SECTION II

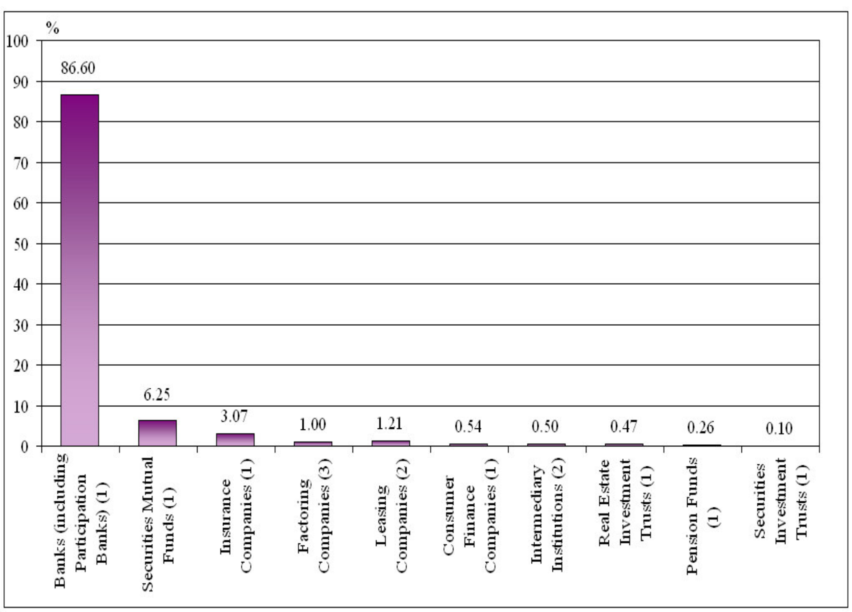
GENERAL STRUCTURE OF THE FINANCIAL SECTOR

As was the case in 2004, the Turkish financial sector has shown a stable course of growth in line with the favorable conditions of the Turkish economy throughout 2005. While decreasing inflation, economic growth and positive expectations have had an effect on the growth of the financial sector, the interest of foreign investors in the banking sector has continued by way of purchases and the establishment of strategic partnerships.

Turkish financial sector maintained its significant progress in 2005.

The Turkish banking sector is composed of deposit banks, development and investment banks and participation banks that operate according to the profit/loss sharing principle.

Chart II.1
Balance Sheet Size of the Financial Sector[1]



Source: BRSA-CBRT, Treasury, CMB, Turkish Capital Market Intermediary Institutions
(1) As of December 2005, (2) As of September 2005, (3) As of June 2005.

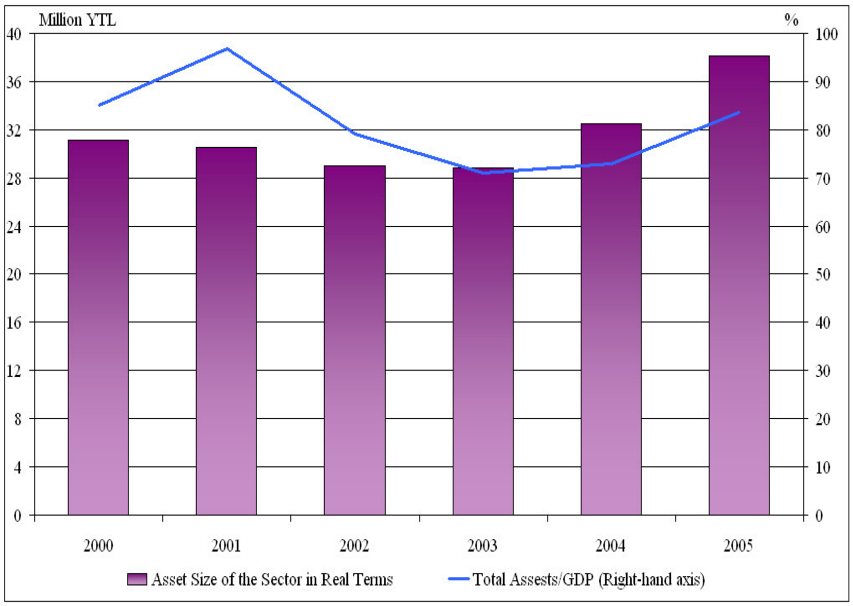
About 86.6 percent of total assets of the financial sector consists of bank assets.

Total asset size of the Turkish financial sector amounted to 469.9 billion New Turkish Liras in 2005 and about 87 percent of total financial sector assets are composed of bank assets. In other words, banks dominate the Turkish financial system, followed by mutual funds and the insurance sector (Chart II.1).

II.1.Banking Sector

Total asset size to GDP ratio of Turkish banking sector has been increasing.

Chart II.1.1
Development of Banking Sector[1,2]



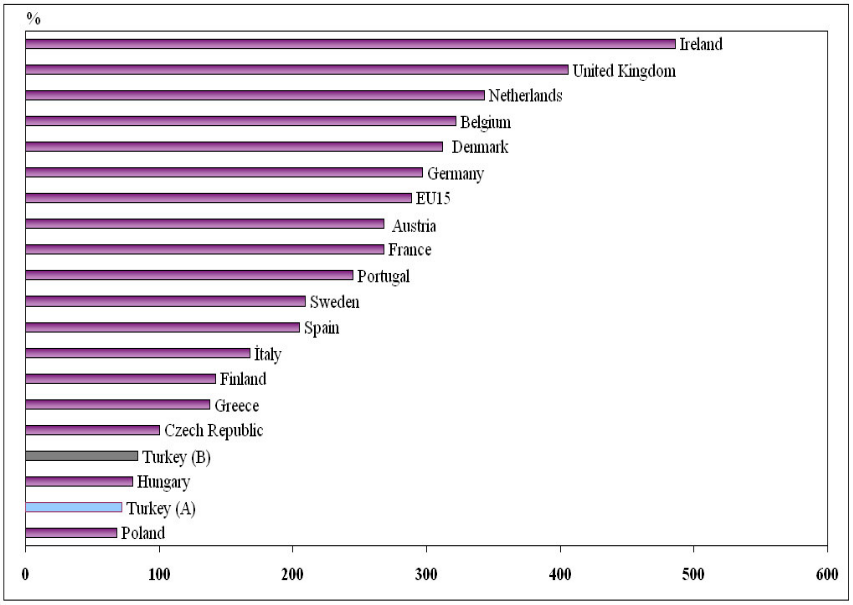
Source: BRSA-CBRT

[1] Asset size of the banking sector is expressed in real terms by using the "1994=100 CPI"

[2] Participation banks are included.

