

Peer Review of Turkey
Review Report

19 November 2015

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Foreword

Financial Stability Board (FSB) member jurisdictions have committed, under the FSB Charter and in the *FSB Framework for Strengthening Adherence to International Standards*¹, to undergo periodic peer reviews. To fulfil this responsibility, the FSB has established a regular programme of country and thematic peer reviews of its member jurisdictions.

Country reviews focus on the implementation and effectiveness of regulatory, supervisory or other financial sector standards and policies agreed within the FSB, as well as their effectiveness in achieving desired outcomes. They examine the steps taken or planned by national authorities to address International Monetary Fund (IMF)–World Bank Financial Sector Assessment Program (FSAP) and Report on the Observance of Standards and Codes (ROSC) recommendations on financial regulation and supervision as well as on institutional and market infrastructure that are deemed most important and relevant to the FSB’s core mandate of promoting financial stability. Country reviews can also focus on regulatory, supervisory or other financial sector policy issues not covered in the FSAP that are timely and topical for the jurisdiction itself and for the broader FSB membership. Unlike the FSAP, a peer review does not comprehensively analyse a jurisdiction's financial system structure or policies, or its compliance with international financial standards.

FSB jurisdictions have committed to undergo an FSAP assessment every 5 years; peer reviews taking place 2-3 years following an FSAP will complement that cycle. As part of this commitment, Turkey volunteered to undergo a peer review in 2015.

This report describes the findings and conclusions of the Turkey peer review, including the key elements of the discussion in the FSB’s Standing Committee on Standards Implementation (SCSI) on 15 October 2015. It is the sixteenth country peer review conducted by the FSB, and it is based on the objectives and guidelines for the conduct of peer reviews set forth in the *Handbook for FSB Peer Reviews*.²

The analysis and conclusions of this peer review are based on the Turkish financial authorities’ responses to a questionnaire and reflect information on the progress of relevant reforms as of September 2015. The review has also benefited from dialogue with the Turkish authorities as well as discussion in the FSB SCSI.

The draft report for discussion was prepared by a team chaired by Nai Seng Wong (Assistant Managing Director, Monetary Authority of Singapore) and comprising Lauren A. Anderson (Bank of England), Patrizia Baudino (European Central Bank), Nicola Brink (South African Reserve Bank) and Calixto Lopez (Central Bank of Mexico). Greta Mitchell Casselle, Costas Stephanou and Ruth Walters (all FSB Secretariat) provided support to the team and contributed to the preparation of the peer review report.

¹ See http://www.financialstabilityboard.org/2010/01/r_100109a/.

² See <http://www.financialstabilityboard.org/2015/03/handbook-for-fsb-peer-reviews/>.

Abbreviations

AML	Anti-money laundering
BCBS	Basel Committee on Banking Supervision
BCP	Basel Core Principles for Effective Banking Supervision
BL	Banking Law
BRSA	Banking Regulation and Supervision Agency
CBRT	Central Bank of the Republic of Turkey
CFT	Combating the Financing of Terrorism
CMB	Capital Markets Board
D-SIBs	Domestic Systemically Important Banks
FATF	Financial Action Task Force
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
FSC	Financial Stability Committee
FSR	Financial Stability Report
FX	Foreign exchange
GDP	Gross domestic product
IAIS	International Association of Insurance Supervisors
ICAAP	Internal Capital Adequacy Assessment Process
KAs	FSB's <i>Key Attributes of Effective Resolution Regimes</i>
LTV	Loan-to-value
MASAK	Financial Crimes Investigation Board
MOF	Ministry of Finance
MOU	Memorandum of Understanding
MPC	Monetary Policy Committee
NPL	Non-performing loan
PEP	Politically Exposed Persons
QIS	Quantitative impact studies
ROA	Return on Assets
ROC	Reserve Option Coefficient
ROE	Return on Equity
ROM	Reserve options mechanism
SDIF	Savings Deposit Insurance Fund
SME	Small- and medium-sized enterprises
SRAG	Systemic Risk Assessment Group
SRCC	Systemic Risk Coordination Committee
TL	Turkish Lira
USD	United States Dollar

Executive summary

Background and objectives

The main purpose of this peer review is to examine two topics that are relevant for financial stability and important for Turkey: the macroprudential policy framework and tools, and bank resolution. Both topics were included in the key FSAP recommendations and are topical for the broader FSB membership. The peer review focuses on the steps taken by the Turkish authorities to implement reforms in these areas, including by following up on relevant FSAP and FSB recommendations.

Main findings

Progress has been made in developing the macroprudential policy framework and the current bank resolution framework has served Turkey well to date. However, there is additional work to be done in both areas. On the macroprudential policy framework, this involves developing an integrated risk assessment and policy framework as well as enhancing public communication of macroprudential policies. On resolution, the current framework can be further strengthened by incorporating additional features of the FSB's *Key Attributes of Effective Resolution Regimes for Financial Institutions (Key Attributes)*.

Macroprudential policy framework and tools

The authorities have made progress in developing their macroprudential policy framework in recent years. In particular, the Financial Stability Committee (FSC), established in 2011, has helped to promote information sharing and the candid exchange of views as well as to coordinate some policy measures among its member institutions;³ the 2013 restructuring of the Banking and Financial Institutions Department within the CBRT has enhanced the focus on financial stability analysis; data collection and analysis on the foreign exchange (FX) positions of the non-financial corporate sector has improved; and the Systemic Risk Assessment Group (SRAG) under the FSC is developing additional risk assessment tools and working to address identified data gaps. Importantly, the authorities have a broad range of tools at their disposal and have used them in a proactive and flexible manner in recent years to slow down the rise in household leverage and to encourage banks to increase core funding.

Further steps can be taken to strengthen the macroprudential framework in a number of areas.

- ***Integrated systemic risk assessment and policy framework:*** The macroprudential framework should ensure integration at three levels: bringing together the analytical contributions of the relevant authorities to present a holistic assessment of systemic risk; linking risk analyses and macroprudential policies to address those risks; and ensuring the overall consistency and coherence of the tools used for macroprudential purposes.

³ The FSC comprises the Undersecretary of Treasury and the heads of the Central Bank (CBRT), Banking Regulation and Supervision Agency (BRSA), Capital Markets Board (CMB) and Saving Deposit Insurance Fund (SDIF) under the chairmanship of the Minister in charge of the Undersecretariat of Treasury.

As regards the analytical dimension, the CBRT and the BRSA have progressed in developing their respective analytical toolkits and sharing the data underpinning some of their risk analyses. While information sharing has improved, there is room for more joint work on analytical tools, methodologies and reports, in line with the FSAP recommendation for joint development of databases and modelling frameworks. Given its mandate, the SRAG should build on the technical expertise of its members (particularly the CBRT) to develop a holistic assessment of systemic risks in support of the FSC's work. The authorities are already taking steps in this area via the development of joint tools (such as a heat map) to assess systemic risks. Other possible steps include more sharing of analytical tools within the SRAG (e.g. via joint groups) and greater coordination in the design and use of such tools so that they complement one another (e.g. stress tests conducted by the CBRT and BRSA).

The second layer of integration involves close correspondence between analytical findings and possible macroprudential policy responses. At present, the SRAG does not regularly prepare a joint risk assessment report or evaluate potential policy responses for the FSC. The involvement of the FSC in the selection of macroprudential tools varies and there does not appear to be an explicit policy framework to guide the application of these tools. Closer integration of the SRAG's risk analysis with the policy discussion in the FSC, building on an integrated assessment of risks, would enhance policy coherence. Clearer communication to the public of the objective(s) that each tool is meant to address would help clarify the mapping between identified risks and proposed policy responses. This will also help clarify those policies that could benefit from coordination among the authorities via the FSC (e.g. policies that target the same objective) and those that could be undertaken independently under the exclusive mandates of the relevant authorities.

Third, the macroprudential tools are controlled by different authorities (primarily the CBRT and BRSA). Different policy measures can be (and have been) used to address the same objective; conversely the same tool can be (and has been) used for different purposes. At present, individual authorities are generally responsible for analysing the impact of their respective policies. The coordination of joint impact assessments of potential policy measures by the FSC, while respecting the operational independence and mandate of its member authorities, has occurred in some instances, particularly on an *ex-post* basis. Such joint policy assessments, especially on an *ex-ante* basis, should be further encouraged to ensure a coherent macroprudential policy framework, since this will enhance awareness about the possible interactions among tools and thereby reduce the risk of leakages or inconsistencies. It would also help to inform the choice of policy mix to achieve the desired objectives, which is an important consideration given the range of tools that can be deployed and multiple policy objectives.

- ***Institutional arrangements and public communication:*** The FSC has met twenty-four times since its formation in 2011, but there is no fixed meeting schedule and the topics discussed cover a broad array of issues that include financial sector development/inclusion strategies. The authorities note that the FSC can meet at any time, and that the meeting typically starts with presentations by member institutions on recent developments and risks. The FSC's functioning may be strengthened by developing a calendar of meetings and by including a holistic assessment of systemic risks (based on joint work by SRAG) as a standing agenda item.

The 2012 amendment to the Decree formalizing the operation of the FSC reinforces the reporting line of the FSC to the Council of Ministers and allows the latter to take additional policy measures to safeguard the financial system.⁴ The authorities view the role of the Council of Ministers as a “backstop” in crisis management, and note that SRAG has developed a protocol defining systemic risk and the role of member authorities. They also point out that no intervention by the Council has been necessary since the 2012 amendment given the consensus among FSC members and the fact that no issue has arisen of a “systemic financial stability” nature. At the same time, the trigger for the Council’s involvement (i.e. the nature/magnitude of systemic risks or the extent to which they have materialised) and the scope of possible measures to be taken (including the extent to which they may fall within the competency of the FSC members) are not specified in the Decree. This necessitates a delicate balance between the authority of the Council of Ministers to act decisively when needed while respecting the operational independence of FSC members. To enhance clarity of roles and accountability, it would be helpful for the authorities to clarify and develop guidelines detailing the circumstances in which the Council of Ministers could act, as well as the processes for action and the implications for FSC member institutions.

In addition, the FSC would benefit by having a well-structured communication strategy on macroprudential measures. FSC meeting minutes and decisions are currently not published. A brief press release is often issued on the website of the Treasury after a meeting, while the FSC Chair provides an outlook of risks and an overview of FSC activities in his speeches. However, this communication remains at a high level and is generally brief. Views on financial stability risks and policy responses are therefore primarily communicated by relevant member institutions via their own channels at different times and based on their particular vantage points. The adoption of a public communication strategy as a “soft” macroprudential tool by the FSC could help market participants better understand its macroprudential policy stance and the analyses, motivations and considerations underpinning agreed measures, which could enhance their effectiveness. Coordinated communication, with the FSC leading the way, would also send a strong signal to the public of the authorities’ shared perspectives and policy intent. In addition, it can enhance the FSC’s accountability to a broader group of stakeholders and incentivise timely and coordinated action by members, both of which are relevant considerations given the FSC’s institutional set-up. The need for such communication is even more pertinent in countries such as Turkey, given the complex interlinkages between monetary and macroprudential policies and multiple policy objectives.

Bank resolution

The authorities already have a fairly comprehensive bank resolution framework in place, which was revised in the 2005 Banking Law (BL) to reflect the significant experience gained from resolving banks during the 2000-01 banking crisis in Turkey. The allocation of

⁴ In particular, the Decree states that “in cases where a negative development that could spread over to the entire financial system occurs and such development is detected by the Financial Stability Committee, the Council of Ministers shall be in charge to determine the measures to be taken and all the relevant institutions and agencies are competent and responsible for prompt implementation of measures taken”.

responsibilities between the BRSA and the SDIF seems well-defined, and there is regular information sharing and cooperation between them. The SDIF has a relatively broad range of resolution powers at its disposal, and the authorities have submitted legislative amendments to provide for additional powers to establish a bridge bank and to use the purchase-and-assumption option in bank liquidation.

Nevertheless, further work is needed to ensure that the resolution framework adjusts to developments in the banking sector.

- ***Enhanced resolution powers and cross-border cooperation***: Since the 2005 BL amendments, the SDIF has taken control of only one small bank, so the effectiveness of the regime in resolving banks that could be systemic in the event of failure has not been tested.⁵ This will become an increasingly important issue as the banking sector grows in size (total assets currently exceed 110% of GDP) and complexity. The lack of some resolution powers found in the FSB's *Key Attributes* – such as to establish a bridge bank, write down or convert liabilities (bail in), and impose a temporary stay on exercise of early termination rights in resolution – may make it difficult for the authorities to resolve the largest banks in the system or to address the simultaneous failure of a number of banks in a timely and cost-effective manner.

While their presence abroad remains limited, Turkish banks are increasingly accessing foreign currency-denominated funding in various forms, much of which is governed by foreign law. Cooperation and information-sharing with relevant foreign authorities is necessary to enhance the authorities' ability to plan and carry out resolution in such cases. The BRSA is allowed to share bank-specific information with foreign bank regulators. However, the current legal framework does not permit the disclosure of bank-specific information to foreign resolution authorities (where the resolution authority is not the bank regulator), while existing MoUs between the BRSA and foreign bank regulators do not specifically provide for cooperation in resolution. These constraints may impede the effective resolution of banks with cross-border operations or foreign funding and could increase the costs of resolution.

The authorities acknowledge that the regime is not fully aligned with the KAs and, in addition to the proposed legislative amendments, have formed a BRSA-SDIF working group to determine how other powers in the *Key Attributes* can best be incorporated into the framework. It is important that the authorities maintain momentum in implementing the draft legislation (once approved by Parliament) and in developing the proposed further reforms that may be particularly important for the orderly resolution of banks that could be systemic in the event of failure.

- ***Recovery and resolution planning and resolvability assessments***: The current framework does not require recovery and resolution planning, and the authorities do not have legal powers to conduct resolution planning or to require banks to adopt changes to their structure or business practices with the aim of improving resolvability. Resolution options

⁵ The assessment that a bank may have systemic impact in the event of its failure is made for the purposes of resolution planning, and is not the same as the identification of a bank as a D-SIB for supervisory purposes in accordance with the BCBS methodology.

and tools are evaluated only when a bank is asked to take prompt corrective actions, based on high-level considerations such as safeguarding confidence and financial stability, prevailing market conditions and cost-effectiveness of resolution. While the current process may work well for small banks, the resolution of larger and more systemic banks with increasingly non-traditional funding structures is likely to be more complex. Furthermore, in the event that a bank's balance sheet deteriorates rapidly, there may be insufficient time to adequately prepare for resolution by developing a proper plan.

Recovery and resolution planning in advance of imminent failure should assist the authorities to develop effective resolution strategies, promote consistency in decision-making, shorten the actual resolution process, and help to identify and address obstacles to resolution. In support of this process, it may be useful for the SDIF and the BRSA to develop a framework for determining systemic importance for recovery and resolution planning. The adoption of powers for authorities to prepare resolution plans and to require banks to adopt measures to remove or mitigate obstacles to resolvability is likely to require legislative reform, but recovery planning could be substantially achieved within the ambit of existing supervisory powers. The organisational arrangements and processes between the BRSA and the SDIF for the development of recovery and resolution plans, respectively, should also be embedded in their business-as-usual operations.

- ***Funding in resolution:*** The current resolution framework imposes conditions on the provision of financial support to a bank in resolution. Those conditions were incorporated into the framework to reduce the moral hazard and high costs associated with public bail-outs, as reflected in the 2000-01 banking crisis. Provided that the SDIF owns the majority or all of the shares in a failing bank, there is no limit on the amount of financial resources that it can use to restructure and strengthen the financial standing of the bank. It can do so by, for example, increasing the capital of, making deposits with, making advances to, and taking over the non-performing assets of the bank. However, the amount that the SDIF may use to acquire the shares of a bank is capped at the amount of insured deposits and participation funds in that bank.

In the event that a systemic risk is identified by the FSC, the Council of Ministers can determine appropriate additional measures to safeguard the financial system. In such a context, any requirement for financial assistance that exceeds the statutory limits and conditions will be escalated to the Council of Ministers, who can approve assistance in excess of those limits and impose conditions on a case-by-case basis.

There may also be instances where official liquidity support to a bank in resolution is required for a period of time to support the resolution strategy. While the CBRT emergency liquidity facilities are only available for solvent banks, the SDIF is also able to provide liquidity by, for example, making deposits in a failing bank that it has acquired. However, the increasing reliance of banks on external wholesale funding may require temporary liquidity assistance in foreign currency that exceeds the limited amount currently available from the SDIF.⁶ In such a scenario, the SDIF could swap its Turkish Lira reserves into foreign currency or rely on advances from the CBRT, but the adequacy,

⁶ Part of the deposit insurance fund is invested in foreign-currency-denominated bonds and deposits.

modalities and implications of such funding (e.g. for macroeconomic policy) merit further consideration. Advance analysis of these issues (e.g. in the context of resolution planning) is needed so that the authorities are operationally prepared to provide on a timely basis any necessary liquidity funding, including in foreign currency, to a firm in resolution.

In light of the currently available means for recovery of public funds that are used in resolution – namely, collections from controlling shareholders and managers for misused funds, the sale of the bank, collections on assets transferred to the SDIF, interest on assets held for sale and liquidation proceeds – the authorities could also consider developing mechanisms for recovery of any shortfall of public funding from the industry, e.g. through additional levies.

Recommendations

In response to the aforementioned findings and issues, the peer review has identified the following recommendations for consideration by the Turkish authorities:

Macroprudential policy framework and tools

1. The authorities should develop a more integrated systemic risk assessment and policy framework by: (a) enhancing joint (inter-agency) assessment of systemic risks; (b) linking the analysis of those risks with the selection of policy tools for macroprudential purposes; and (c) analysing the interactions of tools by different agencies to help inform the choice of policy mix.
2. The authorities should: (1) strengthen the FSC's functioning by developing a regular meeting calendar and by including a holistic assessment of systemic risks (based on joint work by SRAG) as a standing agenda item; and (2) develop guidelines detailing the circumstances in which the Council of Ministers could act in order to safeguard the financial system. The FSC should also develop a public communication strategy to promote clear and coherent communication of the overall macroprudential policy stance, enhance accountability to stakeholders and incentivise timely and coordinated actions by its members.

Bank resolution

3. The authorities should incorporate in the resolution framework additional powers and also provisions for cross-border cooperation and information sharing specified in the *Key Attributes* so as to enhance their ability to resolve banks that could be systemic in the event of failure in a timely and cost-effective manner.
4. The authorities should develop recovery and resolution plans and conduct resolvability assessments for all domestic banks that could be systemic in the event of failure. In addition, the authorities should include legal powers to prepare resolution plans and to require banks to address obstacles to resolvability in further reforms of the resolution regime.
5. The authorities should review their current arrangements to ensure that adequate facilities and agreed procedures are in place for the temporary provision of liquidity to a bank in resolution in both local and foreign currency. The arrangements for funding of banks in resolution should be supported by clear mechanisms for the recovery of public funds from the industry, if necessary.

