----------------------------|------------------|---------------|---------------|-------------------|------------------|
| <b>Number of Employees</b> |                  |               |               |                   |                  |
| -Ziraat Bank               | 36,576           | 35,334        | 29,903        | 35,565            | 33,023           |
| -Halk Bank                 | 10,000           | 14,699        | 13,207        | 12,946            | 14,962           |
| -Emlak Bank                | 15,025           | 9,798         | 8,865         | -                 | -                |
| <b>TOTAL</b>               | <b>61,601</b>    | <b>59,831</b> | <b>51,975</b> | <b>48,511</b>     | <b>47,985</b>    |
| <b>Number of Branches</b>  |                  |               |               |                   |                  |
| -Ziraat Bank               | 1,287            | 1,281         | 1,270         | 1,615             | 1,499            |
| -Halk Bank                 | 804              | 804           | 803           | 803               | 899              |
| -Emlak Bank                | 403              | 403           | 403           | -                 | -                |
| <b>TOTAL</b>               | <b>2,494</b>     | <b>2,488</b>  | <b>2,476</b>  | <b>2,418</b>      | <b>2,398</b>     |

*Source: BRSA, JBDSB*

- A program has been set up to monitor the profit and loss accounts, liquidity position and interest rate spreads of the state banks. Hence, the assets' yield and liabilities' cost can be monitored on a weekly basis, while balance sheets and income statements of the branches are monitored on a daily basis.

- An agreement was signed with an independent audit company to assess the conditions of the state banks.

- Internal control, financial control and risk management units have been set up within both Ziraat and Halk Bank.

### 1.3. Developments in the Balance Sheet and Profitability Performance of State Banks

- Total assets of state banks (Ziraat, Halk and Emlak) amounting 30.8 quadrillion TL in December 2000 increased by 44.6 percent and reached 44.6 quadrillion TL at end-2001.

**Table 6 Consolidated Balance Sheet of State Banks**

| (TL Trillion)              | December      | December      | Change (%)  | Percentage Share |              |
|----------------------------|---------------|---------------|-------------|------------------|--------------|
|                            | 2000          | 2001 (*)      |             | Dec.00           | Dec.01       |
| <b>Assets</b>              |               |               |             |                  |              |
| -Cash & Claims on Banks    | 2,555         | 4,760         | 86.3        | 8.3              | 10.7         |
| -Securities Portfolio      | 1,759         | 25,746        | 1,363.7     | 5.7              | 57.8         |
| -Loans                     | 6,525         | 5,453         | -16.4       | 21.2             | 12.2         |
| -Past Due Loans (Net)      | 722           | 1,065         | 47.5        | 2.3              | 2.4          |
| -Past Due Loans (Gross)    | 1,017         | 3,365         | 230.9       | 3.3              | 7.5          |
| -Loan Loss Reserves (-)    | 296           | 2,301         | 677.4       | 1.0              | 5.2          |
| -Duty Losses               | 15,196        | -             | -           | 49.3             | 0.0          |
| -Other Losses              | 4,061         | 7,554         | 86.0        | 13.2             | 16.9         |
| <b>Liabilities</b>         |               |               |             |                  |              |
| -Deposits                  | 20,234        | 30,351        | 50.0        | 65.7             | 68.1         |
| -Borrowings from Banks     | 4,612         | 3,561         | -22.8       | 15.0             | 8.0          |
| -Other Liabilities         | 5,258         | 6,599         | 25.5        | 17.1             | 14.8         |
| -Shareholder's Equity      | 712           | 4,065         | 470.9       | 2.3              | 9.1          |
| <b>Balance Sheet Total</b> | <b>30,817</b> | <b>44,576</b> | <b>44.6</b> | <b>100.0</b>     | <b>100.0</b> |

Source: BRSA, JBDST

(1) Consolidated balance sheets of Ziraat, Halk and Emlak Bank

(\*) Temporary figures.

- The ratio of shareholder's equity to total liabilities rose to 9.1 percent at end-2001 from 2.3 percent in December-2000, while the share of borrowings from banks in total liabilities declined to 8 percent from 15 percent in the same period.

- Loan portfolio of state banks shrunk by 16.4 percent in nominal terms in 2001. This was partially due to the transfer of some loans to non-performing loans category. In fact, gross loans (loans+non-performing loans) increased by 16.7 percent during the same period.

- The share of securities portfolio in total assets rose to 57.8 percent in December 2001 from 5.7 percent in December 2000 due to government securities issued to state banks against their duty loss claims and as well as for capital support. Due to securities issued against the transfer of FX depo liabilities of SDIF Banks to Ziraat Bank, there has been a significant increase in FX indexed securities of state banks at the end of December 2001.

**Table 7 Securities Issued to State Banks**

| (As of December 31, 2001) | TL Denominated (TL Trillion) |                     |                    |                          | USD Indexed (\$ Million) | Euro Indexed (Million €) | Overall Total (TL Trillion) |
|---------------------------|------------------------------|---------------------|--------------------|--------------------------|--------------------------|--------------------------|-----------------------------|
|                           | Indexed to Repo Rates        | Indexed to Auctions | Indexed to WPI&CPI | Indexed to Deposit Rates |                          |                          |                             |
| Ziraat Bank               | 5,155                        | 6,942               | 196                | 902                      | 1,816                    | 641                      | 16,560                      |
| Halk Bank                 | 777                          | 7,020               | -                  | 699                      | 1,912                    | 1,048                    | 12,966                      |
| <b>TOTAL</b>              | <b>5,932</b>                 | <b>13,962</b>       | <b>196</b>         | <b>1,601</b>             | <b>3,728</b>             | <b>1,689</b>             | <b>29,526</b>               |

Source: JBDSB

- Positive impact of financial and operational restructuring was already reflected in profitability performance of the state banks in 2001. Total losses of Ziraat and Emlak banks,

which was 598 trillion TL in April, turned to a profit of 543 trillion TL in December 2001. During the same period, the loss of Halk Bank declined to 570 trillion TL from 740 trillion TL. Hence, total losses of state banks declined to 27 trillion TL in December 2001 from 1.3 quadrillion TL in April.

**Table 8 Profits and Losses of State Banks**

| (TL Trillion) | April         | May         | June        | July        | Aug.        | Sept.       | Oct.        | Nov.       | Dec. (*)   |
|---------------|---------------|-------------|-------------|-------------|-------------|-------------|-------------|------------|------------|
| Ziraat        | -279          | 459         | 225         | 255         | 118         | 215         | 349         | 438        | 543        |
| Emlak         | -319          | -331        | -425        | -           | -           | -           | -           | -          | -          |
| Ziraat+Emlak  | -598          | 128         | -201        | 255         | 118         | 215         | 349         | 438        | 543        |
| Halk          | -740          | -576        | -759        | -703        | -674        | -627        | -562        | -496       | -570       |
| <b>Total</b>  | <b>-1,338</b> | <b>-448</b> | <b>-960</b> | <b>-448</b> | <b>-555</b> | <b>-412</b> | <b>-213</b> | <b>-58</b> | <b>-27</b> |

Source: BRSA, JBDSB

(\*) Temporary figures.