The total asset size of the banking sector increased by 29.7 percent compared to the previous year and reached 406.9 billion New Turkish Liras in 2005. In real terms, total assets of the sector increased by 17.2 percent in the same period (Chart II.1.1). In USD terms, the total asset size of the financial sector reached 303.3 billion USD from 233.8 billion USD in the same period.

Chart II.1.2
Comparison of the Turkish Banking Sector Asset Size/GDP Ratio with Selected EU Countries[1]



Source: TURKSTAT, BRSA-CBRT, ECB Report - 2005

[1] Turkey (A) shows the data of 2004 including participation banks; Turkey (B) shows the data of 2005 including participation banks. For EU members, the data of 2004 is used.

While the asset size of the Turkish banking sector to GDP ratio was realized as 73 percent in 2004, it reached 84 percent in 2005. When this ratio is compared with new EU countries, it is observed that it is higher than Hungary and Poland and lower than the Czech Republic and other EU members. (Chart II.1.2). This result shows that the Turkish banking sector is developing from year to year although this development is still well under the EU15.

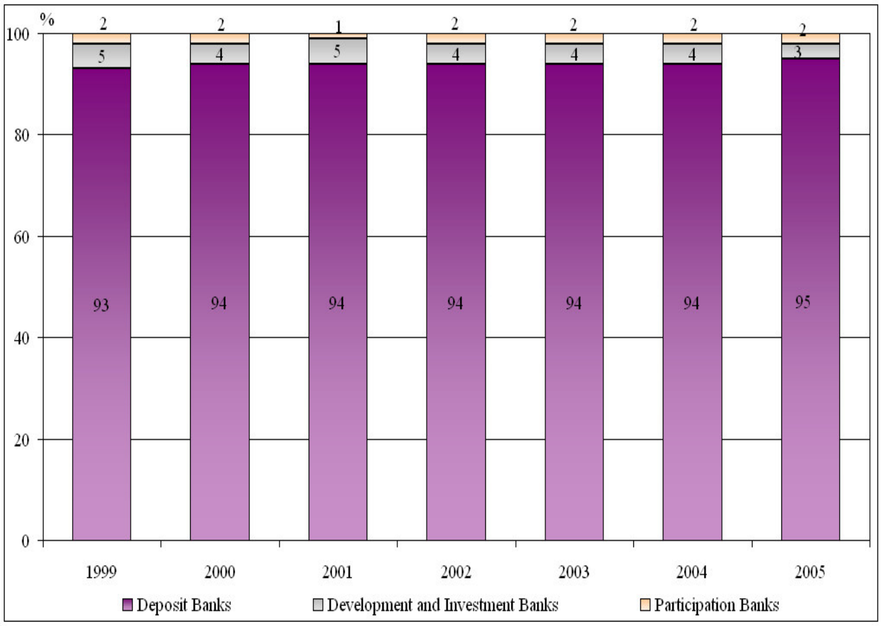
Table II.1.1
Comparison Of Selected Balance Sheet Items with Selected EU Countries[1, 2]

Countries	Deposits / GDP (%)	Loans / GDP (%)	Loans / Deposits (%)	Loans / Total Assets (%)	Total Assets / Number of Banks (Million Euro)
Belgium	143	107	75	33	8,792
Denmark	63	166	264	53	3,005
Germany	113	136	120	46	3,065
Greece	96	76	80	55	3,717
Spain	104	121	116	59	4,963
France	77	93	121	35	4,922
Ireland	123	176	144	36	9,032
Italy	58	88	152	52	2,892
Luxembourg	859	467	54	17	4,291
Netherlands	122	174	142	51	3,639
Austria	98	125	128	45	821
Portugal	103	138	134	56	1,753
Finland	53	69	130	49	585
Sweden	51	115	224	55	2,750
UK	118	142	121	35	16,877
EU15 Ave.	**99**	**122**	**124**	**42**	**3,956**
EU25 Ave.	**96**	**118**	**123**	**42**	**3,464**
Turkey					
2004	**46**	**24**	**53**	**33**	**3,241**
2005	**52**	**32**	**63**	**39**	**5,026**

Source: BRSA-CBRT, ECB Report - 2005
[1]Data of EU countries shown is as of 2004. For EU members data of "credit institutions", for Turkey data of "banks" is used.
2 Participation banks are included for Turkey. In this regard, deposits include participation funds and loans include funds extended by participation banks.

Total loans and total deposits to GDP ratios, which are good indicators of financial depth and the level of intermediation in the system, are below the averages of EU countries in 2004 and 2005, however, the Turkish banking sector continues to demonstrate progress (Table II.1.1).