1. Introduction

Turkey underwent an assessment update under the Financial Sector Assessment Program (FSAP) in 2011. The FSAP Update included assessments of the BCBS *Basel Core Principles for Effective Banking Supervision* (BCPs) and the IAIS *Insurance Core Principles*.⁷

The FSAP reported that the financial system had weathered the 2008-09 global financial crisis relatively well. This was due to the significant capital buffers built up following the 2000-01 banking crisis, more effective fiscal and monetary management, strengthened banking regulation and supervision and conservative banking practices. In addition, Turkey's resilience owed much to a rapid rebound in capital flows and real activity. However, the FSAP noted that new macro-financial risks had emerged in recent years from domestic and international developments. It found that in the context of wide current account deficits, rapid credit growth had increased macro-financial risks; led by the Central Bank of the Republic of Turkey (CBRT), the authorities had responded, but important risks remained. The FSAP also noted that advances in establishing a stronger macroprudential policy framework were being made to ensure timely and well-coordinated responses to emerging risks in future, and recommended that a clearer separation of these arrangements from the crisis management framework would be useful.

The main purpose of the peer review is to examine two topics that are relevant for financial stability and important for Turkey: its macroprudential policy framework and tools, and the bank resolution framework. Both topics were included in the key FSAP recommendations and are topical for the broader FSB membership. The peer review focuses on the steps taken by the Turkish authorities to implement reforms in these areas, including by following up on relevant FSAP recommendations. In particular, the review evaluates progress made in order to draw conclusions and policy implications as well as identify remaining impediments and lessons that could be of benefit to Turkey and its FSB peers.

The report has two main sections, corresponding to the two topics being reviewed. Section 2 focuses on the macroprudential policy framework and tools, while Section 3 covers the bank resolution framework. In addition, Annex 1 provides background information on the structure of the Turkish financial system and on recent regulatory developments; Annex 2 presents an overview of tools used for macroprudential purposes in Turkey in recent years; and Annex 3 summarises the communication strategies of inter-agency financial stability bodies in selected countries. Annex 4 presents the follow-up actions reported by the authorities to other key FSAP recommendations; these actions have not been analysed as part of the FSB peer review and are presented solely for purposes of transparency and completeness.

⁷ See "Turkey: Financial System Stability Assessment" (September 2012, IMF Country Report No. 12/261, <http://www.imf.org/external/pubs/ft/scr/2012/cr12261.pdf>). The BCP and IAIS assessments have not been published.

2. Macprudential policy framework and tools

Background

The FSAP noted the advances made by the authorities in establishing a stronger macroprudential policy framework to ensure timely and well-coordinated responses to emerging risks. In particular, a Financial Stability Committee (FSC) was established in June 2011 by Decree Law 637.⁸ The FSC is composed of the Undersecretary of Treasury and the heads of the CBRT, Banking Regulation and Supervision Agency (BRSA), Capital Markets Board (CMB) and Saving Deposit Insurance Fund (SDIF) under the chairmanship of Minister in charge of the Undersecretariat of Treasury.⁹

The FSAP noted that the FSC had been given both a financial sector systemic risk monitoring function and a crisis management function. It recommended that consideration be given to separating the two functions more clearly given the existence of an inter-agency Systemic Risk Coordination Committee (SRCC),¹⁰ and to ensuring a leading role of CBRT in systemic risk monitoring and prevention; and that the authorities ensure appropriate communication and accountability of the FSC and to strengthen its mandate and powers through primary legislation. In terms of financial sector oversight, the FSAP recommended that the authorities ensure that data is available to assess the risk from unhedged corporate net short foreign exchange (FX) positions and take corrective actions as necessary; and that they jointly develop an approach to risk identification, leveraging the expert resources of the BRSA and CBRT, that combines the monitoring of key indicators with qualitative information.

The IMF's 2014 Article IV report¹¹ complimented the authorities on the implementation of measures to slow consumer credit growth and strengthening of stress tests. It found that the banking sector was well-capitalised, but that banks faced rollover risk on their wholesale external foreign exchange funding and remained indirectly exposed to exchange rate risk through foreign exchange lending to non-financial corporates. It recommended *inter alia* expanding the macroprudential toolkit in order to contain risks to financial stability, in particular the banking system's wholesale external foreign exchange funding.

This section examines the institutional arrangements, analytical framework and toolkit underpinning macroprudential policies in Turkey. It also reviews the progress made to date

⁸ Law on the Structures and Duties of the Undersecretariat of Treasury, No: 4059, Additional Article: 4. See <http://www.treasury.gov.tr/en-US/Pages/Legislation-Duties-of-Financial-Stability-Committee>. A decree law only requires a decision by the Council of Ministers, and it is on the same footing as a parliamentary act.

⁹ See Annex 1 for a description of the regulatory framework, including the mandates of the various agencies.

¹⁰ Until June 2011 Turkey's crisis management framework was mandated in the Banking Law, which authorised the Council of Ministers to determine extraordinary measures to deal with a negative development (as identified jointly by the SDIF, CBRT, BRSA and the Undersecretariat of Treasury). To operationalize the crisis management framework, a Memorandum of Understanding (MoU) signed in April 2009 by the relevant agencies had established the SRCC and charged it with the specific task of collectively identifying a systemic event.

¹¹ See "Turkey: 2014 Article IV Consultation" (December 2014, IMF Country Report No. 14/329, <http://www.imf.org/external/pubs/ft/scr/2014/cr14329.pdf>).

and next steps vis-à-vis the FSAP recommendations on the macroprudential policy framework, drawing on international guidance and cross-country experiences in this area.¹²

Steps taken and actions planned

Institutional arrangements: The FSC aims to identify and mitigate emerging systemic risks, to coordinate macroprudential policy actions, and to better integrate the micro- and macroprudential perspectives among its members. In particular, the FSC's main functions are to: (1) determine and monitor systemic risks that might spread to the entire financial system and identify necessary measures and policy proposals in order to mitigate them; (2) warn related institutions about systemic risks and follow the relevant practices regarding policy proposals; (3) evaluate systemic risk management plans prepared by the related institutions; (4) coordinate systemic risk management; (5) collect all data and information within the context of its duties, and coordinate policies and implementations among the institutions; and (6) make decisions related to other subjects within the framework of this law.

The FSC has met twenty-four times since its formation in June 2011, but does not have a fixed meeting schedule. The Treasury hosts the Secretariat for the FSC and, in that capacity, sets the meeting agenda based on proposals by the members. FSC deliberations are not public; according to the authorities, the topics discussed cover a broad array of issues, ranging from emerging financial stability risks to financial sector development/inclusion strategies and legislative reforms to strengthen financial stability. A meeting typically starts with presentations by member institutions and discussions on recent developments and risks. In cases of meetings on special topics, the FSC Chair may invite officials from other governmental bodies to attend.¹³ The FSC has also established *ad-hoc* working groups to carry out specific studies, such as on the housing market, over-the-counter derivatives reforms and financial inclusion.

According to the authorities, a key role of the FSC has been to foster candid discussions and coordinate among member institutions without compromising their independence. All the decisions taken by the FSC are based on consensus; member institutions are responsible for implementing the agreed action points in accordance with their respective mandates and powers. There is no formal comply-or-explain mechanism as part of the follow-up; however,

¹² See the FSB peer reviews of China, Germany, Netherlands, Russia, Saudi Arabia, UK and US (<http://www.financialstabilityboard.org/publications/peer-review-reports/>); "Macroprudential Policy Tools and Frameworks – Progress Report to the G20" by the FSB, IMF and BIS (October 2011, http://www.financialstabilityboard.org/2011/10/r_111027b/); "Macroprudential Policy: An Organizing Framework" (March 2011, <http://www.imf.org/external/np/pp/eng/2011/031411.pdf>), "Institutional Models for Macroprudential Policy" (November 2011, <http://www.imf.org/external/pubs/ft/sdn/2011/sdn1118.pdf>), "Key aspects of macroprudential policy" (June 2013, <http://www.imf.org/external/np/pp/eng/2013/061013b.pdf>) and "Staff Guidance on Macroprudential Policy" (December 2014, <http://www.imf.org/external/np/pp/eng/2014/110614.pdf>) by IMF staff; and "Macroprudential instruments and frameworks: A stocktaking of issues and experiences" (May 2010, <http://www.bis.org/publ/cgfs38.pdf>) and "Operationalising the selection and application of macroprudential instruments" (December 2012, <http://www.bis.org/publ/cgfs48.pdf>) by the CGFS.

¹³ The Ministry of Development and the Ministry of Finance have been invited several times to provide additional support and to contribute to the work of the FSC.

monitoring of implementation of FSC decisions is exercised both by the relevant member institution and by the FSC Secretariat, which in turn inform the FSC.

As regards accountability, the Decree established the Council of Ministers as the recipient of FSC updates, with the Minister in charge of the Undersecretariat of Treasury (as the FSC Chair) presenting the results of meetings and decisions of the FSC to the Council. An amendment to the Decree in late 2012 clarified that the Council of Ministers would also be responsible for determining policy measures to address systemic financial stability issues.¹⁴ This amendment reinforces the reporting line of the FSC to the Council of Ministers and allows the latter to take additional policy measures in order to safeguard the financial system. However, the trigger for Council of Ministers involvement (i.e. the nature/magnitude of systemic risks or the extent to which they have materialised) and the scope of the possible measures to be taken (including the extent to which they may fall within the competency of the FSC member institutions) are not specified in the Decree.

In order to further strengthen and support the FSC's activities, the authorities established the Systemic Risk Assessment Group (SRAG) in October 2012 that took over relevant duties and responsibilities of the SRCC. The SRAG was established by a protocol signed by the FSC members and its main mandate is to: identify potential systemic risk areas; alert the FSC about potential systemic risks; and improve coordination between member institutions for timely and consistent responses. The SRAG members are the FSC member institutions' deputies, with the BRSA acting as the secretariat.¹⁵ The SRAG meets at least four times a year, and the minutes and outcomes of the meetings are reported to the FSC.¹⁶ SRAG members share their views about the main threats to financial stability and prepare inputs (e.g. *ad-hoc* reports) for some of the policy discussions in the FSC, which are presented by the BRSA. The SRAG does not regularly prepare a joint risk assessment report or evaluate potential policy responses for the FSC, although an SRAG technical working group is currently developing a heat map to facilitate a more integrated risk assessment (see below). If there is a lack of consensus within the SRAG on an important issue, it can be forwarded to the FSC for discussion.

The macroprudential policy and crisis management functions have not been separated as recommended by the FSAP, although the authorities have indicated a willingness to reconsider this issue at the time of the next FSAP Update in the light of recent experience and international developments. For now, the authorities note that the FSC has been effective in assessing major financial stability threats and therefore is well-placed to coordinate

¹⁴ In particular, the Decree states that “in cases where a negative development that could spread over to the entire financial system occurs and such development is detected by the Financial Stability Committee, the Council of Ministers shall be in charge to determine the measures to be taken and all the relevant institutions and agencies are competent and responsible for prompt implementation of measures taken”.

¹⁵ This reflected the fact that, prior to the FSC, the systemic risk assessment was coordinated by the BRSA.

¹⁶ Other inter-agency coordination mechanisms are: the Coordination Committee between the BRSA and the SDIF on matters relating to the latter's competency (see section 3); and the Financial Sector Commission, which is composed of representatives of the BRSA, Ministry of Finance, Treasury, CBRT, CBM, SDIF, Competition Board, Ministry of Development, Borsa Istanbul (BIST) and the associations of institutions that are established under the body of the BRSA. The scope of the Commission's activities is mostly focused on structural and developmental, rather than financial stability, issues.

macroprudential policy measures and crisis management arrangements. The SRAG supports the FSC in this area via the development of a protocol that defines systemic risk and by discussing the periodic updates of institutions' crisis management plans under different risk scenarios.¹⁷

As regards the FSC's member agencies, the institutions most involved in risk analysis and macroprudential policies are the CBRT and BRSA. In the case of the CBRT, financial stability is an auxiliary objective (the primary objective being to achieve and maintain price stability). While aiming to keep inflation close to target, the CBRT promotes financial stability by containing domestic market volatility driven by capital flows and supporting prudent borrowing (see below). Moreover, the CBRT monitors the vulnerabilities of the financial system, assesses risks that might cause instability from a macroeconomic perspective and publishes the Financial Stability Report (FSR), in which it presents its opinions and analyses. To better support these activities, the Banking and Financial Institutions Department of the CBRT was restructured in August 2013. This led to the creation of dedicated divisions that have enhanced the focus on data collection and risk analysis for financial stability purposes.¹⁸ According to Banking Law No. 5411, the BRSA is responsible for the establishment of confidence and stability in financial markets. In this capacity, the BRSA regulates and supervises a broad range of financial institutions, monitors activities and undertakes risk analysis (including stress tests) on these institutions, and has various prudential tools that can be used for financial stability purposes.

Communication: A brief press release is often issued on the website of the Treasury after an FSC meeting.¹⁹ While FSC meeting minutes and decisions are prepared by the Secretariat, they are not published but communicated indirectly via the actions taken by the relevant member institutions. The FSC Chair provides a brief outlook of risks and an overview of FSC activities in his speeches. In addition, member institutions communicate their views on main risks to financial stability and policy responses via their own channels, including speeches, regular reports, working papers and press releases. For example, the FSR is the key instrument for communication of the CBRT on the financial sector and it is published twice per year.²⁰ The BRSA's Annual Report also summarises the macroprudential regulations implemented by the BRSA in collaboration with FSC.

Data collection: Data collection for systemic risk monitoring purposes is carried out by FSC/SRAG member institutions that have the mandate and power to collect such data from

¹⁷ According to the SRAG protocol, systemic risk is defined as the risk of interruption of financial services to the extent that disruption in a part or all of the financial system creates severe negative consequences on the real economy.

¹⁸ The Banking and Financial Institutions Department contributes to the SRAG meetings, prepares the FSR, presents financial stability issues to the monthly Monetary Policy Committee (MPC) meetings and informs the CBRT's Board semi-annually about financial stability issues.

¹⁹ See <http://www.treasury.gov.tr/en-US/Announcement-List?id=2&nm=736>.

²⁰ See <http://www.tcmb.gov.tr/wps/wcm/connect/tcmb+en/tcmb+en/main+menu/publications/reports/financial+stability+report>. The FSR periodically includes special issues (e.g. analytical tools or recent macroprudential policies) and is used to signal possible calibration changes to the reserve requirement ratios.

their respective supervised entities.²¹ Those institutions share the data underpinning their risk analysis and have also developed formal arrangements to cooperate and share information more broadly.²² Through these arrangements, the CBRT can access offsite supervisory data from BRSA instead of using its own powers to collect data directly from banks; in turn, the BRSA can access information on the pricing of loans from the CBRT. In addition to this regular data exchange, the FSC has the power to obtain other necessary data and information as stated in Law No. 4059.

The Banking and Financial Institutions Department of the CBRT recently initiated a “Financial Data Project” to identify evolving data needs for banking sector, non-financial corporations and household analysis. The first phase of the project (stocktaking) was completed in October 2014, while the second phase (gap analysis) is currently under way. The SRAG also recently discussed a BRSA study on the data required for financial stability analysis on the household and corporate sectors.

The FSAP had noted that the non-financial corporate sector was increasingly leveraged and exposed to FX risk, with potential knock-on implications for banks’ credit exposures. It recommended that the authorities ensure data are available to assess the risk from unhedged corporate net short FX positions and take corrective action as necessary. The CBRT has been publishing on a monthly basis the FX assets and liabilities of non-financial companies in Turkey (based on residency).²³ It also initiated in 2013 a corporate sector monitoring project (“RESIM”), comprising a mostly qualitative survey of corporate sector representatives, which includes data on FX borrowing and its motivation. In addition, the CBRT began to publish the Financial Accounts Report in 2012, which includes flow of funds data for the household and corporate sectors.²⁴ While information on FX borrowing by subsidiaries of Turkish companies abroad is not available, the CBRT monitors such borrowing using the published financial statements of firms that are publicly listed in Turkey. The BRSA is also conducting targeted inspections collecting data on corporates’ FX exposures so as to develop a template to regularly collect and monitor such exposures. The information from these data sources is used in CBRT analysis²⁵ and also in BRSA and CBRT stress test scenarios that include an

²¹ According to the Capital Markets Law that came into force in 2012, the CMB may collect information on capital market transactions with the purpose of monitoring systemic risk and maintaining financial stability.

²² On 31 October 2012, a protocol on sharing information and cooperation was signed by the BRSA, Treasury, CMB, SDIF and CBRT. Additional bilateral sub-protocols were signed between the BRSA and Treasury; the BRSA and CMB; the Treasury and CMB; and the CBRT and BRSA.

²³ See <http://www.tcmb.gov.tr/wps/wcm/connect/tcmb+en/tcmb+en/main+menu/statistics/monetary+and+financial+statistics/fx+assets+and+liabilities+of+nonfin+companies/data>.

²⁴ See <http://www.tcmb.gov.tr/wps/wcm/connect/tcmb+en/tcmb+en/main+menu/statistics/monetary+and+financial+accounts/financial+accounts+report>.

²⁵ See, for example, the special topics on short FX positions of non-financial firms in the May 2015 FSR (<http://www.tcmb.gov.tr/wps/wcm/connect/TCMB+EN/TCMB+EN/Main+Menu/PUBLICATIONS/Reports/Financial+Stability+Report/2015/Financial+Stability+Report+-May+2015%2C+Volume+20/>) and on derivative usage in the May 2014 FSR (<http://www.tcmb.gov.tr/wps/wcm/connect/TCMB+EN/TCMB+EN/Main+Menu/PUBLICATIONS/Reports/Financial+Stability+Report/2014/Financial+Stability+Report+-May+2014%2C+Volume+18/>) and the

adverse shock to impairments of FX loans. Finally, the Turkish Central Registry Agency was authorized as a trade repository in April 2015 and will shortly begin collecting data on over-the-counter derivatives transactions, which will augment bank and intermediary data on derivatives collected by the BRSA and CMB respectively.

Analytical framework and risk assessments: The FSAP recommended that the authorities develop an approach to risk identification that combines monitoring of key indicators with qualitative information, and that expert resources of BRSA and CBRT be better leveraged to jointly develop databases and modelling frameworks for financial stability analysis.

Systemic risk is monitored and analysed by the authorities represented in the FSC in line with their institutional mandates. In particular, the regular SRAG agenda's first item is a presentation by member institutions of recent economic and financial developments and of their risk assessments, followed by an open discussion on the issues raised. More detailed risk topics can also be included for discussion in SRAG meetings. However, only some of the analytical tools used by the relevant authorities – BRSA and CBRT – are shared or discussed in the SRAG (see Box 1).²⁶

A risk assessment tool being developed by the SRAG's technical working group is a heat map. The heat map will be utilised to illustrate how a financial shock can affect financial stability and the real economy both quantitatively and qualitatively. Analysis of the heat map is built on four channels that will be prepared by relevant institutions: financial markets (CBRT), financial institutions (BRSA and CBRT), financial infrastructure (BRSA) and the real economy (CBRT and Undersecretariat of Treasury). The data/indicator selection process for each channel is underway and the overall construction of the heat map is expected to be completed in 2016. The authorities view the heat map as a useful first step in expanding their risk assessment toolkit to facilitate more objective and efficient discussions of financial stability risks within the SRAG. The authorities aim to use this analysis as the basis for developing early warning models that can provide a more forward-looking perspective. Such models are expected to supplement stress test analyses and quantitative impact studies with observed data as well as qualitative assessments that incorporate financial system intangibles.