**Regulations Regarding State Banks within the Framework of the Law on Restructuring of Debts to Financial Sector, Act No: 4743.**

√ State banks are not allowed to employ personnel who are not subject to provisions of private law after 31.12.2002.

√ Early retirement is encouraged with 20 percent addition to retirement bonuses within two months period of enactment of Law No: 4743.

√ Members of the Board of Directors and Board of Auditors of Ziraat Bank and Halk Bank, and Board of Liquidation of Emlak Bank will not be deemed as civil servants from the standpoint of the criminal law and administrative law, and their legal liabilities will be subject to the legislation and provisions applied to the private banks operating in the banking sector.

√ State Banks are authorized to restructure credits extended before 21.02.2001.

√ Ziraat Bank and Halk Bank are required to extend an additional loan of at least 1.5 quadrillion TL from their own resources to the agricultural sector, tradesmen and artisans, small and medium sized enterprises and exporters. Additional loan will be extended in accordance with prudent banking procedures.

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## 2. THE RESOLUTION OF SDIF BANKS

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Prompt resolution the banks under the Saving Deposit Insurance Fund (SDIF) has been one of the main elements of the banking sector restructuring program.

The strategy for the restructuring of SDIF banks embodies the following four major components: (1) the resolution of the SDIF banks through merger, transfer, sale or liquidation (2) financial restructuring (3) operational restructuring and (4) management of the assets of the SDIF banks.

### 2.1. Merger, Transfer, Sale or Liquidation Processes of the SDIF Banks

- During the last five years, 19 banks were transferred to the SDIF. 8 of the intervened banks were merged under two transition banks, while 4 banks were sold to the private sector and foreign investors (Table 9 and 10).

- The liquidation process of T.Ticaret Bank and transfer of Tarişbank to SDIF were halted by the judiciary action taken by courts.

- In December 2001, the banking licenses of İktisat Bank, Etibank and Kentbank were revoked and they were put under the liquidation process.

- Thus, as of February 5, 2002, 2 banks, namely Bayındırbank and Toprakbank, remained under the SDIF administration.

- For Toprakbank which was transferred to SDIF in November 2001, sale process was started on January 31, 2002. The sale process is scheduled to be finalized by April 2, 2002.

**Table 9 Restructuring of the SDIF Banks**

|                                     | 1997     | 1998     | 1999     | 2000      | 2001     | As of February 1,<br>2002 | Total |
|-------------------------------------|----------|----------|----------|-----------|----------|---------------------------|-------|
| Banks taken over                    | 1        | 1        | 6        | 3         | 8        | -                         | 19    |
| Merged banks                        | -        | -        | -        | -         | 7        | 1                         | 8     |
| Sold banks                          | -        | -        | -        | -         | 3        | 1                         | 4     |
| License withdrawals                 | -        | -        | -        | -         | 3        | -                         | 3     |
| Banks under Legal Process           | -        | -        | -        | -         | 2        | -                         | 2     |
| <b>Banks that remain under SDIF</b> | <b>1</b> | <b>2</b> | <b>8</b> | <b>11</b> | <b>4</b> | <b>2</b>                  |       |

Source: BRSA

**Table 10 List of Banks Transferred to the SDIF**

| Banks                               | Date of Transfer to SDIF | Current Situation   |
|-------------------------------------|--------------------------|---|
| <b>Sold Banks</b>                   |                          |   |
| Sümerbank                           | December 22, 1999        | Merged Sümerbank was sold to the OYAK Group on August 10, 2001. Merger of Sümerbank and Oyakbank was approved as of January 11, 2002.                             |
| -Egebank                            | December 22, 1999        | -Merged into Sümerbank on January 26, 2001.   |
| -Yurtbank                           | December 22, 1999        | -Merged into Sümerbank on January 26, 2001.   |
| -Yaşarbank                          | December 22, 1999        | -Merged into Sümerbank on January 26, 2001.   |
| -Bank Kapital                       | October 27, 2000         | -Merged into Sümerbank on January 26, 2001.   |
| -Ulusal Bank                        | February 27, 2001        | -Merged into Sümerbank on April 17, 2001.   |
| Bank Ekspres                        | December 12, 1998        | Sold to the Tekfen Holding on June 30, 2001. Transfer was completed on October 10, 2001, and operating as Tekfenbank A.Ş.   |
| Demirbank                           | December 6, 2000         | Sold to HSBC on September 10, 2001. Transfer was completed on October 30, 2001.   |
| Sitebank                            | July 9, 2001             | Sold to Novabank on January 11, 2002. Transfer was completed on January 16, 2002.   |
| <b>License withdrawals</b>          |                          |   |
| Etibank                             | October 27, 2000         | Banking and deposit taking license was revoked as of December 28, 2001.   |
| -Interbank                          | January 7, 1999          | -Merged into Etibank on June 15, 2001   |
| -Esbank                             | December 22, 1999        | -Merged into Etibank on June 15, 2001.  |
| İktisat Bank                        | March 15, 2001           | Banking and deposit taking license was revoked as of December 7, 2001.  |
| Kentbank                            | July 9, 2001             | Banking and deposit taking license was revoked as of December 28, 2001.   |
| <b>Banks under Legal Process</b>    |                          |   |
| T. Ticaret Bank                     | November 6, 1997         | Banking and deposit taking license was revoked as of July 1, 2001. Objection for the liquidation accepted by the State Council, and legal process is in progress. |
| Tarişbank                           | July 9, 2001             | Objection for the transferring to SDIF accepted by the State Council on November 23, 2001, and legal process is in progress                                       |
| <b>Banks that remain under SDIF</b> |                          |   |
| Bayındırbank                        | July 9, 2001             | To be structured as a bridge bank that will focus on asset management.  |
| -EGS Bank                           | July 9, 2001             | -Banking and deposit taking license was revoked as of January 18, 2002. Merged into Bayındırbank.   |
| Toprakbank                          | November 30, 2001        | Sale process is started on January 31, 2002 and scheduled to be completed by April 2, 2002.   |

Source: BRSA.

