**Recent Developments related to the Banking Sector   
and    
the Financial System**

**1999-2000**

*Under the Staff Monitoring Program with IMF the Turkish government launched a program aiming at sustaining stability, reducing inflation described in the authorities' Memorandum of Economic Policies of June 26, 1998. Main features of the program included;*

*(i)                 a large and sustained improvement in the primary budget balance, to narrow the large public sector deficits that lie at the heart of the inflation process;*

*(ii)               the adjustment of public sector wages and agricultural support prices in line with targeted inflation to minimize inflation inertia;*

*(iii)             structural reforms to ensure a lasting strengthening of the public finances;*

*(iv)             stepped up privatization to enhance economic efficiency and lower the domestic borrowing requirement;*

*(v)               measures to strengthen the banking sector; and*

*(vi)             limits on the expansion of the Central Bank's net domestic assets to ensure the consistency of overall policies.*

Turkey has made progress in the implementation of these economic policies. Developments in 1998 and 1999 clearly indicate6d the need to reinvigorate the adjustment effort through a comprehensive program of fiscal and structural reform. Within the context of the Government's agenda certain fiscal and structural reforms have been realized recently.

*The major legal and regulatory measures related to the banking sector and the financial system are summarized below.*

***June 1999***

        ***New Banking Law***

The government has passed a new Banking Law in June 1999, which was published in the Official Gazette dated June 18, 1999. The new Law has established an independent banking regulating and auditing institution free from political authority and important prudential standards have been introduced.

***August 1999***

        ***Change in the Social Security System Regulation***

Reform of the Social Security System, which was one of the top priorities of the government's agenda, was realized. The parliament passed new legislation on the Social Security System. The effects of such a major social security reform will influence the future of the present as well as the next generation.

Within the context of the new legislation, the age of retirement was increased to 58 for women and to 60 for men. The number of paid-premium day is increased from 5,600 to 7,000. The new legislation also brought a phased transition to the system of unemployment insurance within 10 years.

        ***Standard Ratio for "Foreign Currency Net General Position/Capital Base"***

With amendment in the regulation concerning Principles on the Calculation and Application of Standard Ratio for "Foreign Currency Net General Position/Capital Base" published in Official Gazette dated August 5, 1999, the Standard Ratio for Foreign Currency Net General Position/Capital Base was decreased from 30 percent to a maximum of 20 percent. It was decided that the new standard ratio would be reduced gradually in order to be effective as of January 1st, 2000.

        ***Decree on Accounting for and Valuation of Bank Credits and Funds Covering Credits***

With the Decision No. 99/13202 published in the Official Gazette dated 14.08.1999, some amendments has been made in Decree on Accounting for and Valuation of Bank Credits and Funds Covering Credits. According to new legislation, banks are required to set aside as general reserves 0.5 percent of the total of their cash credits and the dischargeable account receivables that are secured by 1st group of collaterals and 0.2 percent of letters of guarantee, guarantees and other non-cash credits. In addition, In case of inability to collect value of compensation of non-monetary credit or of those converted into monetary credits within 30 days after the payment or date of conversion, the credit extended is considered fallen in default. Banks are obliged to remove their cash credits fallen in default from the credit account to enter them into the account receivables to be discharged. If the part falled in default is collected within one month, it is transferred into the credit account. With a provisional article, this period of one month shall be applied as 60 days till 2000, and the implementation of the previous period of time will continue as of 01.01.2000.

        ***Privatization***

Attracting foreign productive capital, promoting economic efficiency, and raising revenues to contain public debt are the key goals of the government privatization program. Within the context of the privatization program, the government have tried to undertake necessary legal measures including those to allow for international arbitration, to permit an acceleration of the privatization in the energy and telecommunication sector.

In August, the draft law changing some articles of the Constitution has been passed through the Parliament. With the change in the Article 47 of the Constitution, the concept of privatization is stated in the Constitution for the first time and the paragraphs below are added to the Article.

"The principles and procedures related to the privatization of enterprises and properties owned by the State Economic Enterprises and other Public Legal Entities shall be determined by Law."

" Which of investment and services governed by the State Economic Enterprises and other Public Legal Entities to be made provided by real or legal entities on the basis of legal contracts shall be determined by Law"

Constitutional change also enabled disputes on privileged agreements concerning public services to be solved through national and international arbitration. International arbitration shall be applied only to disputes including foreign features.

With an amendment in the 2nd paragraph of the Article 155, the State Council is commissioned with communicating its opinion on privilege agreements concerning public services within two months, and with examining drafts on regulations and solving administrative disagreements.

