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RESTRUCTURING AND REFORM OF TURKEY'S BANKING SECTOR AFTER THE FINANCIAL CRISES OF 2000–2001

Brian P. Cunningham

Introduction

The 1990s were a time of unprecedented economic growth and prosperity in the United States and many other countries around the world. In Turkey, however, sustained economic growth was severely hampered by rampant inflation following its continued efforts to liberalize its economy. According to World Development Indicators, Turkey's GDP grew from $151 billion in 1990 to $267 billion in 2000,[1] despite a significant downturn in the middle of the decade. However, during this period annual inflation rates in Turkey ranged from 55 percent to 106 percent. (Togan and Ersel, p. 3) In 1999 Turkey's newly elected government sought the advice and financial assistance of the International Monetary Fund (IMF) in preparing an economic program with the primary goal of freeing the Turkish economy from the problem of inflation that had plagued the nation for over twenty years. (Önal and Erçel, 1999, par. 1)

The program aimed to curb inflation by reducing interest rates through several initiatives, including the strengthening of the country's banking system and increased banking regulation. The program was well supported by Turkish and international investors, and in 2000 the annual inflation rate fell from over 60 percent to 33 percent. (Kumcu, p. 2) This positive start quickly deteriorated, however, as Turkey's banking sector experienced significant crises in November 2000 and February 2001. The disinflationary program became controversial as it was considered by many to be a major factor contributing to the financial crises. The program's critics included Erkan Kumcu, a former vice-governor of the Central Bank of Turkey, who argues that the IMF failed to properly identify and react to market conditions leading up to the crises. Despite controversy over actions leading up to the financial crises, it is

[1]Amounts are in 2009 U.S. dollars. All other dollar values will be given in terms of exchange rates at quoted dates.

clear that improving the structure and regulation of the banking sector was a major part of the IMF initiative in Turkey before and after the crises.

This article discusses the positive steps taken by the Turkish government to improve banking regulations prior to the financial market turmoil in 2000 and analyzes efforts to improve the capital adequacy of banks through stricter regulation. In addition, it examines the Banking Sector Restructuring Program that was the main response to the crises and evaluates the program's effect on competition and efficiency within the banking system. Finally, the article considers important issues facing Turkey's financial industry in 2010 and beyond.

Initial Actions

Improvements in the regulatory framework of Turkey's banking sector began prior to the crises in 2000 and 2001. The Banking Regulation and Supervision Agency (BRSA) was created by the nation's parliament in June 1999. This was important, for the BRSA became the primary regulator of the nation's banks as it took control of duties previously performed by entities under the control of both the Treasury and Central Bank. Revisions and improvements to capital adequacy regulations were made over the next several years as a result of BRSA policy, including the main response to the financial crises that would follow in 2000 and 2001. In addition, the laws governing the operation of the deposit insurance organization known as the Savings Deposit Insurance Fund (SDIF) were amended, and this organization was placed under the control of the newly-formed BRSA. The actions taken in 1999 and 2000 to improve the regulation of Turkey's banks were unsuccessful in preventing the crises the country faced at the end of 2000; however, they served as an essential first phase in the reform of banking sector regulation and created the regulatory structure necessary to prepare an effective restructuring plan to promote recovery.

Establishment of the Banking Regulation and Supervisory Agency

Following the agency's formation, several steps to improve the performance of the BRSA were taken by the Turkish government with the full support of the IMF, leading up to the BRSA becoming fully operational in August 2000. These improvements focused primarily on two major issues facing the BRSA in its first year of operation — the low level of transparency within the agency and its level of independence from the influence of outside parties, specifically government officials. These issues were identified in Turkey's December 9, 1999, Letter of Intent to the IMF as specific areas targeted for improvement through banking law amendments planned for 2000. These amendments were made in accordance with timelines set forth in the Letter. The degree of independence of the agency was increased by removing the input of the Council of Ministers in banking supervision beyond the appointment of members of the BRSA board, and this was a vital improvement that allowed for more effective and efficient operation.

The original BRSA board was appointed in March 2000. According to banking law, members of the board serve six-year renewable terms. Each member of the seven-person board is required to have significant work or academic experience (at least ten years beyond undergraduate study), and candidates may come from two distinct areas — former financial institution executives or experts from academia. ("Banking Law No. 5411," p. 36) Encouraging the appointment of board members from both academia and industry promotes increased diversity of thought and reduces the effects of "groupthink" among board members, which is a significant obstacle to the effective operation of a regulatory body.

