



Economic and Banking Sector Reforms; Impact on Banking Sector in Turkey

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Outline

- **Environment and banking sector prior to reforms**
- **Reforms in economic policy and banking sector**
- **Outcomes of reforms**
- **Selected features of banking sector**



Operational environment prior to reforms

- Uneven growth performance
- High inflation
- High public sector deficit
- Reliance on CB financing
- Quasi-financing of budget by the state-owned banks
- Distortions created by the state
- Short-term capital flows
- Deficiencies in execution and enforcement of banking rules
- High rate of money substitution

Banking sector prior to reforms

- Rather poor function
- Small and fragmented scale
- Weak financial soundness indicators
- Negative working capital
- Subject to fx and interest rates risks
- Poor risk perception and risk management
- Rather vulnerable to shocks
- Easy licensing
- High cost of intermediation



Results

- **Sharp increase in interest rates**
- **Real depreciation of TL**
- **Contraction in GDP an uneven economic growth**
- **Erosion in capital**
- **Blanket guaranty to deposits**
- **Bank failure**
- **Weak confidence**
- **Low level of financing to private sector**



Reforms in economic policies

- Promoting private sector institutions
- Strengthening financial structure;
- Implementing tight and disinflationary policies
- Introducing business incentives to encourage institutional progress
- Conforming to best practice of financial sector rules
- Allowing private and non-resident entry to sectors
- Privatizing state-owned companies
- Improving access to capital markets

Targets

- Improving predictability and growth performance
- Sustaining fiscal, price stability
- Better functioning of market economy
- Creating competitive playing field among institutions
- Providing structure for larger and deepening of financial markets
- Integration to international economies



Reforms in banking sector

- **Building new legal and regulatory framework in line with international best practices**
- **Strengthening of banks and non-banks financial institutions**
- **Removal of interest and exchange rates restrictions**
- **Commercialization and privatization of state-owned banks**
- **Opening financial markets to greater domestic and foreign competition, increase in the level of compliance**

Targets

- **Improving confidence**
- **Sustaining financial stability**
- **Reducing cost of intermediaries**
- **Increasing funds to private sector**
- **Accessing long term international funds**



Main pillars towards stronger banking sector

- Restructuring of state owned banks
- Resolution of the failed banks
- Strengthening of private banks
- Improving the regulatory and supervisory frameworks

Restructuring of state-owned banks; why?

- Dramatically weak financials due to;
 - Uncompensated duty losses
 - Inefficient lending and investment
 - State intervention on management
 - Lack of corporate governance and risk management
 - Irrational investment decision in networking and in technology
- Insufficient preparation for strong competition
- Misfunction of intermeditation

Restructuring of state-owned banks;

- **Some banks were merged**
- **Duty losses of state-owned banks was liquidated**
- **Short-term financing needs were reduced**
- **Working capital was increased**
- **Status was converted to corporation and subject to Banking Act as well as commercial code.**
- **A rather strong board of directors was authorized to re-structure and to prepare for privatization**

Restructuring of state-owned banks

- **Better coordination among public banks**
- **Operational targets changed towards better competition and profitability**
- **Free of charged services became subject to price**
- **HR management was reshaped and number of staff was reduced**
- **Inefficient branches were closed**
- **Real estates and participations were re-priced**
- **High-tech investment supported to widen spectrum of goods and services**