        ***Tax Reforms***

The parliament approved the legislation, which brought certain changes in some tax laws.

***Financial Millennium was postponed, and definition of income was changed, thus the previous implementation will continue for income earned between 1999-2002.***

Financial *Millennium*was postponed to the year 2002. Hence, repo and deposit gains that will be earned between 01.12.1999-31.12.2002 will be subject to withholding tax and no declarations are required for them whatever the amounts are.

For gains derived from the discharge of marketable securities, the period for exemption is reduced from one year to 3-months and the limit is increased to TL 3,5 billion.

No transactions will be carried out depending on the declarations made on 30.09.1998.

Income tax rates except for wage income are increased by 5 points.

***Surveys and works of art are exempted from taxation***.

***Changes was introduced in corporate tax***

The provisional corporate tax rate that is calculated over gains in 6 months periods is reduced to 20 percent from 25 percent. The Board of Ministers is authorised to increase or decrease the rate by 5 points.

The part of gains that’s added to the capital of the institution from the sale of subsidiary shares and immovables of the taxpayer in the year of sales is exempted from corporate tax.

The gains that will arise from the addition of production units as capital in kind to new companies will be exempt from corporate tax between 01.01.1999-31.12.2002.

The gains derived through the sale of the stocks issued -at the establishment or the increase of capital- above their nominal values of the joint stocks and those which are exceptional, will not be taxed at point.

The Board of Ministers is authorised to change the revaluation rate used in the calculation of real estate tax base between zero and the rate declared.

***October 1999***

        ***Change in Taxation Method for Government Securities***

Within the context of changes introduced by the Tax Law No. 4369, approved in July 1998, the valuation for Government Bonds, Treasury Bills and Revenue Sharing Certificates at market value instead of purchase value was brought, and income from these securities became subject to provisional tax.

*Provisional Taxation*

The provisional tax implementation of 25 percent on a 3-monthly basis was brought in July 1998. With Law No. 4444 in August 14, 1999 the rate of provisional tax was reduced to 20 percent from 25 percent and the period of collection was increased to a 6-monthly basis.

*Article No. 279 of the Tax Procedures Code*

An amendment on the valuation of securities in Article No. 279 of the Tax Procedures Code was made in July 1998. According to the amendment, shares and the participation certificates of mutual funds, who invest at least 51 percent of their portfolios in the stocks of companies established in Turkey shall be valued at purchase price, and all other marketable securities shall be valued at market value from December 31, 1999.

However, the date of implementation has been postponed to December 31,1999 in the 1999 Financial Year Budget Law No. 4393.

*Implementation of Article 279 and Provisional Taxation*

The implementation of Article 279, which ensures the transfer of real value of securities into financial tables, affects likely institutions having a high amount of government securities in their assets. Since these institutions have to involve unrealized interest revenues at the end of period with their tax assessment.

For purposes of the provisional tax implementation, banks are required to take into consideration the accrued interest of their government securities while submitting declarations on February 15, 2000 covering both the 4th quarterly period provisional tax and income-loss statements for the year 1999. The implementation on the valuation of securities at market value will be valid during the calculation of income.

***November 1999***

        ***Additional Taxation***

The government passed a new law on additional taxation, which was initially designed to meet part of the huge costs of two recent earthquakes in Turkey.

The new law, which was published in the Official Gazette dated November 26,1999, introduced additional taxes on a wide range of income and corporate revenues and commercial transactions.

Within the context of the law regarding the banking sector, the additional taxes were introduced including four to 19 percent interest tax on government bonds issued before December 1, 1999 depending on maturity, and an additional corporate tax of 5 percent.

As being valid from as of January 1, 2000, the rates for additional interest tax on government bonds issued before December 1, 1999 are stated as below;

1) Of the discount bonds and bills:

- 4 percent from those whose due date falls 1-91 days later,

- 9 percent from those whose due date falls 92-183 days later,

- 14 percent from those whose due date falls later than 183 days.

2) 4 percent from the interest payments for the bonds with three-year maturity, variable interest, and quarterly coupon-payment,

3)                  19 percent from the interest payments for the bonds with three-year maturity, fixed interest, and quarterly coupon-payment.

The amount of this obligation, which has the nature of additional tax may not be offset against the taxes to be paid, but may be charged as an expense item in determining the commercial income (Law no.4481, promulgated in the extra issue of the Official Gazette dated 26.11.1999, numbered 23888).