The regulations regarding election of BRSA board members show Turkey's dedication to removing outside influences, such as elected officials and private sector financial institutions, from the regulatory process. The six-year term length is significant in that it is longer than the term length of other elected officials (e.g., members of parliament), which lessens the temptations of short term political gain. In addition, board members may not be employed by any outside organization while employed by the BRSA and must be at least two years removed from employment in the banking sector. Also, board members must immediately sell or transfer all personally held shares of ownership in

financial institutions. Failure to comply with these regulations is considered to be a resignation from the BRSA board. ("Banks Act No. 4389," p. 3)

The importance of a single, autonomous regulatory agency should not be discounted. Such an organization, in my opinion, is the most effective and unbiased way to regulate an industry, since the conflicting interests of elected officials and private-sector banking representatives can be impediments to efficient regulation. The process of establishing the BRSA and refining the laws governing the organization followed a detailed timeline endorsed by the IMF, and Turkey was able to adhere to this timeline and to successfully meet most self-imposed deadlines. The BRSA became fully operational in August 2000 following the establishment process. The timely enactment of each piece of the BRSA's regulatory framework shows that Turkey considered this initiative a priority in its overall plan to reshape its economy.

Savings Deposit Insurance Fund

Another step taken by the Turkish government to improve the regulatory framework prior to the 2000 and 2001 crises in financial markets was a reworking of the laws governing the operation of the SDIF. The SDIF was founded in 1983 to insure savings deposits in banks under the control of the Central Bank, and from 1994 on it was given responsibility for improving the financial positions of struggling banks when necessary. ("Deposit Insurance and the Differential Premium System in Turkey," p. 5) As part of the disinflationary program, control of the SDIF was shifted to the BRSA; and beginning in 2000 the SDIF was required to seize all banks deemed insolvent by the BRSA and either to take the necessary steps for liquidation or to restructure them for sale in full or in part. (Erelçin) Also, the SDIF was no longer permitted to provide liquidity to any banks other than those in its control. (Önal and Erçel, 1999, par. 55–56)

In my opinion, the orderly restructuring of an insolvent bank is a requirement in modern financial markets as it protects depositors and creditors who are the sources of the funds needed for bank operation. This was recognized by both Turkish and IMF authorities as they developed the disinflationary program. The changes to the operation of the SDIF laid the foundation for orderly restructuring that protects bank assets that are claimed by its lenders (depositors and creditors). In addition, the takeover of insolvent banks plays a role in the discipline of banking executives and management teams as they make decisions regarding risk-taking in the future.

The SDIF played a significant role throughout the process of banking reform, with eight banks falling under its control by May 2000 before the worst of the financial turmoil. As the BRSA became operational, it took control of the SDIF (still funded by the Treasury); and the plans implemented by the BRSA regarding restructuring insolvent institutions were a top priority of the Banking Sector Restructuring Program, as is explained in later sections. Reworking the laws governing the SDIF and redefining its function in order to more efficiently and effectively address insolvent banks were positive steps taken through the disinflationary program.

Capital Adequacy

Through the newly formed BRSA, amendments and additions to banking law attempted to address several other important issues facing the banking sector. Chief among these was the capital adequacy of financial institutions. Capital adequacy of banks is a major issue in the regulatory framework of every nation, with national regulators establishing minimum capital requirements, most often through the use of a capital adequacy ratio that creates a model for determining the level of risk associated with each type of asset held by the institution. Forcing banks and other financial institutions to meet minimum capital requirements allows institutions to maintain solvency in the event that losses of a sizeable magnitude occur in the future.