## 2.2. Financial Restructuring

### *Government Securities Issued to SDIF by Treasury*

- Since December 2000 Treasury has issued government securities in order to strengthen the capital base of SDIF banks.
- SDIF banks sold 4,115 trillion TL of government bonds to the Central Bank and eliminated their short term liabilities.
- 824 trillion TL of government securities were redeemed through cash payment, while 995 trillion TL of them were cancelled and given back to Treasury.
- Table 11 shows the composition of the non-cash government securities issued to SDIF as of December 31, 2001.

**Table 11 Government Securities Issued to SDIF**

| (As of December 31, 2001)             | TL<br>Denominated<br>(TL Trillion) | Dollar<br>Denominated<br>(Million<br>Dollar) | Euro<br>Denominated<br>(Million Euro) | Total(1)<br>(TL Trillion) | Total(2)<br>(TL Trillion) |
|---------------------------------------|------------------------------------|--|---------------------------------------|---------------------------|---------------------------|
| Government Bonds Issued to SDIF       | 3,192                              | 7,431  | 897                                   | 14,450                    | 16,022                    |
| <i>Memorandum Item:</i>               |                                    |  |                                       |                           |                           |
| Government Bonds Issued to SDIF Banks | 3,200                              | 208  | -                                     | 3,472                     | 3,500                     |
| SDIF + SDIF Banks                     | 7,329                              | 7,639  | 897                                   | 17,922                    | 19,522                    |

Source: Treasury (1) Forex denominated bonds converted to TL with issue date rates. (2) Forex denominated bonds converted to TL with 12.31.2001 rates.

### ***Capital and Deposit Support From SDIF Sources***

- 1 quadrillion TL and 1.2 quadrillion TL were transferred from the SDIF's own resources to SDIF banks in the form of capital and deposits respectively.

**Table 12 Capital and Deposit Support from SDIF Sources**

| <b>(As of January 18, 2002)</b> | <b>TL Trillion</b> |
|---------------------------------|--------------------|
| 1. Cash Payment as Capital      | 1,012              |
| 2. Deposited Funds (1)          | 1,151              |
| <b>TOTAL</b>                    | <b>2,163</b>       |

*Source: SDIF*

(1) The advances totaling 751 trillion TL received from CBRT against Special Issue Securities were deposited in to SDIF Banks. This amount is included in the securities issued by Treasury in reports related part, if it is added to deposited funds, deposited funds become 1,902 trillion TL.

### ***Elimination of Short-Term Liabilities***

- SDIF banks eliminated their short term liabilities to clients and private banks by using the funds generated through the out-right sale of 4.2 quadrillion TL special issue bonds to Central Bank.

**Table 13 Short Term Liabilities of the SDIF Banks**

| <b>(TL Quadrillion)</b>                | <b>March 16, 2001</b> |                | <b>May 4, 2001</b> |                | <b>January 18, 2002</b> |                |
|--|-----------------------|----------------|--------------------|----------------|-------------------------|----------------|
|  | <b>TL</b>             | <b>% Share</b> | <b>TL</b>          | <b>% Share</b> | <b>TL</b>               | <b>% Share</b> |
| <b>Central Bank</b>                    | <b>2.6</b>            | <b>33.3</b>    | <b>5.6</b>         | <b>87.5</b>    | <b>3.4</b>              | <b>100.0</b>   |
| - Open Market Operations               | 2.6                   | 33.3           | 5.6                | 87.5           | 3.5                     | 102.9          |
| Overnight Repo                         | 0.3                   | 3.8            | 0.0                | 0.0            | 0.0                     | 0.0            |
| Longer Term Repo                       | 2.3                   | 29.5           | 5.6                | 87.5           | 3.5                     | 102.9          |
| - Interbank Market (O/N)               | 0.0                   | 0.0            | 0.0                | 0.0            | -0.1                    | -2.9           |
| <b>Private Banks (O/N)</b>             | <b>1.7</b>            | <b>21.8</b>    | <b>0.0</b>         | <b>0.0</b>     | <b>0.0</b>              | <b>0.0</b>     |
| - Interbank within CBRT                | 0.3                   | 3.8            | -0.1               | -1.6           | 0.0                     | 0.0            |
| - OTC                                  | 0.3                   | 3.8            | 0.0                | 0.0            | 0.0                     | 0.0            |
| - ISE Repo Market                      | 1.1                   | 14.2           | 0.1                | 1.6            | 0.0                     | 0.0            |
| <b>Customer Repos and O/N Deposits</b> | <b>3.5</b>            | <b>44.9</b>    | <b>0.8</b>         | <b>12.5</b>    | <b>0.0</b>              | <b>0.0</b>     |
| <b>Total</b>                           | <b>7.8</b>            | <b>100.0</b>   | <b>6.4</b>         | <b>100.0</b>   | <b>3.4</b>              | <b>100.0</b>   |

*Source: CBRT, BRSA.*

### ***Reduction in FX Open Positions***

- Open FX positions of SDIF banks, which were around 4-5 billion dollars, decreased substantially as a result of the injection of FX indexed bonds during the second half of May 2001. Due to inclusion of the net open positions of 5 banks intervened in July, SDIF banks' FX open position rose to 1.1 billion dollars during July-November period, but then decreased to 408 million dollars by January 18, 2002.

**Table 14 Foreign Exchange Positions of the SDIF Banks**

| <b>(Million Dollar)</b>                      | <b>April 13</b> | <b>May 18</b> | <b>June 29</b> | <b>Aug. 31</b> | <b>Dec. 28</b> | <b>Jan. 18, 2002</b> |
|--|-----------------|---------------|----------------|----------------|----------------|----------------------|
| 1. FX Position                               | -4,812          | -2,764        | -3,894         | -3,673         | -1,197         | -782                 |
| 2. FX Indexed Position                       | 630             | 2,233         | 3,383          | 2,490          | 748            | 74                   |
| <b>3. On Balance Sheet FX Position (1+2)</b> | <b>-4,182</b>   | <b>-531</b>   | <b>-511</b>    | <b>-1,183</b>  | <b>-449</b>    | <b>-408</b>          |
| 4. Forward Position                          | -132            | -116          | -50            | 66             | 0              | 0                    |
| <b>5. Net FX Position (3+4)</b>              | <b>-4,314</b>   | <b>-647</b>   | <b>-561</b>    | <b>-1,117</b>  | <b>-449</b>    | <b>-408</b>          |

*Source: BRSA*

### ***Determination of Deposit Rates in Line with the Market Rates***

- SDIF banks' deposit interest rates were determined uniformly and below the interest rates on government securities, and brought down to the market level since March 2001.