Chart II.1.3
Distribution of Banking Sector Assets by Groups[1]

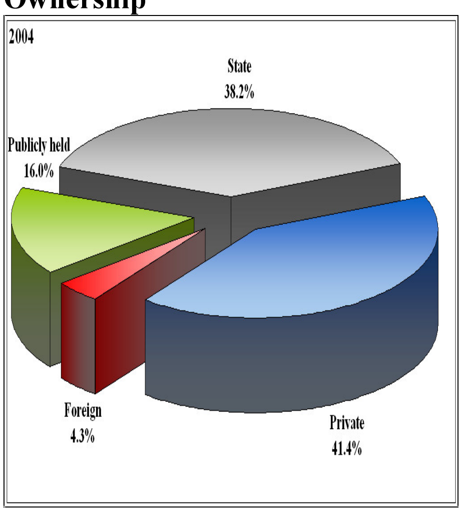


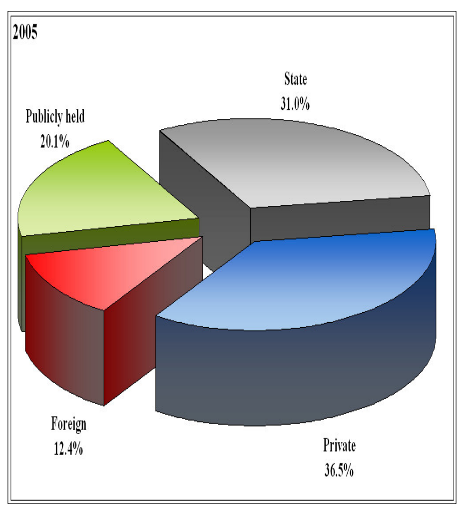
Source: BRSA-CBRT
[1] Deposit banks consist of all foreign, domestic, or state owned banks that collect deposits.

Turkish banking sector is dominated by deposit banks.

As of December 2005, of the 51 banks operating in the Turkish banking sector, 34 are deposit banks, 13 are development and investment banks and 4 are participation banks. The Turkish banking sector is dominated by deposit banks with a share of about 95 percent (Chart II.1.3).

Chart II.1.4
Distribution of Turkish Banking Sector Assets According to Equity Ownership[1]





[1] For publicly held shares, it was not possible to make a distinction between Turkish and foreign investors due to their changing structure.

As of year-end 2005, when compared to the previous year, the share of state-owned and private equity in total assets of the Turkish banking system had decreased, whereas foreign and publicly held equity had increased.

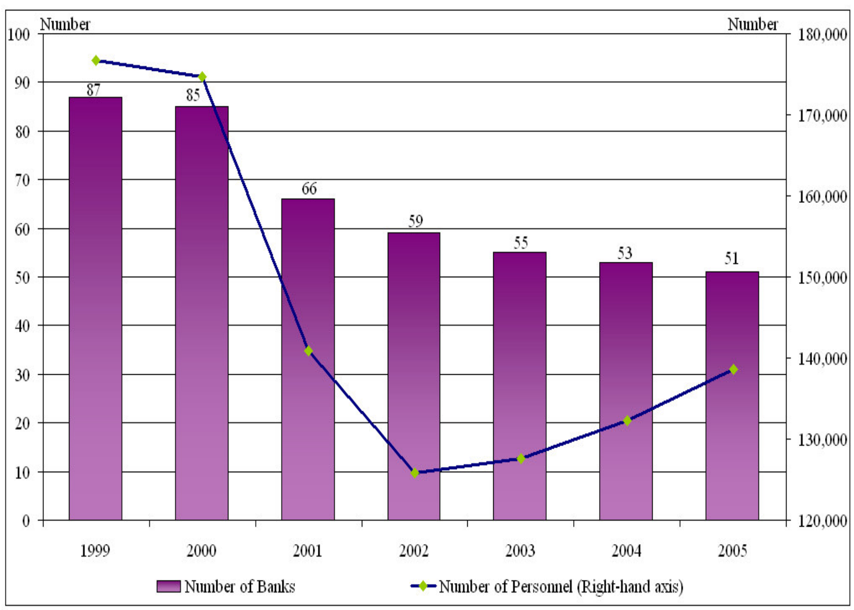
Box.II.1.1. Development of Foreign Equity in the Turkish Banking Sector

The interest of foreign investors in the Turkish banking sector has continued in 2006. If the shares declared to be sold to foreigners of Tekfenbank, Finansbank, Bank Pozitif and Denizbank, the share transfer processes of which have started in 2006 but have not yet been legally terminated, are included, the foreign equity in the sector well exceeds 16 percent.

In parallel to the EU membership perspective and macro economic stability, the interest of foreign investors in the banking sector is expected to continue in the near future.

Number of banks that operate in the sector decreased to 51 in 2005.

Chart II.1.5
Number of Banks and Personnel[1]



Source: BRSA-CBRT
[1] Participation banks are included.

The number of banks in the sector decreased to 51 as a result of the transfer of Ak Uluslararası Bank to Akbank and merger of Family Finans Kurumu and Anadolu Finans Kurumu under the name Turkiye Finans Katılım Bank, whereas branches and personnel increased in number in the said year. As of December 2005, the number of personnel increased by 6.331 and reached 138.657 (Chart II.1.5).

Table II.1.2
Comparison with EU[1]

Countries	The Share of the Largest 5 Credit Institutions (%)	Number of Credit Institutions	Total Number of Branches	Total Number of Personnel	Personnel per Branch	Branch per Credit Institutions	Banking Sector Personnel to Total Population (%)
Belgium	84	104	4,837	71,334	15	47	0.7
Denmark	67	202	2,021	43,877	22	10	0.8
Germany	22	2,148	45,505	712,300	16	21	0.9
Greece	65	62	3,403	59,337	17	55	0.5
Spain	42	346	40,621	246,006	6	117	0.6
France	45	897	26,370	-	-	29	-
Ireland	44	80	909	35,564	39	11	0.9
Italy	26	787	30,946	336,979	11	39	0.6
Luxembourg	30	162	253	22,549	89	2	5.0
Netherlands	84	461	3,649	115,283	32	8	0.7
Austria	44	796	4,360	72,858	17	5	0.9
Portugal	67	197	5,006	52,757	11	25	0.1
Finland	83	363	1,585	25,377	16	4	0.5
Sweden	54	212	2,034	39,181	19	10	0.4
UK	35	413	14,001	511,455	37	34	0.9
EU15 Ave.	**53**	**482**	**12,367**	**167,490**	**13**	**26**	**0.6**
EU25 Ave.	**59**	**335**	**7,984**	**122,301**	**15**	**24**	**0.7**
Turkey							
2004	**58**	**53**	**6,407**	**132,326**	**21**	**121**	**0.2**
2005	**61**	**51**	**6,564**	**138,657**	**21**	**129**	**0.2**