Reduction of risk among banks through more stringent capital requirements was a part of the original IMF-sponsored disinflationary program. In the December 1999 Letter of Intent to the IMF, it is stated that Turkish authorities intended to "by end-June 2000 . . . amend capital adequacy rules to take into account market risks" and to require all banks with unsatisfactory capital adequacy ratios to

"present and adhere to time-bound programs for strengthening their capital positions." (Önal and Erçel, 1999, par. 54)

In the first half of 2000, Turkey implemented the legislation it proposed in the December 1999 Letter of Intent. Banks were required to incorporate market risks, including interest rate and equity risk, into their calculations of capital levels for regulatory purposes. (Pazarbaşıoğlu, p. 170) Stronger foreign exchange exposure limits were also introduced prior to establishment of the BRSA as the Central Bank introduced a provision requiring banks to completely offset foreign exchange positions above certain limits by increasing reserves. (Önal and Erçel, 2000, par. 26) These are examples of significant improvements to capital adequacy regulation made in Turkey during the early stages of the disinflationary program. Other minor amendments to capital adequacy rules within the banking law became fully effective in January 2002 after substantial delays and multiple missed deadlines. (Dervis and Serdengeçti, 2002, par. 35)

Despite several positive actions taken as part of the disinflationary program, it is clear that capital adequacy rules remained a weakness of the Turkish banking regulatory framework. The financial crises of 2000 and 2001, as well as actions taken during the period from 2003 to 2007 to meet international capital adequacy standards, provide strong evidence in support of the claim that capital adequacy regulations in Turkey were not stringent enough. Not surprisingly, in the immediate aftermath of the crises, the undercapitalization of institutions in the banking sector was a major issue and concern. The SDIF took control of ten banks between October 27, 2000, and July 9, 2001 ("Banks Managed by the Savings Deposit Insurance Fund . . . ," p. 2); but the 27 private banks that remained outside of SDIF control (along with state-owned banks) were experiencing their own capital problems in 2001. Regulations requiring undercapitalized banks to submit time-bound recapitalization plans were put into effect; and in June 2001 the BRSA set a target date of December 31, 2001, for all private banks to be in compliance with minimum capital adequacy regulations. (Dervis and Serdengeçti, 2001, par. 12) Despite difficulties experienced by private banks meeting the deadlines set forth by the BRSA, by May 1, 2002, the majority of private banks had met minimum capital requirements. (Thompson et al., p. 1) However, it appears that in 2002 Turkey's minimum capital requirements were not sufficient when compared to international standards.

In May 2002, Fitch Ratings' analysts thought that, despite meeting minimum capital requirements, Turkish private banks were undercapitalized when compared with international standards. (Thompson et al., p. 1) Much of the concern raised by these analysts was a result of conservatism in a highly volatile, post-crisis environment, but many of the issues raised in their report about the regulatory guidelines regarding bank capital are observations that could have been and should have been considered in the original disinflationary program. The Fitch Ratings analysts' report notes that the risks associated with certain assets are not properly accounted for in capital adequacy calculations. Specifically, Turkish treasury securities and other government bonds are assigned a risk rating of zero under Turkish capital regulations; this is a questionable practice when Turkey's sovereign rating of "B" is considered. Additionally, the report stated that it was possible to circumvent new regulations forcing loans made to large owners (defined as owning 10 percent or more of capital) to be deducted from the capital base when calculating capitalization levels. (Thompson et al., p. 3) The report also questioned certain aspects of the standardized market risk measurement method employed by banks to estimate market risk under the legislation introduced in 2001.

It is clear that, despite Turkey's apparent commitment to strict capital requirements for its banks, several areas for improvement existed prior to the crises of 2000 and 2001. In the years after the recovery, Turkey adopted capital adequacy standards more in line with international norms established by the Basel Committee on Banking Supervision as the nation considered potential accession to the European Union.

Banking Sector Restructuring Program

In May 2001 the BRSA introduced the Banking Sector Restructuring Program (BSRP) as a direct response to the crises of 2000 and

2001. The program sought to restructure the three broad types of banks in the market: state-owned banks, private banks, and those under the control of the SDIF. As a result, the major stated objectives of the BSRP were the strengthening of private banks, the swift resolution of SDIF-controlled banks, and a complete restructuring of the public banking system. The BRSA also described the main pillars of the program as: "1) financial and operational restructuring of the banking sector, and 2) further improvement of banking regulation and supervision in order to promote efficiency and competition in the banking sector." ("Banking Sector Restructuring Program Press Release," p. 1) These pillars provide a framework for the program's intended function through which the success of the program can be analyzed. Clearly, the end result of the restructuring program if properly implemented is a reorganized, more efficient, and more competitive banking sector capable of driving future economic growth.