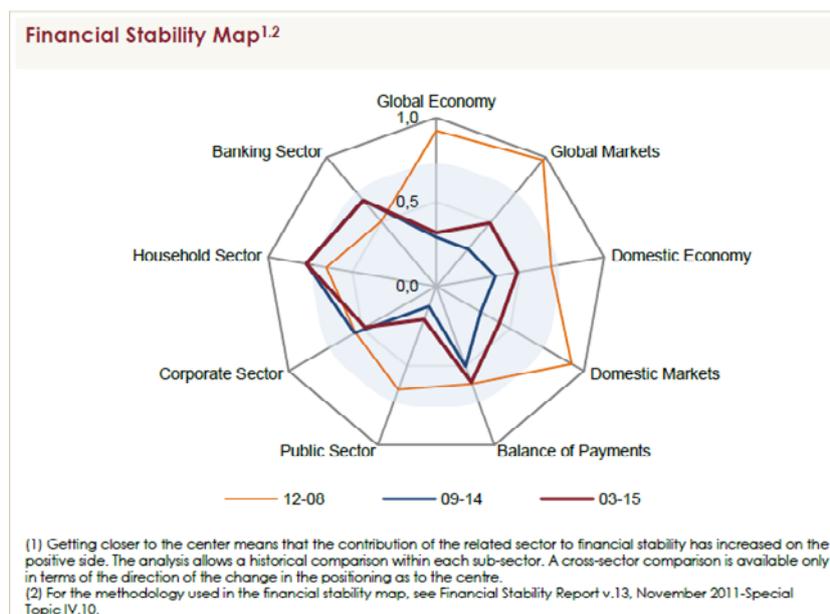
Both the BRSA and CBRT conduct stress tests, although there is room for further coordination between their respective exercises. The two institutions jointly developed the foundations of their stress testing frameworks in 2011 based on technical assistance by the European Central Bank, but their approaches have since diverged and the scenarios underpinning the two exercises are typically different (see Box 1) and are not cross-checked for consistency. The stress test results of the BRSA (which are not published) are shared with the FSC, whereas the CBRT stress test results are published in the FSR and in this way shared with the other FSC members.

Economic Note (available in Turkish) on the risks from foreign currency indebtedness of non-financial firms in Turkey that was issued in August 2014 (<http://www.tcmb.gov.tr/wps/wcm/connect/50d404e1-0137-4871-8445-2742c0e9c5db/EN1413eng.pdf>).

²⁶ The CMB conducts its own assessment of capital market risks, which are discussed in the SRAG (and, if needed, in the FSC).

Box 1: Systemic risk analyses undertaken by the CBRT and BRSA

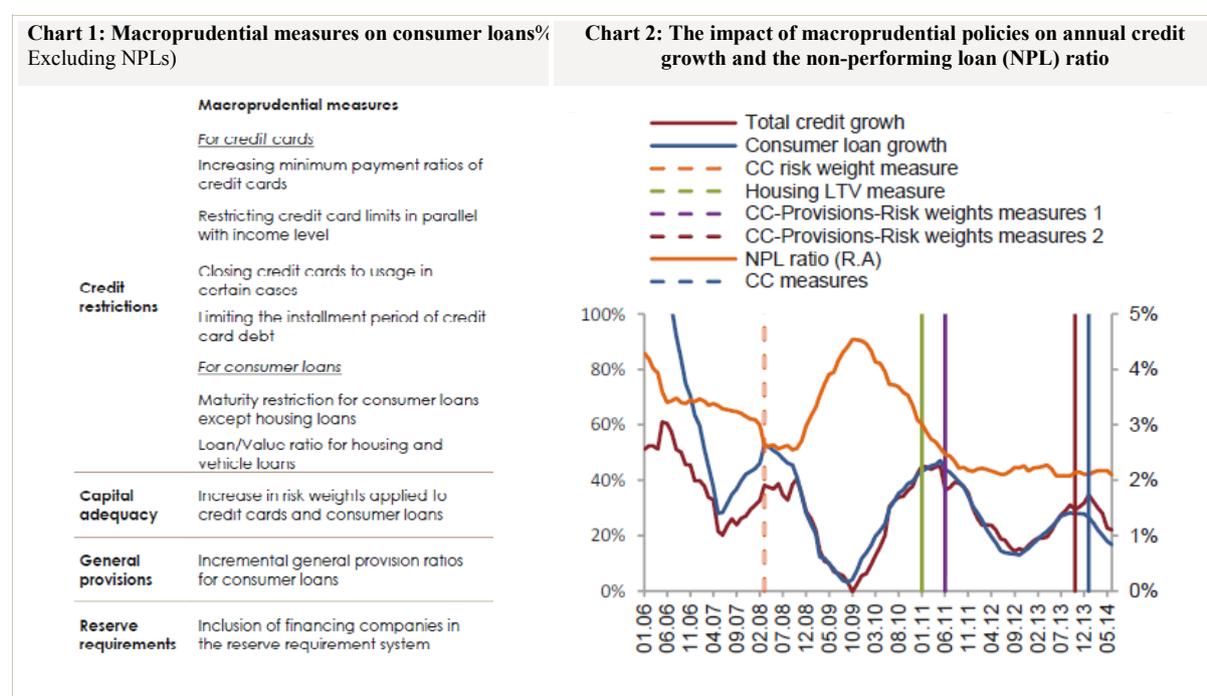
The CBRT assesses the overall resilience of the financial system and the related systemic risk analysis captures intra- and inter-sector interactions. Regular daily and weekly reports of credit developments, credit and liquidity risks, FX net position etc. and the monthly report submitted to MPC meetings are used in systemic risk assessments. Vintage analysis of retail loans, interest rate risk scenarios, DuPont analysis (decomposition of banks' profitability), stress tests (see below), and impact studies of macroprudential tools are also employed. The Financial Conditions and Financial Strength Indices provide information about the overall strength of the financial sector. The Financial Stability Map presented in the FSR, the latest one of which is reproduced below, summarises the major developments and vulnerabilities in the financial system from a sectoral point of view. The inputs come from different channels (Credit Registry Bureau, Custody Bank, The Banks Association of Turkey Risk Centre, Istanbul Settlement and Custody Bank (Takasbank), CMB, BRSA).



The BRSA closely monitors bank lending behaviour and other market developments using high frequency data. Apart from the time dimension of financial stability, it has developed several internal reports analysing the cross-sectional dimension, focusing on trends across banks, lending, FX exposures, derivative transactions, cross-border banking activities etc.

Both the CBRT and BRSA have incorporated stress tests into their risk assessment process. The CBRT presents its macro stress test results via the FSR. The framework evaluates the impact of economic growth, FX and interest rate shocks on the banking sector via the channels of credit risk, repricing risk, income risk and FX risk. For 2015 and 2016, the CBRT is planning to enhance its stress test models by including additional risk modules. In addition, ongoing projects on early warning indicators and systemic risk are planned to be finalized by the end of 2016. The BRSA also performs periodic, top-down stress tests (and reverse stress tests) to assess the resilience of individual banks and of the banking sector to potential shocks to macroeconomic and financial variables. The stress testing approach adopted by the BRSA is based on panel data methods in order to test the general market and idiosyncratic risk specific to each individual bank and a group of banks. During the stress tests, several financial soundness ratios are calculated under baseline or worst case macro scenarios for the next two years. The scenarios employed in the BRSA and CBRT stress tests are typically different, with the CBRT replicating a historical stress event and the BRSA creating an *ad-hoc* scenario based on current conditions in the financial system.

Macprudential policies and tools: Turkey has much experience in the use of tools for macroprudential purposes. The choice of tools, which generally appears to follow a discretionary approach, reflects a range of policy considerations. Several of these tools have been employed in recent years to spur balanced growth and domestic savings by slowing down the rise in household leverage – particularly via consumer loans – and by encouraging banks to increase core funding (see Charts 1-2 and Annex 2).²⁷ In a few cases, tools have been employed to support particular types of credit in response to general economic targets set by the government.²⁸ The overall macroprudential stance is also affected by international developments, the external balance and changes in capital flows, given the reliance of the Turkish economy on these flows and the fact that they are mostly intermediated through the banking sector. For this reason, macroprudential policies to control credit growth have been closely intertwined with monetary policy (see below).



Source: CBRT (November 2014 FSR).

²⁷ See, for example, the special topic on macroprudential policies for consumer loans in the November 2014 FSR (<http://www.tcmb.gov.tr/wps/wcm/connect/TCMB+EN/TCMB+EN/Main+Menu/PUBLICATIONS/Reports/Financial+Stability+Report/2014/Financial+Stability+Report+-November+2014%2C+Volume+19/>). See also Annex IV of the IMF’s 2013 Article IV report for Turkey (Country Report No. 13/363, December 2013, <http://www.imf.org/external/pubs/ft/scr/2013/cr13363.pdf>).

²⁸ These are structural targets outlined in the Development Plans (approved by Parliament), Annual and Medium Term Programs prepared by the Ministry of Development, such as encouraging savings and promoting SME loan growth. See, for example, the Tenth Development Plan covering the period 2014-18 ([http://www.mod.gov.tr/Lists/DevelopmentPlans/Attachments/5/The%20Tenth%20Development%20Plan%20\(2014-2018\).pdf](http://www.mod.gov.tr/Lists/DevelopmentPlans/Attachments/5/The%20Tenth%20Development%20Plan%20(2014-2018).pdf)).

The FSC provides a platform to facilitate discussions about the use of tools by its member institutions for macroprudential purposes. However, its role in the calibration of tools or in the coordination of joint policy actions varies and there is no agreed framework to determine whether a macroprudential measure merits discussion by the FSC. For example, measures that fall under the exclusive competence of the CBRT (see below) are not generally discussed at the FSC, although the CBRT informs the FSC about their use.

Most tools used for macroprudential purposes fall under the exclusive competence of the BRSA and, while micro-prudential in nature, have the goal of affecting overall sector conditions. While the BRSA is solely responsible for their use, it solicits opinions of relevant stakeholders including the industry (via occasional public consultations on proposed measures, as well as contacts with professional associations), government and the FSC. Additional tools, e.g. countercyclical capital buffer and capital surcharges for domestic systemically important banks (D-SIBs), will become available to the BRSA as of January 2016 as part of the rollout of Basel III in Turkey.

The tools used by the CBRT are closely linked to its monetary policy implementation. The CBRT adopted a new monetary policy framework at the end of 2010 in order to increase the resilience of the economy against vulnerabilities resulting from capital flows, excessive credit growth and external balance. The new framework attempts to combine financial and price stability, requiring the use of multiple instruments of both a structural and cyclical nature. Its two intermediate objectives have been to decrease volatility in short-term capital flows and slow down excessive credit growth; in addition to the policy rate, reserve requirements²⁹ and the interest rate corridor³⁰ have been utilized as active policy instruments. In 2012, the CBRT added the Reserve Option Mechanism (ROM) to its toolkit to reduce the adverse impact of volatile capital flows on macroeconomic and financial stability, strengthen gross FX reserves and equip banks with more flexibility in liquidity management.³¹ Overall, the measures

²⁹ Maturity-based reserve requirements have been used to: lengthen the maturity of bank borrowing; promote ‘core’ liabilities (i.e. the ratio of deposits and equity to loans); and encourage TL borrowing. See <http://www.tcmb.gov.tr/wps/wcm/connect/TCMB+EN/TCMB+EN/Main+Menu/MONETARY+POLICY/Reserve+Requirement+Ratios> for details.

³⁰ The interest rate corridor, which is formed between the overnight borrowing and lending rates, has an important role in fine tuning the monetary stance by the CBRT. Under this framework, the corridor is widened downwards to prevent short-term speculative movements and to limit loan growth when capital inflows are large; on the other hand, when capital flows are weak and exchange rate volatility is increased, the corridor is widened upwards. In addition, when excessive credit growth is observed, the CBRT can cause credit supply to decrease by increasing uncertainty about the CBRT funding amount and cost. According to a July 2013 CBRT research note (“Interest Rate Corridor: A New Macroprudential Tool?” (<http://www.tcmb.gov.tr/wps/wcm/connect/TCMB+EN/TCMB+EN/Main+Menu/PUBLICATIONS/Research/Research+Notes+in+Economicss>), the corridor affects the bank lending spread and hence has the potential to be used as a macroprudential tool.

³¹ ROM is a mechanism that allows banks to hold a certain fraction of their TL reserve requirements in FX (USD and/or euro) and standard gold. The mechanism permits banks to manage their FX assets in line with their TL liquidity needs at their own discretion. The banks are provided with flexibility in holding TL reserve requirements and they also voluntarily accumulate foreign currency reserves at the CBRT. ROM, which is expected to work as an automatic stabilizer, decreases the exchange rate volatility in domestic markets caused by capital inflows and thus, to some extent, reduces the need for the interest rate corridor. See the IMF’s “Turkey: Selected Issues Paper” on this topic (Country Report No. 13/364, December 2013, <http://www.imf.org/external/pubs/ft/scr/2013/cr13364.pdf>).

adopted by the CBRT have been adjusted frequently in recent years in order to respond to the changes in the banks' operating environment.

The *ex-post* assessment of the outcome of macroprudential measures is monitored by the relevant institution (and, to the extent it relates to an FSC decision, the Secretariat of FSC), and the main findings are sometimes shared with the FSC for discussion. The BRSA reviews regularly the costs and benefits of its policies with The Banks Association of Turkey and the Interbank Card Center, although it has not published such analysis. At the CBRT, quantitative impact studies (QIS) are used to assess the costs and benefits of macroprudential policies before and after implementation. In general, the QIS are carried out at individual bank level to have granular information about impacts, and are complemented by stress tests, research notes and working papers.³² The FSC, where relevant, invites the Ministry of Development to contribute to the joint impact assessment of macroprudential policies on macroeconomic indicators, given the Ministry's responsibility for setting macroeconomic targets.

Lessons learned and issues to be addressed

The Turkish authorities have made progress in developing their macroprudential policy framework in recent years. In particular, the FSC has helped to promote information sharing and the candid exchange of views as well as to coordinate some policy measures among its member institutions; the 2013 restructuring of the Banking and Financial Institutions Department within CBRT has enhanced the focus on financial stability analysis; data collection and analysis on the FX positions of the non-financial corporate sector has improved; and the SRAG is developing additional risk assessment tools (e.g. heat map) and working to address identified data gaps. Importantly, the authorities have a broad range of tools at their disposal and have used them in a proactive and flexible manner in recent years to slow down the rise in household leverage and to encourage banks to increase core funding.

At the same time, however, further steps can be taken to strengthen the macroprudential policy framework in a number of areas. This includes, in particular, the development of a more integrated systemic risk assessment and policy framework and the strengthening of institutional arrangements, including via the adoption of a public communication strategy to enhance the transparency and effectiveness of policy measures.

Integrated systemic risk assessment and policy framework: The framework for dealing with macroprudential issues in Turkey should ensure integration at three levels: in terms of bringing together the analytical contributions of the relevant authorities to present a holistic assessment of systemic risks; in terms of the link between risk analyses and macroprudential policies to address those risks; and in terms of the overall consistency and coherence of the tools used for macroprudential purposes. While progress has been made since the FSAP, the framework can be further enhanced to support these three layers of integration.

As regards the analytical dimension, the CBRT and BRSA have progressed in developing their respective analytical toolkits and sharing the data underpinning some of their risk

³² See, for example, the special topics on the impact of macroprudential measures for consumer loans in the November 2014 FSR (*ibid*) and on LTV restrictions on car sales in the May 2015 FSR (*ibid*).

analyses (see Box 1). While information sharing has improved, there is room for more joint work on analytical tools, methodologies and reports, in line with the FSAP recommendation for joint development of databases and modelling frameworks. In particular, only some of the risk assessment tools used by the authorities are shared or discussed in the SRAG. Given its mandate, the SRAG should build on the technical expertise of its members (particularly the CBRT) to develop a holistic assessment of systemic risks in support of the FSC's work. The authorities are already taking steps in this area via the development of joint tools (such as the heat map) to assess systemic risks. Examples of other possible steps include more sharing of analytical tools within the SRAG (e.g. via joint study groups) and greater coordination in the design and use of such tools so that they complement one another (e.g. stress tests conducted by the CBRT and BRSA).

The second layer of integration involves close correspondence between analytical findings and possible macroprudential policy responses. At present, the SRAG does not regularly prepare a joint risk assessment report or evaluate potential policy responses for the FSC. The involvement of the FSC in the selection of macroprudential tools varies and there does not appear to be an explicit policy framework to guide the application of these tools. Closer integration of the SRAG's risk analysis with the policy discussion in the FSC, building on the integrated assessment of risks mentioned above, would enhance policy coherence. Clearer communication to the public of the objective(s) that each tool is meant to address would contribute to clarifying the mapping between identified risks and proposed policy responses. This will also help clarify which policies could benefit from coordination among the various authorities through the FSC (e.g. policies that target the same objective) and which measures could be undertaken independently under the exclusive mandates of the relevant authorities.

Third, the authorities have a range of tools at their disposal for macroprudential purposes and these are distributed across institutions, particularly the CBRT and BRSA. Different policy measures can be (and have been) used to address the same objective; conversely the same tool can be (and has been) used for different purposes.³³ At present, individual authorities are generally responsible for analysing the impact of their respective policies. The coordination of joint impact assessments of potential policy measures by the FSC, while respecting the operational independence and mandate of its member authorities, has occurred in some instances, particularly on an *ex-post* basis. Such joint policy assessments, especially on an *ex-ante* basis, should be further encouraged to ensure a coherent macroprudential policy framework, since this will enhance awareness about the possible interactions among tools and thereby reduce the risk of leakages and inconsistencies. It would also help to inform the choice of policy mix to achieve the desired objectives, which is an important consideration given the range of tools that can be deployed and multiple policy objectives.

³³ For example, provisioning rates, risk weights and maturity/payment/income-based limits have all been used to control the growth in consumer loans in 2013, thereby complicating an *ex-post* assessment of their respective effectiveness. The authorities note that the tools used by CBRT and BRSA tend to impact different parts of bank balance sheets – reserve requirements on the liability side and micro-prudential measures on the asset side. However, there are clear inter-linkages between them since, through cost and liquidity channels, they both affect banks' behaviour and financial performance. As another example, BRSA raised loan loss provisioning rates for uncollateralized consumer loans by 300 bps to 4% to curb consumer credit growth in October 2013. At the same time, the provisioning rate for export and SME loans were reduced to 0% and 0.5% respectively from 1% to encourage lending to these sectors.

- ***Recommendation 1: The authorities should develop a more integrated systemic risk assessment and policy framework by: (a) enhancing joint (inter-agency) assessment of systemic risks; (b) linking the analysis of those risks with the selection of policy tools for macroprudential purposes; and (c) analysing the interactions of tools by different agencies to help inform the choice of policy mix.***

Institutional arrangements and public communication: The FSC does not have a fixed meeting schedule, and the topics discussed cover a broad array of issues including financial sector development/inclusion strategies. The authorities note that the FSC can meet at any time and that the meeting typically starts with presentations by member institutions on recent developments and risks. The FSC’s functioning may be strengthened by developing a calendar of meetings and by including a holistic assessment of systemic risks (based on joint work by SRAG) as a standing agenda item.