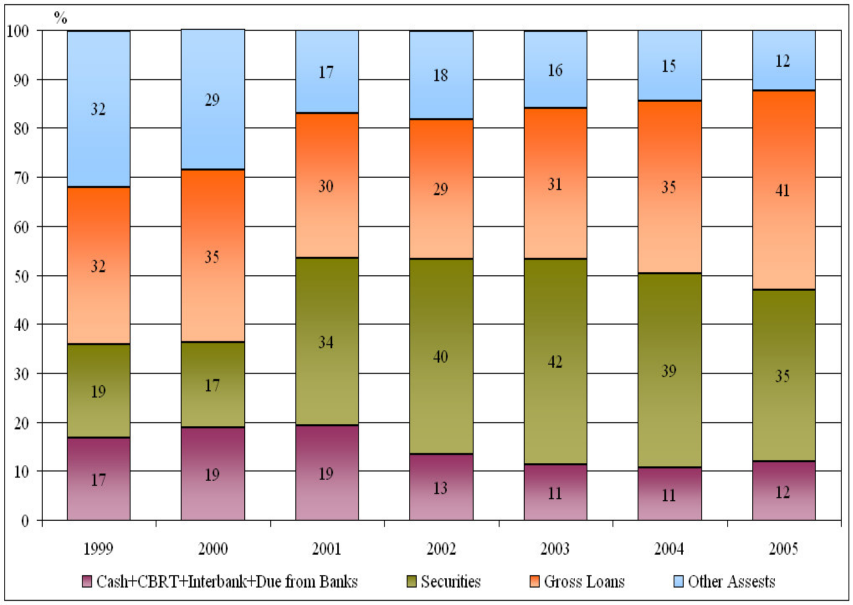
Source: BRSA-CBRT, Eurostat, ECB Report - 2005

[1] Data of EU countries shown are as of 2004. In EU countries, the definition of "credit institution" may differ and non-bank financial institutions may be included in the definition of credit institutions in some cases. The data for Turkey contains participation banks.

The number of banks and branches of the Turkish banking sector is under EU15 and EU25 averages, whereas the number of personnel is above the AB25 but under the AB15 average. The proportion of the number of personnel of the Turkish banking sector to the population is lower than all EU countries. However, as a result of intense branch banking in Turkey, the branch number per bank is much higher than the EU. The number of personnel per branch is also higher than EU15 and EU25 averages (Table II.1.2).

When the asset size concentration of the Turkish banking sector is compared with the EU, it is observed that the asset share of the largest five banks is higher than the EU15 and EU25 averages. (Table II.1.2).

Chart II.1.6
Asset Structure of the Banking Sector[1]



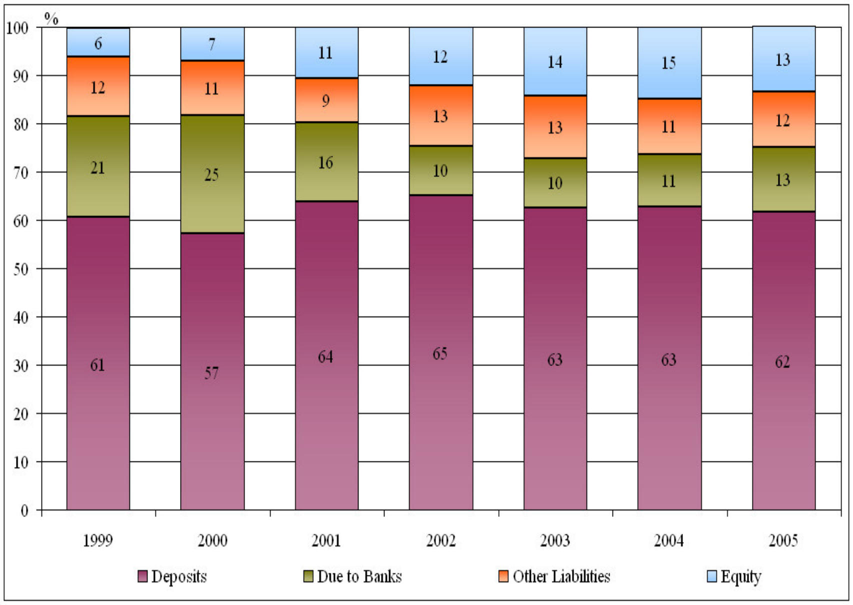
Source: BRSA-CBRT
[1] Participation banks are included.

As of December 2005, share of loan portfolio in the total assets increased to 41 percent.

Due to the Government Debt Securities given to banks during the restructuring process following the crises, securities had become the largest asset item. However, in 2005, compared to the previous year, its share declined by 4 points, to 35 percent, due to the more rapid increase in the loan portfolio (Chart II.1.6).

In line with the positive developments in macroeconomic indicators and positive expectations of the markets, the share of loan portfolio in total assets increased to 41 percent and the loan portfolio became the largest asset item. Increased private banking services and consumer credits played a significant role in the increase of the credit volume (Chart II.1.6).

Chart II.1.7
Liability Structure of the Banking Sector[1]



Source: BRSA-CBRT
[1] Participation banks are included.

In 2005, the share of own funds in total liabilities is 13 percent. The share of deposits in total liabilities is 62 percent with a 1-point decrease when compared to the previous year, while the share of due to banks in total liabilities increased by 2 points and stood at 13 percent. (Chart II.1.7).

Box.II.1.2. Important Changes Introduced by Banking Law No: 5411

Some important changes introduced by Banking Law No: 5411, which was adopted on October 19, 2005 and has been in effect since November 1, 2005, are as follows:

- Financial holding companies are covered in the Law and the BRSA was authorized regarding the establishment, regulation and supervision of financial leasing, factoring and consumer finance companies.
- The name of special finance houses was changed to participation banks.
- Operational fields of banks are clearly defined compatible with European Union legislation.
- In cases where a threat of systemic risk is identified, the Council of Ministers is authorized to determine the measures to be taken.
- The process of restructuring and strengthening the financial conditions of, transferring, merging or selling banks that have been transferred to the Saving Deposits Insurance Fund shall be completed within a maximum of nine months following the transfer date. This period may be extended for a maximum of three months by an SDIF Board resolution.