Resolution of Banks under SDIF Control

The SDIF played a key role in Turkey's response to the 2000 and 2001 crises, and it was a major tool used by the BRSA during the process of restructuring the banking sector. From 1997 to 2003, the SDIF seized control of 20 banks under the provisions of banking law. ("Banking Sector Restructuring Program: Progress Report — (VII)," p. 17) Eight of these banks were transferred to the SDIF in 2001, during the immediate aftermath of the crises. Also, during 2001 the SDIF managed to remove several banks from its control through mergers, sales, or liquidation — an important point considering the fact that no SDIF-controlled banks had been removed from SDIF control during the previous four years. ("Banking Sector Restructuring Program: Progress Report," p. 12) The BSRP can be credited with encouraging the swift resolution of SDIF-controlled banks, as it established a framework for the resolution process. The restructuring and resolution strategy had several main elements, including financial restructuring and operational restructuring of SDIF-controlled banks. ("Banking Sector Restructuring Program: Progress Report," p. 11)

Through its actions, the SDIF made it clear that the preferred outcome for banks under its control was ultimately a sale to an outside investor. Theoretically, in cases when this was not possible, the SDIF had the option of withdrawing all banking licenses and forcing the liquidation process; however, legal obstacles made liquidation a difficult and often impossible outcome. ("Banking Sector Restructuring Program: Progress Report — (VII)," p. 23) As a result, "transition banks" were introduced and were created through the merger of several SDIF-controlled banks to be restructured and sold at a later date.

By October 2003 the total cost of the financial restructuring of banks taken over by the SDIF was $22.5 billion, of which over 75 percent was funded through public sector resources (the remaining cost was covered by SDIF resources including fees paid by registered banks). ("Banking Sector Restructuring Program: Progress Report — (VII)," p. 26) The injection of foreign-exchange-indexed treasury securities allowed the open foreign exchange (FX) positions of SDIF-controlled banks to be reduced from $4.5 billion in May 2001 (when the BSRP was announced) to $561 million by the end of June 2001. ("Banking Sector Restructuring Program: Progress Report — (VII)," p. 28) Despite the seizure of additional banks, the open FX position of SDIF banks stood at $408 million in January 2002. ("Banking Sector Restructuring Program: Progress Report," p. 13) These FX positions became significant liabilities following the decision to float the Turkish lira in late February 2001, which was followed by an overnight depreciation of 25 percent. In addition to significantly reducing FX exposure, SDIF-controlled banks were able to eliminate short-term liabilities by selling government bonds to the Central Bank. ("Banking Sector Restructuring Program: Progress Report," pp. 13–14) These efforts to improve the financial positions of insolvent banks, while a large financial burden to Turkey's treasury, eliminated much of the immediate threat of insolvency of the banks seized by the SDIF.

The operational restructuring strategy that the BSRA put into place through the BSRP involved significant reductions in the number of branches and personnel of seized banks. At the time of their transfer to the SDIF, the 20 seized banks had 1,815 branches and 37,889

employees. Through the restructuring process 265 branches were directly sold, and 851 bank branches were shut down. ("Banking Sector Restructuring Program: Progress Report — (VII)," pp. 29–30) In addition, the total number of employees was reduced by 43 percent by the end of January 2002. ("Banking Sector Restructuring Program: Progress Report," p. 14) These statistics show the level of commitment made by the BRSA and the SDIF to improving efficiency and reducing waste in the banking system. Given the desperate situations of many of the SDIF-controlled banks, across-the-board restructuring was necessary and led to reduction in costs that increased the viability of many of the institutions.

The elimination of short-term liabilities, the reduction of FX exposure, and the decrease in the number of branches and employees significantly improved the financial position and cost burden of banks under SDIF control. The steps taken by the program resulted in several positive outcomes, including the sale of Sümerbank to the OYAK Group in August 2001, the sale of Demirbank to HSBC (a British financial institution), and the sale of Sitebank to the Italian firm Novabank. ("Banking Sector Restructuring Program: Progress Report," p. 12) Overall, eight of the original banks taken over by the SDIF were sold in 2001, and the Sitebank sale was completed in January 2002. However, attempts to liquidate or sell many other banks failed, with legal action being the main obstacle to the liquidation process. As a result, the need for transition banks, which were created through mergers of several SDIF-controlled banks, arose. The sale of the first transition bank, Sümerbank, was a major success; but the other transition bank, Bayındırbank, remained unresolved for several years.

