CENTRAL BANK OF THE REPUBLIC OF TURKEY

G-20 Workshop on Securing Sustainable Economic Recovery

M. İbrahim Turhan
Deputy Governor

November 2009
Seoul, KOREA

Pre-2001 Crisis Environment

- High chronic inflation — 75% on the average between 1990-2001 period
- High and extremely volatile nominal and real interest rates — close to 100% and 30% respectively
- Volatile exchange rates, an exchange rate based stabilization program that caused real appreciation of TRL
- High and growing overall fiscal deficit, 15% of GNP in 1998, 24% in 1999, 20% in 2000, 17% in 2001
- Large and growing public debt – over 100% in 2001
- Excessive overnight borrowing requirement of the state-owned banks that prevented the attainment of the equilibrium level in interest rates and limited the effectiveness of monetary policy
- Significant short FX position in banking system balance sheets

Pre-2001 Crisis Environment

Regulatory and Institutional Framework

- Fragmented banking regulation and supervision authority—lack of focus, coordination and responsibility
- Lack of independence for bank regulation and supervision
- Insufficient prudential regulations
- Extremely weak enforcement, widespread regulatory forbearance
- Deficient accounting and auditing practices, lack of transparency

Banking Crises in Turkey 1994 - 2001

Turkey experienced a decade of banking crises between 1994-2003 and a high number of banks had to leave the banking sector with different exit processes.

In that period, a number of banks had their licenses cancelled and were put into liquidation, while some others were transferred to SDIF to be resolved.

Hand Over Date	Number of Banks	Total Assets (USD millions)	Deposits (USD millions)	Market Share (Total Assets)	Market Share (Deposits)	Number of Depositors
1994	3	3.050	2.165	%4,1	%6,7	55.137
1997	1	1.745	1.446	%1,86	%2,38	1.028.677
1998	1	826	487	%0,70	%0,63	91.061
2000-2001	**18**	**25.456**	**19.101**	**19,07%**	**21,75%**	**6.871.177**
2002	1	6.661	4.924	%5,16	%5,99	993.893
2003	1	5.935	6.059	%3,44	%5,49	398.568
Total	**25**	**43.586**	**34.155**	**%34,31**	**%42,89**	**9.429.245**

Rehabilitation of the State Owned Banks

- Restructuring for better risk management
- Assignment of a Common Board of Directors for state owned Banks
- Injection of capital by Treasury through the sale of bills and bonds to the Central Bank of Turkey to compensate the "Duty Losses"
- Actions to limit further such losses in the future by law
- State owned banks achieved competitive and profitable operations as a result of the measures taken

Role of Savings Deposit Insurance Fund

Total take over of the troubled Banks by SDIF to address "Moral Hazard" problem

- SDIF asked bank owners to pay back the misused funds and bank owners failed to fulfill their obligations
- SDIF took ownership of failed banks' shares in return of public funds transferred to the banks
- A Common Board of Directors was assigned for the taken over Banks
- SDIF resolved the banks through merger of banks, sale of banks, branches, assets and liabilities separately
- SDIF took the left-over assets into its own balance sheet

SDIF Mandate for Resolution

Empowering SDIF

- To use the stricter law developed for public claims –stronger than the ordinary legal framework- to cover losses of failed banks caused due to misused funds
- To have the authority of rescheduling of debts with any debtor
- To take over the shares of affiliated subsidaries, in addition to bank itself, due to their default of payment and to appoint new management to subsidaries
- To offer special discount programs in order to accelerate collection processes
- To sell non-performing loan portfolios to third parties
- To sell the assets of the company including all business contracts and client base in the form of an economic unity rather than the shares of the company

Cost of Crisis Resolution

- Capital injected by SDIF to the taken over Banks for their capital needs to restore their balance sheets
- Treasury have incurred the cost of the operation through the sale of bills and bonds to the Central Bank of Turkey
- The cost of liqudification was almost 35% of the GDP
- An action plan and calendar was set up for the sales of assets in order to cover the obligations of the taken over Banks

Strengthening of the Private Banks

- Strengthening of the capital adequacy ratio
- Sale of assets and subsidiaries
- Mergers to eliminate weaker banks
- Cost cutting measures
- Restructuring of the non-performing loans
- Adoption of the new Banking Law that limits excessive risk taking severely due to personal responsibility to bank owners and managers

Policy Implications and Suggestions

- Empirical evidences support what theory suggests: We cannot neglect the moral hazard risk posed by systemically important financial institutions (SIFI)

  * The nature of the financial system (e.g. interconnectedness), the fact that financial stability is a public good and the need to protect confidence do not permit to wait-and-see type policy inaction, policy makers can never let SIFIs to go bankrupt

  * Shareholders and managers already know this fact

- It is very difficult to impose size restrictions to prevent the formation of SIFIs

- Risk of time inconsistency problem is very high

Policy Implications and Suggestions

- Stricter leverage limit and capital adequacy requirements
  → financial stability premium
- Progressive reserve requirement ratio on liabilities, reaching 100% after a critical treshold → insolvency risk premium
- Public fund (other than the general SDIF) based on specific fees paid by SIFIs to safeguard the required financial support when liquidification of a SIFI is necessary → oversize premium
- Pre-announced immediate liquidification plan (similar to collective action clauses)
- Personal liability of controlling shareholders and managers
- Legal separation of depository banking and investment banking activities (Glass-Steagall)

CENTRAL BANK OF THE REPUBLIC OF TURKEY

G-20 Workshop on Securing Sustainable Economic Recovery

M. İbrahim Turhan
Deputy Governor

November 2009
Seoul, KOREA