- Within the adoption process to European Union legislation, founders of banks should be honest and competent, revocal of the establishment and operating permission should be declared with the reason behind it, in case a legal person is the founder of a bank, the partnership structure is required to be clear and transparent.
- The risk group is defined in the Law and the ratio of total amount of loans to be extended to a risk group to equity is reduced to twenty percent.
- The Financial Sector Commission, consisting of the representatives of relevant institutions, is established under the BRSA. The commission shall make policy suggestions, deliver opinions and ensure cooperation among institutions.
- Banks calculate, achieve, perpetuate and report the minimum liquidity level in accordance with the principles and procedures to be set by the Board of BRSA, upon the approval of the CBRT.
- To facilitate the audit and monitoring functions of the Board of Directors, an Audit Committee, which consists of a minimum of two members appointed from among the members of the Board, shall be employed.
- Reporting systems of banks have been made a component of corporate governance and in order to provide effective control of the top management, the directors responsible for reporting are required to be determined.
- With an intention to protect financial conditions of banks, no resources shall be transferred for financing the deficits of the funds and foundations established by banks exclusively for their employees with a view to provide health, social aid, retirement and saving services. Their right-holders shall be transferred to the Social Security Agency within three years and liabilities shall be paid by relevant institutions within a maximum period of 15 years.

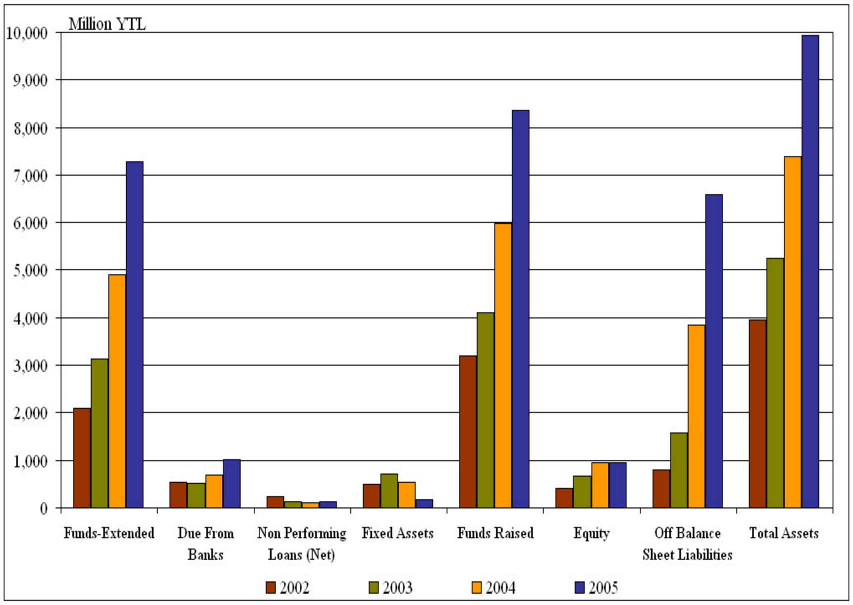
II.2.Participation Banks

Box.II.2.1.Participation Banks

Special Finance Houses, which have been operating in Turkey since 1985, were first put under the coverage of the Banks Act by Law No: 4491 dated 19.12.1999. They were defined as banks under Banking Law No: 5411 dated 19.10.2005, and were called "Participation Banks". Since the beginning of 2005, they have their own uniform chart of accounts in line with their operations. They are subject to the same legal framework as banks, excluding the provisions for fund collection and distribution.

In the same way as Islamic banks, which operate according to the profit and loss sharing principle all over the world, participation banks in Turkey collect funds through special current accounts and profit/loss participation accounts and they distribute these funds by way of financial leasing, financial support for production, profit and loss participation, and trade financing.

Chart II.2.1
Selected Balance Sheet Items of Participation Banks



Sorce:BRSA-CBRT

Total asset size of participation banks, which was 7.4 billion New Turkish Liras at end-2004, increased by 34.7 percent and was realized as 9.9 billion New Turkish Liras in December 2005. As of December 2005, 77 percent of total assets and 58 percent of total liabilities of participation banks was denominated in domestic currency (Chart II.2.1).

The share of funds-extended in total assets increased by 48.5 percent when compared with the previous year and reached 7.3 billion New Turkish Liras as of December 2005. While the share of funds-extended was 66 percent in total assets in 2004, it reached 77 percent at end-2005 (Chart II.2.1).

Table II.2.1
Participation Funds Raised

	Special Current Accounts			Participation Accounts			Total Funds		
Million USD	YTL	FX	Total	YTL	FX	Total	YTL	FX	Total
December 2002	149	503	652	271	2,279	2,550	420	2,782	3,202
June 2003	147	500	647	427	2,131	2,558	574	2,631	3,205
December 2003	277	665	942	851	2,319	3,170	1,128	2,984	4,112
June 2004	371	634	1,005	1,610	2,434	4,044	1,981	3,068	5,049
December 2004	476	822	1,298	1,786	2,908	4,694	2,262	3,730	5,992
June 2005	585	815	1,400	2,648	2,780	5,428	3,233	3,595	6,828
December 2005	1,009	952	1,961	3,432	2,976	6,408	4,441	3,928	8,369

Source: BRSA-CBRT

For participation banks, the main source of funds, other than equity, come from participation funds collected through special current accounts and profit/loss participation accounts, which increased by 39.7 percent compared to the previous year and was realized as 8.4 billion New Turkish Liras as of December 2005. The share of participation accounts in participation funds was 76.4 percent and the rest came from special current accounts at end-2005. While the share of foreign currency denominated funds in total liabilities was 62 percent in 2004, it declined to 47 percent in 2005. (Table II.2.1).