The resolution of insolvent banks in the aftermath of the crises was expensive and not without problems. However, the SDIF proved capable of handling the issues surrounding the seizure and restructuring of insolvent financial institutions. This is important for the Turkish banking sector, as the capability of the SDIF to seize and efficiently restructure insolvent institutions acts as a deterrent to excessive risk-taking by bank executives and managers while also maximizing shareholder and bondholder value preserved in the event of insolvency.

Competition and Efficiency in the Banking System

As publicly stated at the outset of the BSRP, the BRSA hoped that its efforts in response to the 2000 and 2001 crises would allow the banking sector to emerge from the financial turmoil as a more efficient and competitive system. The importance of the banking sector to the overall economy in Turkey cannot be overlooked, as all modern economies rely on the movement of funds through financial markets. Evidence of the importance of financial systems for economic growth includes the failure of financial institutions and freezing of credit markets in the United States and around the world in 2008 which led directly to a worldwide recession. As a result, an increase in efficiency and competition in the sector would prove to be extremely beneficial to the Turkish economy. Therefore, in an analysis of the results of the restructuring program it is prudent to consider trends in efficiency and competitiveness.

One often-cited measure of bank efficiency is the cost efficiency concept. Studies conducted to determine the cost efficiency of a bank attempt to quantify how well a bank is using its available resources to conduct its business. Matousek, Dasci, and Sergi (2008) analyzed the cost efficiency of three state-owned banks and twenty private banks in Turkey from 2000–2005. Their sample covers almost the entire banking sector, as the 23 banks studied controlled 99 percent of the banking system's assets. (Matousek et al., p. 344) The study's results, which are summarized in Table 1, show that a steady improvement in cost efficiency occurred among state-owned banks, private banks, foreign banks, and the banking system as a whole. Interestingly, the state-owned banks were comparatively more efficient over the period. The authors attribute this to the large size of the state banks, the lower price of labor available to the state banks, and the relatively hard budget constraints imposed on state banks. (Matousek et al., pp. 348–49) The authors also acknowledge that the analysis "unambiguously indicates that the Turkish Banking System has a large potential for improvement" in the area of efficiency. (Matousek et al., p. 352) However, the most important conclusion to be

Table 1

Bank Efficiency Estimates (maximum 100%)

	All Banks	State-owned	Private	Foreign
2000	75.6%	83.6%	74.6%	73.5%
2001	79.0%	86.0%	78.1%	77.1%
2002	82.0%	88.1%	81.2%	80.0%
2003	84.5%	89.9%	83.9%	83.1%
2004	86.8%	91.4%	86.3%	85.5%
2005	88.9%	92.8%	88.3%	87.7%

Source: Matousek et al., p. 349.

drawn from their study is that, as the banking system emerged from the crises with the aid of the BRSA's restructuring program, a steady increase in efficiency occurred.

As the efficiency of the banking system increased during the operation of the restructuring program, the sector was also becoming more concentrated. As shown in Table 2 (Panel A), the total number of banks in the sector decreased from 61 in 2001 to 47 in 2005. The reduction in the number of banks operating in Turkey was not unexpected, since the BSRP encouraged merger and acquisition activities through its strategies employed by the SDIF and through tax incentives. (Abbasoğlu et al., p. 5)

Further evidence of increased concentration is provided by Abbasoğlu, Aysan and Güneş (2007) who analyze the degree of competition from 2001–2005 using three separate measures: the percentage of total banking sector assets controlled by the largest three banks (C3), the total percentage of banking sector assets controlled by the largest five banks (C5), and the well-known Herfindahl-Hirschman Index (HHI) as measures of the degree of concentration. All three indices increased over the period, as shown in Table 2 (Panel B), indicating a trend toward increasing concentration. Abbasoğlu et al. also provide H-statistic[2] calculations to determine the level of competition in the banking sector over the same period. As shown in Table 2 (Panel C), two similar models produce H-statistics between 0 and 1, which indicates that the banking sector experienced monopolistic competition over the entire period. (Abbasoğlu et al., p. 12) Therefore, it appears that despite the significant merger and acquisition activity that occurred following the crises, which was encouraged as part of the restructuring program, the banking system managed to remain in a state of monopolistic competition and not one that is overly concentrated.