***December 1999***

        ***Recognition of Turkey's Candidate Status to the EU***

Turkey's candidate status for full-membership to the European Union has been recognised officially at the Helsinki European Council.

The unanimous recognition and announcement of Turkey as a candidate country at the Helsinki Summit, and the declaration in a clear and decisive manner that Turkey will be treated on an equal footing with the other candidates are positive developments for Turkey.

        ***Disinflation Program***

As an extension of the Staff Monitoring Program signed with the International Monetary Fund in July 1998, a new "Stand By Agreement" has been signed recently between the Turkish government and IMF. Within the context of the new agreement, that is to last for three years, the Turkish government launched a disinflation program, which is aiming to achieve disinflation and growth at the same time. Within the context of the program, the Central Bank of the Republic of Turkey (CBTR) announced its exchange rate policy and monetary policy.

The strength of the Program enhances the credibility of the disinflation goals. In setting disinflation goals for 2000-2002, of main importance has been balancing the need to signal a clear break away from the past, against the difficulty of bringing inflation down to lower single digits abruptly, given the inertial component that inflation has in Turkey.

The fundamental goals of the program are given as,

        to bring down the inflation rate through implementing consistent, credible and persistent fiscal, income, monetary and exchange rate policies, all supported by structural reforms.

        to reduce real interest rates to plausible levels,

        to increase the growth potential of the economy,

        to provide a more effective and fair allocation of the resources in the economy.

The main pillars on which disinflation program will operate*;*

a) The first pillar is a tight fiscal policy that consists of increasing the primary surplus, realizing the structural reforms and speeding up the privatization.

b) An income policy in line with the targeted inflation is the second pillar.

c) Monetary and exchange rate policy actions constitute the third pillar, which aim to support the contribution of the first two in decreasing both inflation and interest rates, and to provide a long-term perspective to the economic agents.

And the main targets are determined in the Program are given as below;

-          **12-month CPI (Consumer Price Index) inflation rate:** 25 percent by the end of 2000, 12 percent by the end of 2001, and 7 percent by the end of 2002.

-          **Public sector primary surplus:** equivalent of 2.2 percent of GNP(for the year 2000)

-          **Cash domestic debt:** constant at 27 % of GNP

-           **Total debt stock :** constant at 61 % of GNP

        ***Monetary Program of CBRT***

Within the context of the new agreement, that is to last for three years, the Central Bank of the Republic of Turkey (CBTR) announced its exchange rate policy and monetary policy. The monetary and exchange rate policies are to be guided by two considerations. First, disinflation and a rapid decline in interest rates require that monetary and exchange rate developments become more predictable, so as to reduce the uncertainty on the value of financial investment for both residents and nonresidents. The strengthening of fiscal policy under the program, level of international reserves, coupled with the financial support from the international community, make the introduction of such a commitment feasible. Secondly to avoid to be locked into a monetary and exchange rate framework that while appropriate for disinflation may lead to unnecessary rigidities in the long run, a problem that has affected many emerging markets in recent years. Hence, there is a need for a transparent and pre-announced exit strategy from this exchange rate regime.

*Exchange Rate Policy:*

Main features of CBTR’s exchange rate policy are as follows:

-The exchange rate basket is to be announced on a daily basis covering one-year period.

-The exchange rate basket composed of 1 US dollar + 0.77 EURO will continue to be valid.

During the implementation of the program the exchange rate policy will be designed in two different exchange rate regimes and in two different periods. In the first 18 months which is between January 2000 and June 2001, nominal value of the basket will be increased according to the targeted inflation rate and in the following period the exchange rate policy will be carried out with respect to a “progressively widening band”. This band will widen at a rate of 15 percentage points per annum, measured from edge to edge. The total width of the band will thus reach 7½ percent by end-December 2001, 15 percent by end-June 2002, and 22½ percent by end-December 2002.

*Monetary policy;*

The most important tool of CBTR at reaching its final objective of inflation is to follow the preannounced path of the basket without permitting any deviations from that.

The reflection of exchange rate and monetary policy is to be followed in the context of the main aggregates from the balance sheet of CBTR. Monetary policy and balance sheet of CBTR are designed by imposing a floor to net international reserves in addition to a ceiling restriction for the net domestic assets item (NDA), which are fundamental aggregates of the balance sheet. During each quarter, NDA is to remain broadly constant at its December 1999 level) while allowing some limited flexibility (about +,- 5 percent of total base money) during the quarter to avoid excessive volatility in overnight rates.