The 2012 amendment to the Decree formalizing the operation of the FSC reinforces the reporting line of the FSC to the Council of Ministers and allows the latter to take additional policy measures to safeguard the financial system. The authorities view the role of the Council of Ministers as a “backstop” in crisis management, and note that SRAG has developed a protocol defining systemic risk and the role of member authorities. They also point out that no intervention by the Council of Ministers has been necessary since the 2012 amendment given the consensus among FSC members and the fact that no issue has arisen of a “systemic financial stability” nature.

At the same time, the trigger for the Council of Ministers’ involvement (i.e. the nature/magnitude of systemic risks or the extent to which they have materialised) and the scope of the possible measures to be taken (including the extent to which they may fall within the competency of the FSC member institutions) are not specified in the Decree. This necessitates a delicate balance between the authority of the Council of Ministers to act decisively when needed while respecting the operational independence of FSC members. To enhance clarity of roles and accountability, it would be helpful for the authorities to clarify and develop guidelines detailing the circumstances in which the Council of Ministers could act, as well as the processes for such action and the implications for FSC member institutions.

In addition, the FSC would benefit by having a well-structured communication strategy on macroprudential measures. FSC meeting minutes and decisions are currently not published. A brief press release is often issued on the website of the Treasury after a meeting, while the FSC Chair provides an outlook of risks and an overview of FSC activities in his speeches (including budget speeches to Parliament). However, this communication remains at a high level and is generally brief. Views on financial stability risks and policy responses are therefore primarily communicated by the relevant member institutions via their own channels (e.g. CBRT’s FSR or BRSA’s Annual Report) at different times and based on their particular vantage points. More could be done to promote clear, coherent and coordinated communication to market participants of the analyses, motivations and considerations underpinning policy measures.

The adoption of a public communication strategy by the FSC could help market participants better understand its macroprudential policy stance, which could enhance the effectiveness of agreed policy actions. Such communication has played an important role in the monetary policy toolkit of central banks, and its value is increasingly recognised in the context of

financial stability. Similar bodies in other countries (see Annex 3) use a variety of communication strategies as a “soft” macroprudential tool, which has the potential to curb the build-up of systemic risk by influencing market expectations and opinions. Coordinated communication, with the FSC leading the way, would send a strong signal to the public of the authorities’ shared perspectives and policy intent.

In addition, public disclosure of possible systemic risks and actions to address them can enhance the accountability of the FSC to a broader group of stakeholders and incentivise timely and coordinated action by member institutions, both of which are relevant considerations given the FSC’s institutional set-up (i.e. discussion forum, independent member authorities, consensus-based decisions, limited reporting structures). The need for such communication is even more pertinent in countries such as Turkey, given the complex interlinkages between monetary and macroprudential policies and multiple policy objectives.

- ***Recommendation 2: The authorities should: (1) strengthen the FSC’s functioning by developing a regular meeting calendar and by including a holistic assessment of systemic risks (based on joint work by SRAG) as a standing agenda item; and (2) develop guidelines detailing the circumstances in which the Council of Ministers would act in order to safeguard the financial system. The FSC should also develop a public communication strategy to promote clear and coherent communication of the overall macroprudential policy stance, enhance accountability to stakeholders and incentivise timely and coordinated actions by its members.***

3. Bank resolution

Background

The FSAP concluded that the bank resolution and deposit insurance frameworks in Turkey were well designed, reflecting the experience gained from the 2000-01 banking crisis. In particular, the 2005 Banking Law No. 5411 (BL) had significantly improved procedures for the resolution of failing banks. The FSAP noted that, while the SDIF (which was spun off the BRSA as a separate legal entity in 2004) has significant legal powers for resolving failed banks, the resolution period was relatively long³⁴ and could be usefully shortened.

The April 2013 FSB peer review on resolution regimes found that the Turkish authorities had a range of resolution powers at their disposal and were able to exercise them without shareholder or creditor consent.³⁵ However, it also noted that the bank resolution regime lacks certain powers found in the FSB’s *Key Attributes*.³⁶

This section reviews the bank resolution framework drawing on the *Key Attributes* and current best practice. It examines the process for putting a failing bank into resolution;

³⁴ The 2005 BL limits the resolution period to nine months, with a possible extension of three months.

³⁵ See http://www.financialstabilityboard.org/2013/04/r_130411a/.

³⁶ See http://www.financialstabilityboard.org/2014/10/r_141015/.

resolution powers; the funding of bank resolution; information sharing and cooperation among relevant authorities domestically and abroad; and recovery and resolution planning.

Steps taken and actions planned

Current regime: The resolution regime has undergone significant reform since the 2000-01 banking crisis, during which a number of Turkish banks failed.³⁷ The procedures for resolving failing banks were significantly improved in the 2005 BL reform. Only one resolution case has taken place since 2005 – that of a small bank in May 2015³⁸ – so the effectiveness of the current framework has not been tested in respect of the failure of a bank that could be systemic in the event of failure.³⁹

Roles and responsibilities of the authorities: The two authorities with responsibility for bank resolution are the BRSA and the SDIF. Under Article 71 BL, if the BRSA determines that the conditions for intervention are met in relation to a bank (see below), it can choose one of two possible options – namely, to revoke the bank’s operating permission (in which case it is liquidated) or to transfer the shareholder rights (except dividends) and its management and control to the SDIF.

The SDIF is a public legal entity and Article 111 BL specifies its statutory role as resolution authority to manage, restructure, transfer, merge, sell or liquidate banks over which it has assumed management and control. The SDIF has administrative and financial autonomy when executing its duties. Once the BRSA has determined that management and control of a failing bank will be transferred to the SDIF, the SDIF can select and implement any resolution strategy that falls within its statutory remit and must cooperate with other authorities – primarily the BRSA – during the resolution process. The BRSA retains its supervisory and regulatory authority over a bank in resolution under SDIF management; in applying a resolution strategy, the SDIF must obtain the approval of the BRSA for all actions that would normally require regulatory approval for a bank (for example, a merger or transfer of ownership), since the bank continues to operate and is therefore subject to all requirements of the applicable regulatory regime.

In cases where the failure of a bank might affect the entire financial system, or where the resolution process is likely to require measures that exceed the powers of the SDIF, the SDIF would escalate the issues to the Financial Stability Committee, which may subsequently escalate the matter to the Council of Ministers. If the Council of Ministers decides that

³⁷ 25 Turkish banks failed between 1994 and 2003, 11 of which failed during the 2000-01 banking crisis. See the BRSA working paper “From Crisis to Financial Stability (Turkey Experience)” (September 2010, http://www.bddk.org.tr/WebSitesi/english/Reports/Working_Papers/8675from_crisis_to_financial_stability_turkey_experience_3rd_ed.pdf).

³⁸ See https://www.bddk.org.tr/websitesi/english/Announcements/Press_Releases/14208bankasya_mayis_basinaci_klamasi.pdf.

³⁹ The assessment that a bank may have systemic impact in the event of its failure is made for the purposes of resolution planning, and is not the same as the identification of a bank as a D-SIB for supervisory purposes in accordance with the BCBS methodology.

actions that go beyond the statutory remit of the relevant authorities are necessary, it may recommend legislative action to address that need (see section 2).

The role of the CBRT in resolution is limited to the traditional central bank function as lender of last resort. Under Article 40 of the CBRT Law, the CBRT, upon approval of its Board, may extend credit to banks that are facing liquidity constraints arising from an accelerated withdrawal of funds due to uncertainty or a temporary lack of public confidence. Such liquidity is provided directly by the CBRT and is subject to a number of conditions that include the following:⁴⁰

- the bank must be solvent;
- any payments must not exceed a maturity of one month (although they can be rolled over for a maximum period of one year);
- the funds must be provided against collateral, which is restricted to that accepted in the interbank money market and at prescribed haircut ratios; and
- the credit provided is limited to the amount of funds withdrawn from the bank.

In emergency cases where the resources of the SDIF are insufficient to fund a particular resolution, the CBRT may give advances to the SDIF (see below).

Scope of the regime: All commercial banks operating in Turkey – namely, deposit-taking banks (including branches and subsidiaries of foreign banks) and participation banks (“Islamic banks”) – are subject to the same resolution framework. Only development and investment banks, founded by special laws and comprising a small portion (around 5%) of banking sector assets, are not within the scope of the regime.

The resolution powers in the BL are available for financial holding companies of banks. However, the regime does not provide direct powers in relation to non-bank financial subsidiaries and other operating entities (such as shared service providers) within a group.⁴¹ The Turkish authorities note that the SDIF is able to take over the management of non-bank subsidiaries in the group through control of the financial holding company, which may enable it to ensure continuity of services.

Conditions for intervention: The BRSA may initiate resolution in relation to a bank where any of the following conditions (specified in Article 71 BL) is met:

- a) the bank has not taken restrictive measures required by the BRSA or such measures have not strengthened the bank’s financial structure;
- b) the continuation of the bank’s activities will endanger the rights of depositors (and, in the case of participation banks, the owners of participation funds) and the security and stability of the financial system;
- c) the bank has not fulfilled its obligations as they fall due;

⁴⁰ See <http://www.tcmb.gov.tr/wps/wcm/connect/53697b2e-a468-4efd-bba7-681caceddc61/ANO2009.pdf>.

⁴¹ Article 134 BL gives certain powers in relation to group entities to allow for the collection of the SDIF’s receivables, but these direct powers are not general powers aimed at executing the resolution strategy.

- d) the total value of liabilities exceeds the total value of the bank's assets; or
- e) there has been fraudulent use of the bank's resources by dominant partners or bank managers in such a manner that jeopardises the sound operations of the bank.

Resolution options and powers: Where the BRSA decides to initiate the resolution, the process involves either the revocation of the bank's operating permission (Article 106 BL) or the transfer of the management and control of the bank to the SDIF (Article 107 BL). The Board of the BRSA decides which process to adopt on the basis of general considerations, such as the structure of the balance sheet, the amount of deposits and potential wider impact of the different options.

If the bank is resolved under Article 106, the operating licence of the failed bank is revoked and the SDIF makes a pay-out to the insured depositors. After the pay-out of depositors, the SDIF must apply to the courts for a decision as to whether a bankruptcy proceeding should be initiated for the remainder of the failed bank. If the court accepts the application, the court initiates and conducts the bankruptcy proceedings. If the court rejects the application, the SDIF may start liquidation proceedings through a decision of the SDIF Board.⁴² The main substantive difference between the two processes concerns the availability of enforcement measures and sanctions. If, during the bankruptcy proceedings, the court finds shareholders and management to be at fault in the failure of the bank, their personal assets may be subject to recovery proceedings and criminal sanctions are available in the case of fraudulent actions.

In cases where the BRSA transfers management and control of a bank to the SDIF, the SDIF has wide powers under Article 107 BL, including to: suspend the activities of the bank and to manage it; transfer assets and liabilities; take over its shares and to restructure it; sell or merge it with another bank; and request the BRSA to revoke the operating licence of the bank. The SDIF may also provide financial support to a failing bank if it has acquired all or the majority of its shares. However, the following resolution powers specified in the KAs are not currently available to the SDIF: establish a bridge bank; write down or convert liabilities (bail in); and impose a temporary stay on exercise of early termination rights in resolution.

The current framework requires the SDIF to complete the resolution process within nine months, with a possible extension of three months. This upper limit was included in the 2005 BL in order to shorten the resolution period; however, it does not apply to the disposal of acquired assets from the SDIF's balance sheet. The authorities regard this timeframe as appropriate and indicate that it is based on the principle of ensuring cost efficiency and maintaining the stability of the financial system. They also note that the SDIF will be able to shorten the resolution period of a failed bank with adoption of a bridge bank, for which a legislative amendment has already been submitted to the Parliament (see below).

Recovery and resolution planning and resolvability assessments: The KAs recommend that authorities should ensure that there are recovery and resolution plans in place for all domestic banks that could be systemic in the event of failure. In addition, authorities should have powers to require banks to adopt measures to improve their resolvability.

⁴² To date, the court has not rejected an application for bankruptcy proceedings.

The current framework does not include either provision. Banks are not currently required to develop and maintain recovery plans; the authorities do not have the legal powers to carry out resolution planning and to require a bank to remove obstacles to resolution other than when the bank is already in resolution and under the control of the SDIF. Resolution planning is only conducted once the BRSA notifies the SDIF that a bank has been required to take corrective, rehabilitative or restrictive measures. At that point, when it becomes likely that resolution may be required, the SDIF develops a Resolution Action Plan, which includes alternative bank-specific resolution plans; a verification process for determining the amount of insured deposits to be covered; and plans for the rapid deployment of personnel for the safeguarding of information technology systems and data of the bank. However, this falls short of the resolution planning specified in the *Key Attributes*, and the authorities do not have a framework by which they identify banks that are likely to be systemic in the event of failure for resolution purposes.

Cooperation and information sharing: There is regular exchange of information between the BRSA and the SDIF that enables the SDIF to access supervisory information on individual banks. A Coordination Committee has been established between the two institutions, which meets at least once every three months to further promote the exchange of information and high-level cooperation between them.

The BL allows the BRSA to share information with foreign supervisory authorities, and the BRSA has entered into a number of memoranda of understanding with such authorities to enhance cross-border supervision. However, the current cross-border cooperation arrangements are designed to enhance going-concern supervision as opposed to resolution-related requirements. In particular, the existing memoranda of understanding do not specifically provide for cooperation for resolution-related purposes. Although the SDIF is authorised to sign memoranda of understanding with foreign authorities regarding its duties and responsibilities, the SDIF cannot share bank-specific information directly with foreign authorities, but must do so through the BRSA; and the current framework does not permit the BRSA to share confidential information with foreign resolution authorities that are not also supervisory authorities.

Resolution funding: The SDIF's deposit insurance fund⁴³ can be used to fund a bank resolution provided that the SDIF owns the shares of the bank. By taking ownership of the shares in the bank, the SDIF ensures that shareholders bear loss and do not benefit from the SDIF funding.

Turkey does not have a separate (publicly or privately funded) fund for bank resolution. However, the framework provides for additional funding arrangements for the SDIF:

- The SDIF may borrow from market, upon an authorisation from the Treasury.
- The SDIF may borrow government securities from the Treasury, which may be used as collateral for market funding.

⁴³ The SDIF collects risk-based premiums from the banks on a quarterly basis. The fund size was about USD 8.2 billion as of year-end 2014, which corresponds to 0.95% of total banking sector assets, 1.8% of total deposits and 6.5% of insured deposits and participation funds.

- In consultation with the BRSA, the SDIF may receive advance payments from banks in the amount of up to the total insurance premium paid by them in the previous year. The amount received by the SDIF will be deducted from the banks' future premium obligations.
- In emergency cases where the resources of the SDIF cannot meet the needs, the CBRT may give advances to the SDIF. The maturity, amounts, repayment conditions, interest rates and other conditions of the advance are to be determined by the CBRT in consultation with the SDIF.

In addition, the CBRT can provide emergency liquidity assistance for banks provided certain conditions are met, including that the banks are solvent and that the funds are provided against collateral.⁴⁴ The SDIF is also able to provide limited foreign currency funding since part of the deposit insurance fund is invested in foreign currency-denominated bonds and deposits. Should these resources be inadequate, the SDIF could swap its Turkish Lira reserves into foreign currency or rely on advances from the CBRT.

The public cost of the 2001 banking crisis was very high, and efforts to recover part of the public funding are still ongoing. In order to minimise moral hazard and avoid a repetition of such costs, legal restrictions were imposed on the circumstances in which the SDIF can provide funding to banks in resolution. In order to be able to use the full range of measures conferred under the resolution regime to strengthen the financial position of a bank in resolution or restructure its balance sheet, the SDIF must first acquire the majority or all the shares of the bank. Once it has a majority ownership, it can increase the capital of, make deposits with, make advances to and take over the non-performing assets of the bank in order to strengthen its financial standing and to restructure it, without any limit prescribed in law. The CBRT can provide additional funds to the SDIF if the latter does not have sufficient funds for the purposes of funding a firm in resolution. However, the financial resources that the SDIF can use to acquire a majority or all of the shares of the bank in exchange for assuming losses corresponding to the share capital acquired (according to Article 107 of the BL) are limited to the amount of insured deposits and participation funds in the bank.

There are currently no mechanisms in place to recover public funds, used to fund a resolution action, from the banking sector or financial institutions more broadly. Under the current framework, the means for recovery of the public costs of bank failures is through the sale of banks, collections from governing shareholders and managers for misused funds, collections on assets transferred to the SDIF, interest on assets held by the SDIF and collections from the liquidation of banks and subsidiaries.

Planned reforms: The authorities acknowledge that aspects of the resolution regime need to be reformed to align it more closely with the KAs. A first priority of the SDIF is to obtain the power to establish a bridge bank so as to sell parts of a failed bank without needing to take over the bank shares, and to be able to use purchase-and-assumption transactions in the

⁴⁴ The CBRT facilities for the provision of liquidity in foreign currencies arise from central bank foreign currency operations, such as currency auctions, required foreign currency reserves and reserve option mechanisms, and the foreign currency deposit market.

context of a liquidation to accelerate the liquidation process. The amendments for including these powers in the BL have already been submitted to Parliament.

In addition, the authorities have identified the need to reform the framework by incorporating bail-in powers, the power to stay the exercise of early termination rights, requirements for the preparation of recovery and resolution plans and the ability to conduct resolvability assessments. The BRSA and the SDIF have established a joint working group to analyse how such provisions and other powers found in the *Key Attributes* could best be incorporated into the framework. As part of this process, the two institutions have agreed to focus on the need for improvement in four main areas, namely: resolution powers, funding, information sharing and cooperation and institutional capacity. The joint working group is still formulating policy proposals and necessary legislative amendments on these issues, and the authorities noted that the timeframe to develop and implement these reforms will be determined in due course.

Lessons learned and issues to be addressed

The authorities already have a fairly comprehensive bank resolution framework in place, which was revised in 2005 to reflect the significant experience gained from resolving banks during the 2000-01 banking crisis in Turkey. The allocation of responsibilities between the BRSA and the SDIF seems well-defined, and there is regular information sharing and cooperation between them. The SDIF has a relatively broad range of resolution powers at its disposal, and the authorities have submitted legislative amendments to provide for additional powers to establish a bridge bank and to use purchase-and-assumption in bank liquidation.

Nevertheless, further work is needed to ensure that the resolution framework adjusts to developments in the banking sector, in particular by: incorporating additional provisions of the *Key Attributes* to enhance resolution powers and strengthen cross-border cooperation; requiring recovery and resolution planning for banks; and ensuring adequate facilities are available to provide temporary liquidity support to banks in resolution at short notice.

Enhanced resolution powers and cross-border cooperation: Since the 2005 amendments, the SDIF has taken control of only one small bank, so the effectiveness of the regime in resolving banks that could be systemic in the event of failure has not been tested. This will become an increasingly important issue as the banking sector grows in size and complexity.

