



**BANKING REGULATION AND
SUPERVISION AGENCY**

**BANKING SECTOR RESTRUCTURING
PROGRAM
PROGRESS REPORT-(V)**

November 2002

EXECUTIVE SUMMARY

Structural problems and fragilities which became even more evident after November 2000 and February 2001 crises made it clear that an extensive restructuring program was no more postponable. Within this framework, the Banking Regulation and Supervision Agency prepared the “Banking Sector Restructuring Program” and announced it to the public in May 2001. The restructuring program was based on the following main pillars: (1) Restructuring of state banks (2) prompt resolution of SDIF banks (3) Strengthening of private banks and (4) Strengthening the regulatory and supervisory framework. Progress achieved in these fields are presented below:

Restructuring of State Banks

Financial restructuring of state banks was completed and they began to make profits. Significant steps have been taken within the framework of operational restructuring. Organizational, technological, product, human resources, loan, fiscal control, planning, risk management and service structures of the banks have been restructured in compliance with requirements of modern banking and international competition. Besides, number of branches of the state banks which was 2.494 as of December 2000 was brought down to 1.687 as of September 2002 and number of personnel which was 61.601 was brought down to 30.896.

Resolution of SDIF Banks

20 banks were taken over by the SDIF between 1997-2002. Following the resolution of these banks through merger, sale and liquidation, only two banks, namely Bayindirbank and Pamukbank, remain under the management of the SDIF as of November 11, 2002.

With a view to accelerating resolution process, SDIF banks have been subjected to a comprehensive financial and operational restructuring process. Accordingly, short-term liabilities of SDIF Banks have been liquidated and a portion of deposit and F/X liabilities have been transferred to the other banks. Besides, number of personnel and branches which were 37.889 and 1.815 respectively as of the date of take over were brought down to 6.358 and 255 as of November 4, 2002. Sale process of Pamukbank which is still under the SDIF is continuing. Number of branches and personnel of Bayindirbank which is restructured as a bridge bank to perform asset management activities is projected to be brought down to 6 and 250 respectively by January 2003.

Receivables under follow-up of SDIF banks have been transferred to the Collection Department and efficiency in follow-up and collection activities is ensured. Subsidiaries and real estates of these banks are disposed by taking market conditions into account. As of September 2002, USD 1,1 billion have been collected from receivables under follow-up and a sum of USD 308 million has been generated by the sales of subsidiaries and real estates. Besides, in order to protect economically viable firms and increase the collection ability of the SDIF, repayment agreements have been signed with 1.027 debtors.

Strengthening the Private Banking System

Strengthening private banks, whose financial structures and profitability performances were worsened due to the crises experienced, composes an important part of the Banking Sector Restructuring Program. Within the scope of the program focused on private banks, first steps were taken towards strengthening of the capital structures of private banks with their own resources and limiting the market risks. Important progress has been realized on these areas. Besides, within the scope of Bank Capital Strengthening

Program, 25 private banks were subjected to a three phased audit process. As a result of these audits Pamukbank which had a USD 2 billion capital shortage as of end-2001 was transferred to the SDIF. Also procedures on the subordinated capital request of Vakıflar Bankası for eliminating its capital shortage was finalized as of August 2002 while the necessary capital increase for Sekerbank, which was also determined to have a capital need, was realized as of September 2002.

According to the consolidated data of the 25 banks covered by the Bank Capital Strengthening Program, the funds generated through deposit taking and own fund increases by these banks have been mainly placed in securities. With the improvement observed in profitability, the capital adequacy ratio of the 25 banks in subject was realized as 15,8%.

Restructuring of Debts to the Financial Sector and Resolution of Problem Assets

Following the completion of necessary regulatory and institutional infrastructures, 169 firms applied for financial restructuring of their debts amounting approximately to USD 2,9 billion as of October 2002 and a total amount of USD 406 billion debt of 28 firms was restructured.

Besides, the regulation on asset management companies (AMC) to be established in order to resolve the non-performing loans and mobilize assets of banks was completed and put into effect. Within this framework, the SDIF has initiated feasibility studies concerning the establishment of AMCs.

Strengthening the Framework of Surveillance and Supervision

Concurrently with financial and operational restructuring of banking sector, significant progress has been achieved in legal and institutional regulations which will strengthen the surveillance and supervisory framework, ensure competitiveness and efficiency and improve confidence to and endurance of the sector.

Along these lines, regulations were issued to prevent risk concentration in loans, limit participation of banks to subsidiaries except non-bank financial institutions and ensure preparation and disclosure of banks' balance sheets in compliance with international accounting standards.

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BANKING SECTOR RESTRUCTURING PROGRAM: PROGRESS REPORT¹

1. DEVELOPMENTS PRIOR TO THE RESTRUCTURING PROGRAM (1980-2001)

A significant part of the flow of funds are performed through the banking sector in Turkey. Although the number and size of non-bank financial institutions tended to increase in the recent years, the banking sector still has a share of 75 % in total financial sector assets. The fact that a significant part of non-bank financial institutions are subsidiaries of banks increases the dominance of the banks in the financial sector.

Turkish financial system underwent significant structural changes and gained dynamism as a result of the liberal policies adopted starting from 1980 onwards. Along with deregulation measures introduced, such as removal of selective credit policies, free determination of interest rates on deposits and credits, and liberalization of foreign exchange transactions, efforts to increase the level of compliance of the legislations with the international norms also played a contributing role in this development.

With the help of legislative and institutional arrangements that eased the entry, competition and growth in the sector, the Turkish banking sector experienced a process of fast expansion in terms of bank number, employment, service diversity and technological base. More specifically;

- The number of banks which was 37 in 1980 increased to 64 in 1990 and to 81 in 1999.
- A significant progress was made in opening-up and integrating the banking sector with the international financial system during the 1990s. The number of foreign banks in the form of financial subsidiary or branch reached to 18 in 2000 from 4 in 1980. Share of foreign banks in the sector increased to 5,4% in 2000 from 3,7% in 1992. However the weight of foreign banks in the sector is still low compared to a number of countries having similar characteristics with Turkey.²
- Together with the increase in the number of domestic and foreign banks in banking sector, weight of state-owned banks in the system decreased. Share of state-owned banks in total assets of banking sector went down to 34% in 2000 from about 45% in 1980 and 1990.
- Banking sector took important steps towards adapting itself to developments in technology and improving its technological base. In the last decade, a rapid progress has been observed in the number of ATMs, number of branches having on-line connection, use of the Electronic Fund Transfer (EFT) and SWIFT systems, interactive banking services and internet banking.

¹ The developments experienced in banking sector after 1980 and information regarding the BRSA's goals and strategies in the original text of "Banking Sector Restructuring Program" which was announced to public on May 15, 2001 are also included in the Progress Report in order to allow for monitoring of the restructuring process in an integrated manner.

² The share of Foreign Banks within the sector has decreased to 3,2% in July 2002.

- There has been a significant progress in the diversification of banking services and use of bank cards/credit cards has expanded rapidly. Number of credit cards which were about 1 million in 1992 increased to 13,4 million at the end of 2000.

Table 1: Number of Banks

	1980	1990	1994	1999	2002(*)
Commercial Banks	31	54	55	62	41
Public	8	7	6	4	3
Private	19	25	29	31	21
Foreign	4	22	20	19	15
SDIF	-	-	-	8	2
Investment and Development Banks	6	10	12	19	14
Public	4	3	3	3	3
Private	2	4	6	13	8
Foreign	-	3	3	3	3
Total	37	64	67	81	55

Source: BRSA, Banks Association of Turkey.

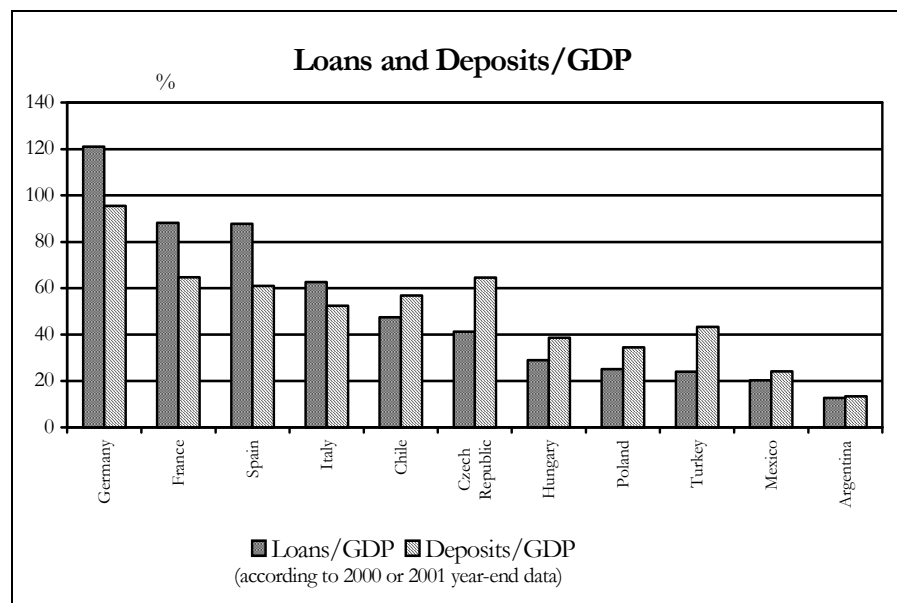
- (*) As of November 11, 2002

Despite a number of serious economic and financial crises experienced during the post-1980 era, some important positive developments in the aggregate financial indicators of the banking sector were observed. Along these lines;

- Total asset size of banking sector increased to USD 58,2 billion in 1990 (%38,2), and to USD 155 billion in 2000 (%76,9) from a level of USD 20,8 billion in 1980 (28,6 % of GNP).
- There was also a rapid increase in the volume of deposits. Total savings deposits which were USD 4,3 billion in 1980 reached to USD 64,4 billion in 2000. The increase realized in foreign currency accounts during the second half of the 1980s was particularly effective in this outcome. As the use of repurchasing agreements became widespread from the second half of the 1990s onwards, part of savings were started to be held in the form of repo. Indeed, the ratio of repo volume realized with clients to savings deposits was about 15% as of end of 2000.
- Off-balance sheet transactions increased rapidly as a result of the diversity in banking services in the 1990s along with the increase in funding the Government Securities through repo and the increase in F/X forward transactions. The ratio of off-balance-sheet transactions to total assets which was 41,4 % in 1992 increased to 100,8 % as of end 2000.

Important steps were taken regarding the adaptation of legal and institutional regulations in banking sector in Turkey to changing conditions and developments in international standards. In that respect, Banks Act Nr. 4389 that entered into force in June 1999 has been an important landmark. Regulation and supervision of the banking sector was transferred to the Banking Regulation and Supervision Agency having the status of administrative and financial autonomy by this Act. All resolutions to be taken in the process from establishment to liquidation of banks were granted to the Agency with the Act dated December 19, 1999, Nr 4491, and the BRSA 's autonomous status was strengthened. Public units responsible for monitoring and supervising the banking sector was combined under the structure of the Banking Regulation and Supervision Agency, and the Agency started to operate as of August 31, 2000.

Despite positive developments in the share of Turkish banking sector within the economy, the sector's openness, diversification of banking services and the legal and corporate framework, there was a remarked deterioration in the functioning of the banking sector to support production activities and direct resources to long-term investments. The share of loans in total assets of the banking sector declined from 47% in 1990 to about 32,8% in 2000. Similarly, the (gross) loans to deposits ratio declined from 85% in 1990 to 56% in 2000. The credit to GNP ratio in Turkey stayed at the lowest levels among the emerging market economies.



The following factors have contributed to the decline in the financial intermediation function of the banking sector:

- **Macroeconomic Instability:** High and volatile inflation rates of the 1990s, the boom-bust cycles of economic growth and the fragility of foreign capital inflows all contributed to the uncertainties and eventually led to a domination of “short-term” behavior on the part of economic agents. The confidence in the Turkish lira also deteriorated leading to an extensive currency substitution. Consequently, the maturity of bank funding sources shortened substantially and the share of foreign currency liabilities in total liabilities increased sharply.
- **High Public Sector Deficit:** The increase in public sector deficit and its financing with high real interest rates from the domestic financial markets led to a sharp decline in the allocation of resources to the real sector. Arbitrage opportunities resulting from high domestic real interest rates made it attractive for banking sector to borrow abroad and finance public sector deficits paving the way to an increase in foreign exchange open position of the banking sector. As a result, the share of government securities in deposit money banks' total assets increased from 10% in 1990 to about 25% in recent years. Also, tax advantages provided to government securities and legislative changes made in reserve requirements and liquid assets contributed to the increase in the government securities portfolio of banks.

- ***Systemic Distortions Created by State Banks:*** Financial health of the state banks deteriorated rapidly as a result of the accumulation of duty losses and inefficient management. Illiquid state banks covered their financing needs from markets borrowing at very high rates and at short maturities. This led to an increase in interest rates and created an uneven playing field for the other banks in the sector. As a result, the state banks became unable to fulfill their banking functions; although state banks accounted for 40% of total deposits their share in total loans was only 25%.
- ***Inadequate Risk Assessment and Management Systems:*** Although the banking sector became more exposed to liquidity, interest rate and foreign exchange rate risks, macroeconomic policies followed especially during the late 1990s, which tended to ease the financing of public debts, made the perception and management of these risks an issue of secondary priority for the banks. The lack of independent and effective supervision and regulation and the existence of deposit insurance also contributed to the weaknesses in risk management.

As a result of all these developments, the Turkish banking system as a whole became subject to the following structural weaknesses:

- Inadequate capital base
- Small and fragmented banking structure
- Dominance of state banks in the whole banking sector
- Weak asset quality (concentrated credits, group banking and concentrated risks, mismatch between loans and provisions)
- Extreme exposure and fragility towards market risk (maturity mismatch, F/X open position)
- Inadequate internal control systems, risk management and corporate governance

Eventually, these structural weaknesses made the banking sector highly sensitive and fragile to domestic and foreign shocks. Banking sector faced important losses as a result of the crisis experienced in the economy in 1994 and three banks were put under liquidation process. Negative effects of the 1994 crisis were overwhelmed in a short period and banking sector grew about 18% on dollar basis annually in the period after 1995. However, the serious narrowing in the economy due to the crises of the Far East and Russia in this period as well as the earthquake experienced in 1999 had a negative impact on the banking sector.