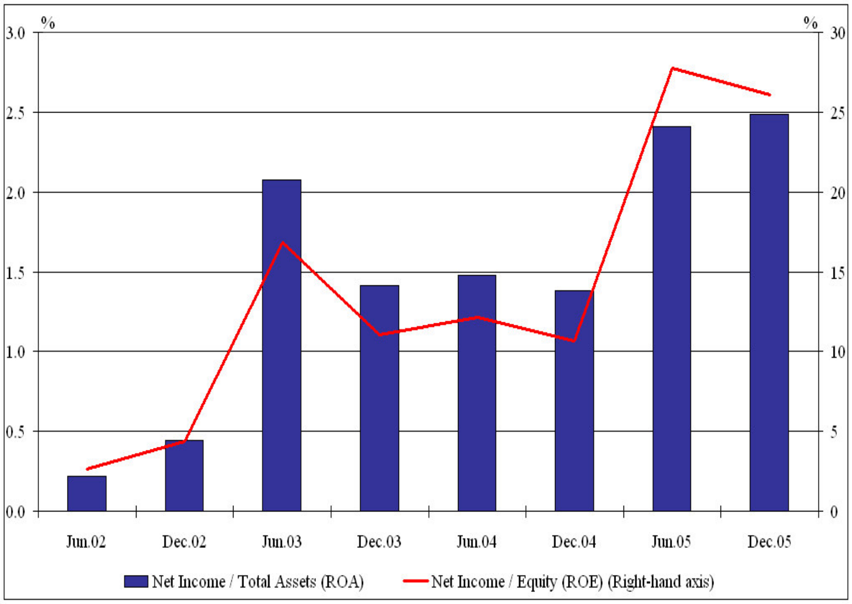
Table II.2.2
Equity of Participation Banks

Million YTL	2002	2003	2004	2005
Total Equity	**400**	**672**	**956**	**951**
Paid-Up Capital	286	420	723	816
Reserve Funds	11	12	72	212
Revaluation Fund of Fixed Assets	123	202	4	1
Profit/Loss of the Period	17	74	102	250
Previous Year Losses or Profits	-38	-37	56	-328

Source: BRSA-CBRT

While equity was 956 million New Turkish Liras at year-end 2004, it declined to 951 million New Turkish Liras by end-2005, as a result of an increase in the previous year's losses. This is due to a change in the accounting system for participation banks.

Chart II.2.2
Return on Equity and Return on Assets of Participation Banks



Source: BRSA-CBRT

Positive profitability performance of participation banks has further improved in 2005.

In 2005 the profitability performance of participation banks further improved. While their profit was 102 million New Turkish Liras at end-2004, it increased by 145 percent and reached 250 million New Turkish Liras as of December 2005. In line with this development, the return on equity and return on assets of participation banks increased dramatically. (Chart II.2.2).

II.3.Insurance, Reinsurance and Private Pension Companies

Table II.3.1.General Information About the Insurance Sector

	2004	2005
Total Number of Firms	50	46
- Insurance	47	45
- Reinsurance	3	1
Insurance Companies According to Capital Structure		
- Public	2	2
- Private	40	38
- Foreign	5	5
Insurance Companies According to Their Activities		
- Life Insurance	9	9
- Life/Pension Insurance	10	10
- Pension Insurance	1	1
- Mixed (Life/Non-Life Insurance)	12	11
- Non-Life Insurance	15	14
The Share of Largest 10 Firms in Total (%)		
- Premiums Written	65	65
- Equity	69	82
- Total Assets	64	67

Source: Treasury

As of December 2005, 45 insurance companies and one reinsurance company operate actively in the sector. Regarding the premiums written, equity and asset size, the share of the first ten companies increased compared to the previous year, further raising concentration in the sector (Table II.3.1).

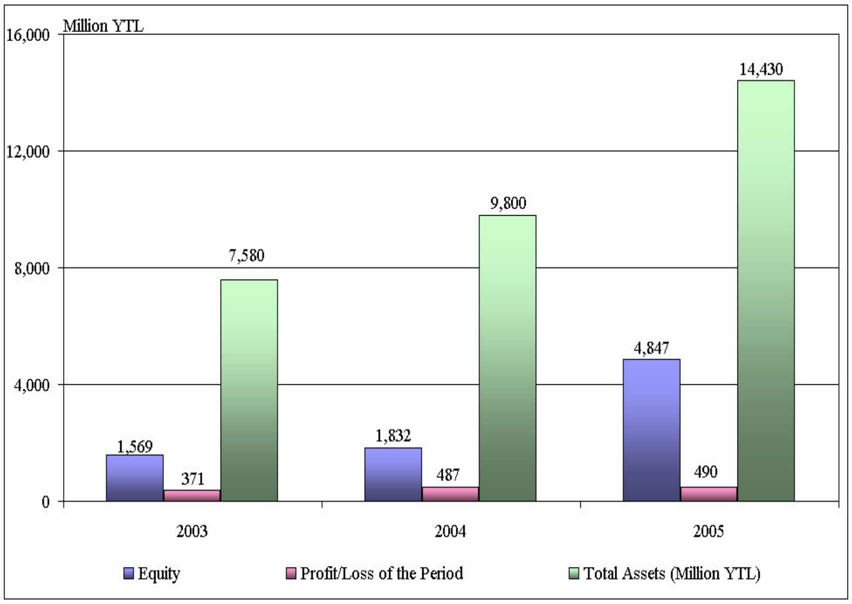
Table II.3.2
Comparison With EU Countries[1]