### *Sale of Deposits to Other Banks*

- An important portion of the SDIF Banks' deposits were sold to other banks through a series of auctions, backed by matching government securities portfolios. Auctions were realized with separated bidding process for TL and FX deposits pools in 5 stages. As a result of these auctions, 479 trillion TL in Turkish Lira and 2,587 million dollars in FX denominated deposits were transferred to 8 private banks .

**Table 15 Sale of SDIF Banks' Deposits**

|                       | <b>TL Deposits<br/>(TL Trillion)</b> | <b>FX Deposits<br/>(Million Dollar)</b> |
|-----------------------|--------------------------------------|---|
| 1 <sup>st</sup> Stage | 193.3                                | 233.0                                   |
| 2 <sup>nd</sup> Stage | -                                    | 692.6                                   |
| 3 <sup>rd</sup> Stage | -                                    | 687.9                                   |
| 4 <sup>th</sup> Stage | -                                    | 409.5                                   |
| 5 <sup>th</sup> Stage | 285.5                                | 563.0                                   |
| <b>Total</b>          | <b>478.8</b>                         | <b>2,586.8</b>                          |
| İktisat Bank.         | 85.4                                 | 121.4                                   |
| EGS Bank              | 36.7                                 | 111.6                                   |
| Etibank.              | 353.7                                | 1,181.9                                 |
| Kentbank              | -                                    | 1,171.9                                 |

*Source: SDIF*

### **2.3. Operational Restructuring**

#### *Reduction in the Number of Personnel and Branches*

- The number of branches of SDIF banks, which was 1,619 at the date of transfer, has been brought down to 856 by January 31, 2002. Excluding the sold banks, the number of branches fell to 502 from 982 during the same period.
- As of January 31, 2002, the number of personnel in SDIF banks has decreased by 42.8 percent (13,924 people) compared to the date of transfer.

**Table 16 Number of Branches and Employees of SDIF Banks**

| <b>Banks</b>       | <b>Number of Branches (*)</b> |                          |                         | <b>Number of Employees(*)</b> |                          |                         |
|--------------------|-------------------------------|--------------------------|-------------------------|-------------------------------|--------------------------|-------------------------|
|                    | <b>As of Transfer Date</b>    | <b>December 31, 2001</b> | <b>January 31, 2002</b> | <b>As of Transfer Date</b>    | <b>December 31, 2001</b> | <b>January 31, 2002</b> |
| Bayındırbank       | 22                            | 16                       | 16                      | 381                           | 414                      | 631                     |
| EGS Bank           | 49                            | 13                       | -                       | 918                           | 409                      | -                       |
| Etibank            | 283                           | 159                      | 36                      | 6,171                         | 2,734                    | 1,288                   |
| İktisat Bank       | 62                            | 62                       | 40                      | 1,305                         | 1,177                    | 803                     |
| Kentbank           | 86                            | 44                       | 44                      | 1,422                         | 961                      | 961                     |
| Milli Aydın Bank   | 41                            | 41                       | 41                      | 528                           | 526                      | 519                     |
| T.Ticaret Bank     | 274                           | 168                      | 160                     | 4,790                         | 2,439                    | 2,410                   |
| Toprakbank         | 165                           | 165                      | 165                     | 2,482                         | 2,458                    | 2,428                   |
| <b>Sub Total 1</b> | <b>982</b>                    | <b>668</b>               | <b>502</b>              | <b>17,997</b>                 | <b>11,118</b>            | <b>9,040</b>            |
| <b>Banks Sold</b>  |                               |                          |                         |                               |                          |                         |
| Sümerbank          | 401                           | 135                      | 135                     | 9,357                         | 3,198                    | 3,198                   |
| Bank Express       | 25                            | 26                       | 26                      | 721                           | 618                      | 618                     |
| Sitebank           | 13                            | 5                        | 5                       | 253                           | 146                      | 146                     |
| Demirbank          | 198                           | 188                      | 188                     | 4,241                         | 3,565                    | 3,565                   |
| <b>Sub Total 2</b> | <b>637</b>                    | <b>354</b>               | <b>354</b>              | <b>14,572</b>                 | <b>7,527</b>             | <b>7,527</b>            |
| <b>Total (1+2)</b> | <b>1,619</b>                  | <b>1,022</b>             | <b>856</b>              | <b>32,569</b>                 | <b>18,645</b>            | <b>16,567</b>           |

*Source: SDIF*

*\* The numbers belong to sold and merged banks as of January 31, 2002 are the numbers on which they are sold or merged date.*

### ***Sale of Branches***

- 164 branches of Etibank, Kentbank and İktisat Bank, which are in the liquidation process, were sold to other banks. 1,253 of personnel were also transferred to these banks.

**Table 17 Sale of Branches**

|              | <b>Number of Branches Sold</b> | <b>Number of Transferred Personnel</b> |
|--------------|--------------------------------|--|
| Etibank (1)  | 95                             | 666                                    |
| Kentbank     | 46                             | 456                                    |
| İktisat Bank | 23                             | 131                                    |
| <b>Total</b> | <b>164</b>                     | <b>1,253</b>                           |

(1) Sale of 65 of the Etibank's branches were completed, the rest 30 is on the signing stage. Transferred personnel belongs to the branches which sale were completed.

### ***Sale of Subsidiaries, Tangible and Intangible Assets***

- To improve efficiency in the management of the SDIF banks' subsidiaries, and sale of tangible and intangible assets, two new departments-namely Subsidiaries Department and Real Estate Department-were established within SDIF.

- As of January 31, 2002, 238.1 trillion TL (including sale awaiting authorization) was raised from the sale of SDIF banks' subsidiaries.

**Table 18 Subsidiary Sales of SDIF**

| <b>(As of<br/>January 2002)<br/>(TL Billion)</b> | <b>Sold by Banks</b> | <b>Sold by SDIF</b> | <b>Transactions carried<br/>out by SDIF</b> | <b>Total</b>   |
|--|----------------------|---------------------|---|----------------|
| Sümerbank  | 15                   | 14.517              | 29.769                                      | <b>44.301</b>  |
| Etibank  | 80                   | 5.000               | 7.370                                       | <b>12.450</b>  |
| Demirbank  | 13.630               | 6.527               | 146.198                                     | <b>166.355</b> |
| T.Ticaret Bank                                   | 622                  | -                   | -   | <b>622</b>     |
| İktisat Bank                                     | 13.828               | -                   | 551   | <b>14.379</b>  |
| <b>Total</b>                                     | <b>28.175</b>        | <b>26.044</b>       | <b>183.888</b>                              | <b>238.107</b> |

Source: SDIF

- As of January 18, 2002, the revenue collected from the sale of SDIF banks' moveable assets and real estate amounted to 66,4 trillion TL. To improve the transparency and efficiency of the real estate sales, all information about the real estates are provided to the investors in the internet site of the BRSA.