November 2000-February 2001 Crises and Their Effects On Banking Sector

Turkey had adopted a comprehensive disinflation program at the beginning of 2000. Main pillars of the program were tight fiscal and monetary policies, ambitious structural reforms and use of a pre-determined exchange rate path as a nominal anchor. Monetary policy was conducted under a currency board type arrangement with liquidity expansion being strictly linked to foreign currency inflows.

The disinflation program had a major impact on banks' balance sheets. First and foremost, with the initial sharp decline in market interest rates and expectation of further

fall in these rates, banks reduced deposit and lending rates. They also increased their exposure to fixed rate treasury securities during this period. On the other hand, the pre-announced exchange rate path and real appreciation of the Turkish lira meant lower cost of funding for foreign currency liabilities. As a result, a number of banks borrowed in foreign currency terms with short maturities and lent in Turkish lira terms with longer maturities. This led to a sharp increase in maturity mismatch and in foreign currency open position of the private banks.

The composition of the asset structure of the banking sector changed significantly in 2000 with an increase in the share of loans and a decline in liquid assets. The increase in consumer credits was particularly notable; it four folded in 2000. Unlike the change in the currency composition of deposits (towards an increase in foreign currency deposits) the currency composition of loans increased in favor of the Turkish lira. As a result of these changes, the exposure of the banking sector to liquidity, interest rate and exchange rate risks increased in 2000.

The subsequent November 2000 crisis led to a significant erosion of the capital base of the banking sector and revealed further the fragility of the system. In particular, the financial health of the state and SDIF banks that relied heavily on overnight funding deteriorated sharply.

Rapid announcement of an additional USD 7.5 bn support under the Supplementary Reserve Facility of the IMF in December 2000 could only calm the market for a limited period. Escalating political uncertainties, the loss of credibility of the exchange rate regime and finally the abolition of the exchange rate peg in February 2001 further hit the already weakened banking sector.

In sum, the banks were hit by three main shocks:

- Sharp increase in funding costs due to the increase in interest rates and maturity mismatch.
- Capital losses due to a sharp mark-to-market decline in the value of government securities holdings
- Capital losses due to a sharp change in foreign exchange rate and open foreign currency position.

The crises experienced led to a serious contraction in the private sector which, in turn, exerted an adverse impact on the asset quality of the banking sector and increased the credit risk of banks.

In consequence, the government adopted a new program “Transition to a Strong Economy” in order to eliminate the confidence crisis and financial instability. The strategy was strongly based on market-orientation and openness to the world economy. An important pillar of the program consisted of a renewed effort to eliminate structural weaknesses that had not been fully tackled by the 2000 program, particularly by strengthening governance and good economic management. Key elements in the area of banking included: a deep financial restructuring of state and SDIF banks; measures to facilitate the participation of private capital in the strengthening of the private banking system; and, a further improvement of banking regulation and supervision.

Along these lines, basic strategies and principles of the BRSA towards establishing a sound banking sector, and developments realized to date are presented in the next two sections of the report.

2. MAIN GOALS AND STRATEGY OF THE BANKING REGULATION AND SUPERVISION AGENCY

The **mission** of the Banking Regulation and Supervision Agency is to create the proper environment in which banks and financial institutions can operate with market discipline, and in a healthy, efficient and globally competitive manner. The creation of a sound banking system is key to achieve long-run economic growth and stability of the country.

In order to fulfill its mission BRSA aims to establish, implement and develop the necessary regulatory and supervisory framework. In this process, main goals of the BRSA are:

- *To enhance banking sector efficiency and competitiveness*– elimination of distortions created by the state banks; strengthening of the banks’ capital base; reduction of the banks’ intermediation costs; minimization of group banking and non-financial activities.
- *To maintain confidence in the banking sector* – in accordance with market discipline and “self responsibility” principle, to design the proper regulation for public awareness; making adequate, understandable and accurate information accessible to the markets in a timely manner; promoting international best standards in accounting and reporting systems; providing a transparent environment in which information on risks is clear and accessible for all parties.
- *To minimize the potential risks to the economy from the banking sector* – prevention of all kinds of transactions and practices that can jeopardize the smooth and safe operation of the banks; developing early warning and prompt correction systems to prevent individual problems from causing systemic risk.
- *To enhance the soundness of the banking sector* - enhancing the flexibility of the sector against risks; giving importance to the improvement of corporate governance; developing internal control and risk management systems; taking market risk into account in the calculation of capital adequacy; improving the BRSA’s capacity for risk-focused and consolidated supervision and control.
- *To protect the rights of depositors* - establishing a balance between the adverse effects of deposit insurance, such as erosion in market discipline and increase in moral hazard, and the need to protect the rights of depositors.

In order to fulfill these goals the main values that the BRSA needs to establish are the following:

- *Cost Effectiveness:* Regulatory and supervisory practices shall be carried out within a cost/benefit approach; and regulation and supervision activities shall be conducted in order to promote competitiveness of the banking sector.
- *Approach Based on Internal Accountability:* Even if regulatory and supervisory function is carried out at optimum, this function cannot go beyond being a secondary means for ensuring soundness and efficiency of the banking sector. The primary means is market discipline. An approach, which emphasizes internal accountability, such as improvement of internal

control mechanisms and use of independent auditing/rating institutions shall be adopted.

- *Impartiality:* The BRSA shall equally treat all institutions that operate in its scope, and fulfill its responsibilities with care and impartiality.
- *Responsiveness:* The BRSA shall adapt itself to policies and practices necessitated by the developments in national and international financial system in a rapid and effective manner, and work with other public institutions in harmony.
- *Participation:* During the formulation of regulations and establishment of practices, importance shall be given to the participation of banks, customers and the professional associations in the sector and academicians; communication channels shall be kept open.
- *Transparency and Accountability:* In order to make the BRSA operate in a transparent manner, public and the relevant public agencies shall be informed about the operations and their outcomes.
- *Consumer Focus:* Besides the service for financial institutions, a service approach focused on consumer demand and needs shall be placed in the structure of the BRSA. For this purpose, a “consumer relations unit” shall be established within the BRSA; and a “consumer affairs page” shall be maintained on the BRSA’s website. With these two services, the BRSA shall make the consumers conscious of financial services, and it shall review its regulations and policies in the light of suggestions and complaints from the consumers.
- *International Cooperation:* The Agency shall be in close cooperation with foreign regulatory and supervisory agencies and international organizations in order to follow rapid change and developments in financial markets, to achieve effective supervision of banks on a consolidated basis, and to get information relating to potential investors in the sector.
- *Expertise and Efficient Organizational Structure:* In order to develop the expertise necessitated by changes in financial sector, the BRSA will give importance to employment of personnel with analytical capability and professionalism, and review its organization structure in accordance with the developments in financial activities and information technology.
- *Performance Assessment:* The BRSA shall conduct public opinion surveys, effectiveness surveys and employee surveys in order to assess public opinion about the performance of the BRSA.

3. DEVELOPMENTS REALIZED WITHIN THE RESTRUCTURING PROGRAM

3.1. Restructuring of State-Owned Banks*

In 2001, financial restructuring of state-owned banks was completed and significant steps were taken regarding operational restructuring. Operational restructuring efforts have been continued in 2002.

Restructuring of state-owned banks has been carried out with the ultimate aim of privatizing these banks. Within this framework, the priority regarding restructuring of state-owned banks has been given to strengthening the financial structures of the banks in question. Simultaneously with strengthening their financial structure, operational restructuring studies were also initialized. Within the restructuring process, the management of the banks in question have been transferred to the Common Board of Directors as the first step and the Board has been granted the authority of restructuring and preparing the state-owned banks for privatization.

3.1.1. Financial Restructuring

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

Liquidation of the Duty Losses

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

- A number of regulations (around 100 Council of Ministers' Decrees and/or Laws) that allowed subsidized lending through state banks (creating duty losses) were annulled in order to prevent generation of new duty losses.

- The practice of appropriating in the central budget the resources required for government supports to be provided through state-owned banks and transferring these funds to the banks in question in advance was commenced.

Resources Transferred for the Restructuring of State Banks

Duty Loss receivables of state banks from the Treasury began to generate in 1992 and reached TL 17,4 quadrillion as of end 2000. TL 2,2 quadrillion of this amount was securitized, while the remaining TL 15,2 quadrillion consisted of unsecuritized duty loss receivables. Unsecuritized duty loss receivables and all interest accrued on them were securitized in 2001 through granting special issue government bonds amounting to TL 23 quadrillion.

Also, within the year 2001, an additional support was given to state banks in order to strengthen their capitals. Specifically, in-cash capital injections were made, amounting to TL 217,6 trillion to Ziraat Bankasi in March, TL 67,2 trillion and TL 40,8 trillion in April respectively to Halk Bankasi and Emlak Bankasi. In addition, government securities were granted to Emlak Bankasi amounting TL 624 trillion and to Halk Bankasi amounting TL 900 trillion in May on their capital. The TL 1,7 quadrillion cost generated in July due to the transfer of Emlak Bankasi to Ziraat Bankasi was covered by giving-out special issue government bonds to Ziraat Bankasi.

The overall total resources transferred to the state banks with the aim of tying the duty loss receivables to securities and providing capital support amounted TL 28,7 quadrillion..¹

....Continued

* Information in this section covers Ziraat, Halk and Emlak banks.

Resources Transferred to State Banks (TL Trillion)			
	Inventory as of December 2000 (1)	Increase in year 2001 (net) (2)	Total (1)+(2)
Liability Generated from Duty Loss	17.413	7.759	25.172
-Tied to Securities	2.217	22.955	25.172
-Ziraat Bankasi	1.354	12.113	13.467
-Halk Bankasi	863	10.797	11.660
-Emlak Bank	0	45	45
-Unsecuritized	15.196	-15.196	0
Capital Support (Subordinated Debt)	-	3.224	3.224
-Ziraat Bankasi	-	1.700	1.700
-Halk Bankasi	-	900	900
-Emlak Bank	-	624	624
Capital Support (Cash Injection)	-	326	326
-Ziraat Bankasi	-	218	218
-Halk Bankasi	-	67	67
-Emlak Bank	-	41	41
Total	17.413	11.309	28.722

Resource: Treasury, BRSA, Joint Board of Directors of State Banks (JBDSB).

1. While unsecuritized duty loss receivables amounting to TL 15,2 quadrillion as of end 2000 were not mentioned in debt stock data, the amount was included within debt stock in the publications of the International Monetary Fund. When evaluated from this view, the real increase in public debt stock within year 2001 due to the restructuring of state banks is approximately TL 11,3 quadrillion.

Reducing Short Term Liabilities

- State banks provided liquidity through outright sale of government securities or repo transactions made with the Central Bank (CBRT) and eliminated their short-term liabilities to the private banks and clients which was around TL 8,5 quadrillion as of March 16, 2001.

Table 2: Short Term Liabilities of State Banks

	TL Quadrillion	
	March 16, 2001	October 23, 2002
1. Central Bank	5,5	-0,8
- Open Market Operations	5,5	0,0
Total Repurchase Agreements	5,5	0,0
O/N Repurchase Agreements	0,2	0,0
Long Term Repurchase Agreements	5,3	0,0
- Interbank Market (O/N)	0,0	-0,8
2. Private Banks +Customer Repurchase Agreements and O/N Deposits	8,5	0,0
Private Banks (O/N)	4,2	0,0
- CBRT Interbank Market	0,4	0,0
- Interbank Money Market	1,9	0,0
- ISE Repo Market	1,9	0,0
Customer Repurchase Agreements and O/N Deposits	4,3	0,0
Total	14,0	-0,8

Source: CBRT

- In order to reduce maturity mismatch and liquidity risk, minimum maturity on repo transactions with clients and corporate 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 the short term borrowing market arising from the liquidity needs of the state banks.

Strengthening the Capital Structure

- Securities and cash were injected to state banks in order to strengthen their capital base. As a result, paid in capital of the state banks rose from TL 476 trillion in December 2000 to TL 3.4 quadrillion in September 2002, while shareholders' equity rose from TL 713 trillion to TL 5 quadrillion during the same period.

Table 3: Own Funds of State Banks

TL Trillion	December 2000	December 2001	Sept. 2002
Ziraat Bankasi			
-Paid-in Capital	261	2.222	2.222
-Reserves+ FARF+SRF	180	470	715
-Profit/Loss	65	526	544
Total Equity	506	3.218	3.481
Halk Bankasi			
- Paid-in Capital	145	1.150	1.150
- Reserves+ FARF+ SRF	171	249	328
-Previous Year Loss	-	-	-581
-Profit/Loss	5	-581	622
Total Equity	321	818	1.519
Emlak Bankasi (*)			
- Paid-in Capital	70	-	-
- Reserves+ FARF+SRF	121	-	-
-Profit/Loss	-305	-	-
Total Equity	-114	-	-
STATE BANKS (TOTAL)			
-Paid-in Capital	476	3.372	3.372
- Reserves+ FARF+SRF	472	719	1.043
-Previous Year Loss	-	-	-581
-Profit/Loss	-235	-55	1.166
Total Equity	713	4.036	5.000

Source: Joint Board of Directors of State Banks

() Emlak Bank has been transferred to Ziraat Bank in July 9, 2001.*

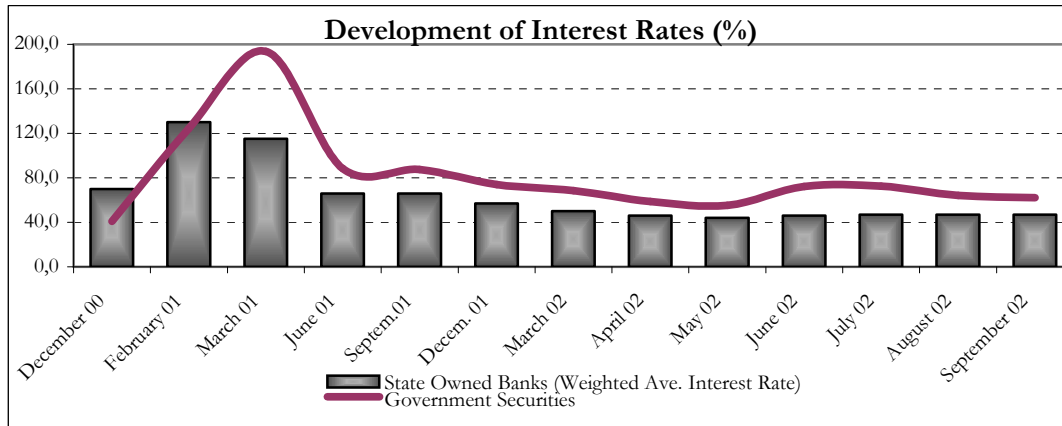
FARF: Fixed Assets Revaluation Fund, SRF :Securities Revaluation Fund.