The lack of some resolution powers found in the KAs may make it difficult for the authorities to resolve the largest banks in the system or to address the simultaneous failure of a number of banks in a timely and cost-effective manner.⁴⁵ For example, the lack of powers such as bail-in and stays on early termination rights, combined with conditions and limits on funding in resolution (see below), may limit the options for achieving an orderly resolution.

While their presence abroad remains limited, Turkish banks are increasingly accessing foreign currency-denominated funding in various forms (see Charts III.2.1-4 in Annex I), much of which is governed by foreign law. Cooperation and information-sharing with

⁴⁵ The size of the banking sector is around 113% of GDP, having experienced significant growth in recent years. Although the sector is not overly concentrated, the four largest banks comprise almost half of total assets, putting a constraint on the extent of government support that could reasonably be provided.

relevant foreign authorities is necessary to enhance the authorities' ability to plan and carry out resolution in such cases. The BRSA is allowed to share bank-specific information with foreign bank regulators. However, the current legal framework does not permit the disclosure of bank-specific information to foreign resolution authorities (where the resolution authority is not the bank regulator), while existing MoUs between the BRSA and foreign bank regulators do not specifically provide for cooperation in resolution. These constraints may impede the effective resolution of banks with cross-border operations or foreign funding and could increase the costs of resolution.

The authorities acknowledge that the regime is not fully aligned with the KAs and, in addition to the proposed legislative amendments, have formed a BRSA-SDIF working group to determine how other powers found in the *Key Attributes* can best be incorporated into the framework. It is important that the authorities maintain momentum in implementing the draft legislation (once approved by Parliament) and in developing the proposed further reforms that may be particularly important for the orderly resolution of banks that could be systemic in the event of failure.

- ***Recommendation 3: The authorities should incorporate in the resolution framework additional powers and also provisions for cross-border cooperation and information sharing specified in the Key Attributes so as to enhance their ability to resolve banks that could be systemic in the event of failure in a timely and cost-effective manner.***

Recovery and resolution planning and resolvability assessments: The current framework does not require recovery and resolution planning, and the authorities do not have powers to require banks to adopt changes to their structure or business practices with the aim of improving resolvability. To do so, authorities need to be provided with legal powers to conduct resolution planning and to require banks to remove obstacles to their resolvability.

Under the current framework, resolution options and tools are evaluated only when a bank is asked to take prompt corrective actions, based on high-level considerations such as safeguarding confidence and financial stability, prevailing market conditions and cost-effectiveness of resolution. While the current process may work well for small banks, the resolution of larger and more systemic banks with increasingly non-traditional funding structures (see section 2) is likely to be more complex. For example, the fact that banks' foreign funding is largely governed by foreign law poses a particular complexity in resolution and may represent an obstacle to resolvability. With the necessary legal powers, the authorities could require banks to take action to mitigate that obstacle, e.g. by requiring banks to ensure that any funding agreements include contractual language recognising the powers of the Turkish authorities to impose losses on creditors through a resolution proceeding.

Furthermore, in the event that a bank's balance sheet deteriorates rapidly, there may be insufficient time to adequately prepare for resolution by developing a proper plan. Recovery and resolution planning in advance of imminent failure should assist the authorities to develop effective resolution strategies. In support of this process, it may be useful for the SDIF and the BRSA to develop a framework for determining the systemic importance of banks for the purposes of recovery and resolution planning. Although resolution plans will always be non-binding and require a degree of judgement in the event of execution, they are useful in ensuring consistency in decision-making, shortening the process and ensuring that

the information needed to execute a resolution is readily available and considered. Advance resolution planning should also help to identify and eliminate obstacles to resolution.

The adoption of powers for authorities to prepare resolution plans and to require banks to adopt measures to remove or mitigate obstacles to resolvability is likely to require legislative reform, but recovery planning could be substantially achieved within the ambit of existing supervisory powers. The organisational arrangements and processes between the BRSA and the SDIF for the development of recovery and resolution plans respectively should also be embedded in their business-as-usual operations. These arrangements should be based on a clear understanding of the respective roles and responsibilities of the authorities, which may be elaborated and codified through memoranda of understanding or other policy statements.

- ***Recommendation 4: The authorities should develop recovery and resolution plans and conduct resolvability assessments for all domestic banks that could be systemic in the event of failure. In addition, the authorities should include legal powers to prepare resolution plans and to require banks to address obstacles to resolvability in further reforms of the resolution regime.***

Funding in resolution: The current resolution framework imposes conditions on the circumstances in which the SDIF can provide financial support to a bank in resolution. Those conditions were incorporated into the framework to reduce the moral hazard and high costs associated with public bail-outs, as reflected in the 2000-01 banking crisis.

Provided that the SDIF owns the majority or all of the shares in a failing bank, there is no limit on the amount of financial resources that it can use to restructure and strengthen the financial standing of the bank. It can do so by, for example, increasing the capital of, making deposits with, making advances to, and taking over the non-performing assets of the bank. However, the financial resources available to the SDIF to acquire the shares of a bank are limited to the amount of insured deposits and participation funds in that bank.

In the event that a systemic risk is identified by the FSC, the Council of Ministers can determine appropriate additional measures to safeguard the financial system. In such a context, any requirement for financial assistance that exceeds the statutory limits and conditions will be escalated to the Council of Ministers, who can approve assistance in excess of those limits and impose conditions on a case-by-case basis.⁴⁶

There may also be instances where temporary liquidity assistance to a bank in resolution is required to support the resolution strategy. When a large bank is put in resolution, it is likely to depend on official liquidity support for a period of time until it has recovered sufficiently to be able to access funding markets again. It may also take time before other market participants have enough confidence in the viability of the resolved bank to transact with it, even if it has been recapitalised. While the CBRT emergency liquidity facilities are only available for solvent banks, the SDIF is also able to provide liquidity by, for example, making deposits in a failing bank that it has acquired. However, the increasing reliance of banks on external wholesale funding (see section 2 and Annex 1) may require temporary liquidity

⁴⁶ The involvement of the Council of Ministers only takes place in systemic risk situations and not during a normal bank resolution process.

assistance in foreign currency that exceeds the limited amount currently available from the SDIF. In such a scenario, the SDIF could swap its Turkish Lira reserves into foreign currency or rely on advances from the CBRT, but the adequacy, modalities and implications of such funding (e.g. for macroeconomic policy) merit further consideration. Advance analysis of these issues (e.g. in the context of resolution planning) is needed so that the authorities are operationally prepared to provide on a timely basis any necessary liquidity funding, including in foreign currency, to a firm in resolution.

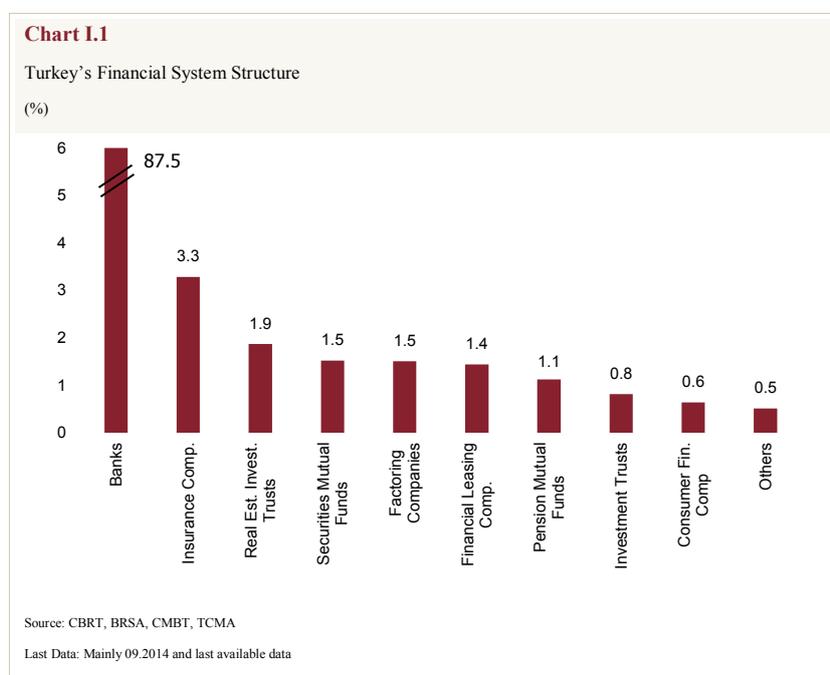
While the framework has been designed with a view to limiting the costs of resolution to public funds, the authorities also recognise that temporary public funding may be required. In light of the currently available means for recovery of public funds that are used in resolution – namely, collections from controlling shareholders and managers for misused funds, the sale of the bank, collections on assets transferred to the SDIF, interest on assets held for sale and liquidation proceeds – the authorities could also consider mechanisms for recovery of any shortfall of public funding from the industry, e.g. through additional levies.

- ***Recommendation 5: The authorities should review their current arrangements to ensure that adequate facilities and agreed procedures are in place for the temporary provision of liquidity to a bank in resolution in both local and foreign currency. The arrangements for funding of banks in resolution should be supported by clear mechanisms for the recovery of public funds from the industry, if necessary.***

Annex 1: Structure of the financial system and recent developments⁴⁷

Financial system structure

The Turkish financial system is dominated by the banking sector, which represents over 85% of total financial system assets (Chart I.1).



Currently there are 51 banks in the banking system. Turkish banks operate in 33 countries. The number of foreign financial institutions operating in Turkey is 155, classified as banks (31), non-bank financial institutions (26), branches (87) and representative offices (11).

Structure of bank balance sheet: There have been mild changes in the structure of Turkish banking system since 2011. Four new foreign deposit banks have entered to the banking system during this period (Table I.1.1).

Table I.1.1

Structural Indicators of Turkey's Banking Sector

	2011	2012	2013	2014
Total Number of Banks	48	49	49	51
Deposit banks	30	31	31	33
Participation banks	4	4	4	4
Investment and development banks	13	13	13	13
SDIF Bank	1	1	1	1
Concentration Indicators (Asset)				
Share of first 5 banks (%)	58	57	48	55
Share of first 10 banks (%)	83	83	81	81
Herfindahl-Hirschman Index	855	829	792	789

⁴⁷ Based on information provided by the Turkish authorities.

The ratio of total assets of banking sector to GDP increased from 94% in 2011 to 113% in 2014Q3 (excluding the CBRT). The decrease in the share of domestic private deposit banks in the banking system has been offset by the increasing share of foreign deposit banks, participation banks and investment and development banks (Table I.1.2).

Table I.1.2

Banking System at a Glance (2011-2014)

	2011	2012	2013	2014
Banking System				
Balance sheet and quality of loans				
Assets (% of GDP)	93.8	96.7	110.7	113.3*
Loans/Total Assets	56.1	58.0	60.5	62.2
Government securities/Total assets	23.4	19.7	16.6	15.2
Loans/Total deposits	98.2	102.9	110.7	117.9
Year-on-year loan growth	29.9	16.4	31.8	18.5
Deposits/Total assets	57.1	56.3	54.6	52.8
Funds borrowed/total assets	14.2	13.2	15.4	15.7
NPLs (gross,% of total loans)	2.8	2.9	2.8	2.9
Provisioning ratio	79.4	75.2	76.3	73.9
FX exposure (banking system)				
FX assets/FX liabilities	83.7	85.9	82.5	82.8
FX loans/total loans	29.0	26.0	28.1	29.0
FX deposits/total deposits	33.9	32.6	37.2	37.2
State-owned Deposit Banks				
Balance sheet and quality of loans				
Assets (% of GDP)	26.4	26.7	30.9	31.6*
Share of total assets in the banking sector	28.1	27.5	28.0	28.3
Loans/Total Assets	52.9	53.2	57.2	60.3
Government securities/Total assets	32.3	26.9	22.6	19.1
Loans/Total deposits	80.4	81.5	92.2	106.5
Year-on-year loan growth	25.8	10.8	37.9	22.9
Deposits/Total assets	65.8	65.2	62.1	56.7
Funds borrowed/total assets	8.6	9.7	11.5	12.4
NPLs (gross,% of total loans)	2.6	3.4	3.0	3.1
Provisioning ratio	86.6	79.3	82.0	77.9
Domestic Private Deposit Banks				
Balance sheet and quality of loans				
Assets (% of GDP)	47.7	48.8	53.1	54.1*
Share of total assets in the banking sector	50.8	50.5	48.0	47.7
Loans/Total Assets	56.5	58.6	61.7	63.1
Government securities/Total assets	23.2	19.8	16.9	16.3
Loans/Total deposits	100.7	107.7	113.4	118.0
Year-on-year loan growth	36.6	15.8	26.6	17.1
Deposits/Total assets	56.1	54.4	54.4	53.5
Funds borrowed/total assets	14.3	12.4	13.7	14.0
NPLs (gross,% of total loans)	2.4	2.3	2.3	2.5
Provisioning ratio	79.7	73.7	75.7	76.4

	Foreign Deposit Banks			
Balance sheet and quality of loans				
Assets (% of GDP)	12.2	12.6	16.0	16.8*
Share of total assets in the banking sector	13.0	13.0	14.5	14.6
Loans/Total Assets	57.1	61.9	59.9	61.3
Government securities/Total assets	15.1	12.9	11.0	9.5
Loans/Total deposits	108.3	108.5	113.8	112.0
Year-on-year loan growth	14.6	22.3	35.7	18.8
Deposits/Total assets	52.7	57.0	52.7	54.8
Funds borrowed/total assets	20.8	15.2	19.8	18.2
NPLs (gross,% of total loans)	4.5	5.0	4.5	4.2
Provisioning ratio	74.8	72.8	75.3	68.8
Participation Banks				
Balance sheet and quality of loans				
Assets (% of GDP)	4.3	5.0	6.1	6.0*
Share of total assets in the banking sector	4.6	5.1	5.5	5.2
Loans/Total Assets	68.6	68.2	64.6	61.5
Government securities/Total assets	3.5	3.5	5.0	6.5
Loans/Total deposits	98.3	100.1	101.2	98.2
Year-on-year loan growth	25.0	24.5	29.3	3.3
Deposits/Total assets	69.9	68.2	63.8	62.6
Funds borrowed/total assets	11.5	13.1	15.9	14.3
NPLs (gross,% of total loans)	3.2	3.2	3.6	5.0
Provisioning ratio	65.4	75.1	63.2	62.4
Investment and Development Banks				
Balance sheet and quality of loans				
Assets (% of GDP)	3.2	3.7	4.5	4.8*
Share of total assets in the banking sector	3.4	3.8	4.0	4.2
Loans/Total Assets	55.2	57.8	65.0	68.3
Government securities/Total assets	12.0	10.9	6.9	5.9
Year-on-year loan growth	43.5	32.7	49.6	26.6
Funds borrowed/total assets	37.9	41.2	47.8	49.1
NPLs (gross,% of total loans)	1.5	1.0	0.9	0.8
Provisioning ratio	76.3	73.6	66.4	64.1
Memorandum items				
Share of the assets held by the five largest banks	58.4	56.7	47.5	54.7
Share of the assets held by the three largest public banks	28.0	27.5	27.9	28.2
Share of the assets held by the three largest private banks	36.3	35.9	34.1	33.2

*As of 2014Q3.

In the banking sector balance sheet, loans and deposits are the main items. The share of loans increased from 52% in 2010 to 62% in 2014, while the share of deposits declined from 61% to 53% over the same period. On the asset side, the share of required reserves and receivables from the CBRT also increased, and this was offset by a decrease in the share of securities held. On the liabilities side, the share of term deposits declined while the share of issued securities increased significantly. In 2014, this balance sheet item had the highest growth rate among all the liabilities items. Interbank borrowing and funds raised from repo transactions also gained share in 2014 compared to 2010. Issuing bonds is a new tool for banks to raise

funds with longer maturity. The share of bank bonds increased from 1.5% in 2011 to 4.4% in 2014 (Table I.1.3). The average maturity of FX issued bonds is around 5 years.

Table I.1.3

Turkish Banking Sector Balance Sheet (Major Items)

(%, Million TL)

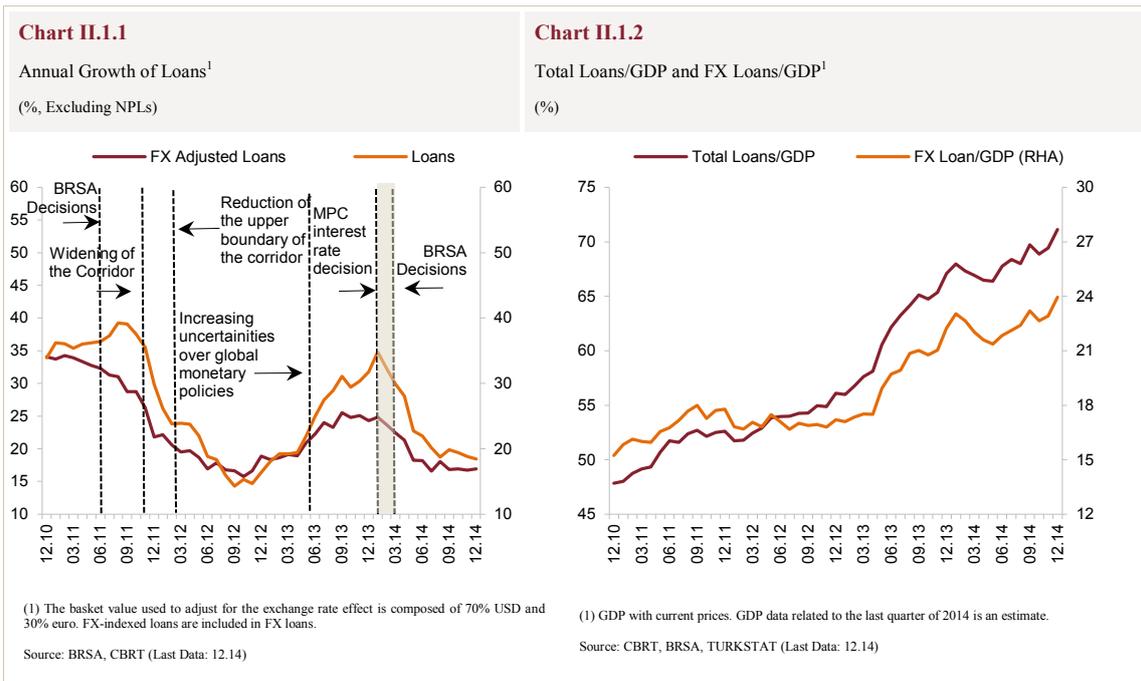
	2010	2011	2012	2013	2014				Yoy
	Share	Share	Share	Share	Share	TL	FX	Total	
Receivables from Banks	4.1	4.1	3.3	3.4	3.2	22,044	41,080	63,124	6.2
Securities Available for Sale (Net)	18.5	15.3	14.3	11.3	11.0	174,046	44,929	218,975	12.0
Required Reserves and Receivables from Central Bank	5.6	7.4	9.4	10.9	10.6	21,716	189,539	211,255	12.3
Loans*	52.2	56.1	58.0	60.5	62.2	880,969	359,739	1,240,708	18.5
Securities Held to Maturity (Net)	9.4	7.3	4.8	5.0	4.0	56,449	24,308	80,757	-6.3
Other Assets	10.2	9.8	10.2	9.0	9.0	145,840	33,500	179,339	15.2
TOTAL ASSETS						1,301,064	693,095	1,994,159	15.1
Deposit (Participation Funds)**	61.3	57.1	56.3	54.6	52.8	661,343	391,350	1,052,693	11.3
a) Demand Deposits (Participation Funds)	9.8	10.0	10.1	10.2	10.0	117,676	80,775	198,450	12.0
b) Term Deposits (Participation Funds)	51.5	47.2	46.2	44.4	42.8	543,667	310,576	854,243	11.1
Payables to Banks	12.2	13.8	12.7	14.7	14.7	42,700	250,528	293,228	15.3
Funds from Repo Transactions	5.7	8.0	5.8	6.9	6.9	77,611	59,758	137,369	15.3
Securities Issued (Net)	0.3	1.5	2.8	3.5	4.5	31,036	58,224	89,260	47.4
a) Bonds and Bills	0.3	1.5	2.7	3.4	4.4	29,834	58,224	88,058	47.8
Other Liabilities	3.1	3.2	3.8	3.7	3.6	51,080	20,666	71,746	12.3
TOTAL	86.6	88.1	86.7	88.8	88.4	925,151	837,051	1,762,202	14.5
Paid - in Capital	4.8	4.1	4.0	3.4	3.2	64,666	0	64,666	9.0
Legal Reserves	7.2	7.4	7.6	7.1	7.1	141,499	136	141,635	15.4
TOTAL SHAREHOLDERS' EQUITY	13.4	11.9	13.3	11.2	11.6	228,383	3,574	231,957	19.7
TOTAL LIABILITIES						1,153,534	840,625	1,994,159	15.1

* Loans extended to banks are included in "Receivables from Banks" item.