The studies summarized in this section strongly suggest that through the BSRP, Turkish authorities managed to increase efficiency and promote merger and acquisition activity to salvage the assets of struggling institutions without making overly significant sacrifices in the area of competition. In addition, the recovery of Turkey's financial sector following the restructuring program created opportunities for recovery of the economy as a whole, with the nation experiencing average annual GDP growth of 7.2 percent from 2002–2006. (Çimenoğlu et al., p. 185) The financial stability during this period allowed for the policies implemented as part of the disinflationary program (including fiscal policy controls and a free-floating Turkish lira) to take hold, resulting in average annual inflation from 2002–2006 of only 15.0 percent. Inflation rates decreased significantly during the post-crisis period; and a 6.5 percent annual inflation rate was achieved in 2009. (Central Bank of the Republic of Turkey; Çimenoğlu et al., p. 185) It is clear that the more efficient, stable banking sector that emerged following the BSRP had a positive impact on the entire Turkish economy, as the policy decisions made by the BRSA encouraged a strong banking sector capable of fueling economic growth.

[2]Defined as the sum of the factor price elasticities of interest revenue with respect to capital, labor, and physical capital.

Table 2

Panel A: Number of Operating Banks in Turkish Banking System

	2001	2002	2003	2004	2005
Sector Total	**61**	**54**	**50**	**48**	**47**
Commercial	**46**	**40**	**36**	**35**	**34**
State-owned	3	3	3	3	3
Privately-owned	22	20	18	18	17
Foreign	15	15	13	13	13
SDIF-controlled	6	2	2	1	1
Non-Depository	**15**	**14**	**14**	**13**	**13**
State-owned	3	3	3	3	3
Privately-owned	9	8	8	8	7
Foreign	3	3	3	2	3

Panel B: Concentration Indices (maximum 1.0)

	2001	2002	2003	2004	2005
C3	0.370727	0.403774	0.429238	0.425586	0.456325
C5	0.475055	0.488920	0.493417	0.489567	0.534048
HHI	0.083636	0.088299	0.094170	0.094883	0.098053

Panel C: H-Statistics[1]

	2001	2002	2003	2004	2005
Model 1[2]	0.5650542	0.2438027	0.1830553	0.1814690	0.1923365
Model 2[3]	0.5975753	0.4919328	0.5785956	0.1884205	0.3922842

Source: Abbasoğlu et al., pp. 7, 11–12.

[1]H-Statistic computation uses the following inputs: a) unit price of loanable funds, b) unit price of labor, c) unit price of capital.

[2]Model 1 uses the following unit price approximations: a) ratio of annual interest expenses to total funds, b) ratio of annual personnel expenses to number of employees, c) ratio of physical capital expenditure to total prices.

[3]Model 2 uses the following unit price approximations: a) ratio of annual interest expenses to total deposits, b) ratio of annual personnel expenses to total assets, c) ratio of other operations and administrative expenses to total assets.

Issues Facing the Banking Sector In the Future

As part of Turkey's bid to become a member of the European Union (EU), the Turkish government has launched several economic initiatives aimed at meeting EU requirements and standards. These initiatives include compliance with EU banking legislation, which parallels standards developed by the Basel Committee on Banking Supervision. (Pazarbaşıoğlu, p. 170) The Basel Committee develops and publishes standards with the goal of improving the quality of banking supervision worldwide, including the Basel II Framework regarding capital adequacy requirements and measures. (Basel Committee on Banking Supervision) Following the introduction of the BSRP, Turkey began making plans to fulfill the requirements of Basel II and the accompanying EU directives. In 2003 six large Turkish banks took part in the third Quantitative Impact Study (under BRSA supervision) in order to determine the potential impact of the enactment of Basel II policies; and plans were made to implement the EU equivalent legislation by 2007. (Pazarbaşıoğlu, pp. 171–72) Turkey's government and the BRSA made a firm commitment to meet inter-

national standards, and legislation introduced in 2005 put the country in full compliance with Basel II guidelines. (Çimenoğlu et al., p. 190) This legislation focused primarily on improving corporate governance rules and internal risk control, and its quick implementation is a product of Turkey's commitment to compliance with international standards as it continues the EU accession process going forward.