**Table 19 Sales of Movable Assets and Real Estates of the SDIF Banks**

| <b>(January 18,2001, TL Billion)</b> | <b>Sale of Movables</b> | <b>Sale of Real Estate</b> | <b>Total</b>  |
|--------------------------------------|-------------------------|----------------------------|---------------|
| Sümerbank                            | 14,256                  | 12,246                     | 26,502        |
| Etibank                              | 4,913                   | 25,253                     | 30,166        |
| Demirbank                            | 0                       | 204                        | 204           |
| Kentbank                             | 45                      | 162                        | 207           |
| Sitebank                             | 50                      | 0                          | 50            |
| İktisat Bank                         | 183                     | 2,870                      | 3,053         |
| Tariş Bank                           | 36                      | 496                        | 532           |
| Bayındırbank                         | 144                     | 115                        | 259           |
| T.Ticaret Bank                       | 384                     | 2,276                      | 2,660         |
| EGS Bank                             | 341                     | 260                        | 601           |
| Toprakbank                           | 7                       | 0                          | 7             |
| Real Estate Dep.                     | -                       | 2,214                      | 2,124         |
| <b>Total</b>                         | <b>20,359</b>           | <b>46,006</b>              | <b>66,365</b> |

Source: SDIF

## 2.4. Asset Management and Collection

### *Transfer of NPL Files and Loan Files to the Collection Department*

- As of December 2001, 6,110 of institutional and 63,717 of individual loan files, with a total book value of 3.7 quadrillion TL, were transferred to the Collection Department (COD) of SDIF. 315 trillion TL and 24,8 million dollars were paid to the banks in return to net book value of transferred loans.

**Table 20 Loan Files Transferred to SDIF**

| Banks             | Number of Files Transferred (*) |               |               |                            |
|-------------------|---------------------------------|---------------|---------------|----------------------------|
|                   | October 31<br>Total             | Institutional | Individual    | December 28, 2001<br>Total |
| Sümerbank (**)    | 19,011                          | 2,963         | 14,765        | 19,011                     |
| Etibank           | 954                             | 1,031         |               | 1,031                      |
| Bank Ekspres      | 177                             | 177           |               | 177                        |
| Türk Ticaret Bank | 220                             | 295           |               | 295                        |
| İktisat Bank      | 171                             | 171           |               | 171                        |
| Demirbank (**)    | 36,608                          | 207           | 35,806        | 36,017                     |
| Kentbank          |                                 | 547           | 9,643         | 10,190                     |
| Sitebank (**)     |                                 | 105           | 263           | 380                        |
| Bayındırbank      |                                 | 97            |               | 97                         |
| EGS Bank          |                                 | 517           | 3,240         | 3,757                      |
| <b>Total</b>      | <b>57,141</b>                   | <b>6,110</b>  | <b>63,717</b> | <b>71,136</b>              |

Source: BRS A

(\*)Provisional figures, file transfer and confirmation process is on progress.

(\*\*)1,283 non-loan files from Sümerbank, 4 from Demirbank and 22 from transferred.

### *Cash Inflows Realized by the SDIF*

- A collection of 903.5 million dollars has been realized from SDIF banks between their date of transfer and December 31, 2001.

**Table 21 Cash Collections by the SDIF**

|  | <i>Million Dollar</i> |
|--|-----------------------|
| <b>1. Collections by SDIF Banks</b>                  |                       |
| Cumulative collection as of July 2001                | 804.1                 |
| August   | 9.5                   |
| September  | 26.4                  |
| October  | 23.4                  |
| November   | 7.8                   |
| December   | 4.3                   |
| <b>Sub Total</b>                                     | <b>875.5</b>          |
| <b>2. Collections by Department of Collections</b>   |                       |
|  | <b>28.0</b>           |
| <b>Total Collections (1+2)</b>                       | <b>903.5</b>          |
| Of which:-from ex-bank owners and their corporations | 310.3                 |
| -Other   | 593.2                 |

Source: SDIF

### *SDIF Lawsuit and Prosecution Statistics*

- The number of lawsuits filed by the SDIF for various reasons rose to 119 by January 17, 2002, while the number of lawsuits filed against the Fund increased to 348 during the same period. Thus, the number of claims dealt with by the Legal Department of the SDIF has increased to 488.

**Table 22 Lawsuits and Prosecutions Relating to SDIF(1)**

| Characteristics                                  | August 16, | October 24, | December 25, | January 17, |
|--|------------|-------------|--------------|-------------|
|  | 2001       | 2001        | 2001         | 2002        |
| <b>Lawsuits filed by SDIF</b>                    | <b>80</b>  | <b>90</b>   | <b>104</b>   | <b>119</b>  |
| -Individual bankruptcy                           | 22         | 30          | 37           | 43          |
| -Actions of debt                                 | 7          | 8           | 8            | 8           |
| -Preliminary injunctions                         | 12         | 12          | 14           | 14          |
| -Lawsuits concerning declaration of property     | 8          | 8           | 8            | 8           |
| -Execution proceedings                           | 31         | 32          | 37           | 46          |
| <b>Lawsuits filed against SDIF</b>               | <b>270</b> | <b>287</b>  | <b>307</b>   | <b>348</b>  |
| -Lawsuits concerning off-shore accounts          | 206        | 208         | 222          | 244         |
| -Actions of debt                                 | 8          | 14          | 16           | 23          |
| -Lawsuits concerning stocks                      | 12         | 15          | 18           | 29          |
| -Action for negative declaration                 | 1          | 2           | 2            | 2           |
| -Lawsuits about payment of uninsured deposits    | 2          | 2           | 2            | 2           |
| -Lawsuits concerning complaints                  | 5          | 5           | 5            | 5           |
| -Actions for commandment                         | 9          | 11          | 11           | 11          |
| -Lawsuits of nullity                             | 2          | 4           | 5            | 5           |
| -Lawsuits about adjustment on terms of contract  | 1          | 1           | 1            | 1           |
| -Lawsuits about provisional article              | 24         | 25          | 25           | 25          |
| -Lawsuits about merits                           | -          | -           | -            | 1           |
| <b>Files Transferred to SDIF from banks sold</b> | <b>-</b>   | <b>5</b>    | <b>7</b>     | <b>21</b>   |
| <b>Overall Total</b>                             | <b>350</b> | <b>382</b>  | <b>418</b>   | <b>488</b>  |

Source: SDIF

(1) Lawsuits filed for loans are not included. The banks themselves file these cases; and the legal procedures for the transferred files are executed by the Collection Department of the SDIF