- There have been significant improvements in the capital adequacy ratio of state banks. This improvement was due to the capital injections as well as the increase in the share of government securities, which has zero credit risk weight in the calculation of CAR, in the total assets of the state banks.

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 and the deposit interests of the banks in subject showed a development parallel to the decrease in market interest rates.



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

- In accordance with the principles of efficiency and productivity, state banks were enabled to determine all their loan interest rates by taking the resource costs into account.

- State banks have become more prudent in 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 TL 3,663 trillion³ in September 2002 from TL 1,017 trillion in end-2000, while provisions for non-performing loans increased to TL 2.957 trillion in September 2002 from TL 296 trillion during the same period.

3.1.2. Operational Restructuring

- The banking and deposit taking licenses of Emlak Bank were revoked and the bank was transferred to Ziraat Bank. Emlak Bank's non-banking related properties and shares in its subsidiaries, commercial immovables, immovables in excess, all its receivables under legal prosecution and provisions set aside for these were excluded in the bank's transfer to Ziraat Bank.

- Significant progress has been achieved regarding the reduction of number of branches and personnel of state banks. The number of branches which was 2.494 as of December 2000 was brought down to 1.687 as of September 2002, while the number of personnel was reduced to 30.896 from 61.601.

Table 4: Number of Branches and Employees

	Dec. 2000	March 2001	June 2001	Sept. 2001	Dec. 2001	March 2002	June 2002	Sept. 2002
Number of Employees	61.601	59.831	51.975	48.511	47.985	43.907	37.054	30.896
-Ziraat Bankasi	36.576	35.334	29.903	35.565	33.023	29.173	22.923	22.796
-Halk Bankasi	10.000	14.699	13.207	12.946	14.962	14.734	14.131	8.100
-Emlak Bankasi	15.025	9.798	8.865	-	-	-	-	-
Number of Branches	2.494	2.488	2.476	2.418	2.398	2.052	1.691	1.687
-Ziraat Bankasi	1.287	1.281	1.270	1.615	1.499	1.383	1.141	1.138
-Halk Bankasi	804	804	803	803	899	669	550	549
-Emlak Bankasi	403	403	403	-	-	-	-	-

Source: Joint Board of Directors of State Banks

- Operational restructuring of state banks aims at restructuring these banks in terms of organization, technology, human resources, financial control, planning, risk

³ Loss due to the merger with Emlak Bankasi, amounting to TL 1.9 quadrillion is included in this amount. Furthermore, the provision set aside for the loss due to the merger with Emlak Bankasi is TL 1,4 quadrillion.

management and service quality so that they could operate according to the requirements of modern banking and international competition. To summarize the developments along these lines:

- The fundamental principle in new organization structure of state banks was determined as “client oriented service apprehension” and “matrix relationship in organization”. Accordingly, institutional structure of state banks was built to comprise Strategic Profit Units, Support Units and Control Units.
- State banks were re-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, placed under this Board. By such a structuring, each department was aimed to gain expertise regarding its duty field.
- Through “Regulation on Internal Control and Risk Management Systems of Banks” entered into force in 2001, Bank Risk Committee and High Level Risk Committee have been established within the structure of state banks. “Risk Management Group” has been divided into: Market Risk Department and Loan Risk Management Department in the new organization structure. Risk management group works in full compliance with the principles and procedures of the BRSA’s regulation on risk management.
- 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.

3.1.3. Developments in the Profitability Performance of State Banks After Restructuring

- Positive impact of financial and operational restructuring started to reflect itself in profitability performance of the state banks. Profit of Ziraat Bank increased to TL 126 trillion in the second quarter and to TL 614 trillion in the third quarter from TL 119 trillion in the first quarter of 2002. With the profit amounting to TL 622 trillion generated by Halk Bankasi in end-September the total profit of state banks became TL 1.236 trillion in the same period.

Table 5: Profits and Losses of State Banks

(TL Trillion)	Ziraat Bankasi	Emlak Bankasi	Ziraat + Emlak Bankasi	Halk Bankasi	Total
April 2001	-279	-319	-598	-740	-1.338
May.	459	-331	128	-576	-448
June	225	-425	-200	-759	-960
July	255	-	255	-703	-448
August	118	-	118	-674	-556
Sept.	215	-	215	-627	-412
Oct.	349	-	349	-562	-213
Nov.	438	-	438	-496	-58
Dec.	526	-	526	-581	-55
Jan. 2002	99	-	99	49	148
Feb.	80	-	80	92	172
March	119	-	119	142	261
Apr.	63	-	63	135	198
May.	-6	-	-6	191	185
June	126	-	126	326	452
July	251	-	251	430	681
August	482	-	482	539	1.021
Sept.	544	-	614	622	1.236

Source: JBDSB

Table 6: Consolidated Balance Sheet of State Banks

	TL Trillion			% Share		
	Dec. 2000	Dec. 2001	Sept. 2002	Dec. 2000	Dec. 2001	Sept. 2002
Assets						
-Cash & Claims on Banks	2.077	4.760	4.116	6,7	10,7	7,7
-Securities Portfolio *	2.427	26.344	33.110	7,9	59,3	62,6
-Loans	6.915	5.453	5.143	22,4	12,3	9,7
-Loans under Follow-Up(Net)	721	1.065	706	2,3	2,4	1,3
-Loans under Follow-Up	1.017	3.366	3.663	3,3	7,6	6,9
-Provisions for Loans under Follow-Up (-)	296	2.301	2.957	1,0	5,2	5,6
-Duty Losses	15.196	-	-	49,3	-	-
-Other Assets	3.481	6.781	10.121	11,3	15,3	19,0
Liabilities						
-Deposit**	20.353	30.351	37.531	66,0	68,4	70,6
-Borrowings from Banks***	3.909	3.561	3.303	12,7	8,0	6,2
-Other Liabilities	5.842	6.455	7.362	19,0	14,5	13,8
-Shareholder's Equity	713	4.036	5.000	2,3	9,1	9,4
Balance Sheet Total	30.817	44.403	53.196	100,0	100,0	100,0

Source: BRSA, JBDSB

* Fixed securities are included in the Securities Portfolio. Due to the fact that repurchase transactions are followed-up in the balance sheet as of February 2002, repurchase amount has been shown in the securities portfolio item of assets, and in other liabilities item of liabilities.

** Banks' Deposits are excluded.

*** In the "Borrowings from Banks" item, there are Banks' Deposits and Interbank Money Market transactions.

Regulations Regarding State Banks

- The legal framework for the restructuring of state banks was established with the "Act No: 4603 on Ziraat, Halk and Emlak Bank" published in the Official Gazette dated November 15, 2000.
- With the Act No: 4743 published on January 31, 2002, some additional regulations on state banks were put into force. In summary:
 - ✓ State banks shall not employ personnel who are not subject to provisions of private law after December 12, 2002.
 - ✓ Within the scope of restructuring of state banks, 20 percent addition to retirement bonuses has been provided in order to encourage early retirement.
 - ✓ Members of the Board of Directors, Board of Auditors and Board of Liquidation 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.
 - ✓ Ziraat Bank, Halk Bank and Emlak Bank Under Liquidation are authorized to restructure loans extended before February 21, 2001 (loans extended to artisans and craftsman, small and medium sized enterprises, and agricultural loans). Also, it is foreseen that Emlak Bank Under Liquidation may participate in the debt restructuring process but is not to provide any additional financing.
 - ✓ 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.

3.2. Resolution of SDIF Banks

Immediate resolution of failed banks transferred to the SDIF constituted an important part of the banking sector restructuring program.

In this section; legal basis of banks' transfers to the SDIF, fiscal costs of these transfers, resolution of these banks through financial and operational restructuring and follow-up, collection and sales activities carried out to minimize the fiscal burden brought to public sector are evaluated.

3.2.1. Banks Transferred to the SDIF and Reasons for Their Transfers

Within the period of 1997-2002, 20 banks were transferred to the SDIF.

Of the 20 banks, three banks were taken over according to the previous Banks Act (Article 64 of the Banks Act Nr. 3182). Of the remaining 17 banks, 5 were taken over according to Article 14/3 while 12 were taken over according to Article 14/3 and 4 of the Banks Act.⁴

Table 7: Legal Basis for Banks' Transfer to the SDIF

Article 64 of the Ex-Banks Act Nr. 3182	Article 14/3 of the Banks Act Nr. 4389	Article 14/3 and 4 of the Banks Act Nr. 4389
Ticaret Bankasi	Yasarbank	Egebank
Bank Ekspres	Demirbank	Yurtbank
Interbank	Sitebank	Sumerbank
	Ulusalbank	Esbank
	Tarisbank	Etibank
		Bank Kapital
		Iktisat Bankasi
		Bayindirbank
		Kentbank
		EGS Bank
		Toprakbank
		Pamukbank

3.2.2. Fiscal Burden Brought by and Resources Transferred to the Banks Taken Over

Losses and Liabilities taken over from the SDIF Banks

As of the date of transfer, total liabilities of the banks taken over by the SDIF (excluding Pamukbank) was USD 25,8 billion. Of this amount, deposit accounts amounted to USD 21,0 billion and non-deposit liabilities amounted to USD 4,8 billion. Accounts subject to the deposit insurance amounted to USD 15,3 billion of the deposits. Liabilities abroad amounted to USD 1,3 billion of the non-deposit liabilities. As of the date of transfer, total loss of SDIF banks (excluding Pamukbank) was USD 13,6 billion.

⁴ Articles of Law regarding the transfer of banks to the Fund are presented in Box 17.

Legal Basis Regarding the Take-Over of Banks by the SDIF

Article 14/3 of the Banks Act Nr. 4389 (as amended by the Act Nr.4743):

If the Agency (BRSA) in its sole discretion determines that,

a) a bank does not take the measures in part or in whole stated in paragraph (2) of this Article, the financial structure of the bank cannot be strengthened although the measures have been taken in part or in whole, or the financial structure has become so weak that it could not be strengthened even if those measures were taken, or,

b) a bank can not fulfill its obligations as they fall due or,

c) the value of the liabilities of the bank exceeds the value of the assets, in accordance with the valuation standards determined by the Board for the implementation of this Article or,

d) the continuation of its activities would threaten the rights of depositors and the security and the stability of the financial system,

The Board may transfer the management and control and privileges of shareholders except dividends, of a bank to the Fund or revoke the license of the bank to perform banking activities and/or to accept deposits, with an affirmative vote of at least five members of it.

Article 14/4 of the Banks Act Nr. 4389(Amended by the Act Nr. 4743):

If shareholders who directly or indirectly, individually or with other shareholders hold the bank's management and control, are found to have made use of the bank's resources for their own interests directly or indirectly in a manner jeopardizing a secure functioning of the bank or caused the bank to sustain a loss as a result of such misuse, then the Board with an affirmative vote of not less than five members may transfer the rights of shareholders except dividend rights, and the bank's management and control to the Fund.

Article 64 of the Abrogated Banks Act Nr. 3182:

1. If it is determined as a result of the audits that the financial structure of a bank is seriously weakening, the Minister can request the following from the Board of Directors within an appropriate time schedule granted by him.

- a) Increasing capital or collecting the unpaid part of the capital or acquiring subordinated loans,
- b) Not paying dividends, setting aside provisions for the receivables which may not be collected,
- c) Decreasing expenditures through closing some of the branches, suspending or limiting to employ further personnel or through various ways,
- d) Completely or partially disposal of subsidiaries or fixed assets,
- e) Avoiding from risk-generating activities, suspending or limiting loans, increasing the measures on follow-up of the inefficient or non-performing loans,
- f) Revoking the representative authorities of the personnel who are deemed to weaken the financial structure of the bank with their acts in breach of the legislation,
- g) Calling for General Assembly Meeting,
- h) Taking other measures needed to strengthen the financial structure. The Board of Directors shall take necessary measures and submit the resolutions adopted and the measures taken in the form of monthly reports to the Undersecretariat.

In case of necessities and provided that the above-mentioned measures are reserved, the minister is authorized to

- appoint members to the following Boards by dismissing all or some members of the Board of Directors, Executive Board or Board of Auditors or increasing the number of the members of Board of Directors and Auditors
- take all measures to strengthen financial structures including deferment or cancellation of legal reserve requirements by removing penal interest on them thereby taking the opinion of the CBRT.

The obligation stipulated in paragraph 1 of Article 22 is not required for the members of the Board of Directors appointed in accordance with this Article.

2. Regardless of the request to take the above-mentioned measures, the Minister is authorized to consign the bank management to the SDIF by also taking the opinion of the CBRT or to request the enforcement of the provisions of Article 68.

The minister is authorized for the mergers and acquisitions of these banks, all capitals of which are owned by general and annexed budget administrations or state economic enterprises and authorized to determine the principles and procedures.

Banking licenses of investment and development banks, financial structures of which are not deemed possible to be strengthened despite the enforcement of paragraph 1 are revoked in accordance with Article 12.

Table 8: Liabilities of SDIF Banks
(USD Million as of the Date of the Take-Over)

Total Liabilities	25.832
- Total Deposits	21.034
- Deposits Denominated in TL	8.863
- Deposits Denominated in FX	12.171
- Other	4.798
For Information	
- Deposit Subject to Insurance	15.275
- Domestic Liabilities(*)	1.681
- Receivables from Abroad	626
- Liabilities to Abroad(net)	1.055
- Liabilities to Abroad.(net)/Total Liabilities(%)	4,1

Note: Except Pamukbank.

(*) Including foreign loans received and deposits of residents abroad.

Apart from FX and capital market transaction losses, provisions set aside for non-performing loans also played a significant role in the generation of losses of the SDIF banks.

Loans extended to majority shareholders have a significant effect on non-performing loans. In fact, funds used by majority shareholders from their own banks and from other Fund banks (except Pamukbank) amounted to USD 7.9 billion (calculated by the exchange rates as of the date of their utilization). Reimbursement and indemnification lawsuits and execution-bankruptcy lawsuits have been filed and necessary legal proceedings have been carried out for the reimbursement of the amount in question.