Results

State-owned banks

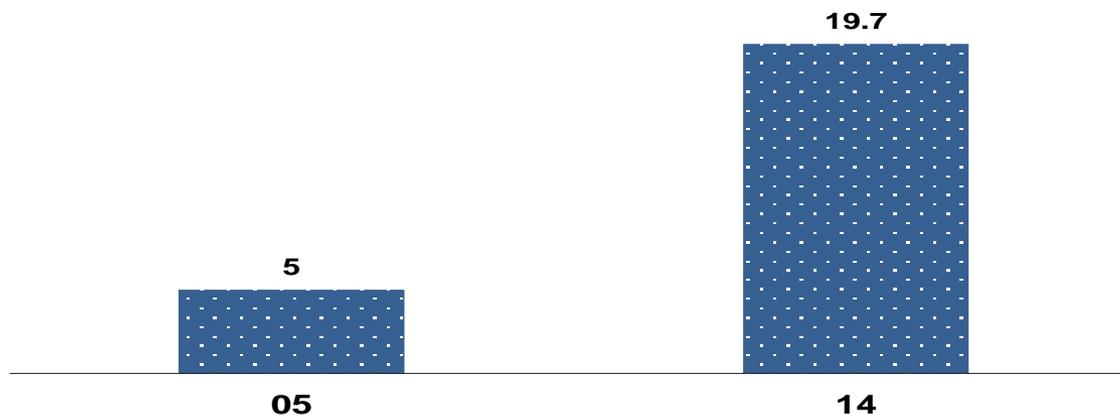
Selected ratios

%	2002	2009	2014
Loans/total assets	14	40	61
NPLs (before special provisions)/loans	79	5	3
Special provisions for loans/NPLs	69	87	78
Loans/deposits	20	56	107
Permanent assets/total assets	15	4	4
Shareholders' equity/total assets	8	10	11
Free capital/total assets	-7	5	13
Average ROE (annual)	-2	31	15
Average ROA (annual)	0	3	2

State-owned banks

Shares in the sector %	2002	2014
Securities portfolio	51	36
Loans	20	27
Total assets	36	28
Deposits	39	30
Non-deposit funds	33	28
Shareholders' equity	24	26
Net profits	-3	33

Free float of state-owned banks (%)



Resolution of failed banks

- Financially weak 22 banks were transferred to Saving Deposit Insurance Funds (SDIF).
- Short-term obligations of these banks were met.
- Some banks taken over by the SDIF was merged, one was transferred to state-owned bank and some others were sold to existing or new investors after restructuring.
- Rather strong and special articles was included in Banking Act for faster collection of due from previous ownerships and borrowers

Strengthening of private banks

- Tree-step audit were exercised in order ensure transparency and full capitalization
- Shareholders capital was increased.
- Bad assets were fully provisioned before restructured via Istanbul Approach, a voluntary programme or sold to asset management companies.
- Tax incentives were introduced for mergers and take over.

Improving the regulatory and supervisory frameworks

- **Banking Regulation and Supervision Agency, an autonomous authority of the banking sector was founded.**
- **Banking Act was revised; regulation, on and off site supervision were reintroduced in line with the best practice. Licensing shareholders conditions tightened.**
- **Banks were forced to establish efficient systems for internal auditing, risk management and corporate governance.**
- **Inflation accounting system, international accounting and reporting standards were implemented. Consolidated and non-consolidated practices were enforced.**

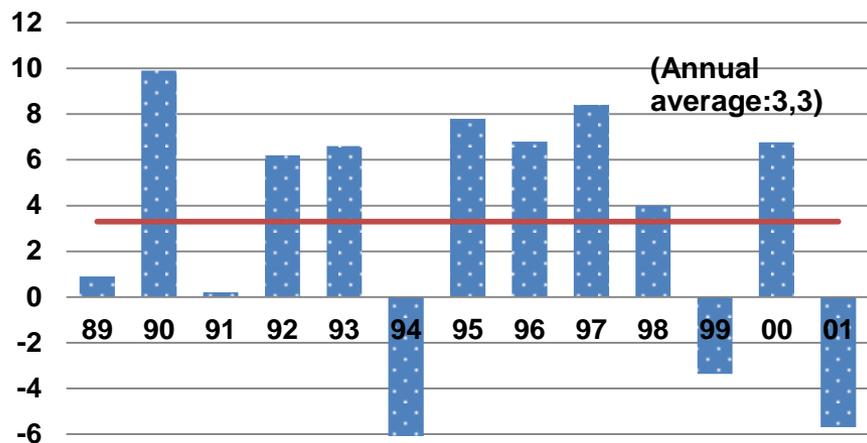
Improving the regulatory and supervisory frameworks

- **Capital adequacy has been determined by rules of Basel II and Basel III.**
- **Credit and Bank Cards Act became operational**
- **Non-banks financial institutions Act was introduced.**
- **Capital Market Act was re-designed to enlarge capital market activities.**
- **Bankruptcy Act, Commercial Code and Obligations Code, International Arbitrage Act, Consumer Protect Act**
- **Payment System rules were integrated to international rules.**