	Number of Insurance Firms	Number of Reinsurance Firms	Total Premiums Written (Million USD)	Premiums Written per Individual (Million USD)	Total Premiums Written to GDP (%)
UK	500	44	254,363	3,887	12.8
Netherlands	333	6	52,036	3,209	10.1
Belgium	120	-	33,088	2,787	9.4
France	411	33	161,483	2,668	9.0
Ireland	224	-	16,274	3,372	8.7
Finland	147	5	13,783	2,651	8.5
Denmark	187	9	17,119	3,183	8.1
Italy	239	10	110,575	1,911	7.5
Portugal	73	1	10,931	1,075	7.4
Germany	602	46	170,137	2,039	7.0
Sweden	167	5	21,040	2,356	7.0
Austria	50	4	14,887	1,851	5.9
Spain	351	2	46,968	1,144	5.6
Luxembourg	95	270	8,179	2,485	4.2
Greece	104	1	3,668	343	2.1
EU15 Ave.	**240**	**29**	**78,207**	**2,331**	**7.5**
Turkey					
2003	**50**	**3**	**3,330**	**47**	**1.3**
2004	**47**	**3**	**4,663**	**65**	**1.6**
2005	**45**	**1**	**5,833**	**80**	**1.6**

Source: OECD Insurance Statistics Yearbook 1994-2003, Sigma-Swiss Re-9/2000 and Treasury
[1] Data of EU countries shown is as of 2003, pension fund premiums are not included.

When the general structure of the insurance sector, premiums written per individual and premiums written to GDP ratio of the Turkish insurance sector are compared with EU countries, it is observed that the Turkish insurance sector is growing but it is still small in size (Table II.3.2).

Chart II.3.1
Assets and Equity in the Insurance Sector[1,2]



Source: Treasury
[1] Chart of Accounts for the Insurance Sector changed as of 1.1.2005.
[2] Data of reinsurance companies is not included.

While the total asset size of the insurance sector was 9.8 billion New Turkish Liras at end-2004, increasing by 47 percent, it was realized as 14.4 billion New Turkish Liras by year-end 2005. Equity of the sector increased by 165 percent in 2005 due to inflation accounting that raised capital reserves, but profit for the period remained the same (Chart II.3.1).

While the number of reinsurance companies was 3 at the end of 2004, it decreased to 1 as a result of merger and closure. In this context, asset size of the reinsurance sector, which was 619 million New Turkish Liras at the end of 2004, reached 996 million New Turkish Liras as of December 2005.

Table II.3.3
Premiums Written by the Insurance Sector[1]

(%)	2003	2004	2005
Life Insurance	21	18	16
Non-Life Insurance	79	82	84
Total Premiums Written (Million YTL)	**4,961**	**6,621**	**7,816**

Source: Treasury
[1] Pension fund premiums are not included.

The share of the life insurance field in total premiums written, which was 21 percent at the end of 2003, decreased to 16 percent as of December 2005 (Table II.3.3). This decline stems from the transfer of some life insurance premiums to the private pension system. In the non-life insurance field, accident insurance has the highest share according to the number of premiums written.

Box II.3.1.Private Pension System

The Private Pension Law No: 4632 was published in the Official Gazette on April 7, 2001 and has been in effect since 7 October 2001. The system is based on voluntary contribution plans. The purpose of the system is to increase the welfare of individuals in the retirement period and to strengthen the Turkish economy with long-term resources. It is expected that in the long-run the system will increase economic development and employment, will provide deepening in the capital markets and will contribute to a healthier financial sector.

The Undersecretariat of Treasury, Capital Markets Board, Takasbank and Pension Monitoring Center are responsible from the operations of the private pension system. In general, the Undersecretariat of Treasury regulates and supervises from the regulatory perspective while pension funds, portfolio management companies and mutual funds are regulated by the Capital Markets Board. The Pension Monitoring Center provides information to the Treasury and Capital Markets Board as supervisory authorities. The shareholders of the center are the Treasury (Group A shares) and 11 pension companies (Group B). The duty of Takasbank is to keep custody of the assets of pension funds.

Contributions collected from individuals are invested by pension companies in pension mutual funds in accordance with the framework legislation of the Capital Markets Board. These contributions are directed to fixed income investments like government securities or reverse repo transactions as well as to variable yield investments such as equities.

Table II.3.4
Basic Indicators of Private Pension System

	2003	2004	2005	Mar.06
Number of Contracts (Thousands)	17	297	705	807
Total Contribution (Million YTL)	6	239	911	1,176
Total Amount Invested (Million YTL)	6	229	1,061	1,368

Source: Pension Monitoring Center

Participation in the private pension system has been increasing rapidly. While in 2004, the number of contracts was 297 thousand and the total contribution amount was 239 million New Turkish Liras, the number of contracts reached 807 thousand and the total contribution amount reached 1,176 million New Turkish Liras by 2005. The total amount invested, which is total contributions net of administration costs and other costs, including the life insurance premiums transferred, was 229 million New Turkish Liras in 2004, and reached 1,368 million New Turkish Liras in the first quarter of 2006 (Table II.3.4).

Table II.3.5
Pension Mutual Funds

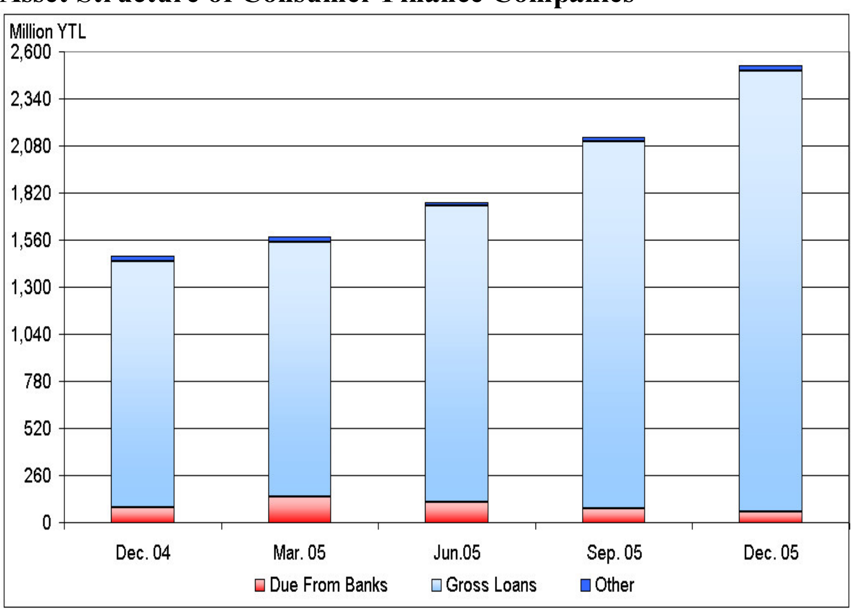
	2003	2004	2005	Mar.06
Portfolio Value (Million YTL)	42	298	1,232	1,567
Distribution of the Portfolio (%)				
Equties	8.7	13.2	11.0	11.3
Government Debt Securities	76.0	72.6	80.4	71.8
Reverse Repo	10.1	9.1	6.5	13.3
Stock Exchange Money Market	0.7	3.3	0.9	0.5
Non-Domestic Securities	4.4	1.8	0.9	0.7
Other	0.0	0.0	0.2	2.4
Average Maturity of the Portfolio (Days)	566	407	558	651