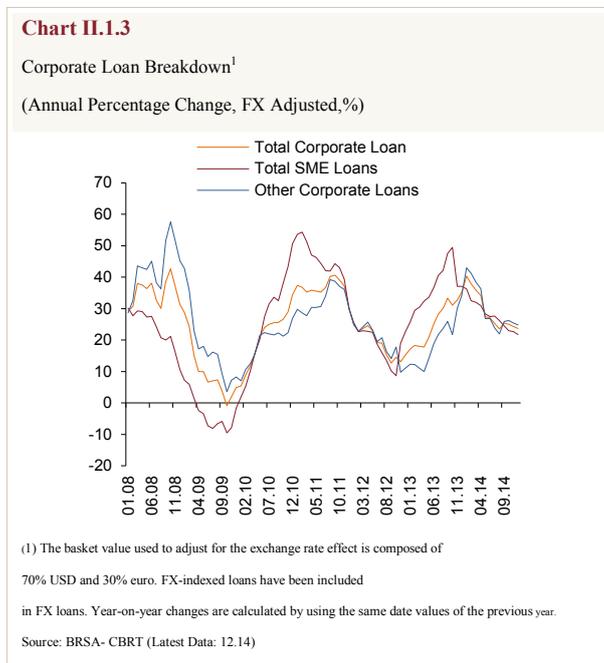
** Deposit and participation funds collected from banks are included in "Payables to Banks" item.

*** "Loans Extended to Banks" and "Deposit (Participation Funds) Collected from Banks" are provided for information.

Loan developments: The measures taken by the BRSA to limit consumer loan growth contributed to the downward trend observed in the annual loan growth rate during January-July 2014. In the second half of 2014, the growth rate has stabilised (Chart II.1.1). Similarly, after a drop in early 2014, the ratios of total loans to GDP and FX loans to GDP have resumed their growth at a more moderate pace (Chart II.1.2).



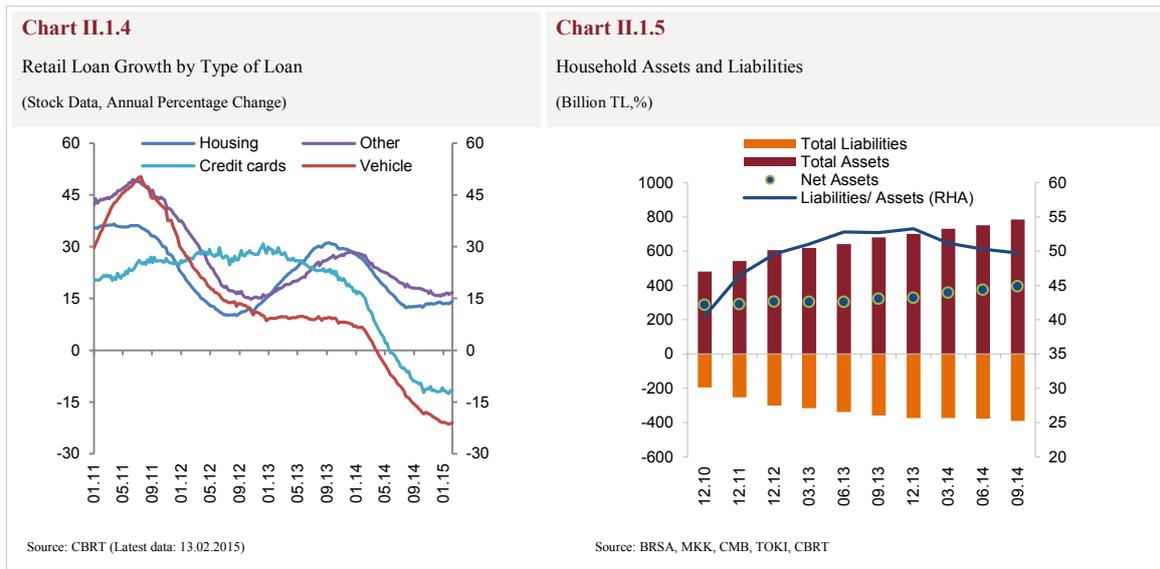
In terms of corporate lending, TL loan growth remains strong, whereas the annual growth of FX loans is comparably weaker. The shares of corporate, small and medium enterprises (SME) and retail lending are 44%, 27% and 29% respectively. In the last three years, the share of corporate and SME lending has increased at the expense of retail lending. SME and other corporate loans have grown in line with total corporate loans (Chart II.1.3).



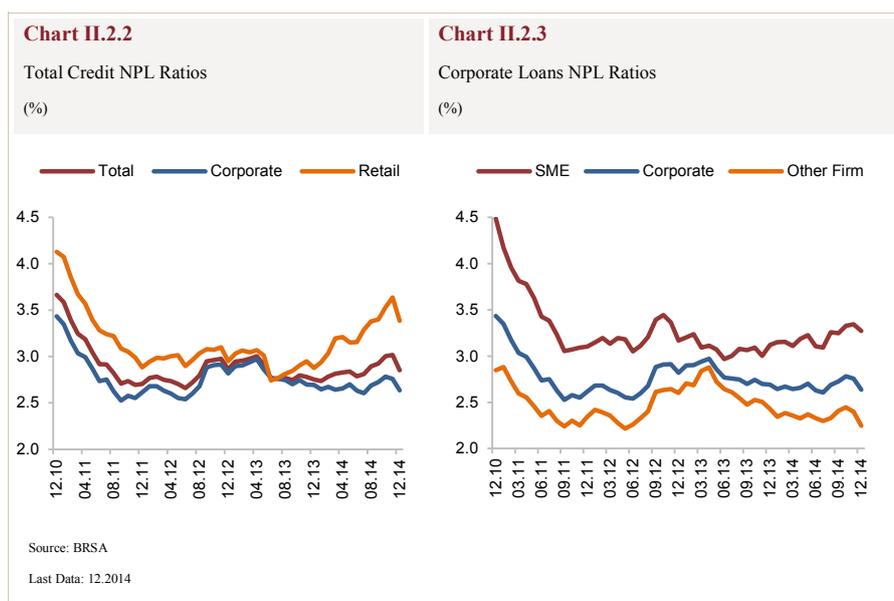
In response to the tight monetary policy stance and macroprudential measures taken by the CBRT and the BRSA, retail loan growth began to decline from mid-2013 and has recently stabilised at lower levels (Chart II.1.4).

Housing and general purpose loans increased rapidly in late 2012 as interest rates dipped to historic lows and loan maturities were extended. However, this trend was reversed in 2013. Moderation in credit growth levels continued in 2014, especially for housing and general purpose loans. Credit cards and vehicle loan growth experienced considerable declines in growth during the second half of 2014 (Chart II.1.4).

Net household assets have improved gradually due to decelerating growth of household debt, most of which is composed of fixed rate loans denominated in local currency (Chart II.1.5).



The NPL ratio for total loans has been relatively flat since the second half of 2013, although its sub-components (retail and corporate loans) have moved in opposite directions (Chart II.2.2 and Chart II.2.3).

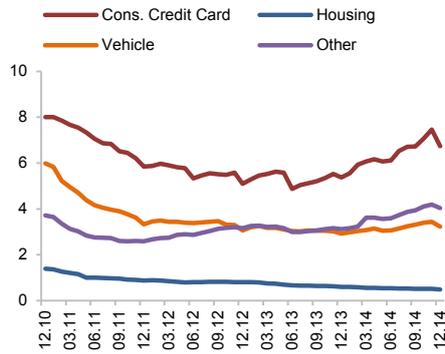


For retail loans, the highest NPL ratio levels are found in consumer credit cards and other consumer credits (Chart II.2.4).

Chart II.2.4

Consumer Credit NPL Ratios

(%)



Source: BRSA

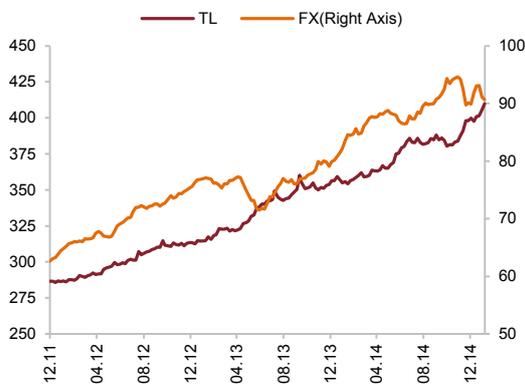
Last Data: 12.2014

Deposits: The annual growth rate of savings deposits has not shown a significant change for a long time. The annual growth rate of FX savings deposits, which increased sharply in the first half of 2014, has displayed a downward trend, whereas the growth rate of TL savings deposits has accelerated after November 2014 (Chart III.1.1 and Chart III.1.2).

Chart III.1.1

Development of TL-FX Savings Deposits¹

(Billion TL, Billion Basket)



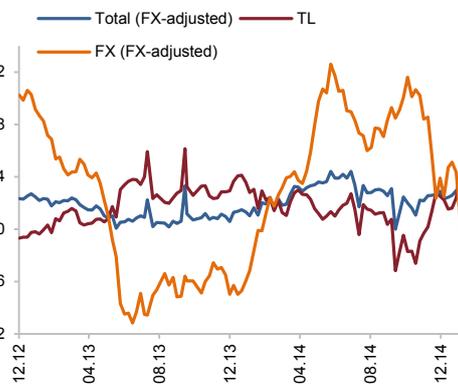
(1)FX savings deposit has been adjusted for the exchange rate effect with the(0,6\$+0,4€) currency basket.

Source: CBRT (Latest Data: 06.02.15)

Chart III.1.2

TL-FX and Total Savings Deposits¹

(Adjusted for Exchange Rate Effect, Annual Percentage Change)



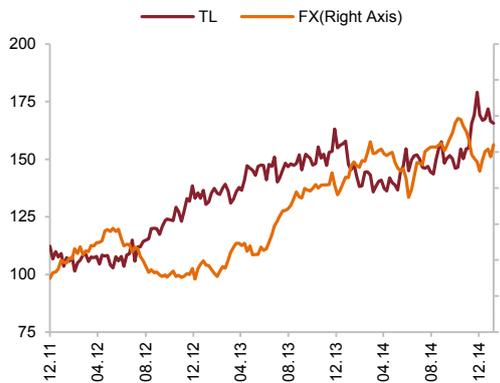
(1)FX savings deposit has been adjusted for the exchange rate effect with the(0,6\$+0,4€) currency basket.

Source: CBRT (Latest Data: 06.02.15)

Commercial deposits continue to display a weak growth trend. This weak trend was triggered by the deceleration in the growth rate of FX commercial deposits that has become more apparent after the second quarter of 2014. TL commercial deposits, whose annual growth rate declined rapidly since May 2013 with the increasing fluctuations in exchange rates, have started to show an upward trend more recently (Chart III.1.3 and Chart III.1.4).

Chart III.1.3Development of TL-FX Commercial Deposits¹

(Billion TL, Billion Basket)

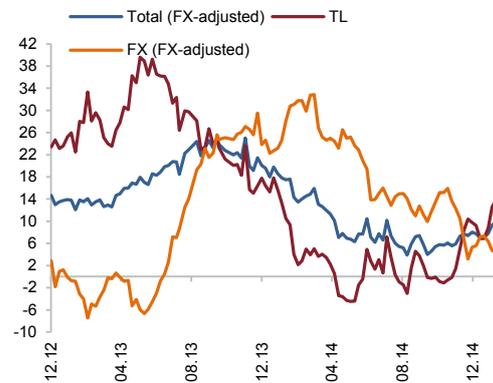


(1)FX saving deposit has been adjusted for the exchange rate effect with the(0,65+0,4€) currency basket.

Source: CBRT (Latest Data: 06.02.15)

Chart III.1.4TL-FX and Total Commercial Deposits¹

(Adjusted for Exchange Rate Effect, Annual Percentage Change)



(1)FX saving deposit has been adjusted for the exchange rate effect with the(0,65+0,4€) currency basket.

Source: CBRT (Latest Data: 06.02.15)

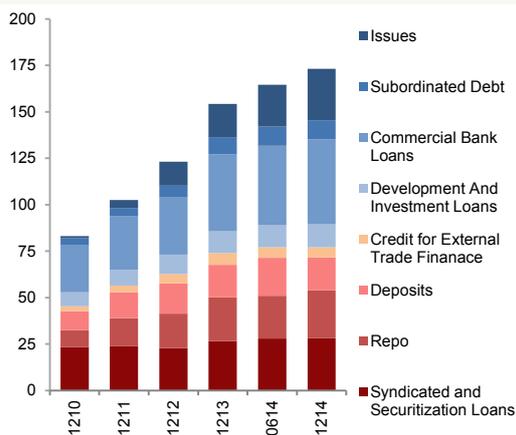
External liabilities: The total amount of the Turkish banking sector's external liabilities to financial institutions reached USD 174 billion at the end of 2014, increasing 12% compared to 2013. Commercial bank borrowing and securities issuance (which only started abroad in 2010) are the two major drivers of this increase in external liabilities (Chart III.2.1).

The external debt rollover ratio of the banking sector has shown a modest rise in 2014 and it still remains above 100%. This ratio has been above 100% for a long time (Chart III.2.2).

Chart III.2.1

Composition of Banks' External Liabilities

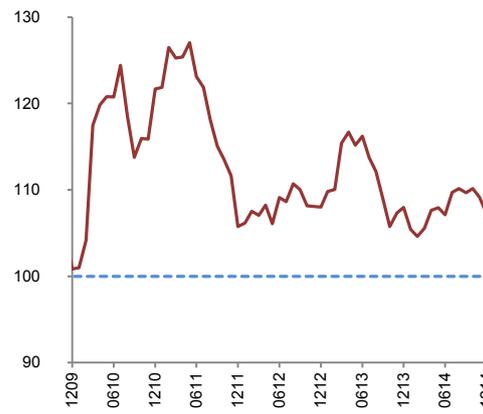
(Billion USD)



Source:BRSA-CBRT, CMB, PDP (Latest Data: 12.14)

Chart III.2.2External Debt Rollover Ratio of Banks¹

(%)

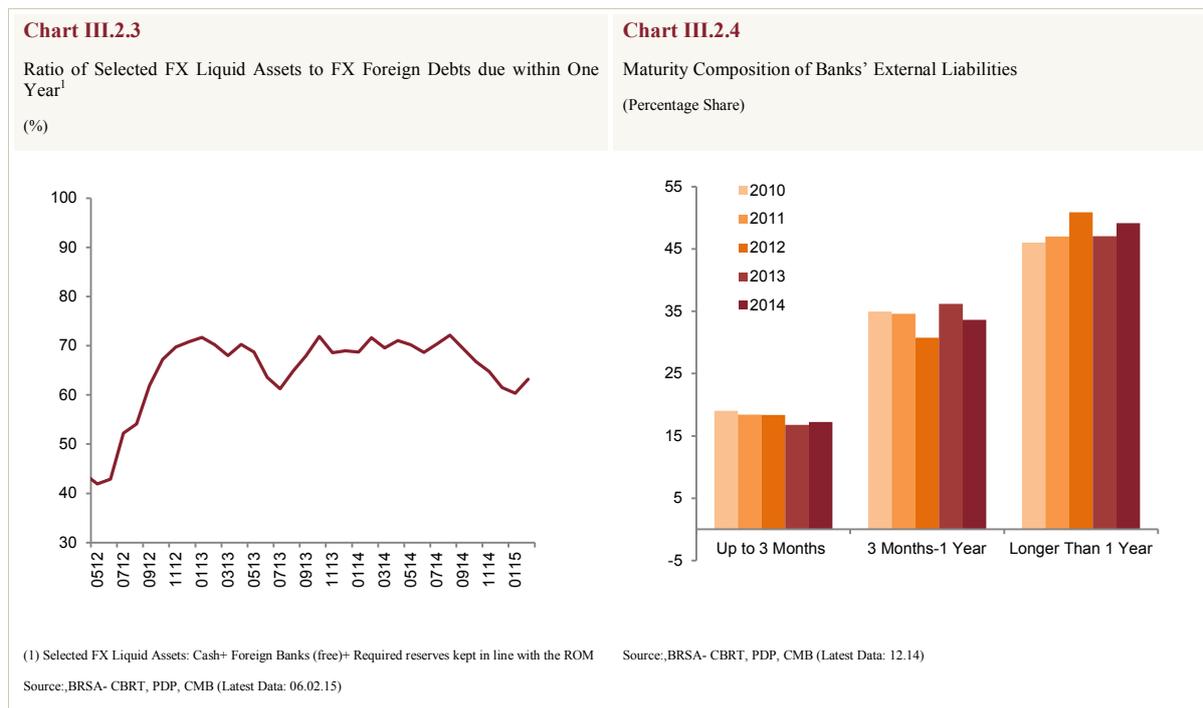


(1)Calculated based on 6-month-moving averages of total foreign borrowing and repayment amounts including security issues.

Source:BRSA-CBRT, CMB, PDP (Latest Data: 12.14)

The ratio of FX liquid assets (which is the sum of banks' cash and free deposits in banks abroad and FX and gold reserves kept within the framework of the Reserve Options Mechanism (ROM) at the CBRT) to external debt within one year significantly increased in 2012 due to the introduction of the ROM, and has remained fairly stable since then. Moreover, banks have a portfolio of TL 12 billion equivalent in FX-denominated unencumbered government debt securities that is not included in the definition of liquid assets due to their price fluctuations in times of stress (Chart III.2.3).

In terms of the maturity structure of the external liabilities, the share of liabilities with a maturity of longer than 1 year continues to represent almost half of the total (Chart III.2.4).