In September 2009, in response to the global financial crisis that began in 2008, the Basel Committee met with central bank governors and other officials from around the world to develop a comprehensive set of regulations and supervisory policies aimed at improving banking supervision. It remains to be seen if regulatory legislation in the EU, and elsewhere around the world, will be amended in response to the global financial crisis and Basel Committee recommendations. As a result, changes to EU directives regarding Turkey's banking regulation are unknown; but as of 2009 Turkey's banking sector has met all EU accession requirements and the banking industry is not an obstacle to potential accession.

In the aftermath of the 2000 and 2001 crises, the banking sector experienced increased consolidation. However, since 2005 the number of banks operating in Turkey has not changed considerably; and as of 2009 there are a total of 45 banks in the system, compared with 47 in 2005. During the next several years, there is a distinct possibility of another phase of consolidation (Sabancı Dinçer) through mergers and acquisitions, as domestic banks look to expand and foreign banks enter the market. The BRSA will need to play a role in preventing problems that can arise from too much consolidation, namely decreased competition. In addition, increased concentration can lead to a situation where the public sector is forced to "bail out" an institution that is large enough to pose a systemic risk to the entire banking system and economy. Similar situations occurred in the United States during 2008; however, Turkey differs from the United States in that a large portion of its banking system is state-controlled. Thus, the failure of private banks in Turkey is not as great a threat to the system as a whole, but the BRSA must consider the systemic risks associated with the potential failure of large institutions.

Another trend that has developed in the banking system following the 2000 and 2001 crises and restructuring efforts is a substantial increase in foreign capital. Prior to 2001 the participation of foreign banks in Turkey was insignificant, but this changed as structural changes to the banking system created more attractive opportunities for foreign investors. (Çimenoğlu et al., p. 191) By December 2007, nine of Turkey's ten largest private banks had some type of foreign interest in their capital base. (Çimenoğlu et al., p. 191) Increased participation of foreign investors in Turkey's banking system (and in other sectors of the economy as well) is a result of improved financial stability and efforts of business representatives and the government to promote openness and encourage direct investment. This has allowed for more efficient resolution of SDIF-controlled banks as foreign bidders became significant players in merger and acquisition activity. Foreign investment should continue to fuel growth in the banking sector and subsequently the entire economy in the future, and the success of efforts to privatize the state controlled banks will undoubtedly be enhanced by the availability of foreign capital. As of 2009, Vakifbank and Halkbank shares have been publicly floated, with approximately 30 percent of each firm owned by investors outside the Turkish government. (Erelçin) A second public offering is planned for each bank, and these offerings will reduce the government's share in each bank to between 51 and 55 percent. (Erelçin) However, it appears that the government will retain majority ownership (and thus operational control) of each bank for the foreseeable future. In addition, Ziraatbank (the largest bank in Turkey) provides a significant source of revenue for Turkey's treasury, making privatization in the near term unlikely. (Erelçin)

Conclusion

Since the announcement of Turkey's IMF-supported disinflationary strategy in 1999, the country's banking sector has experienced major crises, significant concentration, and important regulatory changes. These changes have been a result of the initial policies of the disinflationary program, as well as part of the BRSA's response to the crises of 2000 and 2001. Prior

to these crises, Turkish officials correctly identified several areas for improvement in banking regulation. The formation and strengthening of the BRSA, the adaptation of the laws and policies governing the operation of the SDIF, and the identification of issues with capital adequacy laws were among the positive steps taken prior to the crises. However, capital requirements for Turkish banks remained weak before a serious effort was made to fully comply with international standards as outlined by the Basel Committee.

As a direct response to the 2000 and 2001 crises, the BRSA launched a restructuring program aimed at recapitalizing and reforming public and private banks in the system in order to promote efficiency and competition. The SDIF played a major role in this process as it performed financial and operational restructuring, merged many of the insolvent institutions it seized, and was able to sell several of the banks to outside parties.

However, the process of restructuring insolvent banks in the banking system was costly and not without problems, including legal obstacles to forced liquidation; and this is a concern for the BRSA in future situations. In addition, as Turkey continues its pursuit of EU membership, the BRSA will continue to play a significant role as Turkey's regulatory framework, and the strength of its banking sector must continue to meet EU directives. Also, the potential for future consolidation and increased concentration in the banking sector exists, which could impact competition and the amount of systemic risk associated with individual financial institutions. The existence of the BRSA will allow for more effective management of these potential issues as Turkey's banking sector and the economy as a whole looks toward the future.

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