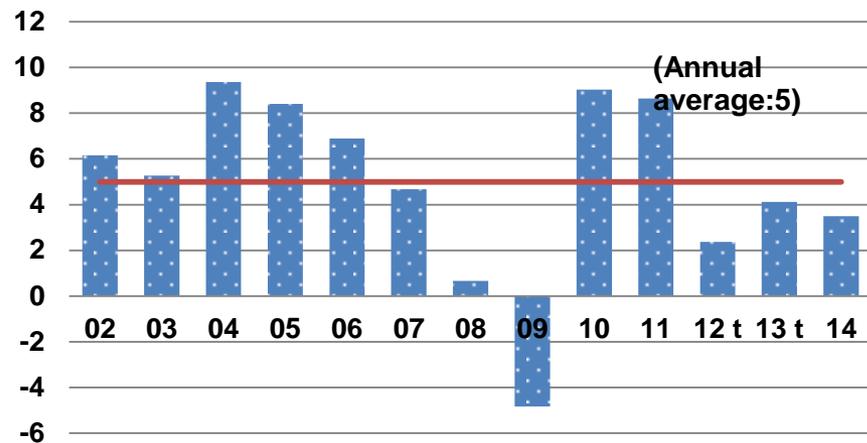
Outcomes of economic reforms

- **Faster and sustainable growth.**
- **Better environment for higher investment led by the private sector.**
- **Free market principles; encouraged private sector and foreign investment and increased international competitiveness.**
- **Rebuild confidence resulted higher demand for TL and lower risk premium; real interest rates declined.**
- **Removal of blanket deposit guaranties**

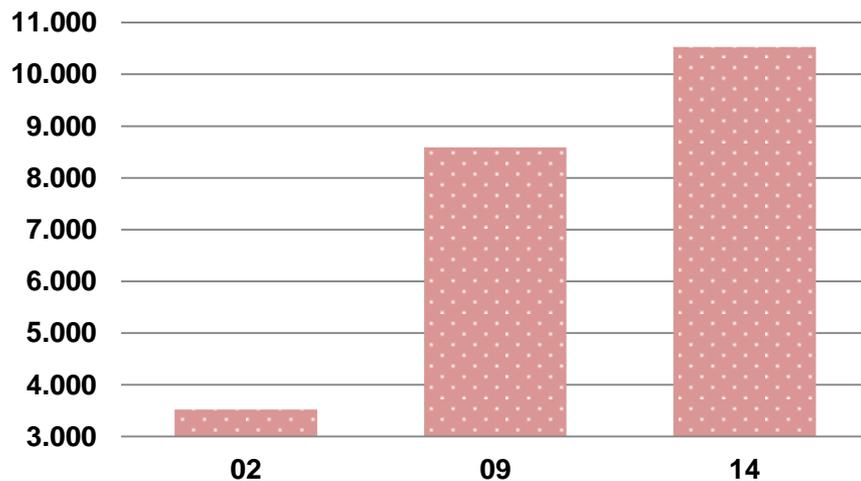
**GDP growth
(At fixed prices, %)**



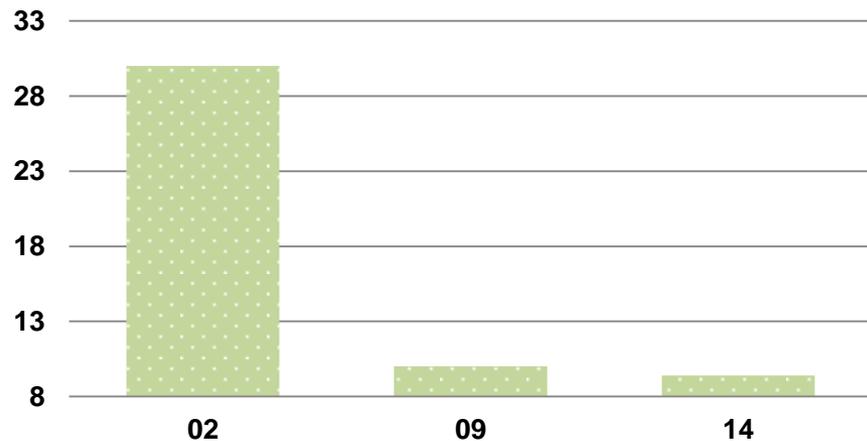
**GDP growth
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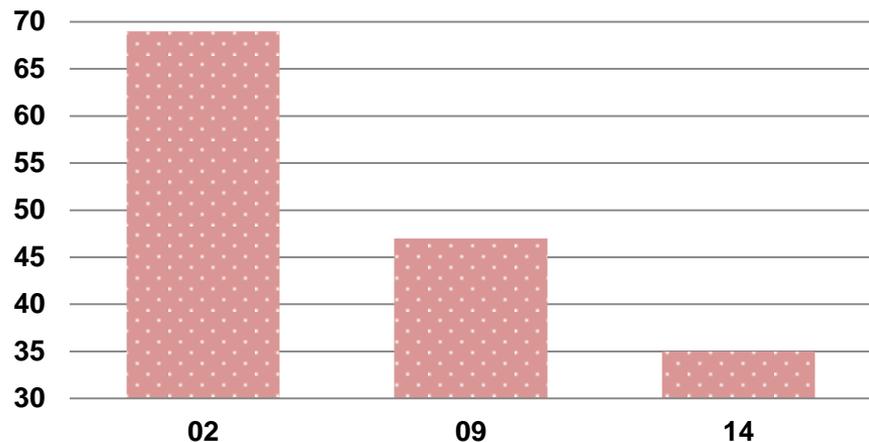
Income per capita (USD)