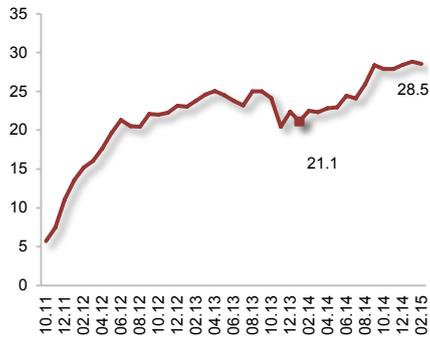


As noted above, securities issued by banks have been on the rise in recent years as an alternative source of funding (Chart III.3.1 and Chart III.3.2). The weighted average maturity of domestic securities issued as of December 2014 is 293 days, and of securities issued abroad in FX is 61 months. The increase in securities issued is considered as a favourable development since it contributes to decrease of the maturity mismatch in the banking sector's balance sheet.

Chart III.3.1

Domestic Securities Issued

(Billion TL)

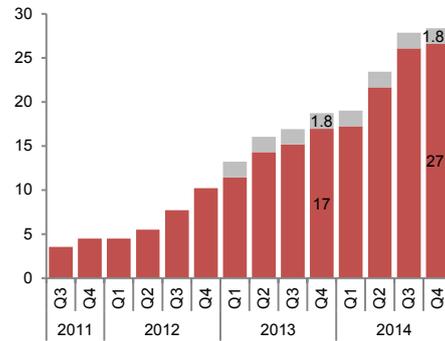


Source: PDP, CBRT calculations

Chart III.3.2

Securities Issued Abroad

(Billion USD, Billion TL)

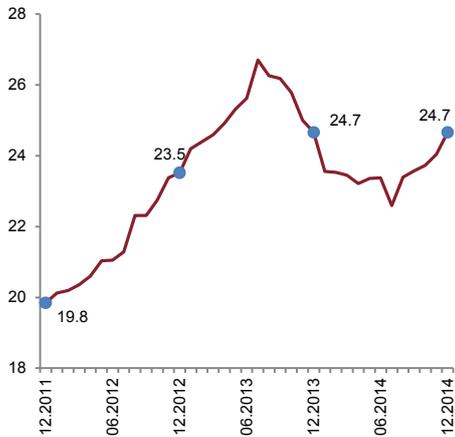


Capital adequacy and profitability of banking sector: The return on assets and return on equity of the banking sector have decreased since mid-2013 and have stabilised at relatively lower levels (Chart IV.1 and Chart IV.2).

Chart IV.1

Net Income of Banking Sector

(Billion TL)

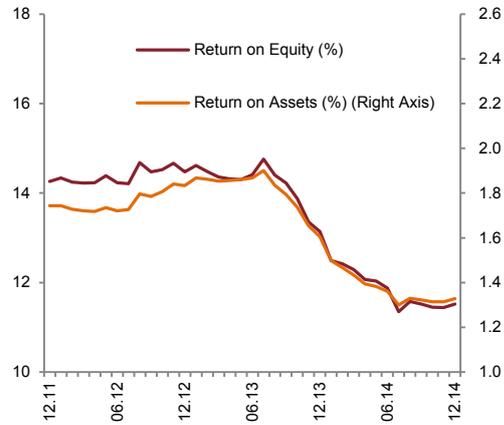


Source: BRSA - CBRT

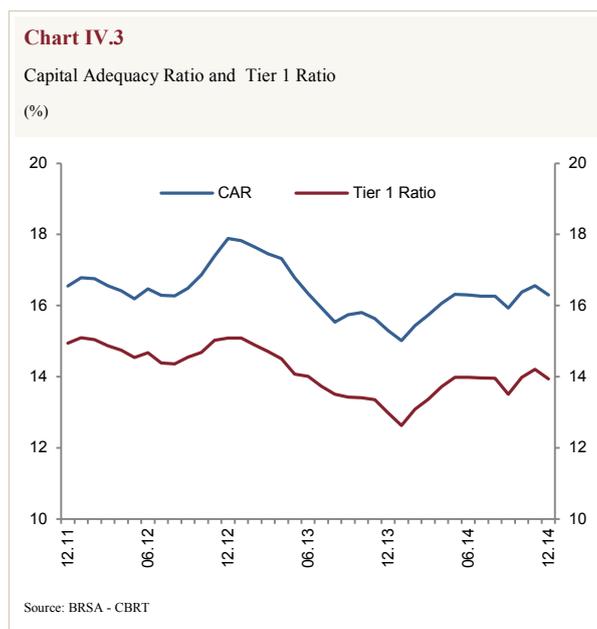
Chart IV.2

Return on Assets and Return on Equity

(%)



The capital adequacy of the banking sector has remained in excess of 16% in recent years, which is well above the legal (8%) and target ratios (12%). The Tier 1 capital ratio is also high, which denotes that the quality of banks' regulatory capital is strong (Chart IV.3).



Regulatory framework

The Turkish financial system is overseen mainly by five institutions: Undersecretariat of Treasury (Treasury), CBRT, BRSA, Capital Markets Board of Turkey (CMB), and SDIF.

Treasury

In its broadest terms, the role of the Treasury is to assist in the determination of economic policies, and within the framework of these policies, to regulate, implement, and determine principles for monitoring and better implementation of activities related to treasury operations, public finance, state economic enterprises, state shareholdings, bilateral and multilateral foreign economic relations, relations with international and regional economic and financial organizations, loans and grants received from and given to foreign countries and organizations, arrangements and operations in the area of capital flows under the finance policies of the country and the insurance sector. The Treasury is responsible for monitoring and evaluating the internal and external developments in the financial system; conducting studies for developing the financial sector and strengthening the financial stability. The Treasury is responsible for cooperating with financial regulatory and supervisory institutions as well as stock markets. The Treasury is the unique regulatory and supervisory authority of the insurance system. The Treasury regulates all insurance activity domiciled in Turkey, including insurance undertakings (non-life, life, pension and reinsurance companies), insurance intermediaries (insurance brokers, agents), loss adjusters, and actuaries.

CBRT

The primary objective of the CBRT is to achieve and maintain price stability as stated in the CBRT Law No. 1211. The CBRT is also responsible for taking measures to sustain the stability of the financial system. Accordingly, financial stability is the auxiliary objective of the CBRT. Some of its main responsibilities are to determine the exchange rate regime jointly with the government, to determine the procedures and principles of reserve requirements and liquidity requirement, to monitor financial markets, to manage the gold and the FX reserves

of Turkey, to establish and secure the uninterrupted functioning of payment, security transfer and settlement systems to enable safe and swift transfer of money and securities.

BRSA

The BRSA with the authority given by Banking Law No. 5411 regulates and supervises banks (deposit banks, investment and development banks and participation banks and the branches in Turkey of such institutions established abroad) and financial holding companies, financial leasing companies, factoring companies, consumer financing companies and asset management companies. And within the scope of the Law on Bank Cards and Credit Cards No.5464, the institutions willing to establish card systems, issue bank cards and credit cards, exchange information on card holders, and engage in clearing and settlement activities are also regulated by the BRSA. In addition, the BRSA is empowered to authorize and supervise the activities of institutions that will perform the independent audit, valuation, rating and outsourcing activities for banks. Moreover, financial leasing, factoring and financing companies established in Turkey are subject to the provisions of the Financial Leasing, Factoring and Financing Companies Law No. 6361, according to which the BRSA is empowered to grant permissions for establishment and operations, conduct onsite and offsite supervision of these companies. Finally according to the Law on Payment and Security Settlement Systems, Payment Services and Electronic Money Institutions No. 6493, the authorization and supervision of the payment institutions and electronic money institutions are performed by the BRSA.

CMB

The CMB, which is empowered by the Capital Markets Law (CML) enacted in 1981, is the regulatory and supervisory authority in charge of the securities markets and institutions in Turkey. Main duties of the CMB are to enhance investor protection, adopt the norms of the international capital markets and fully integrate them into regulations, promote and enhance the effectiveness of both the supply and the demand side of the markets, promote transparency and fairness in the capital markets, facilitate modernization of the market structure and enhance the infrastructure of the capital markets. The CMB regulates and supervises exchanges and organized markets where stock, derivatives, precious metals and precious stones are traded, financial intermediaries which operate in securities markets and institutional investors. Moreover, the institutions like Central Registry Agency, Settlement and Custody Bank (Takasbank), Turkish Capital Markets Association, Investor Compensation Center, independent audit firms, rating agencies, appraisal firms, market operators, and trade repositories are subject to the CMB regulation and supervision.

SDIF

The SDIF is a public legal entity which has been established in 1983 to insure deposits and participation funds in order to protect the rights and interests of depositors and to ensure confidence and stability in financial markets. The SDIF is authorized to insure deposits and participation funds; manage the banks whose management and control have been transferred to the SDIF; strengthen and restructure their financial standing; transfer, merge, sell or liquidate these banks; execute and conclude the follow-up and collection transactions of the receivables of the SDIF and manage the SDIF's assets and resources. The SDIF has administrative and financial autonomy while executing its duties.

Annex 2: Tools used for macroprudential purposes in Turkey (2010-present)

Measure	Adoption Date	Specific Objective	Description	Agency	Communication (all that apply)
Loan-to-value ceilings (LTV)	December 2010	Mitigate and prevent excessive credit growth and leverage	- Ceilings on housing loans for consumer: 75 % - Ceiling for commercial real estate: 50 %	BRSA	BRSA press release
Implicit Nominal Credit Growth Target	Spring 2011	Mitigate and prevent excessive credit growth and leverage	- Maximum limit for credit growth: 25 %	CBRT	CBRT financial stability report
High risk weights for consumer loans	June 2011	Mitigate and prevent excessive credit growth and leverage	- For new general purpose loans with maturities below two years, the risk-weighting increased to 150 % (from 100 %). - For new general purpose loans with maturity greater than two years, the risk-weight increased to 200 % (from 100 %).	BRSA	BRSA press release
Increased provisions for consumer loans	June 2011	Mitigate and prevent excessive credit growth and leverage	- For new (performing) general purpose loans, general provisions were increased from 1 % to 4 %. - Specific provisions for (pre-nonperforming) loans increased from 2 % to 8 %. - The higher provisioning requirements are conditional on banks having a consumer loan portfolio exceeding 20 % of total loans or having a general purpose loan NPL greater than 8 %.	BRSA	BRSA press release
Limits to credit card payments	June 2011	Mitigate and prevent excessive credit growth and leverage	- If three or more monthly payments within a calendar year are less than half of the outstanding balance for the period, the individual credit card limits cannot be increased and cash advances for such credit cards cannot be permitted, unless the outstanding balance for the period is fully covered.	BRSA	BRSA press release
Interest Rate Risk	August 2011	To constrain maturity mismatch in the banks' balance sheet and to contain systemic risk accumulation	- Announced by BRSA to contain interest rate risk through capital charges on large maturity mismatches, discouraging duration gaps. - Effective from 2012.	BRSA	
Changes to minimum Capital Adequacy Requirements	September 2011	To add buffer against spill-over risks arising from parent banks of the economies that were affected from sovereign debt crisis	- Amended by the BRSA in September 2011 to apply to banks with foreign strategic shareholders as of January 2012. - The minimum ratio would depend on various factors such as the CDS spread of the parent and its sovereign, EBA stress test results and the public debt ratio in the country of origin.	BRSA	BRSA press release
Changes to deposit insurance premiums	September 2011	Limit the systemic impact of misaligned incentives	- The deposit insurance fund introduced a premium surcharge for large banks and a new factor to calculate the banks' score for the deposit premium determination.	SDIF	SDIF press release
Resource Utilization Support Fund (RUSF)	January 2013	Mitigate and prevent excessive maturity mismatch and market illiquidity	- With this arrangement, the maturity of loans of banks and finance companies in their direct borrowing from domestic resident was changed to redirect them to the long term. This arrangement reduced the risk of a liquidity coverage ratio of short-term external debt. - New RUSF rate; • 3% for loans up to 1 year, • 1% for loans with average maturity between 1-2 years,	Ministry of Finance	The Official Gazette, Speeches of Ministers

			<ul style="list-style-type: none"> • 0.5% for loans with average maturity between 2-3 years • 0% for loans with average maturity longer than 3 years. 		
Credit card limits introduced	October 2013	Mitigate and prevent excessive credit growth and leverage	- Consumer credit card limits were tied to incomes. - Minimum payment limits and risk weights were increased.	BRSA	BRSA press release
Changes to provisioning rate	October 2013	Mitigate and prevent excessive credit growth and leverage	- Increased general provisioning rates for uncollateralised consumer loans to 4 % from 1 %; - Decreased general provisioning rates on export and SME loans to 0 % and 0.5 % respectively from previous 1 %.	BRSA	BRSA press release
Increase in risk weights for vehicle loans granted to consumer	October 2013	Mitigate and prevent excessive credit growth and leverage	- Risk weights increased from 75 % to 150 % for vehicle loans of which remaining maturity is between 1-2 years; - to 200 % for vehicle loans of which remaining maturity is more than 2 years	BRSA	BRSA press release
Cap on number of instalments of credit card loans	December 2013	Mitigate and prevent excessive credit growth and leverage	- Number of instalments of credit card loans shall be capped at 9 months; - Expenses for telecommunication devices, precious metals, restaurant services, food and fuel oil is excluded from the scope of credit card instalment payments	BRSA	BRSA press release
Maturity restriction to consumer loans	December 2013	Mitigate and prevent excessive maturity mismatch and market illiquidity	- Consumer loans (other than housing and vehicle loans) must be repaid at most in 36 months, vehicle loans in 48 months.	BRSA	BRSA press release
LTV to vehicle loans	December 2013	Mitigate and prevent excessive credit growth and leverage	- Depending on the value of the vehicle, a LTV ratio between 50% and 70% has been introduced.	BRSA	BRSA press release
Equity Financing Regulations	April 2015	Enhance financing channels for corporates and prevent excessive leverage	- Corporations are allowed to deduct 50% of paid in cash equity financing costs.	Ministry of Finance	The Official Gazette
Interest rate corridor	End of 2010	Smooth exchange rate volatility	- Raising the upper bound of the corridor in periods of weak risk appetite would limit the amount of capital outflows for a given level of domestic interest rate and country risk premium. On the other hand, interest rate volatility can be considerably increased by widening the interest rate corridor downwards in periods of strong capital flows.	CBRT	CBRT press release, annual monetary and exchange rate policy documents
Reserve Requirement Ratios (RRRs)	March 2015	Provide incentives for maturity extension on FX borrowing	RRRs for FX non-core liabilities with a maturity up to 1 year and 2 years have been increased.	CBRT	CBRT Press Release
	February 2015	Support financial stability by taking into account the latest developments in global markets, and to encourage the extension of maturities of non-core liabilities	The number of maturity brackets for FX non-core liabilities has been increased and the RRRs for FX non-core liabilities have been revised and increased for some brackets in a way to encourage the extension of maturities of non-core liabilities.	CBRT	CBRT Press Release
	May 2015	Support financial stability in light of the latest developments in global markets	RRRs for FX short-term liabilities have been increased.	CBRT	CBRT Press Release

March 2013	In line with the strategic framework set out at the MPC meeting held on 19 February 2013, to implement a measured tightening through reserve requirements	RRRs for TL and FX short-term liabilities have been increased.	CBRT	CBRT Press Release (decision of MPC)
February 2013	In line with the strategic framework set out at the MPC meeting held on 22 January 2013, to implement a measured tightening through reserve requirements	RRRs for TL and FX short-term liabilities have been increased.	CBRT	CBRT Press Release (decision of MPC)
December 2012	To support financial stability by taking into account the latest developments in global markets, and to lengthen the maturity of FX liabilities	RRRs for FX short-term liabilities have been increased.	CBRT	CBRT Press Release
October 2011	In line with the strategic framework set out at the MPC meeting held on 4 August 2011, to provide FX liquidity to the banking system	RRRs for TL core liabilities have been decreased.	CBRT	CBRT Press Release (decision of MPC)
September 2011	In line with the remarks made at the MPC meeting of 20 September 2011 pertaining to recent data and news on the global economic activity, to meet the TL liquidity requirement of the banking system permanently and at a lower cost	RRRs for TL short-term liabilities have been decreased. The reductions have also been designed to encourage the lengthening of the maturities of the TL non-core liabilities.	CBRT	CBRT Press Release (decision of MPC)
September 2011	In line with the strategic framework set out at the MPC meetings held on 23 August 2011 and 20 September 2011, to provide FX liquidity to the market	RRRs for FX liabilities have been decreased. The reductions have also been designed to encourage the lengthening the maturity structure of FX liabilities.	CBRT	CBRT Press Release (decision of MPC)
August 2011	In line with the strategic framework set out at the MPC meeting held on 4 August 2011, to provide FX liquidity to the banking system	RRRs for FX liabilities have been decreased by 0.5 point for all maturities.	CBRT	CBRT Press Release (decision of MPC)
July 2011	To lengthen the maturity of liabilities	RRRs for FX long-term liabilities have been decreased.	CBRT	CBRT Press Release
April 2011	To lengthen the maturity of liabilities	RRRs for Turkish lira and FX short-term liabilities have been increased.	CBRT	CBRT Press Release
March 2011	To lengthen the maturity of liabilities	RRRs for Turkish lira liabilities have been increased.	CBRT	CBRT Press Release
January 2011	To lengthen the maturity of liabilities	RRRs for Turkish lira liabilities have been increased.	CBRT	CBRT Press Release