Table 9: Deposits and Losses of SDIF Banks and Funds used by the Majority Shareholders (USD Million)

Bank	Total Deposit	Loss	Share %	Receivables from Majority Shareholders		Reimbursement and Indemnification	
				Funds Used By Majority Shareholders	Funds Used from other Fund Banks (**)	Total	Amount(***)
Bank Ekspres (*)	487	435	3,2	343	107	451	-
Bank Kapital	370	393	2,9	278	131	409	278
Bayindirbank	197	116	0,8	71	66	137	71
Demirbank (*)	2.828	648	4,7	-	52	52	-
Egebank	1.811	1.220	8,9	489	138	628	489
EGS Bank	600	545	4,0	293	1	294	293
Esbank	1.965	1.113	8,2	627	189	816	627
Etibank	1.521	698	5,1	436	255	690	436
Iktisat Bankasi (*)	1.894	1.954	14,3	726	42	768	726
Interbank	1.905	1.269	9,3	1.160	261	1.421	-
Kentbank	1.013	681	5,0	133	43	175	133
Sitebank (*)	75	53	0,4	8	0	8	-
Sumerbank	1.144	470	3,4	299	52	350	299
Tarisbank (*)	132	74	0,5	-	0	0	-
Toprakbank	1.063	880	6,4	534	71	605	534
T.Ticaret B.(*)	1.446	777	5,7	30	0	30	-
Ulusal Bank (*)	356	524	3,8	5	0	5	-
Yasarbank (*)	1.475	1.149	8,4	103	41	144	-
Yurtbank	752	656	4,8	719	196	915	719
Total	21.034	13.654	100,0	6.255	1.645	7.900	4.605

Note: Reimbursement and indemnification lawsuits are filed for the reimbursement of funds used by majority shareholders in their favor and losses incurred as a result.

(*)Reimbursement and indemnification lawsuits are not filed for these banks due to the fact that they are taken-over pursuant to Article 64 of Act Nr. 3182 and Article 14/3 of the Act Nr. 4389. However, necessary lawsuits regarding Interbank and Bank Ekspres ensuring the follow-up of the receivables for the funds used by the majority shareholders from their own banks have been filed.

(**)Execution-bankruptcy and personal responsibility proceedings are carried out in accordance with the Acts Nr. 6183 and Nr. 2004.

(***) Other receivables and losses which are not subject to reimbursement and indemnification are followed up in accordance with the Acts Nr. 6183 and Nr. 2004 besides through lawsuits on receivables and personal responsibility lawsuits.

Resources Transferred to the SDIF Banks

Funds needed for strengthening financial structures of SDIF Banks, their restructuring and transfer of their liabilities are met by special issue government bonds issued by the Treasury, advances granted by the Central Bank of the Republic of Turkey and the SDIF's own resources.

Using the conversion rates of August 31, 2002, TL equivalent of the principal values (as of the issuance date) of F/X denominated and F/X based securities issued by the Treasury within the borrowing agreements made with the SDIF amounts to TL 27,5 quadrillion (USD 16,9 Billion).⁵

Table 10: Special Issue Bonds Issued by the Treasury to the SDIF

Total (TL Trillion)	27.489
Total (USD Million)	16.873
- TL Denominated (TL Trillion)	10.651
- USD Denominated and USD Based (USD Million)	8.640
- Euro Denominated and Euro Based (Euro Million)	1.721

Note: Figures do not include interests accrued to the issued securities. TL and F/X equivalents are calculated by using the CBRT exchange rates as of August 31, 2002.

An important portion of the resources provided by the Treasury were used for liquidation of short-term liabilities, payment of some liabilities in cash, and transfer of deposits.

Table 11: Special Issue Bonds Issued by the Treasury

	TL Trillion	USD Million
Transferred through banks sold	2.259	1.387
Transferred due to the transfer of F/X liabilities	3.930	2.412
Transferred through deposit tenders	4.897	3.006
Reimbursed to the Treasury	994	610
Redeemed before maturity	6.466	3.969
Remained in the Fund Banks	3.294	2.022
Transferred for liquidation of short-term liabilities	5.608	3.442
Redeemed at maturity	40	25
TOTAL	27.489	16.873

Besides, TL 1.514 trillion of capital (USD 2.213 million) were transferred from SDIF's own resources to the Fund Banks. TL 353.8 billion of the government securities was transferred to T.Ticaret Bankasi on February 15, 2002 while TL 901,0 trillion of the government securities transferred from other Fund Banks to Bayindirbank were converted into subordinated loans. On the other hand, the SDIF deposited funds to these banks on various dates in order to enable them meet their liabilities. Total deposits of the SDIF in sold banks and in the remaining Fund Banks amounted to TL 1.243 trillion as of November 11, 2002.

3.2.3. Financial and Operational Restructuring

In order to avoid increase in losses and to accelerate resolution process, the Fund Banks have been subjected to an intensive financial and operational restructuring. Accordingly, short-term liabilities of the Fund Banks were reduced; their open positions

⁵ Taking into account both the SDIF's repayment of TL 1 quadrillion to the Treasury over the April-May 2002 period and the interest accrued on the funds used from the Treasury, the SDIF's debt to the Treasury amounts to TL 35 quadrillion (USD 21,4 billion).

were remarkably reduced; determination of their deposit interest rates in line with market conditions were ensured; their deposits and F/X liabilities were transferred to other banks; and number of their branches and personnel were reduced.

Elimination of Short-Term Liabilities

- The SDIF banks eliminated their short term liabilities to clients and private banks amounting to TL 5,2 quadrillion as of March 16, 2001 by using the funds generated through out-right sale of special issue bonds to Central Bank. Also, short term liabilities of the SDIF banks to the Central Bank were eliminated in 2002.

Table 12: Short-term Liabilities of SDIF Banks

	TL Quadrillion		
	March 16, 2001	May 4, 2001	October 23, 2002
Central Bank	2,6	5,6	0,0
- Open Market Operations	2,6	5,6	0,0
Overnight Repo	0,3	0,0	0,0
Longer Term Repo	2,3	5,6	0,0
- Interbank Market (O/N)	0,0	0,0	0,0
Private Banks (O/N)	1,7	0,0	0,0
- Interbank Market within CBRT	0,3	-0,1	0,0
- Interbank Money Market	0,3	0,0	0,0
- ISE Repo Market	1,1	0,1	0,0
Customer Repos and O/N Deposits	3,5	0,8	0,0
Overall Total	7,8	6,4	0,0

Source: CBRT.

Closing of F/X Open Positions

• Open F/X positions of SDIF banks, which were around USD 4-5 billion prior to May 2001, decreased substantially as a result of the injection of F/X indexed bonds during the second half of May 2001 and became USD 561 million as of end-June, 2001. Although the F/X net open position had increased with the transfer of Pamukbank to the Fund, it decreased to USD 306 million as of October 11, 2002 as a result of F/X based securities injection.

Table 13: Foreign Exchange Positions of the SDIF Banks

(USD Million)	April 13, 2001	May 18, 2001	June 29, 2001	Dec. 28, 2001	October 11, 2002
1. On-Balance Sheet F/X Position	-4.812	-2.764	-3.894	-1.197	-1.863
2 F/X Indexed Position	630	2.233	3.383	748	1.557
3. On-Balance Sheet F/X Position (1+2)	-4.182	-531	-511	-449	-306
4. Forward Position	-132	-116	-50	0	0
5. Net General F/X Position (3+4)	-4.314	-647	-561	-449	-306

Bringing of Deposit Rates in Line with Market Rates

- The 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.

Transfer of the SDIF Banks' Deposits and F/X Liabilities to Other Banks

• With a view to accelerating the resolution of the Fund Banks, their deposits and F/X liabilities were transferred to other banks. An important portion of 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 pools of TL and F/X deposits in 5 stages. As a result of these auctions, TL 479 trillion in Turkish Lira and USD 2.587 million in F/X denominated deposits were transferred to 8 private banks.

- F/X liabilities of the SDIF Banks amounting to USD 2,4 billion were transferred to state banks.

Table 14: Transfer of Deposits and F/X Liabilities of SDIF Banks

	Deposits Transferred through Tender		F/X Liabilities Transferred to State Banks (USD Million)
	TL Deposits (TL Trillion)	F/X Deposits (USD Million)	
Iktisat Bankasi	85,4	121,4	628,5
EGS Bank	36,7	111,6	1,0
Etibank	353,7	1.181,9	819,1
Kentbank	-	1.171,9	839,1
Bayindirbank	-	-	125,1
Overall Total	478,8	2.586,8	2.412,8

Reducing the Number of Branches and Personnel

- The number of the branches of SDIF Banks was 1.815 as of the date of transfer and resolution of 624 branches have been completed through acquisition or branch sale. Total number of the branches of Pamukbank and Bayindirbank under the SDIF is 255. The number of branches of Bayindirbank became 59 due to transfers from Toprakbank and is projected to be brought down to 11 as of end-November 2002 and to 6 by January 2003.

- 37.889 personnel were transferred with the banks taken over by the SDIF. With sold banks and branches, employment of 10.146 personnel has been preserved. Number of the employees of Pamukbank and Bayindirbank which are still under the SDIF is 6.358. The number of employees of Bayindirbank became 1.268 after the transfers from Toprakbank and is projected to be brought down to 250 by year-end.

Table 15: Number of Branches and Employees of the SDIF Banks

	Number of Branches				Number of Employees			
	As of Transfer Date	Transferred through Sold Banks	Sold Branches	Current (04.11.02)	As of Transfer Date	Transferred through Sold Banks	Transferred through Sold Branches	Current (04.11.02)
Bayindirbank	22	-	-	59	381	-	-	1.268
Toprakbank	165	-	78	-	2.482	-	744	-
Pamukbank	196	-	-	196	5.320	-	-	5.090
EGS Bank	49	-	3	-	918	-	39	-
Etibank	283	-	91	-	6.171	-	975	-
Iktisat	62	-	23	-	1.305	-	131	-
Kentbank	86	-	46	-	1.422	-	456	-
Tarisbank	41	29	-	-	528	274	-	-
T. Ticaret	274	-	-	-	4.790	-	-	-
Sumerbank	401	135	-	-	9.357	3.198	-	-
Bankekspres	25	26	-	-	721	618	-	-
Sitebank	13	5	-	-	253	146	-	-
Demirbank	198	188	-	-	4.241	3.565	-	-
TOTAL	1.815	383	241	255	37.889	7.801	2.345	6.358

3.2.4. Resolution of SDIF Banks Through Acquisition, Merger, Sale or Liquidation

Of 20 SDIF Banks, 12 were resolved through merger while sale of 5 banks (Bank Ekspres, Sumerbank (merged), Demirbank, Sitebank and Tarisbank) to foreign and domestic investors were completed.

Banking and deposit accepting licenses of T. Ticaret Bank was revoked as of July 1, 2001. The Council of State's General Assembly of Administrative Lawsuit Departments made a ruling that halted the execution of the process but this was refused by the 10th Department of the Council of State. The liquidation decision was taken on August 9, 2002 and liquidation process still continues.

Sale process of Pamukbank, which was one of the two banks under the SDIF as of November 5, 2002, has been initiated and the deadline to submit bids has been extended from October 4, 2002 to December 20, 2002. Bayindirbank has been restructured as a bridge bank and continues to perform its activities under the SDIF.

Table 16: The Restructuring Process of SDIF Banks

	1997	1998	1999	2000	2001	As of November 11, 2002	Total
Number of Banks Taken Over	1	1	6	3	8	1	20
Number of Merged Banks	-	-	-	-	7	5	12
Number of Sold Banks	-	-	-	-	3	2	5
Number of Banks, Licenses of which were Revoked	-	-	-	-	-	1	1
Number of Fund Banks	1	2	8	11	9	2	2

Table 17: List of Banks Transferred to the SDIF

Banks	Date of Transfer to the Fund	Current Status
Merged Banks		
Egebank	December 21,1999	-Merged into Sumerbank on January 26, 2001.
Yurtbank	December 21,1999	-Merged into Sumerbank on January 26, 2001.
Yasarbank	December 21,1999	-Merged into Sumerbank on January 26, 2001.
Bank Kapital	October 27, 2000	-Merged into Sumerbank on January 26, 2001..
Ulusal Bank	February 28, 2001	-Merged into Sumerbank on April 17, 2001.
Interbank	January 07, 1999	-Merged into Etibank on June 15, 2001.
Esbank	December 21, 1999	-Merged into Etibank on June 15, 2001
Iktisat Bankasi	March 15, 2001	Banking and deposit taking license was revoked as of December 7, 2001 and the liquidation process initiated. Upon the resolution adopted in the General Assembly Meeting on April 04, 2002 the liquidation decision was revoked and the Bank was merged under Bayindirbank.
Kentbank	July 09, 2001	Banking and deposit taking license was revoked as of December 28, 2001 and the liquidation process initiated. Upon the resolution adopted in the General Assembly Meeting on April 04, 2002 the liquidation decision was revoked and the Bank was merged into Bayindirbank.
EGS Bank	July 09, 2001	-Banking and deposit taking license was revoked as of January 18, 2002 and merged into Bayindirbank as of the same date.
Etibank	October 27, 2000	Banking and deposit taking license of the bank was revoked as of December 28, 2001 and the liquidation process initiated. Upon the resolution adopted in the General Assembly Meeting on April 04, 2002 the liquidation decision was revoked and the Bank was merged into Bayindirbank.
Toprakbank	November 30,2001	Banking and deposit taking license of the bank was revoked as of September 30, 2002 and merged into Bayindirbank as of the same date.
Sold Banks		
Bank Ekspres	December 12, 1998	Sold to the Tekfen Holding on June 30, 2001. Approval of the transfer was made on October 26, 2001.
Demirbank	December 06, 2000	Sold to HSBC on September 20, 2001. Approval of the transfer was made on October 30, 2001.
Sumerbank	December 21, 1999	Merged Sumerbank was sold to the OYAK Group on August 9, 2001. Merger of Sumerbank and Oyakbank was approved on January 11, 2002. Operating as Oyakbank.
Sitebank	July 09, 2001	A share transfer agreement was signed with Novabank on December 20, 2001. The transfer procedure was carried out on January 25, 2002.
Tarisbank	July 09, 2001	The share transfer agreement regarding the acquisition by Denizbank A.S. was signed on October 21, 2002. Actual share transfer was completed as of October 25, 2002.
Banks Under Liquidation Process		
T.Ticaret Bankasi	November 06, 1997	In the Extraordinary General Assembly Meeting held on August 09, 2002, dissolution and liquidation of the bank was decided and liquidation decision was approved on August 14, 2002 by the Trade Registry and published in the Trade Register Gazette Nr. 5616 dated August 19, 2002. Liquidation process is continuing.
Banks Under the SDIF		
Bayindirbank	July 09, 2001	Is being restructured as a bridge bank which will perform asset management

Pamukbank	June 19, 2002	function. Offered to sale on June 29, 2002. Sale process is continuing. The deadline specified for investors to submit their bids is December 20, 2002.
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An effort was made to reduce employment losses while reducing the liabilities through the sale of banks taken over by the SDIF. As a matter of fact, a total of USD 2,4 billion worth liability has been transferred with the sold banks and employment of 7.801 personnel in the new banks has been ensured.