Within this context, all base money is to be created through the balance of payments and domestic interest rates are to be fully market determined, and no capital movements will be sterilized. The interbank interest rates posted by CBRT are to be adjusted daily in line with the movements of the overnight money market rates.

        ***Amendment in the application of Reserve Requirement and***

***Liquidity Requirement***

With the new amendment concerning the application of reserve requirement and liquidity requirement, which was published in the Official Gazette dated December 10, 1999, the reserve requirement ratio is decreased from 8 percent to 6 percent. On the other hand, 2 percent of TL deposits is to be held as free deposits with the Central Bank. This new liquidity requirement may be met on the average of daily data for the reserve requirement period, rather than on a continuous basis. Thus, without causing any change in the total of the legal requirements, banks are provided with flexibility in meeting their liquidity needs on weekdays.

"The Legal Requirement Table" is shown below;

The Reserve Requirement Ratio (RR) and Liquidity Ratio (LR)

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **TL Denominated** | | | | | | **FX Denominated** | | | | |
|  | **RR** | **LR** | | | **TOTAL** | **RR** | **LR** | | | **TOTAL** |
|  |  | Free Deposits | Government Securities | Vault Cash |  |  | Free Deposits | Government Securities | Vault Cash |  |
| Deposits | %6 | %2 | %4 | %2 | %14 | %11 |  | %1 | %2 | %14 |
| Other Liabilities |  | %8 | %4 | %2 | %14 |  | %11 | %1 | %2 | %14 |
| Excess Open Position |  | %8 |  |  |  |  |  |  |  |  |

Source: [www.tcmb.gov.tr](http://www.tcmb.gov.tr/)

        ***Recent Amendments in the Banks Act No.4389***

In June 1999, the parliament had approved a new Banks Act. With the Law No.4491, which was published in the Official Gazette dated 19.12.1999 No.23911, certain amendments have been made in this Act in order to strengthen key prudential regulations and to place the banking supervision framework on a proper foundation by increasing transparency and independence in the operation of the Banking Auditing and Regulation Agency (BRSA), and providing all of tools needed for the improved resolution of problem banks.

The Banking Auditing and Regulation Board became fully autonomous by removing the involvement of the Council of Ministers from all decisions in the area of supervision other than the appointment of the members of the Board. The decisions to licence and delicense banks, and to approve provisioning regulations are rested with the Board. With the recent amendments, the three year period during which a Board member was prohibited from the employment as a senior executive in the banking sector, a provision made it difficult to find active professional to take Board positions, was eliminated as well. The Board is to be named by the end of March 2000, and to be in full operation by the end of August 2000.

The prudential standards were strengthen for bank lending to owners and to single or related parties. The ratio of total loans to those having a indirect relationship is to be declined from the current 75 percent of capital to 25 percent until 2007 with a 5 percent decline in every six months.

With the new amendments, the Savings Deposit Insurance Fund was given authority and responsibility to restructure a problem bank to facilitate its sale in full or in part or to liquidate the remainder based on existing laws. The fund is no longer permitted to lend or otherwise provide liquidity support to banks other than those under its full control.

        ***New Provisioning Regulation***

Decree on procedures for determination of types of loans and other types of receivables that banks are required to set aside provisions, No: 99/13761 was published in the Official Gazette dated 21.12.1999. With the new regulation, more stringent loan loss provisioning in line with international standards is to be applied fully to all new loans, including renewal of any existing loans, from January 1, 2000.

According to the Decree banks are obliged to categorize their loans and other receivables into five subdivisions ranked according to recoverability and creditworthiness. The provisions to be set-aside by banks in respect of their loans and other receivables shall be in accordance with the collaterals’ value and the ability to liquidate them within the legal framework.

        ***Application of Consolidation Principle in the Banking Regulations***

Necessary modifications have been made recently in the regulations related to the capital adequacy and foreign exchange exposure limit of banks to apply on a consolidated basis.

Within this context, two Decrees related to"the principles concerning the accounting and implementation of the standard ratio for foreign currency net general position/capital base on a consolidated basis" and "the principles and procedures on the measurement and valuation of capital adequacy of banks on a consolidated basis” are published in the Official Gazette dated 21.12.1999, being effective after June 30, 2000.

With these Decrees aiming at enhancing transparency and improving the monitoring capabilities of the authorities, banks are required to issue consolidated financial statements of themselves and their financial affiliates and to report twice a year.

http://www.tbb.org.tr/english/_themes/ana-web/divider.gif

***February 2000***

        ***Valuation of Repo and Reverse Repo Transactions and Time Deposit Accounts and Provisional Tax Implementation***

According to the General Decree on Corporate Income Tax, which was published in the Official Gazette dated 06.02.2000, repo and reverse repo transactions, time deposit accounts are subject to valuation process within the context of Article No. 279 of the Tax Procedures Code.