#### ***Legal and Institutional Arrangements Regarding SDIF***

- During 2001, the necessary amendments have been made in the Banks' Act to prepare the legal infrastructure to accelerate the collection process of SDIF banks' receivables, and to strengthen SDIF's authority .
- The Law No: 4743 which was issued on January 31, 2002 includes the following changes and amendments with regard to SDIF:
  - SDIF Banks are authorized to participate in the Financial Restructuring Framework Agreements.
  - SDIF may participate in the Financial Restructuring Framework Agreements provided that it does not provide additional finance.
  - SDIF may defer or settle in installments some of its claims and receivables that are subject to the "Code of Collection Procedures of Public Claims, Act No: 6183" within Financial Restructuring Framework Agreements.
  - Certain transactions and agreements made by the SDIF were exempted from some taxes, duties, fees and fund levies.
  - SDIF is authorized to take all kinds of measures to restructure the subsidiaries of the banks under its administration.
  - Within two years following the completion of mergers, acquisitions and selling, SDIF may file lawsuits against former auditors and board members of the intervened banks.
  - The scope of SDIF's possession on its claims were re-arranged.
  - Limitation period in the lawsuits against SDIF regarding the debts, commitments and claims taken over from intervened banks will cease for a period of nine months.
- By the amendment to the SDIF's Regulations on January 18, 2002, Department of Human Resources and Budget, and Department of Internal Auditing were established in the Fund organization.
- An agreement was signed between SDIF and a consultancy firm for the reorganization of Subsidiaries and Real Estate Departments in order to manage, sale, and liquidate the subsidiaries and real estates efficiently.
- An auditing agreement was signed between SDIF and an auditing company, for independent auditing of the balance sheet and the income statements of the SDIF.

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### 3. STRENGTHENING THE PRIVATE BANKING SYSTEM

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The financial structure and profitability of the private banks deteriorated sharply in the aftermath of the November and February crises. The implementation of a program to ensure the soundness and sustainability of the private banking system is the remaining most important component of the banking sector restructuring strategy.

In this framework, measures regarding the recapitalization of private banks, resolving the Non-Performing Loans (NPLs), limitation of FX open positions and encouragement of mergers and acquisitions have been put into place.

#### *Strengthening The Capital Structure and Solving The Bad Loans Problem*

- In the aftermath of the November and February crises, the BRSA has arranged meetings with private banks' representatives to discuss the extent to which they were affected by the crises and to come up with proposals to solve their problems. As a conclusion of these discussions, time-bound commitment letters comprising capital injection, utilization of subordinated debt, and restructuring strategies have been agreed with private banks. The enforcement of these commitment letters has been strictly monitored, and they have also been being revised along with the changes in the macroeconomic environment.

- In order to increase "Own Funds" through the sales of real estate and subsidiary shares, existing tax incentives were enhanced.

- As a result, private banks realized 1,765 trillion TL of own funds increase from a total commitment of 1,884 trillion TL as of December 31, 2001.

**Table 23 Shareholder's Equity of Private Banks**

|                                  | 2000 December<br>(TL Trillion) | 2001 November<br>(TL Trillion) | Percentage<br>Change |
|----------------------------------|--------------------------------|--------------------------------|----------------------|
| Paid-in capital                  | 3,254                          | 4,804                          | 47.6                 |
| Reserves                         | 825                            | 1,122                          | 36.0                 |
| Fixed Assets Revaluation Fund    | 717                            | 1,008                          | 40.6                 |
| Securities Revaluation Fund      | 1,768                          | 1,162                          | -34.3                |
| Profit (Loss) for the Period     | 419                            | 886                            | 111.5                |
| Profit (Loss) for Previous Years | -16                            | -7                             |                      |
| Total Equity                     | 6,968                          | 8,975                          | 28.8                 |

Source: BRSA

- However, deeper than expected recession in domestic economy and uncertainties in the global economy increased the need for additional capital, while limiting the scope for raising new capital from domestic and foreign private investors.

- These developments required the strengthening of the current program by developing strategies for NPL problem, corporate debt restructuring and recapitalization of the private banks. In this regard, "Act on Restructuring of the Debts to the Financial Sector and Amendments to be made in some Laws, Act Nr: 4743" was put into effect on January 31, 2002.

- According to the amendment to the Banks Act with provisional Article (4), privately owned deposit banks will go through a three step-auditing and supervision. Those that satisfy certain conditions can receive a one time support in the form of SDIF's participation in Tier 1 capital or subordinated debt (Tier 2 capital) as necessary.

- The Act No: 4743 also includes tax incentives to encourage the establishment of asset management companies and arranges the framework for voluntary corporate debt restructuring.

### **Strengthening The Capital Structure of Private Banks**

- **Scope:** Privately owned deposits banks that are established in Turkey
- **The Phases of Recapitalization:** The process of strengthening the capital structure consist of three main steps;

#### **1. Audit and Assessment**

- Auditing of the bank's contracted independent auditor
- Auditing of the first independent auditing company's report by a second independent auditor for compliance with the announced principles and procedures of independent auditing
- BRSA's assessments of all these inputs using on-site and off-site supervision results

**2. Bank Recapitalization:** In case of loss that can not be covered by provisions, some banks will need to hold, in addition to ordinary General Assembly, an Extra-ordinary General Assembly, to perform a write-down of capital, authorize new capital, submit business plans, and raise additional capital within the strict limit of regulation.

**3. State Support:** Providing state support to the banks whose Capital Adequacy Ratio (CAR) is under 8 percent and meeting the necessary conditions

- **The Methods of Recapitalization:** Capital support shall be done in two ways:
  - a) Investing direct capital not more than the amount paid by the shareholders to increase the CAR to 5 percent (participation to common equity)
  - b) Providing subordinated debt (convertible bonds with 7-year maturity) to increase CAR to 9 percent

- **Conditions for State Support:**

-All banks that have positive CAR and has an asset share of at least 1 percent in the banking sector as of September 30, 2001 or increased their shares to this level by mergers and acquisitions may benefit from both participation to common equity and subordinated debt supports.

-The banks that have an asset share under 1 percent in the sector can only benefit from the subordinated debt support if they increase their CAR to 5 percent.