Table 18: Bank Sales

	Sale Price (USD Thousand)	Value of Own Funds Transferred (USD Thousand)	Asset Size (USD Million)	Deposits Transferred (USD Million)	Number of Branches Transferred	Number of Personnel Transferred
Bank Ekspres	8	0	159	143	26	618
Sumerbank	36	0	1.463	1.261	135	3.198
Demirbank	350.000	208.916	873	554	188	3.565
Sitebank	3.000	2.907	10	6	5	146
Tarisbank	0	0	70	73	29	274
TOTAL	353.044	211.823	2.575	2.036	383	7.801

3.2.5. Asset Management and Collection

Transfer of Loan Files to the Collection Department

Efficiency in follow-up and collection process has been increased by transferring the SDIF banks' receivables under follow-up to Collection Department (COD).

As of September 30, 2002 a total of 124.785 files have been transferred to COD, 766 of which are majority shareholder files, 10.510 other corporate files and 113.509 individual files. Principal book values registered at bank balance sheets of cash loans transferred to COD amount to USD 3,6 billion.

Table 19: Receivables Under Follow-Up Transferred to COD

As of September 30, 2002	Majority Shareholders (**)	Other Corporate	Individual	Total
Number of Files	766	10.510	113.509	124.785
Amount of Debt Taken Over (USD billion) (*)	2.424	1.149	74	3.647

(*) The amount of debt taken over is the principal book values registered at bank balance sheets of the cash loans taken over by the Collection Department of the SDIF. It does not include the accrued interest and provisions set aside.

(**) When accrued interest included, the total amount of the loans extended to majority shareholders is (as appears in Table 9) USD 7.900 million.

Collections Realized from the Receivables under Follow-up

- Collection of receivables under follow-up of the SDIF banks amounting USD TL 1,1 billion was realized between their date of transfer and September 30, 2002. USD 875 million of this amount was collected by the Fund banks, and the remaining USD 228,5 million by the Collection Department (COD).

Table 20: Collections Realized from the Receivables under Follow-Up

As of September 30, 2002 (USD Million)	Majority Shareholders and		
	Corporate	Individual	Total
Collections by the COD	202,0	26,5	228,5
- Cash Collections	189,8	26,5	216,3
- Other(*)	12,2	-	12,2
Collections by Fund Banks(**)	875,0	-	875,0
Total Collections	1.077,0	26,5	1.103,5
Non-Cash Risk Reductions (*)	439,2	-	439,2
TOTAL RISK REDUCTION	1.516,2	26,5	1.542,7

(*) Non-cash risk reductions and other collections have been converted to US dollars as of September 30, 2002.

(**) Shows the collections realized by the Fund banks until end-2001.

(***) Data on collections from majority shareholders are available as of end-August and amounts to USD 173 million.

Repayment Scheduling of Receivables

In order to protect viable firms and increase collectibility of the Fund receivables, repayment agreements are being made with debtors. As of September 30, 2002 a total of 1.027 protocols were made between the Fund and debtors amounting to USD 706,9 million, USD 86,6 million of which was collected as of the same date.

Table 21: Rescheduled Receivables

As of September 30, 2002 (USD Million)	Number of Protocols	Total Value	Paid Value	Amount to be Paid
Other Corporate Debtors	358	454,4	62,1	392,3
- Firms Included in the Istanbul Approach	1	26,2	0	26,2
- Other	357	428,2	62,1	366,1
Individual Debtors	665	2,7	0,1	2,6
TOTAL	1.027	706,9	86,6	620,4

Sale of Subsidiaries and Immovable Assets

To improve efficiency in realizing the sale of the Fund banks' subsidiaries, and movable and immovable assets, two new departments-namely Subsidiaries Department and Real Estate Department-were established within the SDIF.

Part of taken over banks' subsidiaries was resolved by the banks themselves. Following establishment of the Subsidiaries Department some of the remaining subsidiaries were transferred to the said department which thereafter started to execute the resolution process.

Table 22: Distribution of Subsidiaries on Bank Basis

As of September 30, 2002	Number of subsidiaries as of the date of transfer to the SDIF	Subsidiaries sold by banks	Subsidiaries left in the sold banks	Current subsidiaries held by the SDIF banks	Subsidiaries transferred to the SDIF	Subsidiaries sold by the Subsidiaries Department	Subsidiaries being sold by the Subsidiaries Department	Number of Remaining Subsidiaries
Sumerbank*	50	8	6	-	36	19	-	17
Etibank	56	17	-	-	39	8	1	30
Demirbank	20	5	2	-	13	8	-	5
T.Ticaret B.	30	6	-	24	-	-	-	-
EĞS Bank	6	-	-	-	6	1	-	5
Bayindir B.	11	3	-	5	3	-	-	3
Sitebank	2	-	-	-	2	2	-	-
Iktisat B.	25	3	-	-	22	2	1	19
Kentbank	7	-	-	-	7	-	-	7
Toprakbank	9	-	-	-	9	-	-	9
Tarısbank	5	-	-	5	-	-	-	-
Pamukbank	37	-	-	15	22	-	-	22
Total	259	42	8	49	159	40	2	117

(*) Includes subsidiaries belonging to banks merged under Sumerbank.

- As of September 30, 2002, a sum of TL 298,8 trillion was raised from sales of the Fund banks' subsidiaries including those, sales of which have been decided but waiting for the completion of approval procedures.

Table 23: Subsidiary Sales

As of September 30, 2002			
	Number	TL Trillion	USD Equivalent (USD Million)*
Subsidiaries sold by banks	42	31,0	24,0
Subsidiaries, sales of which are finalized by the SDIF	40	262,5	187,8
Subsidiaries, sales of which are still continuing	2	5,3	3,2
TOTAL REVENUE		298,8	215,0
<i>Memo item: Current Subsidiaries of the SDIF and their Book Values (**)</i>	117	91,3	55,3

(*) Calculated by taking the USD foreign exchange rate as of the collection date.

(**) As the transfer process of the 22 subsidiaries taken over from Pamukbank is not finalized, book values of these subsidiaries are not included.

PS: The fact that the sale values are highly above the book values should be taken into account.

- Part of taken over banks' immovables was resolved by the banks themselves. Following the establishment of the Real Estates Department some of the remaining subsidiaries were transferred to the said department which started to execute the resolution process.

As of September 30, 2002, a sum of TL 147,5 trillion was raised from the sale of the Fund banks' immovables.

Table 24: Sale of Immovable Assets

As of September 30, 2002			
	Number	TL Trillion	USD Equivalent (USD Million)*
Immovables Transferred to the SDIF	3.367		
Immovables sold by the Fund Banks	..	55,2	39,7
Immovables, sales of which have been finalized by the SDIF	359	92,3	53,3
TOTAL REVENUE		147,5	93,0
<i>Memo item: Current immovables of the SDIF and their Book Values</i>	3.008	286,4	173,5

(*) Calculated by taking the USD exchange rate as of the collection date.

Note: The fact that the sale values are well above the book values should be taken into account.

Follow-Up and Lawsuit Statistics

The SDIF spends every effort in legal terms for realizing the collection of receivables, protection of public rights and punishment of those responsible. Along these lines:

- 8 reimbursement and indemnification and 68 personal bankruptcy lawsuits have been filed against majority shareholders of the related banks.

Table 25: Lawsuits Filed by the SDIF

Type of Lawsuits	August 16, 2001	December 25, 2001	November 7, 2002
-Individual bankruptcy	22	37	68
-Actions of debt (Reimbursement-Indemnification) *	7	8	8
-Precautionary measures	12	14	13
-Criminal Lawsuits filed due to wealth declaration fails	8	8	15
-Execution proceedings	31	37	63
-Annulment of securities	-	-	1
-Tax refund	-	-	5
-Objection to Sale	-	-	2
-Other lawsuits	-	-	9
Total	80	104	184

Note: Lawsuits filed for loans are not included. The banks themselves file loan lawsuits; and the legal procedures for the transferred files are carried out by the Collection Department of the SDIF.

*Follow-up of the lawsuit filed against the major shareholders of İktisat Bankası is being carried out within the scope of Act No. 6183 by the Collection Department.

- Also, the Collection Department of the SDIF has filed lawsuits against majority shareholders, 99 of which under the framework of the Act Nr. 6183 on Procedures for Collection of Public Receivables and 546 under the framework of Act Nr. 2004 on Execution and Bankruptcy. On the other hand, the SDIF has taken over the management and/or control of 58 firms owned by the majority shareholders.

Table 26: Actions Taken Against Majority Shareholders

As of September 2002	
Number of Lawsuits Filed According to the Act Nr. 2004 on Execution and Bankruptcy	546
Number of Lawsuits Filed According to the Act Nr. 6183	99
Number of Files Concluded	97
Number of Firms, Management and Control of Which are Taken Over	58
EGS Bank	8
Iktisat Bankasi	7
Egebank	10
Sumerbank	1
Bank Kapital	4
Kentbank	7
Toprakbank	21

- There are 68 individual lawsuits filed pursuant to article 17 of the Banks Act Nr. 4389 against the ex-managers of the banks transferred to the SDIF. The number of managers against whom lawsuits are filed reaches 518 when the banks lawsuits are taken separately in each case.

Table 27: Number of Managers Sued

Banks	Number of Managers(*)	Banks	Number of Managers(*)
Egebank	59	Iktisat Bankasi	17
Yurtbank	18	Bayindirbank	13
Sumerbank	59	Kentbank	6
Esbank	31	EGS Bank	23
Yasarbank	10	Toprakbank	7
Etibank	173		
Bank Kapital	102	TOPLAM	518

(*) As of September 15, 2002. Shows the number of managers sued by considering each lawsuit separately.

- There exist 860 lawsuits filed against the SDIF as of November 7, 2002, most of which are due to off-shore accounts, lawsuits denounced to the SDIF and actions of debt.

Table 28: Lawsuits Filed Against the SDIF

Types of Lawsuits	August 16, 2001	December 25, 2001	November 7, 2002
-Lawsuits related to off-shore accounts	206	222	338
-Actions of debt	8	16	115
-Lawsuits concerning stocks	12	18	37
-Action for negative declaration	1	2	4
-Lawsuits related to payment of uninsured deposits	2	2	2
-Lawsuits related to complaints	5	5	6
-Payment orders	9	11	29
-Annulment of transaction	2	5	70
-Cancellation of objection	-	-	4
-Lawsuits related to adjustment on terms of contract	1	1	3
-Lawsuits related to provisional article 3	24	25	36
-Action for recovery	-	-	2
-Premium claims	-	-	2
-Compensation lawsuits	-	-	3
-Real Estate Value Assessment and Cancellation of the Registry Record	-	-	1
-Ceasing of joint ownership	-	-	4
-Tax Refund	-	-	5
-Lawsuits denounced to the SDIF	-	-	177
Files Transferred to the SDIF from Sold Banks	-	7	22
Total	270	315	860

Note: The legal procedures for the files transferred to the SDIF are carried out by the Collection Department of the SDIF.

Legal and Institutional Arrangements Regarding SDIF

In 2001, necessary amendments were made in the Banks Act and new regulations were issued for the organizational structure of the SDIF in order to establish the legal infrastructure to accelerate the follow-up and collection process of the SDIF banks' receivables. Along these lines;

- With the Act No.4672, so as to accelerate the follow-up and collection process of receivables of the SDIF, especially regulations aiming rapid collection of the funds misused by the majority shareholders and directors of the bank (such as establishing Specialized Courts and clarification of the enforcement of the Act No.6183 for the collection of Fund receivables) have been issued.
- With the Act No.4743;
 - √ In case all shares of a bank, the management and control of which is transferred to the SDIF, can not be owned by the SDIF following the take over of the bank's losses, the SDIF is authorized to take over those shares by paying the shareholders within the time period to be determined by the Board and on the basis of the value of shares to be found after subtracting the taken over losses from the equity capital.
 - √ Banks, shares of which completely or partially belong to the SDIF are also authorized to participate in the Financial Restructuring Framework Agreements alongside the financial restructuring contracts to be signed with debtors whose debts are restructured or tied to a new redemption plan within the framework of the afore-mentioned agreements.
 - √ The SDIF is authorized to participate in Financial Restructuring Framework Agreements alongside the Financial Restructuring Framework Contracts to be signed in accordance with these agreements, on condition that it does not provide any further financing.
 - √ Of loans and other receivables were restructured or tied to a new redemption plan, SDIF may defer or settle in installments some of these loans and receivables which are subject to the "Code of Collection Procedures of Public Claims" in accordance with the Financial Restructuring Framework Agreements.
 - √ Certain transactions and contracts made by the SDIF were exempted from all sorts of taxes, duties, fees and fund levies, except the contribution to education levy.
 - √ The SDIF is authorized to take all kinds of measures, with a view to restructure the subsidiaries of the banks under its administration, which have economic values, including provision of sources within the framework of the principles and procedures determined by the Board.
 - √ Within two years following the completion of mergers, acquisitions and sales of the SDIF banks, the SDIF may file lawsuits against former auditors and board members of these banks.
 - √ The scope of the SDIF's powers on its claims was re-arranged.
 - √ In case the execution proceedings and any lawsuits, engendered by execution proceedings within which SDIF takes part due to the banks under the scope, result completely or partially against the SDIF, compensations and fines stipulated in the Execution and Bankruptcy Act shall not apply to the SDIF.
 - √ Halt of prescription periods for a certain time (9 months) concerning the execution proceedings and the lawsuits filed or to be filed for debts and commitments undertaken or receivables taken over by the SDIF has been provisioned.
- Substantial steps have been taken towards strengthening the organizational structure of the SDIF. Within this framework;
 - √ Human Resources and Budgeting Department was established under the SDIF in order to perform all kinds of activities concerning workforce and manpower planning along with personnel policy, estimation of all expenses and activities regarding these expenses.
 - √ Internal Auditing Department was established under the SDIF in order to supervise the compliance of the execution of the services by the service units to the Act, resolutions of both the Banking Regulation and Supervision Board and the Board of Directors of the SDIF as well as other existing regulations.
 - √ An "Audit Agreement" was signed between the SDIF and an audit company on January 10, 2002 for independent audit of the balance sheet and the income statements of the SDIF as of 2001 year-end. The report of the independent audit company was announced to the public on May 5, 2002.
 - √ In order to ensure the management, liquidation, collection and sale of the individual and institutional deferred payments along with subsidiaries and real estates in a rational and income generating manner, and with a view to increase the efficiency and productivity of subsidiaries and Real Estate Departments through re-organization, a consultancy service contract was signed with a private company.
 - √ In order to execute the Fund collections more efficiently the Collection Department has been restructured into two separate departments: First Collection Department and Second Collection Department.