Regarding the provisional tax implementation, banks are obliged to take into account the accrued interest from repo, reverse repo transactions, and time deposit accounts as of the valuation date, while submitting declarations on February 15, 2000 covering both the 4th quarterly period provisional tax and income-loss statements for the year 1999.

***May 2000***

        ***An Amendment in the Application of Liquidity Ratio***

With an amendment on the application of liquidity requirement, published in the Official Gazette dated May 5, 2000, the liquidity ratio, which is applied to excesses of foreign exchange position of banks is increased from 8 percent to 100 percent of total amount, which shall be hold as free deposits in TL with the Central Bank.

***June 2000***

         ***Change in the level of coverage by the Saving Deposit Insurance Fund***

The Decision on saving deposits subject to insurance and premiums to be collected by the Saving Deposits Insurance Fund No.2000/682 was published in the Official Gazette dated 01.06.2000. According to the Decision, saving deposit accounts on the Turkish lira and foreign currency deposit accounts being of the nature of saving deposit opened by real persons (both residents and non-residents) with domestic branches of banks operating in Turkey and authorized to accept deposit are subject to the deposit insurance.

With the decision, the level of coverage on saving deposit accounts opened and/or renewed after the publication of this Decision was changed. Up to 100 billion TL per account will be covered until 31.12.2000, and up to 50 billion TL as from 01.01.2001. However, the fund still covers 100 percent of saving deposit accounts opened before the Decision.

The premium rate shall be as follows on the basis of the quarterly totals of the Turkish lira saving deposits and foreign currency deposits being of the nature of saving deposit account opened by real persons;

i)                    25 per ten thousand for banks, who fulfill all of the prudential ratios,

ii)                   26 per ten thousand for banks, who fulfill all of the prudential ratios except one.

***July 2000***

         *Quarterly reporting on a consolidated basis*

An amendment was made on the principles and procedures related to the preparation and notification of consolidated financial statements by banks, which was published in the Official Gazette dated July 5, 2000. With this amendment, banks are required to report quarterly on a consolidated basis.

***August 2000***

         ***Regulations on the Savings Deposit Insurance Fund***

Regulation on the Savings Deposit Insurance Fund introduced by the Banking Regulation and Supervision Board on August 26, 2000, defined the organizational structure, duties and responsibilities of the Fund with conditions applicable to utilization of the Fund.

Banking Regulation and Supervision Agency is responsible for the management, functioning, auditing of the “Savings Deposits Insurance Fund” and for establishing the principles of savings deposits insurance.

***September 2000***

***Regulations on Resource Utilization Support Fund***

With an amendment to the Communiqué No.6 related to Decree No.88/12944 by Communiqué No.27 on the Resource Utilisation Support Fund published in Official Gazette dated September 9, 2000, the ratio of fund deduction for consumer loans extended by banks and finance corporations was increased to 8 percent from 3 percent. Thus, a significant distinction between consumer loans and other types of loans extended by banks was created in terms of fund deduction.

         ***Decision of the Banking Regulation and Supervision Board about Kıbrıs Kredi Bankası Ltd. Istanbul/Turkey Branch Office.***

With the Decision No. 59 of the Banking Regulation and Supervision Board (BRSB) published in the Official Gazette dated September 28, 2000 and became effective on the same date, the license for accepting deposits and engaging in banking operations of Kıbrıs Kredi Bankası Ltd. Istanbul/Turkey Branch Office, which headquartered in Lefkoşe, was revoked in accordance with the paragraph (3) of the Article 14 of the Banking Law No.4389. The reason behind this decision was that Kıbrıs Kredi Bankası Ltd. Istanbul/Turkey Branch Office failed to take measures, which are deemed to be appropriate in line with the paragraph (2) of the same Article for the purpose of strengthening its financial structure.

***October 2000***

         ***Decision by the Banking Regulation and Supervision Board on the transfer of two commercial banks’ management to the Saving Deposits Insurance Fund.***

With the decisions numbered 85 and 86 of the Banking Regulation and Supervision Board, published in the Official Gazette dated 27 October 2000, the privileges of shareholders except dividends and the management and audit of two commercial banks, namely Bank Kapital T.A.Ş. and Etibank A.Ş. who did not take the measures stated in the paragraph (2) of Article 14 in order to overcome the problems in its financial structure, has been transferred to the Savings Deposits Insurance Fund in accordance with the paragraphs (3) and (4) of Article 14 of the Banking Law No. 4389.