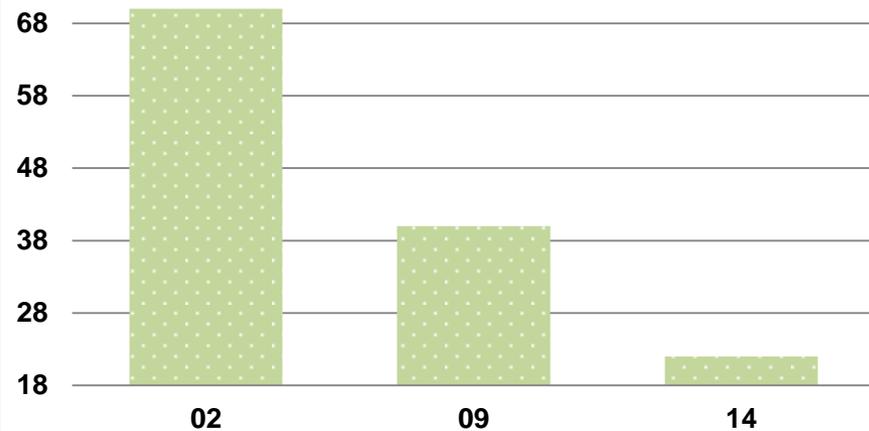
**Inflation
(Annual % chg)**



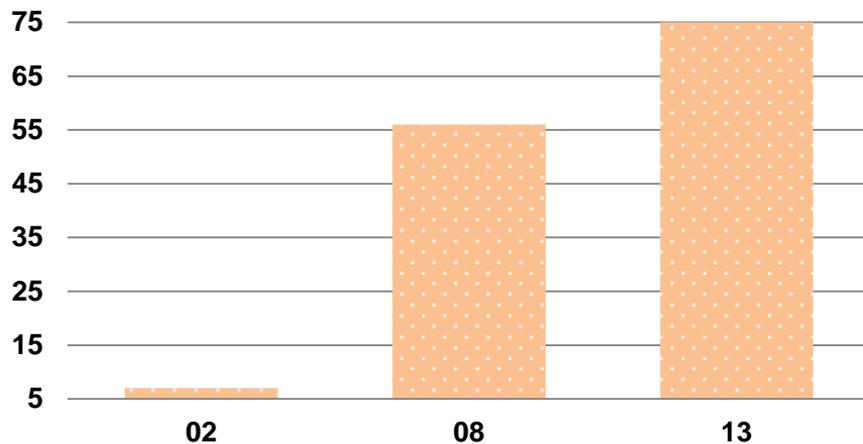
**Public sector debt
(As % of GDP)**



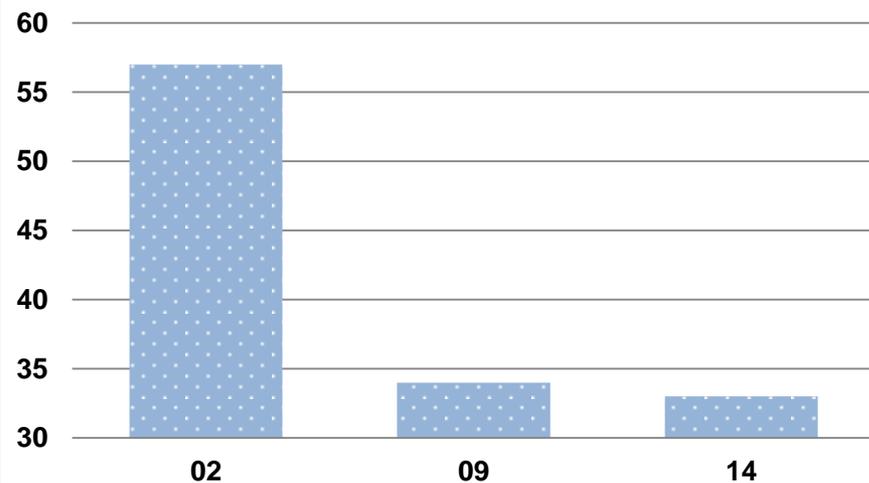
**Public sector domestic debt/total assets
(%)**



**Capital flows
(USD billion)**



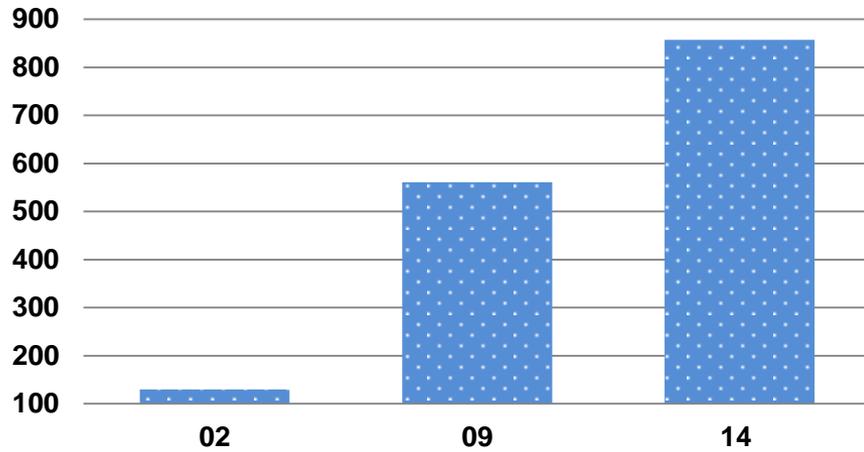
Fx deposits(total deposits (%))



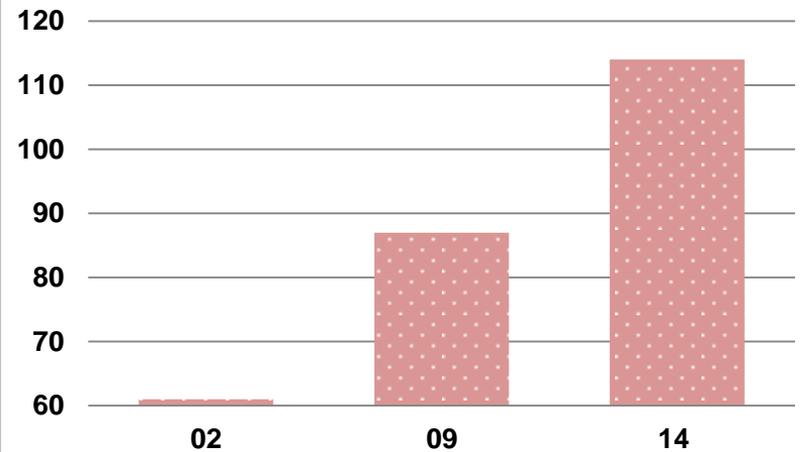
Outcomes of reforms in banking sector

- **Better functioning for financing economic activities**
- **Higher lending to private sector and households**
- **Faster asset growth**
- **Less risky environment**
- **Healthy financial soundness indicators**
- **Wider spectrum of loans and services**
- **Intense competition by non-residents with higher share in total assets**
- **Increase in market capitalization**
- **Decline in margin with widening business volume**
- **Stronger resilience absorbing unexpected shocks, as experienced in 2008**