3.3 Strengthening the Private Banking System

Financial structure and profitability of the private banks deteriorated sharply in the aftermath of the crises experienced. Establishing soundness and sustainability of the private banking constitutes an important element of the banking sector restructuring program. At first stage of the program, measures regarding the recapitalization of private banks, resolving the Non-Performing Loans (NPLs), limitation of F/X open positions and encouragement of mergers and acquisitions have been put into place. In line with the program, important developments were achieved in strengthening of the capital base of private banks with their own resources and restriction of their market risks.

The impact of the recession in the economy in 2001 was more profound than expected and lasted longer, while uncertainties in the global economy were also at an increasing trend. Under such an environment domestic/foreign investors' hesitation towards the sector became stronger and the possibility to convert fixed assets into cash were extremely limited. These adverse developments led to an increase in capital needs, while also severely constraining the private sector's ability to raise new capital.

In consequence, the need to strengthen the strategy regarding private banks with new instruments became evident. These new instruments are; (1) strengthening of private banks' capital through public support if necessary, (2) resolution of NPL's in banking sector through the Istanbul Approach and establishment of asset management companies. "Act on Restructuring of the Debts to the Financial Sector and Amendments to Be Made to Some Laws", Act No.4743 which established the legal framework and grounds for these instruments was put into force on January 31, 2002.

As stipulated by the Provisional Article 4 added to the Banks Act through the above stated amendment, privately owned deposit banks shall go through a three stage audit. Those which 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 necessary⁶.

Besides, within the scope of restoring soundness in the private banking system mergers and acquisitions of banks and their subsidiaries have been encouraged, while important improvements have also been realized in establishing internal control and risk management systems within the banking system.

Strengthening Capital Structures of Private Banks with Their Own Resources

- In order to solve the capital inadequacy problem which became more evident in the aftermath of the November and February crises and to increase the participation of the bank owners and shareholders to capital increases, time-bound commitment letters were taken and consequently private banks realized a capital increase amounting to TL 2,2 quadrillion as of December 31, 2002.
- This tendency continued in year 2002 and a total of TL 765 trillion capital increase was realized as of August 2002, with TL 632 trillion of this amount being raised by private commercial banks.

⁶ Detailed explanations and results of audit and assessment phase of the program have been announced to the public through "Introductory Report" and "Progress Report". These reports are also available in full text at BRSA's web site (www.bddk.org.tr).

Table 29: Distribution of Capital Increases by Bank Groups

(As of August 2002, TL billion)	Commercial Banks				Development and Investment Banks			Total
	Public	Private	Foreign	Foreign Bank Branches	Public	Private	Foreign	
Committed	-	811.701	17.100	1.737	50.000	64.250	2.400	947.188
Realized	-	631.701	17.100	1.737	50.000	61.660	2.400	764.598

Limitation of Foreign Exchange Rate and Interest Rate Risks

- Private banks tended to close their foreign currency open positions following the November and February crises which increased uncertainties in the economy and caused high fluctuations in exchange rates. Furthermore, domestic debt swap transactions carried out by the Treasury in June 2001 also helped private banks to cover their foreign currency open positions. As a result, on-balance sheet foreign currency open positions of private banks decreased to USD 2.1 billion in June 2001 and to USD 1.5 billion at end-2001 from USD 9.0 billion at end-2000. On-balance sheet open positions of private banks have continued to decline in 2002 and become USD 119 million as of October 11.

Table 30: Developments in the Foreign Currency Positions of Private Banks

USD Million	Nov. 2000	2001			2002								
		Feb19	June	Dec.	Jan.	Feb.	March	Apr.	May	June	July	Aug.	Oct. 11
On-balance sheet positions	-10.674	-8.960	-2.056	-1.487	-1.225	-1.325	-991	-936	-654	-1	-148	-341	-119
Forward Position	9.720	7.911	2.196	1.597	1.362	1.384	1.312	1.015	952	-88	-43	7	-4
Net General Position	-954	-1.049	140	110	137	59	321	80	299	-86	-191	-334	-122

On-balance sheet Position: Foreign Currency Position excluding Forward Transactions

Net General Position: Foreign Currency Net General Position including Forward Transactions

- The fact that the share of floating rate, FX indexed, and FX denominated bonds in the domestic borrowing are high has contributed to the reduction of interest rate risk as well as exchange rate risk of banks.

Implementation Results of the Bank Capital Strengthening Program

By “Banking Sector Restructuring Program” entered into practice in May 2001, private banks, financial structures and profitability performances of which had been worsened by the effects of November and February crisis, were aimed to have a healthier structure and to reach the internationally accepted minimum capital level. According to the Provisional Article 4 added to the Banks Act Nr. 4389 through the Act Nr. 4743, 25 privately owned deposit banks under the scope of the Program went through a three stage audit and standard reports displaying the real financial status of the banks in question as of December 31, 2001 were prepared. Cash capital increases, correction of provisions set aside for non-performing loans, positive changes engendered in the market risk and valuation of securities were taken into account during the evaluations and accordingly, Vakıflar Bankası, Pamukbank and Sekerbank were determined to have had capital needs.

- As a result of the audits made, the management and supervision of Pamukbank, determined to have a capital deficit amounting to about USD 2 billion as of December 31, 2001, was transferred to the Savings Deposit Insurance Fund by the Resolution of the Banking Regulation and Supervision Board dated June 18, 2002 Nr. 742 and according to paragraphs (3) and (4) of Article 14 of the Banks

Act Nr. 4389. Due to the fact that Pamukbank has been transferred to the Fund, persons directly or indirectly holding 10% or more shares in Pamukbank and besides these, directly or indirectly holding 10% or more shares in Yapi ve Kredi Bankasi, lost the fit and proper criteria required by the the Banks Act. Accordingly, partnership rights, other than dividend, of these persons in Yapi ve Kredi Bankasi was started to be exercised by the Fund according to Article 8, paragraph 2/c of the Banks Act. Currently, partnership right of 36.84 % of Yapi ve Kredi Bankasi has been exercised by the Savings Deposit Insurance Fund.

- Sekerbank's capital need was determined to be TL 28.897 billion and in the extraordinary general assembly dated 08.07.2002, the Bank's capital was first decreased to TL 45.282 billion from TL 100 trillion in accordance with the mandatory provision of the Act, and then increased to TL 76 trillion with the increase to be covered in cash by shareholders. The capital increase process was finalized as of September.
- Vakiflar Bankasi, which was determined to be having capital deficit, demanded subordinated loan in the amount enough to reach at 9% capital adequacy ratio. It was found appropriate to allocate subordinated loan amounting to TL 213.344 billion to the Bank by the Savings Deposit Insurance Fund upon the Resolution of the Banking Regulation and Supervision Board dated August 08, 2002 Nr.774 . Necessary procedures regarding the loan were completed by August 26, 2002.

Restructuring of Debts to Financial Sector (Istanbul Approach)

With the Act Nr. 4743, restructuring of debts to financial sector, aiming to help private sector companies which became insolvent due to financial crises continue to operate and re-gain solvency, was provisional. Accordingly, restructuring of bank's receivables or tying them to a new redemption plan became possible, in accordance with the "Financial Restructuring Framework Agreements" and through tying these agreements to "Financial Restructuring Contracts" within three years as from the date of their approval by the BRSA and through providing additional finance to debtors if necessary.

Within the framework of the legislation introduced for restructuring of debts to the financial sector, Financial Restructuring Framework Agreement issued by the Banks Association of Turkey (BAT) was submitted to the creditor firms on May 24, 2002 with a view to be signed. The Agreement was signed by 25 banks, 17 financial institutions, Emlak Bankasi under liquidation process and the SDIF and was approved by the BRSA on June 4, 2002. The BAT completed "Application Form" and "Letter of Commitment" to be signed by debtor firms and sent them to banks and other financial institutions that have already signed the Framework Agreement. Also, "Report on Working Principles and Procedures of Arbitration Council" was completed and Turkiye Sinai Kalkinma Bankasi was charged with the task of "Coordination Secretariat".

**Creditor Institutions which have Signed the
Financial Restructuring Program Framework Agreement**

Banks			
1.	Türkiye Cumhuriyeti Ziraat Bankası	14.	Türk Dış Ticaret Bankası
2.	Türkiye Halk Bankası	15.	Türk Ekonomi Bankası
3.	Türkiye Vakıflar Bankası	16.	Türkiye Garanti Bankası
4.	Akbank	17.	Türkiye İmar Bankası
5.	Denizbank	18.	Türkiye İş Bankası
6.	Fiba Bank	19.	Yapı ve Kredi Bankası
7.	Finans Bank	20.	Toprakbank
8.	Milli Aydın Bankası	21.	Türk Ticaret Bankası
9.	Oyak Bank	22.	Türk Eximbank
10.	Pamukbank	23.	Türkiye Kalkınma Bankası
11.	Sekerbank	24.	Nürol Yatırım Bankası
12.	Tekfenbank	25.	Bayindirbank
13.	Tekstil Bankası		

Non-Bank Financial Institutions			
1.	Garanti Factoring	10.	Garanti Leasing
2.	Aktif Leasing	11.	Vakıf Leasing
3.	Ulus Factoring	12.	Albaraka Türk Special Finance Inst.
4.	İs Genel Leasing	13.	Yapı Kredi Factoring
5.	İmar Leasing	14.	Finans Leasing
6.	Vakıf Deniz Leasing	15.	Finans Deniz Leasing
7.	Ziraat Leasing	16.	Dis Ticaret Leasing
8.	Yapı Kredi Leasing	17.	Dis Ticaret Factoring
9.	Asya Finans Special Finance Inst.		

Other	
1.	Emlak Bankası under Liquidation Process
2.	Savings Deposit Insurance Fund

41 small-scale and a total of 128 large-scale companies⁷ belonging to 17 groups have been taken under the scope of restructuring as of October 2002. Amount of debt belonging to small-scale companies brought under the scope of restructuring has been about USD 299 million, while the amount for large-scale companies have been about USD 2,5 billion. Furthermore, the total signed contract amount has reached to USD 406 million, with USD 210 million belonging to small-scale companies and USD 197 million belonging to large-scale companies, as of October 2002. Given that the evaluation period for debtor companies under the scope of Financial Restructuring Framework Agreement is 90 days, number of signed restructuring agreements are expected to increase in the coming days.

Table 31: Companies and Debts Covered By Financial Restructuring

-As of October 2002-	Total Application		Signed FRA	
	Number	USD Million	Number	USD Million
Number of Large-Scale Companies	(17 Groups) 128	2.554,0	(2 Groups) 16	196,5
Number of Small-Scale Companies	41	298,7	12	209,2
Total Number of Companies	169	2.852,7	28	405,7

Source: Türkiye Smaî Kalkınma Bankası

⁷ Companies are basically separated into two different groups regarding their scales under the scope of Financial Restructuring Framework Agreement. The criteria for the “large-scale” companies in the first group have been determined as follows: number of registered employees of the company must be over 100, annual export volume of the company must be over USD 15 million, annual turnover thereof must be over TL 25 trillion and audited balance sheet size thereof must be over TL 15 trillion. Companies out of this classification are assessed as medium and small-scale companies.

When the geographical distribution of 28 companies signed financial restructuring agreements (FRA) as of October 2002 are examined, it is seen that 9 of them are operating in Aegean region, 7 are in Marmara region, 5 are in Black Sea region, 4 are in Central Anatolia and 3 are in East and Southeast Anatolia regions. When applications are examined, Marmara region becomes the leading region with 88 companies.

Table 32: Geographical Distribution of the Companies (Number)

	Application	Signed FRA		
		Large	Small	Total
- Marmara	88	3	4	7
- Aegean	24	7	2	9
- Mediterranean	6	-	-	-
- Central Anatolia	30	4	-	4
- Black Sea	6	1	4	5
- Eastern Anatolia	8	1	-	1
- Southeastern Anatolia	7	-	2	2
Total	169	16	12	28

Source: Türkiye Smaı Kalkınma Bankası

When sectoral distribution of 169 firms which applied for financial restructuring agreement is examined, it is seen that highest number of applicants have been 23 and 22 from textile and textile products sector and food and animal products sector respectively. These are followed by other manufacturing industry and metal products and processed metal industry sectors with 12 applicants for each. With respect to the highest number of agreements signed by sector, it is seen that 9 firms in cement and ready mixed concrete sector (2 large-scale and 7 small-scale) and 6 firms in textile and textile products sector (5 large-scale and 1 small-scale) signed the agreement.