***November 2001***

         ***Decision by the BRSB on requirements, which must be met by any person who has submitted an application for founding a bank or acquiring shares of existing banks or purchasing shares of banks under the SDIF.***

With the Decision published in the Official Gazette no. 24221 of November 5, 2000, The Banking Regulation and Supervision Board (BRSB) has established requirements, which any investor which has applied to the Agency for founding a new bank or made a request for assignment of shares or who intends to submit a proposal for purchasing shares of banks put under control of the Savings Deposit Insurance Fund (SDIF) shall meet, as described in detail in the following paragraphs in accordance with paragraph (11) of Article 3, paragraph (2) of Article 7 and paragraph (2) of Article 8 of the Law No. 4389.

1. The founders of a bank or any natural person and corporate body intending to take over shares of a bank shall have an adequate financial capability which a founder or a shareholder of a bank must have.

Financial capability shall be assessed based on such factors as:

            a) provision of the necessary funds from legal commercial, industrial and other activities,

b) assets composing the financial capability shall not have been acquired through unregistered activities.

2. The capital subscribed or the amount of shares to be taken over shall have been provided free of any type of simulation.

Applicants shall disclose the source of funds they intend to use for their capital subscriptions or assignment of shares beyond doubt where this is considered necessary.

3. Such natural persons and persons who are shareholders of corporate bodies shall have the reputation which a bank owner is expected to have.

Reputation shall be assessed based on such factors as:

a) having a good character and being virtuous,

b) not having been involved in suspicious activities,

c) not have displayed a moral weakness in discharging his obligations,

d) having a reputable past.

4. Applicants shall not:

a) have been declared bankrupt or made a composition with their creditors,

b) have, directly or indirectly, an interest more than ten percent in any banker, bank, insurance company or any institution engaged in money and capital markets which are being subjected to liquidation or any bank transferred to the Fund,

c) have, directly or indirectly, an interest more than ten percent interest or a lesser interest which entitles him to appoint members to board directors or board of auditors in any bank which is being subject to a legal proceeding pursuant to Article 14 of the Banking Law,

d) have been punished with a heavy imprisonment or imprisonment over five years or convicted of any infamous crime including simple or aggravated embezzlement, extortion, bribery, theft, fraud, falsification, abuse of trust or smuggling offenses other than smuggling of people and goods, conspiring in public contracts and procurements and sales, money laundering or disclosing Government's secrets, tax evasion or attempt to evade taxes or taking part in any tax evasion attempt excluding negligent offences even if he has been pardoned.

5. Applicants shall provide any information and document, which may be required by the Banking Regulation and Supervision Agency, in order to substantiate that they meet the requirements set forth above.

6. Applicants who are citizens of a foreign country shall be subject to requirements applicable to natural persons and corporate bodies who are residents of Turkey. Whether any foreign applicant meets the specified requirements shall be assessed based on information and opinions to be received from competent authorities which issue licenses to carry out banking operations and transactions on financial markets in its home country.

         ***Law on the privatization of three state-owned commercial banks, namely T.C. Ziraat Bankası, T. Halk Bankası A.Ş. T. Emlak Banksı A.Ş.***

The parliament passed a new Law concerning the T.C. Ziraat Bankası, T. Halk Bankası AŞ, T. Emlak Bankası AŞ, which aims ensuring the effective working of these banks in compatible with the principle Savings Deposits Insurance Fund ples of international competition and to strength their financial and administrative structure and to make necessary preparations and arrangements for privatization process.

The law envisages a restructuring and privatization period of three years for these banks and also authorizes the Council of Ministers to prolong this period by up to one-and-a-half years.

Under the law, the state may not assign duties to any of the three banks before physically providing the necessary funds. It further states that the Treasury within the schedule outlined in the restructuring program would meet duty losses of banks.

Provisions of the law, which is to stay in effect until the government stake in the banks is reduced to below 50 percent shall be executed by the Council of Ministers.

         ***The BRSA announced its action plan for the banks under the SDIF***

Banking Regulation and Supervision Agency (BRSA) announced its action plan related to sale of shares of banks, management and control of which were transferred to the Savings Deposit Insurance Fund (SDIF) on November 17, 2000.

1. Preparation of banks, management and shares of which have been transferred to the Savings Deposits Insurance Fund, for sale;

1.1. Completion of a review of financial conditions of the banks managed by the Fund, preparation of their financial statements as of August 2000 when the SDIF was transferred to the Banking Regulation and Supervision Agency (this process has been completed.)