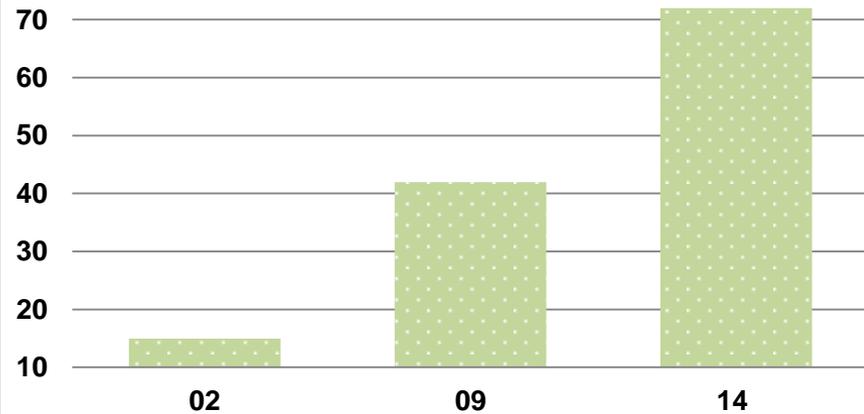
**Total assets
(USD billion)**



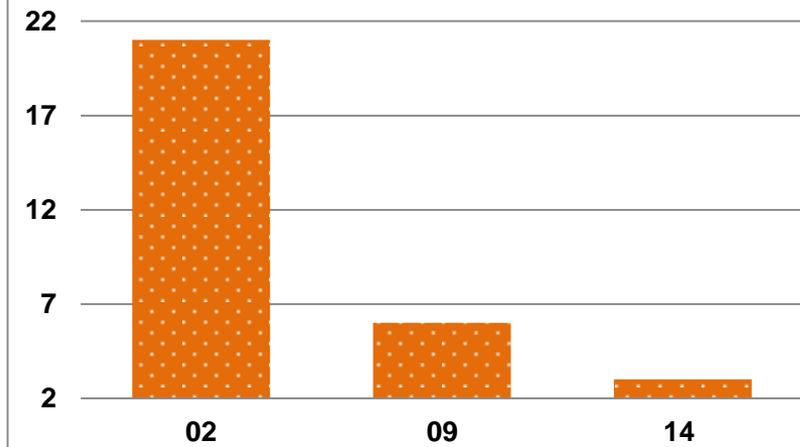
**Total assets
(As % of Gdp)**



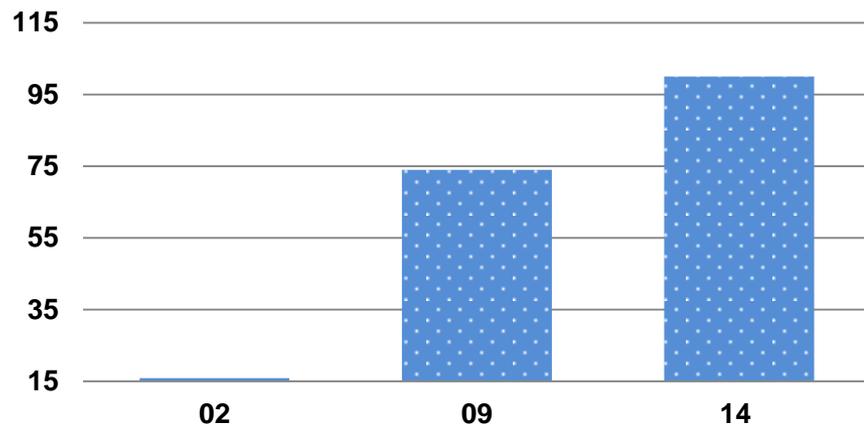
**Total Loans
(As % of Gdp)**



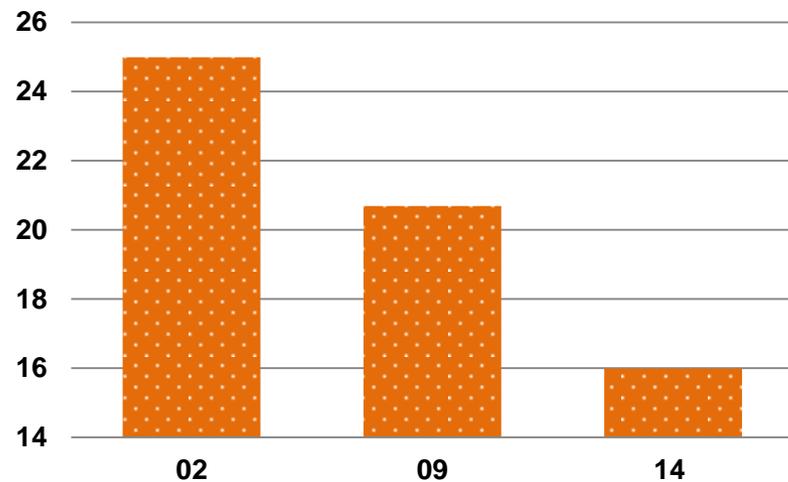
NPLs/Total loans (%)



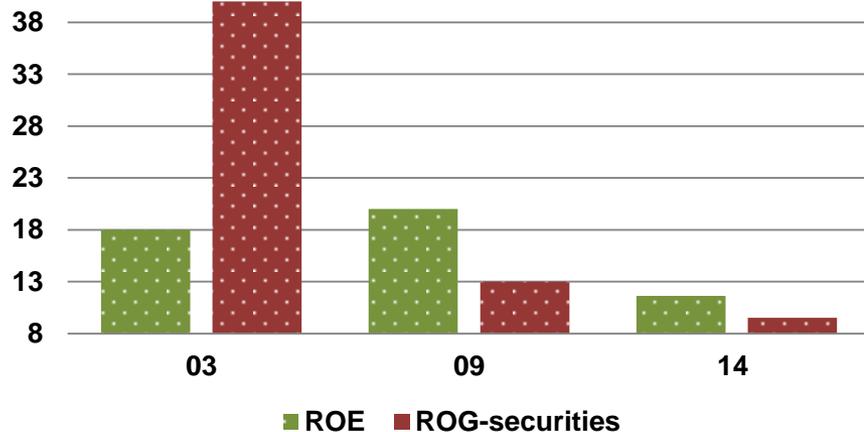
**Shareholders' equity
(USD billion)**



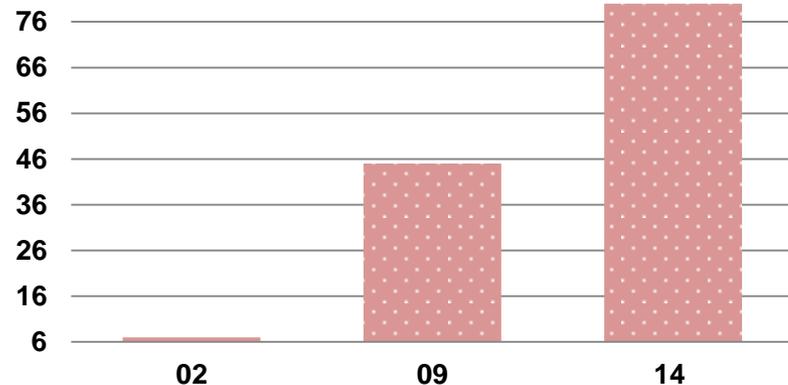
Capital adequacy (%)



Return on average equity (%)



**Market capitalization of financial institutions
(USD billion)**



Financial sector; regulation, supervision and asset size

Financial institutions	Authorities	Share in total assets (%)
Banks and other financial institutions	BRSA	92
Banks		88
Leasing companies		1
Factoring		1
Consumer finance companies		1
Capital market companies	CMB	5
Mutual funds		2
Securities dealer		1
Real estate investment funds		1
Pension funds		1
Insurance companies	Treasury	3
Payment system	Central B.	

Lessons learned

- **Domestic savings are the backbone of sustainable development.**
- **Financial institutions are key channels between savings and investment.**
- **Central bank liquidity postpones the problems, lack of reforms postpones the solutions.**
- **Countries with strong and efficient financial sectors adjust themselves to rapidly a changing and challenging global environment.**
- **Internationally accepted rules, efficient execution of rules by a well equipped authorities are essential for financial stability.**
- **Either financing to state or private sector, banks should be operated according to rules of risks management and of sufficient return to feed capital.**
- **Macro economic stability and best practice of market principles are needed for well functioning of financial markets.**
- **Price stability, financial stability, fiscal stability keep the risk premium at low level.**

Thank you.

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