- **Objectives of Recapitalization Scheme:**

- Ensuring transparency and enhancing confidence in banking sector
- Maximizing capital contributions by banks' owners
- Minimizing the fiscal cost by preventing transfer of viable banks to SDIF
- Encouraging mergers and acquisitions
- Enabling banks to start extending credits to real sector
- Contributing to efficient functioning of corporate debt restructuring schemes
- Creating an appropriate environment for removing blanket guarantee, thus restoring market discipline

- **Measures to Ensure Efficient and Appropriate Use of Public Funds**

- Direct capital injection by SDIF will be limited with the amount paid by the shareholders.
- SDIF will be shareholder on behalf of government in the direct capital injection
- Subordinated debt will be given with a yield that is consistent with market conditions
- Subordinated debt will be convertible to equity share
- The stocks of the major shareholders shall be taken as pledge
- Any bank in which SDIF holds equity, it would have board representation with veto rights
- Banks will submit comprehensive business plans, projections and commitments to performance measures as a condition for state support
- Banks will extend 60 percent of Tier 1 capital support as credits to non-group firms by end June-2003

### ***Limiting FX Short Positions and Interest Risk***

- In the aftermath of the November and February crises, increasing uncertainties and high volatility of the exchange rates have risen the tendency of private banks to narrow their FX short positions. Voluntary domestic debt swap operation in June 2001 has also contributed to the reduction of FX open positions in the private banks. In fact, private banks' FX open positions (on balance sheet) declined to 1.3 billion dollars in January 18, 2002 from 8.4 billion dollars in end-2000.

**Table 24 Foreign Exchange Position of Private Banks**

| (USD Million)                       | December<br>2000 | May 25,<br>2001 | June 22,<br>2001 | December 28,<br>2001 | January 18,<br>2002 |
|-------------------------------------|------------------|-----------------|------------------|----------------------|---------------------|
| FX Position                         | -10,876          | -8,417          | -7,476           | -8,264               | -8,563              |
| FX Indexed Position                 | 2,499            | 2,157           | 3,977            | 6,777                | 7,303               |
| <b>On balance sheet FX Position</b> | <b>-8,377</b>    | <b>-6,260</b>   | <b>-3,499</b>    | <b>-1,487</b>        | <b>-1,260</b>       |
| Forward position                    | 7,195            | 5,992           | 3,217            | 1,597                | 1,427               |
| <b>Net FX Position</b>              | <b>-1,182</b>    | <b>-268</b>     | <b>-282</b>      | <b>110</b>           | <b>167</b>          |

*Source: BRSA daily reporting system*

- Increase in the share of floating rate, FX indexed and FX based bonds in Treasury's borrowing have also contributed to the limitation of the interest rate risk.

**Table 25 Domestic Debt Stock by The Instruments**

|                         | December 2000 |              | December 2001 |              |
|-------------------------|---------------|--------------|---------------|--------------|
|                         | TL Billion    | Percentage   | TL Billion    | Percentage   |
| Fixed Rate Notes        | 20.4          | 56.0         | 17.7          | 14.5         |
| Floating Rate Notes     | 13.0          | 35.7         | 60.9          | 50.0         |
| FX typed and FX indexed | 3.0           | 8.2          | 43.5          | 35.6         |
| <b>Total</b>            | <b>36.4</b>   | <b>100.0</b> | <b>122.2</b>  | <b>100.0</b> |

*Source: Treasury*

*Note: Indicates the distribution of cash and non-cash bonds. A significant decrease is also observed in the share of fixed rate bonds in total cash bonds, compared to the year-end 2000.*

### ***Mergers and Acquisitions***

- In 2001, tax incentives have been realized to encourage mergers and acquisitions of banks and their subsidiaries. In this context, "The Regulation on Banks' Mergers and Acquisitions" defining general principles and procedures on banks' mergers and acquisitions has been prepared by the BRSA and published on 27.06.2001. In addition, the legal changes allowing banks' subsidiaries to take advantage of tax incentives mentioned in Act Nr: 4605 was made and put into effect on 03.07.2001.

- With the contribution of these regulations merger and acquisition activities tended to accelerate in 2001. The preconditions included in the bank recapitalization scheme is expected to encourage further mergers and acquisitions in the Turkish banking sector in 2002.

**Table 26 Mergers and Acquisitions of Banks**

| The Banks Subject to Merger and Acquisition |                     | The New Bank        | Explanation  |
|---|---------------------|---------------------|--|
| Osmanlı Bank                                | Körfez Bank         | Osmanlı Bank        | Birleşik Türk Körfez Bank A.Ş. have been transferred to Osmanlı Bank A.Ş. on 31.08.2001.   |
| Garanti Bank                                | Osmanlı Bank        | Garanti Bank        | Osmanlı Bank A.Ş. have been transferred to T. Garanti Bank A.Ş. on 14.12.2001.   |
| HSBC Bank Plc.                              | Demirbank           | HSBC Bank Plc.      | Demirbank was taken over by HSBC Bank Plc. on 14.12.2001.  |
| Tekfen Yatırım                              | Bank Ekspres        | Tekfen Bank         | Transfer of Bank Ekspres to Tekfenbank A.Ş. has completed on 26.10.2001, as of which date the name of Bank Ekspres has been changed as Tekfenbank A.Ş. |
| Oyak Bank                                   | Sümerbank           | Oyak Bank           | On 11 January 2002 the sale of Sümerbank has completed and put in action under the name of Oyakbank A.Ş.   |
| Morgan Guaranty                             | The Chase Manhattan | JPMorgan Chase & Co | The merger of these two banks has approved on 14.12 .2001  |

**Developments in the Sale Process of Vakıfbank Shares<sup>(1)</sup>**

The sale process of the Vakıfbank's shares held by the Government Trust Administration Department, which was halted due to November and February crises, has resumed.

In this regard, a Valuation Committee and a Committee for the Selection of the Consultancy Firm were established in August 2001. Letters were send to the top ten worldwide investment banks in October, and an agreement with a consultancy firm was signed in November 2001.

In December 2001, an auction was held for the block or wholesale of the Government Trust Administration Department's shares at Vakıfbank (A/B type). The eligible banks will perform their due diligence upon the signature of confidentiality agreements and place their offers by April 2002. The sale process is scheduled to be completed by June 30, 2002.

(1) Due to its special status, the developments in the sale process of Vakıfbank's shares are provided in this section rather than the section on Restructuring of the State Bank's which essentially focuses on the developments in Ziraat, Halk and Emlak banks.

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#### **4. STRENGTHENING THE REGULATORY AND SUPERVISORY FRAMEWORK**

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In parallel to the financial and operational restructuring of the banking sector, legislative amendments and institutional changes are being adopted. These efforts aim to strengthen regulatory and supervisory framework, facilitate sound banking practices and thus establish confidence in the sector.

Prudential regulations are concentrated in the following areas: capital adequacy, risk management, lending limits, loan loss provisioning, adoption of International Accounting Standards, independent auditing and cooperation with foreign supervisory authorities.

##### **Regulations on Capital**

- With the amendments made to the Banks Act in June 2001, definition of “consolidated own funds” is introduced to allow consolidation of related parties lending and make the regulation fully consistent with EU Directives.