1.2 Assessment of quality of the banks' assets (this process has been completed.)

1.3) Determination by the Banking Regulation and Supervision Board of types of assets to be taken over by the Asset Management Unit created within the SDIF and conditions for such transfer,

1.4) Elimination of the banks' bad assets (exclusion of losses and bad debts from their balance sheets) and determination of funds necessary for capital adequacy ratio for each bank and for all the banks (this process has been completed).

1.5) Implementation of the common management procedure adopted for addressing such issues as rehabilitation of banks, an efficient use of resources, pursuing their rights, receivables and litigations and ensuring their efficient management and implementation of the action plan by all banks in an harmonious manner, and application of decisions made by boards of directors of the Banking Regulation and Supervision Board and the SDIF (this process has been completed).

2. Determination of requirements to be met by applicants who intend to purchase shares of banks managed by the SDIF (this process has been completed).

3. Purchasing of Special Category State Public Borrowing Notes, which are needed to improve financial conditions of banks and to be borrowed from the Treasury Undersecretariat by determining conditions regarding their repayment, term, type and interest rates (this process has been completed)

4. Completion of investigations related to investors and review by investors of the banks.

4.1. Issuing invitations to potential buyers who will apply to the SDIF in order to purchase shares of the banks and submission of their application forms to the Agency (to be completed on December 15)

4.2 Approval by the Board of buyers who meet requirements laid down by the Board and informing them of the result (to be completed on December 22).

4.3 Signing confidentiality agreements with investors who meet specified requirements and permitting them to carry out reviews and inspections in banks in which they are interested (to be completed in January 2001).

4.4 Receipt and evaluation of proposals submitted by organizations which have performed required reviews (to be completed in February 2001)

5. Preparation by the SDIF of tender specifications, release of tender notices (to be completed in February 2001).

6. Preparation by investors of their proposals by taking conditions set forth in the specifications and obtaining all kinds of information relevant to the banks and by also causing performance of a "due diligence" study where deemed necessary and submission of these proposals to the Fund (to be completed in the first week of April 2001).

7. Evaluation of proposals and completion of bidding processes (to be completed by the end of April 2001).

8. Signing of sale agreements and transfer of shares.

        ***Amendment in the application of Reserve Requirement and Liquidity Requirement***

Pursuant to the new amendments concerning the application of reserve requirement and liquidity requirement, the reserve requirement ratio for TL deposits is reduced by two percentage points to 4 percent, and the liquidity requirement ratio for non-deposit TL accounts of banks was decreased to 6 percent from 8 percent, which shall be maintained as TL free deposits with the Central Bank.

The legal requirement table including the latest changes is given below.

**Reserve Requirement Ratio (RR) and Liquidity Ratio (LR)**

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **TL Denominated** | | | | | | **FX Denominated** | | | | |
|  | **RR** | **LR** | | | **TOTAL** | **RR** | **LR** | | | **TOTAL** |
|  |  | Free Deposits | Government Securities | Vault Cash |  |  | Free Deposits | Government Securities | Vault Cash |  |
| Deposits | %4 | %2 | %4 | %2 | %12 | %11 |  | %1 | %2 | %14 |
| Other Liabilities |  | %6 | %4 | %2 | %12 |  | %11 | %1 | %2 | %14 |
| Excess Open Position |  | %100 |  |  |  |  |  |  |  |  |

         ***Regulations on Resource Utilization Support Fund***

With an amendment to the Communiqué on the Resource Utilisation Support Fund published in the Official Gazette dated November 25, 2000, the ratio of fund deduction was increased to 10 percent from 8 percent for consumer loans extended by banks and finance corporations and to 5 percent from 3 percent for other types of loans. Accordingly, the same ratio was raised by 3 percentage points to 6 percent for loans obtained from abroad by the persons domiciled in Turkey other than banks and finance companies as well as in imports based on acceptance credits, time letter of credit and payments against goods.

***December 2000***

***Recent Developments due to Liquidity Squeeze in the Banking Sector\****

As of November 22nd, the financial markets entered into turmoil due to an extreme liquidity squeeze. It can be said that the recent liquidity problem emerged mainly from the changes in the behavior of the banking sector. Anticipating a decline in the profitability of treasury bill operations, banks switched to the credit market which is by definition, less liquid.