Table 33: Sectoral Distribution of the Companies (Number)

	Application	Signed FRA		
		Large	Small	Total
- Food and Animal Products	22	-	-	-
- Management Activities of Holding Companies	9	2	-	2
- Construction	9	2	1	3
- Foreign Trade Capital Companies	6	-	-	-
- Tourism and Entertainment	9	-	-	-
- Leasing, Intermediation and Other Financial Services	6	-	-	-
- Metal Products and Processed Metal	12	1	-	1
- Packing, Paper and Card Board Products	7	2	1	3
- Wholesale Trade	9	2	-	2
- Retail Trade	9	-	-	-
- Textile and Textile Products	23	5	1	6
- Ship and Boat Construction	1	-	-	-
- Cement, Ready Mixed Concrete Production	9	2	7	9
- Motor Vehicle Parts and Accessories	3	-	-	-
- Transportation, Storing and Communication	10	-	-	-
- Plastic Goods Production	4	-	-	-
- Ceramic Floor and Wall Tile Production	4	-	-	-
- Electronic and Home Appliances	2	-	-	-
- Road Transportation	3	-	1	1
- Other Production and Management Activities	12	-	1	1
Total	169	16	12	28

December 31, 2000 data are taken as basis in determining the basic activity indicators of firms which are under the coverage of financial restructuring. Accordingly, number of employees in firms under the scope of financial restructuring has been 22.081 as of end-October. 5.063 of these employees were in small-scale firms and 17.018 of

them in large-scale firms. Total asset volume of these firms has been TL 2,6 quadrillion and overall sales amounted to nearly TL 1,1 quadrillion. Besides, total export volume of these firms have been approximately USD 455 million.

Table 34: Activity Statistics Regarding the Companies Taken under the Financial Restructuring Program (*)

	Total as of October 2002
a) Large-Scale Companies	
Total Employment	17.018
Total Export Volume (USD Million)	392
Total Turnover Volume (TL Trillion)	913
Total Assets (TL Trillion)	2.138
b) Small- Scale Companies	
Total Employment	5.063
Total Export Volume (USD Million)	63
Total Turnover Volume (TL Trillion)	199
Total Assets (TL Trillion)	438
Total	
Total Employment	22.081
Total Export Volume (USD Million)	455
Total Turnover Volume (TL Trillion)	1.111
Total Assets (TL Trillion)	2.577

Source: Industrial Development Bank of Turkey, BAT

(*)Data as of December 31, 2000.

Establishment of Asset Management Companies

Within the framework of the Act Nr. 4743 which entered into force on January 31, 2002, establishment of Asset Management Companies (AMC) was encouraged by providing some tax facilities in order to resolve the past-due loans and mobilize bank assets. Within the framework of the Act, it is possible for the SDIF to participate into AMCs with 20% stake at the maximum.

By the “Regulation on Establishment and Operations of Asset Management Companies” published in the Official Gazette dated October 1, 2002, conditions that AMCs to be established shall bear, qualifications required for founders and managers, operation fields and principles and procedures on the audit and disclosure have been all settled. Thus, the legal infrastructure has been already established.

Together with the finalization of the legal infrastructure, the SDIF also initiated feasibility studies for AMC establishment and has announced to public the action plan concerning the issue. The activities are still continuing.

Encouraging Mergers and Acquisitions

- Tax incentives have been introduced in order to facilitate mergers and acquisitions of banks and subsidiaries and, by contribution of these incentives, an increase in mergers and acquisitions has been observed. On the other hand, recently, applications concerning the merger of non-bank financial institutions with banks reach the BRSA but as the procedures concerning the issue have not been finalized yet, evaluations are still continuing.

Table 35: Developments Concerning Mergers and Acquisitions in the Banking Sector

Banks Subjected to Merger and Acquisition		New Bank	Explanation
Osmanli Bankasi	Korfezbank	Osmanli Bankasi	On August 31, 2002 Birlesik Turk Korfez Bankasi A.S. has been transferred to Osmanli Bankasi A.S. with all its rights, receivables, debts and obligations upon termination of its legal entity.
Garanti Bankasi	Osmanli Bankasi	Garanti Bankasi	Osmanli Bankasi has been transferred to Garanti Bankasi as of December 14, 2001.
HSBC Bank Plc.	Demirbank	HSBC Bank Plc.	Demirbank has been transferred to HSBC Bank A.S. as of December 14, 2001.
Tekfen Yatirim	Bank Ekspres	Tekfen Bank A.S.	The transfer of Bank Ekspres to Tekfen Bank A.S. has been finalized on October 26, 2001 and its title has changed as Tekfenbank A.S. as of the transfer date.
Oyak Bank	Sumerbank	Oyak Bank	The sale of Sumerbank has been finalized on January 11, 2001 and the bank has started to operate under the name of Oyakbank A.S.
Morgan Guaranty	The Chase Manhattan	JPMorgan Chase & Co	The merger of the two banks has been registered on December 14, 2001.
Sinai Yatirim Bankasi	T. Sinai Kalkinma Bankasi	T. Sinai Kalkinma Bankasi A.S.	Sinai Yatirim Bankasi has been transferred to T. Sinai Kalkinma Bankasi on March 29, 2002

Establishment of Internal Control and Risk Management Systems

Important developments on the establishment and improvement of corporate governance and risk culture have been experienced with the “Regulation on Internal Control and Risk Management Systems of Banks” published and entered into force on February 8, 2001. Within this framework, the importance of the establishment of efficient internal audit and risk management systems has been realized by all banks in the sector and the regulatory amendments necessary to activate the system and the work on forming the organizational structure have been almost finalized. On the other hand, work for establishing the risk management system on a consolidated basis continues in many private banks.

Performance Evaluation for January-June 2002 Period of 25 Banks Covered by the Bank Capital Strengthening Program

- The **total asset size** of banks covered by the program has increased by 14,7% from TL 102,2 quadrillion (USD 71 billion) in end-2001 to TL 117,2 quadrillion (USD 73,1 billion) in the first half of 2002.
- The most prominent increase in assets in the first half of 2002 has been realized in securities portfolio with TL 10,7 quadrillion. The fact that repo transactions were commenced to be covered within the balance sheet since February 2002 have been a contributing factor in this development. The share of **Securities Portfolio** within total assets increased from 27,7% in end-2001 to 33,4% in June 2002.

Table 36: Balance Sheet of Banks Covered by the Program

	TL Trillion		USD Billion	
	December 2001	June 2002	December 2001	June 2002
Liquid Assets	1.707	1.083	1.185	675
Banks	11.242	8.833	7.810	5.511
Interbank Money Market	6.828	6.805	4.743	4.246
Securities Portfolio	12.429	16.919	8.634	10.557
Fixed Securities	15.914	22.174	11.055	13.835
Loans	24.045	29.654	16.703	18.502
Receivables under Follow-Up (Net)	5.244	4.810	3.642	3.001
Total Assets	102.158	117.155	70.965	73.097
Deposits	72.752	80.485	50.537	50.218
Foreign Loans Received	11.308	12.812	7.855	7.994
Own Funds	10.570	12.189	7.342	7.605

Note: The table provides inflation-corrected balance sheet data of the 25 banks covered by the Bank Capital Strengthening Program.

- **Loan** portfolio has increased from TL 24 quadrillion (USD 16,7 billion) in end 2001 to TL 29,7 quadrillion (USD 18,5 billion) in June 2002 and its share in total assets increased from 23,5% to 25,3 %. New loan extensions had an effect on the increase in the loan portfolio. The ratio of deposits to loans increased from 31,3% in December 2001 to 32% in June 2002.
- **Receivables under follow-up** (gross) slightly declined from TL 7,907 trillion in December 2001 to 7,877 in June 2002. The fact that no increase has been experienced in the loans under follow-up in the first half of the year in an environment where the effects of the economic stagnation still continued is actually observed as a positive development. On the other and, the increase in the number of large size firms to be evaluated within the scope of the Istanbul Approach will result in the restructuring of part of the problem loans which will mean a reduction in the outstanding balance in the medium term.
- **Transformation ratio of the loans to follow-up** (loans under follow-up/ loans (gross)) declined from 24,7% at end-2001 to 21% in June 2002. At the first half of 2002, the special provisions set aside by banks for the loans under follow-up increased by 15,2%, the ratio of provisions set aside for the loans under follow-up increased from 33,7% in December 2001 to 38,9% in June 2002.
- **Deposits** increased from TL 72,8 quadrillion (USD 50,5 billion) in end-2001 to TL 80,5 quadrillion (USD 50,2 billion) in June 2002. Savings deposits constituting 16% of the total deposits increased by 3,6% when compared to year-end, while foreign exchange accounts constituting 67% of the total deposits decreased by 2,1% in real terms. As of June 2002 deposits of commercial establishments constituted 8,5%, and bank deposits constituted 4,2% of total deposits. 64,4% of savings deposits and 63% of foreign exchange accounts were held at 4 big banks.
- **Loans from foreign banks** which amounted to USD 7,855 billion as of end 2001 increased to 7,994 in June 2002. A sum of USD 900 billion equivalent syndicated loans was utilized at the first half of year 2002. Syndicated loans to be repaid until May 2003 amount to USD 2,4 billion.
- **Off-balance sheet transactions** increased from TL 61,3 quadrillion as of end-2001 to TL 67,9 quadrillion in June 2002. Transactions related to foreign exchange and interest rates decreased from TL 24,8 quadrillion as of end-2001 to

TL 19,6 quadrillion in June 2002 due to some banks which have reduced the futures transactions they make, especially with their own groups. The almost 100% increase in commitments resulted mainly from credit card limit commitments, revocable credit appropriation commitments and the increase in deposited values.

Table 37: Main Items Concerning Off-Balance Sheet Transactions

(TL Trillion)	December 2001	June 2002
Guarantees and Suretyships	28.152	32.214
Commitments	8.384	16.097
Transactions on Foreign Exchange and Interest Rates	24.781	19.591
TOTAL	61.317	67.902

- Banks within the scope of the program have generated profits amounting to TL 516 trillion (USD 322 million) in the first half of 2002. Within this period 17 banks declared TL 744 trillion term profit and 8 banks declared TL 228 trillion term loss. In the first half of 2002 the most important income item was the interest income on securities which constituted 45,9% of total interest income and the most important expense item was the interest paid to deposits which constituted 84,3% of interest expenses. TL 1,574 trillion of the non-interest expenses which amounted to TL 2.945 trillion was from net foreign exchange losses and TL 598 trillion of it was provisions set aside for receivables under follow-up. Profit amounting to TL 740 trillion was generated from capital market transactions.

Table 38: Profit/Loss Statements of the Banks Covered by the Program

	TL Trillion		USD Billion	
	Dec. 2001	June 2002	Dec. 2001	June 2002
Interest Income	25.362	10.216	17.618	6.374
Interest Expense	15.959	6.690	11.086	4.174
Net Interest Income	9.402	3.526	6.531	2.200
Non-Interest Income	4.131	1.904	2.870	1.188
Non-Interest Expense	8.800	4.015	6.113	2.505
Net Non-Interest Income	-4.668	-2.110	-3.243	-1.317
Other Non-Interest Income	-6.531	-835	-4.537	-521
Net Monetary Position Profit /Loss	-1.949	-75	-1.354	-47
Net Profit/Loss	-3.941	516	-2.738	322

- Own funds of the banks within the scope of the program increased from TL 10,570 trillion in end-2001 to TL 12,189 trillion in June 2002. The capital adequacy ratios of the banks in subject was 15,8% as of June 2002.

Table 39: Own Funds of the Banks Covered by the Program

(TL Trillion)	December 2001	June 2002
Paid-Up Capital	5.248	5.420
Reserves	3.802	4.269
Inflation Reserves	10.719	12.633
Revaluation Differences	1.430	1.191
Period Losses	-4.133	-228
Past Year Losses	-6.743	-12.113
Period Profit	192	744
Past Year Profits	55	271
OWN FUNDS	10.570	12.189

3.4 Strengthening the Framework of Surveillance and Supervision and Increasing the Efficiency in the Sector

In parallel to the financial and operational restructuring of the banking sector, necessary legislations and institutional arrangements are being adopted. These efforts aim to strengthen regulatory and supervisory framework, ensure efficiency and competitiveness in banking sector, facilitate sound banking practices and thus establish confidence in the sector.

Prudential regulations are concentrated on the following areas: capital adequacy, risk management, loan exposures, loan loss provisioning, compliance with the 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” was introduced in compliance with EU Directives and subjecting the calculation of lending limits and standard ratios on a consolidated basis to this definition was ensured. Regarding the excessive limits that may arise within this framework, a transition period until December 31, 2003 was granted to the banks.
- “Regulation on Measurement and Assessment of Banks Capital Adequacy” that defines principles and procedures for the calculation of banks’ CAR both on consolidated and unconsolidated basis by taking into consideration market risks- namely interest rate, exchange rate and equity risks- was published on February 10, 2001. This regulation has been null and void as of January 31, 2002 with the enforcement of a new regulation under the same title which draws up additional regulations on capital adequacy. The new regulation brings forth following amendments:
 - A provision concerning the publication by banks of the capital adequacy ratio in each March, June, September and December starting from June 2002 was added.
 - A provision authorizing the Agency to establish a ratio above the determined minimum capital adequacy ratio for each bank or bank group, by taking the adequacy of the internal audit and risk management systems of the banks into account was introduced.
 - Principles and procedures regarding the measurement of risks and capital adequacy issues related to banks’ option operations were defined.
 - Additions were made to the standards of the risk measurement models.
 - The table showing risk weights was re-arranged to comply with the inclusion of the repo transactions in the balance sheet and items of the securities portfolio included in the calculation of the market risk were dropped from the table.
 - A “Structural Position” definition was introduced to prevent erosion of banks’ own funds from steep price and foreign exchange rate movements. Principles and procedures regarding the structural positions to be taken into consideration in the calculation of CAR were published on May 08, 2002

- In accordance with the provisional Article 1 of the Regulation, the application of market risks on a consolidated basis in the calculation of capital adequacy was initiated on July 01, 2002.
- Principles and procedures for the inclusion of Tier 3 Capital, as defined by the regulation, in the calculation of capital adequacy were published on March 8, 2002.
- With the amendments to the Regulation on Banks' Establishment and Operations on January 31, 2002, definition of own funds was changed, and addition of general loan loss provisions to Tier 2 capital without netting out was introduced. Additionally, equity participations to all financial institutions were included in the items to be deducted from the capital. As a result of these changes, a single own fund definition has been set for the system, providing uniformity both in the calculation of credit limitations and in the application of financial ratios.
- On the other hand, taking into account the needs for evaluating the structures of off-shore banking activities along with their connections with the parent company, bringing these issues under regulation and supervision and having access to accurate information about these issues, "Regulation on Amendments to be made to the Regulation on Banks' Establishment and Operations" was published on July 9, 2002. Besides, with the "Regulation on the Amendment made to the Regulation on Banks' Establishment and Operations" published on October 23, 2002, some provisions were amended with a view to facilitating implementation and ensuring flexibility.