- “Regulation on Measurement and Assessment of Banks’ Capital Adequacy” that defines principles and procedures to calculate banks’ CAR both on consolidated and solo basis was published in January 31, 2002. This regulation defines the principles and procedures concerning the incorporation of market risks -namely interest rate, exchange rate and equity risks- in the calculation of CAR and replaces the existing regulation which was issued on February 2001. The new regulation brings the following amendments:

- Principles and procedures regarding the measurement of risks and capital adequacy issues related with the banks’ option operations are defined.

- Directives about the standards of the risk measurement models are re-arranged.

- Risk weights is re-arranged to comply with the inclusion of the repo transactions in the balance sheet.

- “Structural Position” is defined to prevent erosion of banks’ own funds from steep price and foreign exchange rate movements. The work on the principles and procedures about inclusion of the structural positions in the calculation of capital adequacy ratio is continuing.

- With the amendments to the Regulation on Banks’ Establishment and Operations on January 31, 2002, definition of own funds has been changed, and the addition of general loan loss provisions to Tier 2 capital without netting out is brought. Additionally, capital supplements to all financial institutions are included in amounts to be deducted from the capital. As a result of these changes, a single own fund definition is set for the system, which provides a uniformity both in the calculation of credit limitations and in the application of financial ratios.

- “Regulation on the Principles and Procedures of the Banking Sector Recapitalization Scheme” was published on February 1, 2002. The purpose of this Regulation is to lay down the principles and procedures for the recapitalization scheme designed for the privately owned deposit-taking banks incorporated in Turkey with the ultimate aim to establish a sound and transparent banking system. The Regulation stipulates the details of the general assembly to be held by banks; the procedures regarding an increase or decrease of the banks’ capital; the measures that need to be taken based on assessments of the Banking Regulation and Supervision Agency; the transfer period for shares which are subject to the capital increase; the issuance of convertible bonds and triggers for the conversion of these bonds into shares; the sale of banks’

shares taken over by the Savings Deposit Insurance Fund and conversion of subordinated debts to capital.

### **Regulations on Risk Management**

- With the “Regulation on Banks’ Internal Audit and Risk Monitoring System” which was put into effect on 08.02.2001, principles for an efficient risk monitoring system have been set out. After July 2001, banks have reported their activities and their organizational preparations according to the regulation on quarterly basis. These reports are being evaluated regularly and monitored closely.

- A committee was set-up to identify structured finance products that are used to hedge FX open positions. The committee started its work in October and submitted its first report in December 2001, pointing out the need to identify the risks incorporated with the broader use of structured finance products apart from meeting FX open position limits, and suggesting to establish another committee to determine necessary regulations to limit those risk. The works on these issues are to be completed by March 2002.

- Regulation on principles and procedures about the implementation of the Foreign Exchange Net Position/Own Funds standard ratio for banks on consolidated and unconsolidated basis was published on January 31, 2002. With this regulation, compliance with the changes in the definition of the own funds and consolidated own funds is provided.

### **Regulations on Credit and Subsidiaries’ Limits and Loan Loss Provisioning**

- By the amendment to Banks Act in June 2001, risk group definition and calculation of lending limits for a single group considering direct and connected lending has been introduced in order to prevent (credit) risk concentration. This amendment, which includes banks’ shareholders and subsidiaries in the same risk group, shall prevent risk concentration on a particular group and improve the asset quality of the banking sector.

- The sum of direct or indirect lending to a single party is limited by the 25% of the own funds. Banks that exceed lending limits for a single risk group, cannot extend new lending to a real or legal party of this risk group. Additionally, banks are required to comply with these limits by end-2006.

- 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.

- Starting from January 1, 2002, forward contracts, option contracts and other similar derivative type operations are included under the definition of “credit” to limit the overall exposure to individual and related counter parties.

- Corporate tax deductibility of specific provisions is clarified.

- With the amendment made by the Act No: 4743 on January 31, 2002, existing 4-year transition rule for loan loss provisioning is eliminated.

- “Regulation on Loan Loss Provisioning” was amended on January 31, 2002 and an explanatory circular was published to clarify the implementation related issues. By the amendments, existing procedures on the restructuring of NPLs and other claims are revised in order to improve the efficiency of the voluntary corporate debt restructuring programs.

## **Accounting Standards and Independent Auditing**

- “Uniform Accounting Plan and Standards to be Applied by Banks” was changed in order to allow the inclusion of repo transactions in balance sheet beginning from February 1, 2002.
- Draft Regulation of Accounting Practices, which is compatible with the International Accounting Standards (IAS) has been posted at BRSA’s internet site for discussion. This regulation will be on a trial implementation period starting from February 1, 2002 and be fully implemented from July 1, 2002 onward in order to ensure that banks’ end-2002 balance sheet comply with IAS.
- On February 1, 2002 two separate regulations were published setting out the principles and procedures of independent auditing and authorization of independent auditing companies. With the regulation on principles and procedures of independent auditing, the procedures and principles to be applied in independent auditing are brought to international auditing standards and regulated in a more detailed fashion.
- The BRSA issued the regulation on principles and procedures of independent auditing to be carried out in banks within the context of bank recapitalization scheme on February 1, 2002. According to this regulation, consolidated and unconsolidated financial statements will be prepared to reflect the banks’ true financial position, by incorporating losses arising from required provisions from loans and other claims, from adverse exchange rate changes or from other activities. The audits of the privately-owned deposit banks will be based on the banks’ financial statements set up as of December 31, 2001. The audit reports prepared by the independent audit institutions will be assessed by a second independent auditing institution for conformity with the announced audit instructions and procedures. The “Independent Auditing” is to be carried out in line with the International Accounting Standards.

## **Supervision of Foreign Branches and Offshore Banks and Cooperation Agreements with Foreign Supervision Authorities**

- Offshore banks established by banks or by their major shareholders have been held under tight supervision rules thanks to agreements signed with other countries’ supervision authorities. In this context, 13 branches and one subsidiary have been supervised in Bahrain-Manama, Luxemburg, Malta, and the supervision of a subsidiary in Holland is completed. Additionally, on-site supervision of offshore Turkish banks in Turkish Republic of Northern Cyprus (NCTR) is done.
- In the context of international cooperation, BRSA has intensified its efforts in signing Memorandum of Understanding (MoU) with foreign supervision authorities. In this regard, MoUs were signed with the Central Bank of NCTR on 17.09.2001 and with the Central Bank of Albania on 19.10.2001. Moreover, draft MoUs have been sent to Holland, Malta, Luxemburg, Bahrain, Romania, Switzerland and Ireland.