Change in behavior stemmed from a substantial fall in the interest rates from the inception of the new economic program. During this period, the deposits of the banking sector fell in real terms and the maturity of deposits declined. This further constrained the liquidity position of the banking system

The banks resort to the foreign resources as a means to finance mainly in the form of short-term credits. However, the liquidity problem soared due to the seasonal year-end FX demand of foreign institutional investors. The strengthened open position requirements accompanied by the long holiday period in year-end intensified the local banks’ foreign exchange demand earlier than usual. Foreign investor’s seasonal FX demand was also augmented due to the deterioration in the economic situation in Argentina as well as the delays in structural reforms in Turkey. Shortcoming in the expected FX revenues from privatization raised concerns about the future of the economic program.

Consequently, on November 22nd the Central Bank sold about USD 1.5 billion to the market and the overnight repo rates hit 200% levels and the rates in the secondary bond and bill market rose to 50%.

However, in contrast to the Central Banks’ view, increase in interest rates did not curb the demand for foreign exchange. In fact the squeeze in TL liquidity fueled the demand for FX as it caused an increase in TL interest rates. These significant high interest rates were perceived as a risk rather than a higher yield and the FX demand from international players continued.

In the period between 17 – 30 November, the CB sold approximately USD 6.2 billion to the markets and the foreign exchange reserves of the CB is estimated to have declined from USD 24.2 billion to USD 18.5 billion.

The Central Bank announced that the net domestic assets ceiling would be restored at the new level attained in the last few days i.e. around TL 2000 trillion. Originally the net domestic assets target was set at TL – 1200 trillion, allowing for a fluctuation within a band of +/- 5% of the previous quarter’s monetary base.

It is apparent from this announcement that the Central Bank has firmly reassured the markets about its position to stick to original monetary program and to the principle that the TL liquidity will be created only through FX purchases. This accompanied by recent declaration of Deputy Prime Minister Mr. Mesut Yılmaz, outlook for devaluation of the TL is highly unlikely.

The government and the Central Bank resorted to certain measures in order to cope with the negative expectations of the market; firstly, the government announced the time schedule for the privatization of the Turkish Telecom. Accordingly, it is declared that 33.5% of the Telecom will be sold to a strategic partner with management rights and details of the auction will be announced until December 14th. Secondly, the law concerning the rehabilitation and privatization of the state-owned banks and the supplementary tax package has been approved by the parliament.

These attempts although not expected to be effective in easing the liquidity squeeze and the tension in the market in the very short-run, imply that the government will make up for the delays in the reforms. Hence, culmination of aforementioned measures is expected to have positive impact on the markets in the year 2001. Furthermore, it is envisaged that the adverse pressure of C/A deficit, which is anticipated to be low due to expected modest growth of the economy in 2001, is going to be considerably lower than what it was during this year.

Appropriately, the government started the negotiations with the IMF for a Supplementary Reserve Facility (SRF). Currently an IMF mission headed by Mr. Michael Deppler, head of IMFs’ European section, is in Turkey to negotiate the conditions for the extra funding facilities such as the SRF. It is envisaged that during this visit the CB’s monetary policy, the rehabilitation of the banking sector together with the solutions to overcome the liquidity trap will be discussed.

According to the press reports of this morning an agreement with the IMF has already been attained and the official announcement about the details of the agreement will be made public tomorrow morning (Dec.6, 2000).

       ***Increase in the withholding tax rates***

Pursuant to the Decision of the Council of Ministers No.1712/2000, which was published in Official Gazette dated December 20, 2000, the withholding tax rates on deposits, dividends and interest revenues from repo transactions were increased to the same level. The decision, which will be applied as of January 1, 2001 implies that;

-         the withholding tax rate on the Turkish lira deposits, and dividends paid by the special finance houses, was increased to 16 percent from 15 percent,

-         the withholding tax rate on interest revenue from repo transactions was increased to 16 percent from 14 percent.

       ***Supplementary Letter of Intent dated December 18, 2000.***

The Turkish government’s letter of December 9, 1999, requesting a three-year stand-by arrangement with the Fund, and in two subsequent letters-dated March 10 and June 22, 2000-requesting completion of the first two reviews, the main elements of the government’s ambitious disinflation and fiscal adjustment program had been described, and the course of economic policies over 2000-02 was chartered. The recent letter-dated December 18, 2000- provides an update on economic developments since the completion of the second review, discusses our policy goals for 2001-02 in light of these developments, and outlines the key policy measures needed to achieve those goals. With this letter the government also request the completion of the third and fourth program reviews, as well as access to Fund resources amounting to SDR 5.784 billion under the Supplemental Reserve Facility.