Regulations on Risk Management

- With the "Regulation on Banks' Internal Audit and Risk Management Systems" put into force on February 8, 2001, principles and procedures of establishing an efficient internal auditing system and an efficient risk management system to manage the risks to be encountered were set out. Following the efficient operating of the afore-mentioned systems and within the framework of this regulation, risk-focused monitoring of the banking system on an activity-basis is intended. As of July 2001, banks started to report their activities and organizational preparations according to the regulation on a quarterly basis. These reports are evaluated regularly and monitored closely.
- "Regulation on Principles and Procedures about the Implementation of the Foreign Exchange Net Position/Own Funds Standard Ratio for Banks on both Consolidated and Unconsolidated Basis" was published on January 31, 2002. With this regulation, compliance with the amendments to own funds and consolidated own funds definitions was provided. Also, the practice of treating the part of net general open positions exceeding the required level as commitment in the application of liquidity requirement was annulled.
- Draft communiqué Nr.1 has been issued with a view to determining the principles for "Regulation on Bank's Internal Audit and Risk Management Systems" and ensuring clarification about internal auditing practices. The communiqué in question will be published following the evaluation of the opinions submitted by banks on the draft communiqué. With this Communiqué, the following issues have been determined in a detailed manner: control and examination activities to be performed by banks in accordance with the

provisions of the related regulation and practices to be realized in these fields; duties and responsibilities of Board of Inspectors, Internal Control Center and Risk Management; auditing of subsidiaries by the mother company bank; auditing committees to be optionally formed by banks; and principles and procedures for filling in the “Risk Matrix” presented in the Annex of the Regulation. Fundamental principles for the processes and controls to be realized for lending, purchase-sale, asset-liability management and liquidity management activities will be presented in the Annex of the Communiqué.

- Also prepared was draft “Circular Regarding the Evaluation of Risk Measurement Models of Banks by the Agency” which sets out the principles and procedures for evaluating the risk measurement models to be used in risk measurement by banks and for granting permission to their use. The Circular will be published following the evaluation of opinions taken from banks about the draft. Besides, work on netting of reverse positions in purchase-sale accounts of banks in capital requirement calculations have been continuing.

Regulations on Lending and Subsidiary Limits and Loan Loss Provisioning

- With the introduction of “Regulation on Establishment and Operations of Banks” on June 27, 2001, risk group definition and calculation of loan exposures for a single group considering direct and connected lending were established in order to prevent (credit) risk concentration. This regulation, which includes banks’ shareholders and subsidiaries in the same risk group, will prevent risk concentration on a particular group and improve the asset structure of the banking sector in accordance with the safety, resolution and productivity principles. Banks, total loans of which extended to a risk group exceed the required levels stipulated in the Banks Act, shall not extend further loans to natural persons and legal entities included in this risk group. Besides, banks are required to gradually remove the amounts exceeding the required levels by end-2006.
- With the amendments made to Banks Act by Act No.4672;
 - Banks’ non-financial subsidiaries are limited to 15% of their own funds and the total sum of all such subsidiaries are limited to 60% of the banks’ own funds 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”.
 - Corporate tax deductibility of specific provisions is clarified.
- With the amendment made by Act No.4743 on January 31, 2002, the four-year transition period granted to banks for loan loss provisioning was eliminated.
- Regulation on Loan Loss Provisioning was introduced on June 30, 2001. Provisions of this regulation regarding the principles and procedures of restructuring of loans and other receivables or of tying them to a new redemption plan were amended on January 31, 2002 and a circular for the enforcement thereof was published. With this circular, the issues on classification of loans and other receivables, principles for collaterals and provisioning and whether non-deposit money banks are subject to provisions of the regulation, have been clarified. With the amendments made to the regulation, existing practice on

restructuring of loans and other receivables was revised in order to introduce flexibilities which improve the efficiency of regulations on restructuring debts to financial sector through providing additional loans or implementing new redemption plans for these debts.

Regulations on Accounting Standards, Independent Audit and Mergers and Acquisitions

- In order to ensure accounting of repo and reverse-repo transactions be compliant with the International Accounting Standards and in accordance with the “priority of the core” principle of accounting required for a sound monitoring of banking risks, amendments were made to “Accounting Standards, Uniform Accounting Plan and Explanations Thereof to be Implemented by Banks” on December 13, 2001 and January 31, 2002 taking effect as of February 01, 2002.
- In accordance with Article 13 of the Banks Act, “Regulation on Accounting Practices”, along with its annexes, was introduced on June 21, 2002. It prevents transactions from being unrecorded and ensures transparency and uniformity in banks’ accounts and records, sound and reliable accounting of activities in accord with their essential characteristics; timely and accurate preparation of financial statements; independent auditing; and reporting and publication of these statements. With this regulation, which entered into force as of July 01, 2002, compliance of the banks’ 2002 year-end balance sheets with International Accounting Standards (IAS) have been targeted. Besides, with the Regulation which amended the Regulation on Accounting Practices published on October 2002, provisions drawn up in the Regulation on Banks’ Establishment and Operations were transferred to the Regulation on Accounting Practices and points of confusion existed in practice were clarified.
- “Regulation on Principles for Independent Auditing” was published on January 31, 2002. It sets out the principles and procedures for audit by independent institutions of compliance of accounts and records of the banks and special finance institutions covered by the Act No.4389 with the legislation on accounting and recording plan which was put into force pursuant to aforementioned Act’s Article 13 and for approval of balance sheets, profit/loss statements and consolidated financial statements to be published within the framework of audit results. With this regulation, principles and procedures to be employed in independent audits were re-arranged in compliance with international auditing standards and in a more detailed manner.
- “Regulation on Authorization of Audit Institutions and Permanent or Temporary Withdrawal of Their Authorization”, which sets out the authorization of the independent auditing institutions that can approve the balance sheets and profit/loss statements of banks along with special finance institutions and draws up permanent or temporary withdrawal of their authorizations, was published on January 31, 2002. Provisional Article 2 of this Regulation was abrogated by the Regulation published on March 29, 2002.
- “Regulation on the Preparation and Publication of Interim Financial Statements of Private Deposit-Money Banks” was published on March 29, 2002. This Regulation aimed at laying down the principles and procedures for the preparation and publication of the interim financial statements to be prepared between 01.01.2002 and 01.07.2002 by the private deposit-money banks which are under the scope of the provisional Article 4 of the Banks Act No. 4389.

- “Regulation on Mergers and Acquisitions of Banks” which was issued by the BRSA and published on June 27, 2001, sets out the principles and procedures for the merger of a bank operating in Turkey with a bank or several banks; or for acquisition of its all debts, receivables and deposits by a bank operating in Turkey. Article 20 of this Regulation was amended on September 14, 2001. With the Regulation published on October 5, 2002, Article 18 of the “Regulation on Mergers and Acquisitions of Banks” regarding facilities provided for merged banks over reserve requirements and savings deposit insurance premium payments was amended.

Regulation issued Within the Framework of Bank Capital Strengthening Program

- “Regulation on Principles and Procedures of Banking Sector Restructuring Program” dated February 01, 2002 draws up the details of the capital support program to be realized under the scope of the restructuring program. The Regulation lays down the principles and procedures of the recapitalization scheme designed for the private owned deposit-taking banks established in Turkey. In compliance with Provisional Article 4 of the Banks Act No. 4389, the Regulation stipulates principles, procedures, and other details on the following issues: The general assembly to be held by banks; increasing or decreasing of the banks’ capital; measures that need to be taken based on assessments of the Banking Regulation and Supervision Agency; transfer period for shares which are subject to the capital increase; issuance of convertible bonds and conversion of these bonds into shares; sale of banks’ shares taken over by the Savings Deposit Insurance Fund; and conversion of subordinated debts to capital.
- “Regulation on Principles and Procedures of Independent Audit to Be Carried Out in Banks According to Provisional Article 4 of the Banks Act No. 4389” was published on February 01, 2002. Articles on inflation accounting and some other articles of this Regulation were amended on 02.03.2002 and articles on the scope of auditing activity to be carried out by the first institution were amended on March 29, 2002.
- “Regulation on Principles and Procedures of Second Independent Audit to Be Carried Out in Banks According to Provisional Article 4 of the Banks Act No. 4389” was published on March 27, 2002. It sets out; the principles and procedures for auditing of independent audit reports drawn up pursuant to "Regulation No. 4389, Concerning the Principles and Procedures of Independent Auditing to be Carried Out in Banks according to Provisional Article 4 of the Banks Act No. 4389" by a second independent audit institution for purposes of ensuring compliance with the independent audit rules and procedures and principles concerning determination of the second independent audit institutions by the Agency. Article 5 of this Regulation regarding determination of the second institution was amended on March 29, 2002.
- “Regulation on General Conditions for the Approval and Implementation of Financial Restructuring Framework Agreements” was published on April 11, 2002.
- With the Regulation published on June 13, 2002 Article 9 of “Regulation on General Conditions for Approval, Acceptance and Implementation of Financial Restructuring Framework Agreements” was amended. This regulation establishes;

- provisions to be set aside for loans which have been taken under the scope of financial restructuring framework and for which financial restructuring contracts have been signed with debtors and,
- principles and procedures for classification of these loans.

- “Regulation on Principles and Procedures for Establishment and Operations of Asset Management Companies” was published on October 1, 2002. The Regulation sets out the principles and procedures for establishment and operations of asset management companies, which will operate with a view to purchasing receivables and other assets of banks, special finance institutions and other financial institutions and re-selling them by restructuring.

Regulations Pertaining Special Finance Institutions

- In accordance with the Act No.4672, Association of Special Finance Institutions of Turkey was established. With a view to protect deposits in Special Finance Institutions, the Association has been authorized to establish “Assurance Fund” and to determine the principles and procedures for operating of the Fund.
- “Regulation on Establishment and Operations of Special Finance Institutions” was published on September 20, 2001. The definitions entitled “own funds” and “consolidated own funds” and some articles were amended on March 07, 2002.
- “The Status of Special Finance Institutions Association” was put into force by the Decree No.2001/3138 of Council of Ministers dated October 26, 2001.

Memorandum of Understandings Signed between Supervisory Authorities of Foreign Countries and the BRSA

- The soundness of Turkish banks’ operations carried out through their foreign subsidiaries, branches and representative offices closely influence the stability and the safety of Turkey’s financial markets as well as that of host countries. In this respect, it is important to set up an institutional framework on an international basis which will allow evaluation of cross-border operations’ nature and their links with the parent company, to have access to accurate information so as to ensure the regulation and supervision of these operations and to facilitate cooperation between countries on supervision and monitoring.
- Accordingly, memorandum of understandings are signed with supervisory authorities of the other countries. With the enhanced mutual cooperation, supervision and due diligence are performed on off-shore banks established by banks or by their majority shareholders. Along these lines, 13 banks and a subsidiary in Bahrain-Manama, Luxembourg and Malta and a subsidiary bank in Holland were supervised on-site and assessments were finalized. Besides, on-site supervision of some off-shore banks belonging to Turkish banks operating in Cyprus were done.

- Within the scope of mutual cooperation with supervisory authorities of other countries, the BRSA signed Memorandum of Understanding (MoU) with the Central Bank of the Republic of Northern Cyprus, the Central Bank of Albania and National Bank of Romania on September 17, 2001, October 19, 2001 and February 19, 2002 respectively while a number of other countries are under way.

Other Regulations for Increasing Efficiency of the Sector

- By the amendment to the Banks Act, provisions of the Turkish Commercial Code No. 6762 and provided that the ratio of total assets of banks, which are to be acquired or merged, to aggregate assets in the sector does not exceed twenty percent, the provisions of the Consumer Protection Act No. 4054 shall not apply to mergers and acquisitions with a view to accelerate the merger and acquisition processes.
- Tax incentives have been introduced with a view to facilitate the mergers and acquisitions of banks and their subsidiaries. Besides, the Act No.4603 which allows the application of tax incentives stated in the Act No.4605 for the mergers of banks' subsidiaries entered into force on July 3, 2001.
- Upon the Decree dated July 27, 2001 of the Council of Ministers, differentiation in withholding tax rates on repo and TL as well as F/X deposit interest earnings according to their maturities was introduced. Within this framework, withholding rates on TL deposit accounts were brought down to; %14 for maturities from 3 to 6 months, %10 for from 6 to 12 months and %6 for those exceeding 12 months. Withholding rates on F/X deposit accounts did not change for those maturities exceeding one year, but the rates on the accounts with a less than one year maturity were raised from %16 to %18. Withholding rates on repos were raised from %16 to %20.
- On August 8, 2001, the Central Bank of the Republic of Turkey initiated the practice of paying interest on required reserves set aside for deposits so as to reduce resource costs of banks.
- The Central Bank changed the implementation of reserve and liquidity requirements on March 29, 2002 with a view to contribute to lowering of financial intermediation costs and to provide liquidity management with a more flexible structure. Within this framework, reserve and liquidity requirement ratios were reduced by a total of 2 points and interest payment on F/X denominated required reserves was decided to be introduced.
- Besides, stamp duty on forward contracts have been removed and stock market transaction costs have been reduced.

**Publications Concerning the
Banking Sector Restructuring Program:**

Name	Date
Banking Sector restructuring Program	May 15, 2001
Banking Sector Reform: Progress Report-I	August 2, 2001
The SDIF Banks: Performance and Evaluation Report	August 24, 2001
Banking Sector Restructuring Program: Action Plan	September 25, 2001
Banking Sector restructuring Program : Progress Report –II	November 8, 2001
Banking Sector restructuring Program: Progress Report -III	February 6, 2002
Banking Sector restructuring Program: Progress Report -IV	July 23, 2002
Banking Sector restructuring Program: Progress Report -V	November 2002
Bank Capital Strengthening Program	January 11, 2002
Bank Capital Strengthening Program – Introduction Guide	February 20, 2002
Bank Capital Strengthening Program – Progress Report	June 21, 2002

Note: All of the publications are available in full text at the web site of the BRSA.

www.bddk.org.tr

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