Source: CMB

The portfolio value of pension mutual funds rose sharply in 2005 and in the first quarter of 2006 and the dominant share of Government debt securities in the portfolio maintained its weight.

II.4.Consumer Finance Companies

Chart II.4.1
Asset Structure of Consumer Finance Companies



Source: CBRT

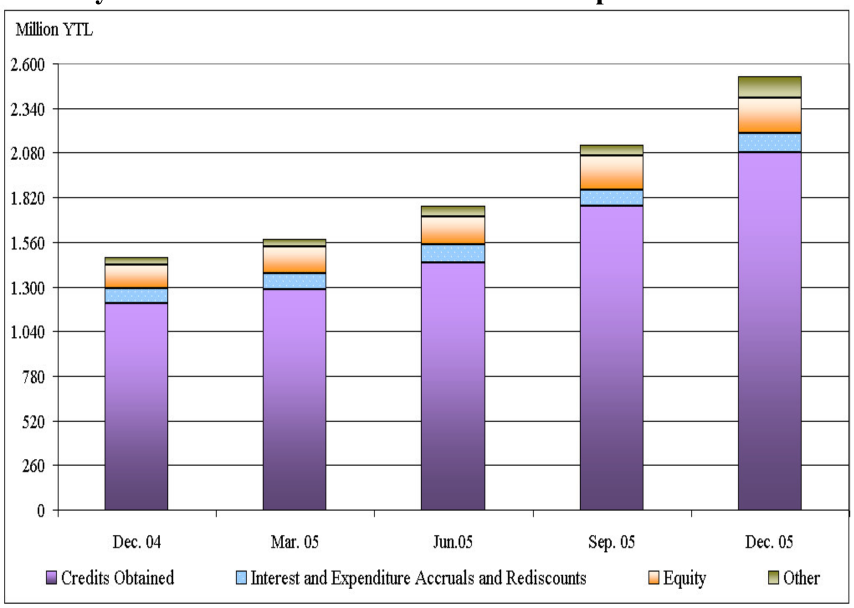
Asset size of consumer finance companies increased by 72 percent in 2005.

As of year-end 2005, nine consumer finance companies were operating in Turkey. While their asset size was 1.5 billion New Turkish liras at the end of 2004, it increased by 72 percent reaching 2.5 billion

New Turkish Liras as of December 2005. In accordance with their operational structure, gross loans hold the largest share in total assets, which was realized as 96.6 percent as of December 2005 (Chart II.4.1).

Loans provided by consumer finance companies increased by 78,7 percent, compared to the previous year and were realized as 2.4 billion New Turkish Liras by year-end 2005, which was due to the fall in interest rates and increase in consumer demand. About 72 percent of loans are retail and 28 percent are corporate.

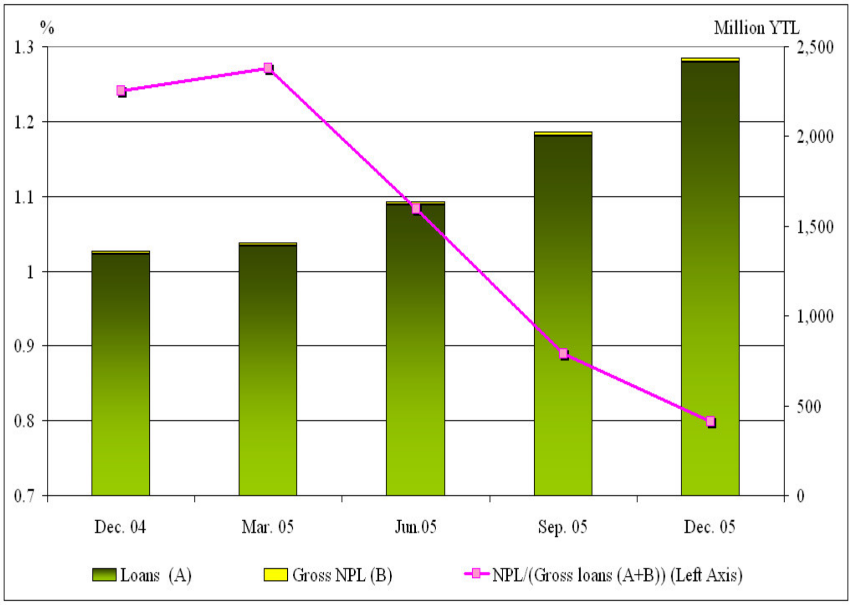
Chart II.4.2
Liability Structure of Consumer Finance Companies



Source: CBRT

The liability structure of consumer finance companies has shown growth as a result of the increase in credits obtained (Chart II.4.2). Credits obtained, constituted 82.6 percent of liabilities and 93.1 percent of this amount was borrowed from abroad.

Chart II.4.3
Non-Performing Loan Ratio of Consumer Finance Companies



Source: CBRT

Non-Performing loan ratio has been decreasing.

The NPL ratio of consumer finance companies was decreasing throughout 2005, going down to 0.8 percent at the end of 2005 from 1.2 percent in 2004. This is mainly due to the fact that loans grew faster than the NPL (Chart II.4.3).

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