Remuneration of Turkish Lira Reserve Requirements	November 2014	To provide further support for core liabilities in order to spur balanced growth and domestic savings	Financial institutions whose core liability ratios (ratio of deposits and equity to loans) are higher than the sector average will be remunerated at a higher rate unless they worsen their own situation.	CBRT	CBRT Press Release
	May 2015	To reduce the costs of TL reserve requirements and thus to enhance the efficiency of ROM	The remuneration rate for the required reserves maintained in TL has been raised by 50 basis points.	CBRT	CBRT Press Release
Reserve Option Mechanism (ROM)	March 2015	To meet the temporary FX liquidity needs of the financial sector	Reserve option coefficients (ROCs) for FX reserves have been changed for the first tranche and the last five tranches.	CBRT	CBRT Press Release
	January 2015	To strengthen the automatic stabilizing feature of ROM, and to largely compensate for the FX liquidity withdrawal that would arise from the changes in FX reserve requirement ratios	Technical adjustments have been implemented in reserve option tranches and coefficients, in a way also to largely compensate for the FX liquidity withdrawal that would arise from the changes in FX reserve requirement ratios.	CBRT	CBRT Press Release
	August 2014	Taking the latest developments in global financial markets and operational processes regarding reserve requirements into account	The foreign currencies that can be maintained for TL required reserves have been limited to the US dollar only.	CBRT	CBRT Press Release
	January 2014	In light of the latest developments in global markets and with a view to supporting financial stability, to ensure a more effective functioning of ROM working as an automatic stabilizer	ROCs for FX reserves have been increased for the last four tranches.	CBRT	CBRT Press Release
	May 2013	To support financial stability in light of the latest developments in global markets	For FX reserves, one more tranche has been added to the existing tranches by keeping the upper limit unchanged, and the ROCs have been raised by 0.1 points for all tranches excluding the first tranche.	CBRT	CBRT Press Release
	April 2013	To support financial stability in light of the latest developments in global markets	ROCs for FX reserves have been increased by 0.2 points for all tranches except for the first tranche.	CBRT	CBRT Press Release
	March 2013	To support financial stability in light of the latest developments in global markets	For FX and gold reserves, one more tranche has been added to the existing tranches by keeping the upper limit unchanged, and the ROCs have been raised by 0.1 points for all tranches excluding the first tranche.	CBRT	CBRT Press Release
	February 2013	To support financial stability in light of the latest developments in global markets	ROCs for gold reserves have been raised by 0.1 points for all tranches.	CBRT	CBRT Press Release
	November 2012	To support financial stability in light of the latest developments in global markets	ROCs for all tranches of FX reserves (except for the first tranche of 40%) and those for all tranches of gold reserves have been raised by “0.1” and “0.2” points respectively.	CBRT	CBRT Press Release
	October 2012	To support financial stability in light of the latest developments in global markets	ROCs for all tranches of FX reserves have been increased by “0.1” points.	CBRT	CBRT Press Release
	September 2012	To support financial stability in light of the latest developments in global markets	ROCs for all tranches of FX reserves have been increased by “0.2” points.	CBRT	CBRT Press Release
	August 2012	To narrow the cost differential of meeting the TL reserve requirements in TL or in FX, and enable the banks to benefit fully from the facility as called	The upper limit for FX reserves has been raised to 60%, and the reserve requirement for the additional 5% tranche has been decided to be maintained in USD and/or euro, and multiplied by a reserve option coefficient (ROC) of “2”. ROC for the first tranche corresponding to 40% of Turkish lira reserve requirements has been raised to “1.1”.	CBRT	CBRT Press Release

	for by their liquidity needs	The upper limit for gold reserves has been raised from 25% to 30%, where this 5% additional tranche will be multiplied by a ROC of "2".		
July 2012	To narrow the cost differential of meeting the TL reserve requirements in TL or in FX, and enable the banks to benefit fully from the facility as called for by their liquidity needs	The upper limit for FX reserves that might be held to maintain Turkish lira reserve requirements has been raised to 55%, and the reserve requirement to be maintained in FX for the additional 5% tranche has been decided to be multiplied by a factor of 1.9.	CBRT	CBRT Press Release
July 2012	To narrow the cost differential of meeting the TL reserve requirements in TL or in FX, and enable the banks to benefit fully from the facility as called for by their liquidity needs	The upper limit of the facility for FX reserves has been raised to 50%. The third tranche of this facility corresponding to the additional 5% will be maintained in US dollar and/or euro over the total amount calculated by multiplying by a coefficient of "1.7". The upper limit for gold reserves has been raised from 20% to 25%, and banks are allowed to hold TL reserve requirements in gold over the total amount calculated by multiplying the first tranche corresponding to 20% of TL reserve requirements by a coefficient of "1", as previously, and the second tranche corresponding to 5% of TL reserve requirements by a coefficient of "1.5".	CBRT	CBRT Press Release
June 2012	To narrow the cost differential of meeting the TL reserve requirements in TL or in FX, and enable the banks to benefit fully from the facility as called for by their liquidity needs	The upper limit of the facility for FX reserves has been raised to 45%, and the banks are allowed to hold TL requirements in US dollar and/or euro over the total amount calculated by multiplying the first tranche corresponding to 40% of TL reserve requirements by a coefficient of "1", as previously, and the second tranche corresponding to 5% of TL reserve requirements multiplied by a coefficient of "1.4".	CBRT	CBRT Press Release
March 2012	To strengthen the build-up of the Central Bank's gold reserves and positively influence cost and liquidity channels of the banking sector	The upper limit for standard gold reserves that may be held to meet TL reserve requirements has now been raised from 10% to 20%.	CBRT	CBRT Press Release
November 2011	In order to strengthen the build-up of gold reserves and to provide more flexibility in the banking system's liquidity management	Up to 10% of the reserve requirements maintained for TL liabilities has been allowed to be maintained as "standard gold".	CBRT	CBRT Press Release
October 2011	To meet the TL liquidity requirement of the Turkish banking system permanently and at a lower cost, while at the same time bolstering the build-up of the Central Bank's FX reserves	The upper limit for FX reserves that may be held to meet TL reserve requirements is raised from 20% to 40% of lira liabilities.	CBRT	CBRT Press Release
September 2011	To meet the TL liquidity requirement of the Turkish banking system permanently and at a lower cost, while at the same time bolstering the build-up of the Central Bank's FX reserves	The upper limit for FX reserves that may be held to meet TL reserve requirements has been raised from 10% to 20% of Turkish lira liabilities.	CBRT	CBRT Press Release
September 2011	To meet the TL liquidity needs of the banking system in a more permanent way and lower cost, to support and use Central Bank's foreign exchange reserves timely, controlled and effectively	The facility (ROM) that up to 10% of reserve requirements for TL liabilities can be maintained in US dollar and/or euro has been provided to banks.	CBRT	CBRT Press Release

Leverage Based Reserve Requirements	January 2013	In order to avert the risks that might stem from operating under high leverage, banks that raise the leverage ratios to excessive levels are subjected to additional reserve requirement.	The leverage ratio subject to the CBRT's policy is calculated by dividing the sum of tier-1 capital to total liabilities and off-balance sheet items with certain consideration ratios (Tier-1 Capital/(Total Liabilities+Off Balance Sheet Items)). This policy was effective since 2013 for monitoring purposes. The leverage ratio, which the additional reserve requirement range is based on, has been effective since the last quarter of 2013, and was gradually widened until the last quarter of 2015. Reporting is made within 3 months following the calculation period, and the banks in the given range maintains additional reserve requirements for 6 reserve requirement periods following the first maintenance period at the 4th calendar month.	CBRT	MONETARY AND EXCHANGE RATE POLICY REPORT FOR 2013
Inclusion of Financing Companies into Reserve Requirement System	December 2013	Taking into account the rapid increase in loans extended by financing companies, to prevent unfair competition and to ensure a sound monitoring of the credit channels of the non-bank sector as required by financial stability, financing companies have also been included in the reserve requirements coverage.	Financing companies will hold required reserves for their liabilities, at the accounts to be opened with the CBRT, under the current ratios applied to the banks.	CBRT	CBRT Press Release

Source: CBRT, BRSA.

Annex 3: Communication strategies of financial stability bodies in selected countries

	Netherlands*	Germany*	US*	UK*
Macroprudential body	Financial Stability Committee (FSC)	Financial Stability Committee (FSC)	Financial Stability Oversight Council (FSOC)	Financial Policy Committee (FPC) under the Bank of England (BoE)
Chair of body	DNB President	State Secretary (Federal Ministry of Finance)	Secretary of the Treasury	Governor of the BoE
What types of information are communicated to the public?	Governance structure for FSC, summaries/ record/minutes of FSC discussions, financial stability risks and policy measures/ recommendations	Similar to Netherlands, except summaries of FSC discussions are usually not published.	Similar to Netherlands	Similar to Netherlands
Who usually communicates on macroprudential issues?	FSC and DNB	FSC (via Federal Ministry of Finance, Bundesbank and BaFin), Bundesbank	FSOC and member agencies	FPC, PRA and FCA
How is communication carried out?	Dedicated FSC website , separate from its member agencies. Website includes information on FSC meeting accounts and recommendations. A report is also produced for the Minister of Finance and sent to Parliament.	No dedicated webpage for the FSC. Macroprudential information from FSC tends to be disseminated on the websites of all 3 voting member agencies (i.e. Federal Ministry of Finance, Bundesbank and BaFin). The FSC also reports on its activities to the Bundestag.	Dedicated FSOC page on the website of the Treasury. The page includes minutes of FSOC meetings, and an Annual Report that contains recommendations to agencies. Parts of some FSOC meetings are open to the public via live webcasts. Policies or recommendations are also communicated by member agencies on their respective websites. FSOC sessions that discuss individual institutions or other market-sensitive information are not publicly disclosed.	Dedicated FPC page on the website of the BoE. The page includes records of FPC meeting discussions and media announcements of policies or recommendations. BoE's semi-annual FSR is also released under the FPC given its oversight. PRA and FCA also communicate on macroprudential policies, in response to FPC recommendations. Besides text documents, FPC has employed pictorial documents and videos to reach out to a wider public audience.

	Netherlands*	Germany*	US*	UK*
When is communication carried out?	FSC meetings are held at least twice a year. Meeting summaries are published about one month thereafter. Warnings and recommendations are generally made public. Since its inception in Nov 2012, the FSC has made one recommendation publicly (May 2015).	FSC meetings are held quarterly, but are not accompanied by a press release. The authorities have expressed a preference for the FSC to only engage in public communication when necessary (e.g. to announce a warning or a recommendation) in order to maximise its impact. FSC publishes Annual Report to the Bundestag (main communication tool). Since its inception in Jan 2013, the FSC has published one recommendation (June 2015).	FSOC meets every month and FSOC minutes are published once approved one or two meetings thereafter. FSOC has published recommendations in every issue of its Annual Report, which started in 2011. Other macroprudential information (e.g. financial risks) is also disseminated through the Annual Report.	The FPC meets quarterly. FPC meeting records are published about 2 weeks after the meeting. Outside of its own policies, FPC has made recommendations to other bodies in 6 out of 10 meetings since it came into operation in full fledge in Apr 2013 (an interim FPC was in place since Feb 2011).
Granularity of information communicated	<u>FSC meeting account/ conclusions</u> Typically 3-4 pages long. They usually contain brief overview of risks and detailed discussions of a few risk topics. Recommendation and underlying considerations appeared in the conclusion of a recent meeting. <u>Policy/recommendations</u> Based on FSC's recommendation on reducing the LTV limit, the communication covers risks being addressed, specific recommendation and policy considerations.	<u>Policy/recommendations</u> Based on FSC's recommendation on new instruments for residential property market, the communication covers risks being addressed, general recommendations, detailed analyses and policy considerations.	<u>FSOC meeting minutes</u> Typically up to three pages long (excluding attendee list). They usually cover discussions of a few risk topics. For the closed sessions, the focus is on how the meetings proceeded and approvals rather than discussions and considerations underlying decisions. Minutes of the open sessions contain more details. <u>Policy/recommendations</u> Annual Report includes a list of recommendations (one chapter) that are fairly broad. Communication of detailed recommendations is less prevalent – the sole example to date being on money market fund reforms, which covered risks, identification of agencies to follow-up, specific recommendations and options, analyses, policy considerations and soliciting public comments.	<u>FPC meeting record</u> Typically 10-20 pages long. They usually contain comprehensive scan of risks, in-depth discussions of a few risk topics, recommendations as well as underlying analyses and considerations, and progress review of past recommendations. <u>Policy / recommendations</u> These are communicated through FPC meeting records, with policies and recommendations clearly marked. The communication usually covers risks being addressed, a few specific recommendations, extensive analyses and policy considerations. Follow-ups are placed on the same page as FPC's recommendation

Sources: FSB peer review reports (<http://www.financialstabilityboard.org/publications/peer-review-reports/>), national websites.

Annex 4: Follow-up of other key FSAP recommendations

This Annex presents the follow-up actions reported by the Turkish authorities to key FSAP recommendations that are not covered in sections 2 and 3. The actions mentioned below have not been evaluated as part of the peer review and are presented solely for purposes of transparency and completeness.

Recommendations	<i>Steps taken to date and actions planned (including timeframes)</i>
Overall financial sector oversight	
<p>Consider further prudential action to ensure strong capital positions and stability of funding.</p>	<p>Macro prudential regulations and the requirements of Basel III encourage Turkish banks to keep their capital base strong. Moreover, the BRSA's policies of 12% target capital adequacy ratio and restrictions on dividend payments continued.</p> <p>Additionally, as also stated in the 2014 Article IV IMF report, the banking sector remains well-capitalized as system wide capital adequacy remains above 16% (well above regulatory minima) and capital is almost entirely Common Equity Tier 1.</p> <p>The distribution of the funding sources has not experienced any significant change for a long time. As of July 2015, 54% of the liabilities are consisted of deposits. However, in line with economic activity, the BRSA observed that banks' wholesale external funding in FX has increased in recent years in nominal terms with preferable maturities due to ample and cheap external wholesale funding. However, the BRSA emphasizes that both the cost of obtaining such funding (market dynamics) and the banks' substantial FX deposits at the CBRT associated with ROM and FX reserve requirements have played important role on this increase.</p> <p>Moreover, banks' external FX funding rollover ratio remains above 100% and they have not experienced any difficulty to rollover their FX funding. In terms of diversification, total FX bond issuances by Turkish banks abroad grew by 46.1% year-on-year in 2014 and reached to US \$23 billion with an average maturity longer than 5 years.</p> <p>In terms of prudential measures, there is a limitation on net FX position of banks which is 20% of their own funds. FX risk of banking system has been increasing during the recent years and on-balance sheet FX Net Open Position is almost fully hedged by risk mitigation techniques leaving the unhedged position around 0.2% of on-balance sheet assets and well within the regulatory limits.</p> <p>Finally, Basel-III compliant LCR regulation is in effect (reporting started in 2014, enforcement has begun in January 2015)</p> <p>Besides, further policy actions adopted by the CBRT are as follows:</p> <p>1- Remuneration of required reserves depending on a core liability ratio</p> <p>CBRT is supporting core liabilities of financial institutions in order to spur balanced growth and domestic savings. To this end, CBRT remunerates the Turkish lira component of required reserves of financial institutions, depending on their core liability ratio. Starting from 2015, the remuneration rate for each quarterly period is determined as the weighted average cost of the CBRT funding minus either 500 or 700 basis points, depending on the ratio of the sum of deposits (excluding public sector and interbank deposits) (D) and shareholders' equity (E) to total gross loans (L). The required reserves of financial institutions whose core liability ratios are higher than the</p>

	<p>sector average are remunerated at a higher rate unless they worsen their own situation⁴⁸.</p> <p>2- Leverage-based reserve requirements</p> <p>In order to avert the risks that might stem from operating under high leverage, banks that raise the leverage ratios to excessive levels are subjected to additional reserve requirement. In this context, a countercyclical and macroprudential policy based on leverage ratios has been put into effect in a gradual way. The leverage ratio subject to the CBRT's policy is calculated by dividing the sum of tier-1 capital to total liabilities and off-balance sheet items with certain consideration ratios (Tier-1 Capital/(Total Liabilities+Off Balance Sheet Items)). This policy was effective since 2013 for monitoring purposes. The leverage ratio, which the additional reserve requirement range is based on, has been effective since the last quarter of 2013, and was gradually widened until the last quarter of 2015. Reporting is made within 3 months following the calculation period, and the banks in the given range maintains additional reserve requirements for 6 reserve requirement periods following the first maintenance period at the 4th calendar month.</p> <p>3- Differentiation of reserve requirement ratios according to the maturities of liabilities</p> <p>Starting from 2011, reserve requirement ratios are differentiated according to the maturity structure of liabilities, in order to lengthen maturity structure of liabilities, reduce the maturity mismatch between assets and liabilities, and thus promote the financial stability. These ratios are reviewed regularly and revised when necessary. The following link gives the changes in required reserve ratios according to maturities, historically⁴⁹.</p>
<p>Consider further measures to address the risk of worsening lending standards in the consumer and SME segments.</p>	<p>The Turkish banking system remains robust and resilient with the average capital adequacy ratio well above regulatory standards, strong asset quality, and ample liquidity buffers. Regulatory and supervisory standards are compatible with international standards. Despite the recent volatility in the currency markets and interest rates increase, the non-performing loans ratio remained around 3% level.</p> <p>In light of the strong pickup in consumer lending, the authorities put in place a set of prudential measures to limit the growth trend to more balanced levels and reorient resources to more productive sectors. Credit card spending with installments has been the major driving force of the total credit card balance growth in the last five years. Following the first round of changes in credit card limits and maturity limits on consumer loans in the last quarter of 2013, the number of instalments on credit card spending was limited to 9 months in early 2014. Additionally, loan-to-value requirements for vehicle loans were</p>

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<http://www.tcmb.gov.tr/wps/wcm/connect/TCMB+EN/TCMB+EN/Main+Menu/Announcements/Press+Releases/2014/ANO2014-64>.

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<http://www.tcmb.gov.tr/wps/wcm/connect/tcmb+en/tcmb+en/main+menu/statistics/banking+data/required+reserve+rati+os>.

	<p>differentiated based on the value of vehicles.</p> <p>Higher funding costs were reflected in the consumer and commercial lending rates. Macroprudential measures pursued by the BRSA weighed especially on consumer credit demand. Consumer lending growth slowed down significantly from 24.9% in 2013 to 7.2% in 2014 in nominal terms whereas commercial loan growth remained robust. In July 2014, the BRSA has issued risk management guidelines on credit risk. This guideline has specific and detailed requirements for loan extension to customers including individuals and SMEs. There is an ongoing work on collecting household income data that may be used as a basis to introduce caps on the level of household debt to income.</p>
Micro-prudential regulation and supervision-Banking	
<p>Review and revise key aspects of the supervisory and regulatory framework to bring it fully into line with the Basel framework, especially as regards the supervision of key risks and the definition of capital.</p>	<p>Update on Regulations: Turkey has been implementing Basel II and Basel II.5 since July 2012.</p> <p>The regulations about banks' internal risk models in line with Basel requirements have also been completed and issued in September 2014. The guidelines on application and validation process for internal risk models are expected to be finalized by the end of 2015.</p> <p>The BRSA has also finalized and published new regulations on own funds, capital conservation and counter cyclical capital buffers, liquidity and leverage in line with Basel III reforms and timeline. As a Basel Committee member, Turkey will be going through RCAP process starting from 2015Q3.</p> <p>Additionally, to address the main recommendations of the FSAP team; Regulation on Internal Systems of Banks and Audit Regulation have been modified that clarifies ICAAP requirements for banks and establishes the regulatory infrastructure for issuing specific risk management guidelines.</p> <p>With that, detailed risk management guidelines on Credit Risk, Market Risk, Operational Risk, Counterparty Credit Risk, Liquidity Risk (Funding and Market), Interest Rate Risk in the Banking Book (yield curve risk, basis risk, optionality risk), Concentration Risk, Country and Transfer Risk (Indirect Country Risk, Sovereign Risk, Macroeconomic Risk and Contagion Risk) have been issued. Moreover, the stress testing framework is regulated more explicitly and the BRSA has also issued the supporting guidelines on stress testing and ICAAP Report preparation.</p> <p>Update on supervision: As part of Basel II-Pillar 1 requirements, a detailed supervision handbook and a standard data receiving format (Detailed Credit Risk Analysis Form—DCRAF) were prepared for use of the on-site supervision teams. Currently DCRAFs are being filled by the banks on a monthly basis.</p> <p>A more comprehensive and risk based approach including a new supervision cycle has been developed and started in September 2013. This cycle includes Identification of Risky Areas (IRA), Preparation of Audit Plan, Specific reports (SR), Supervisory Review and Evaluation Process (SREP), Rating Process, Conclusion Meetings, Panel Process.</p> <p><u>IRA</u>: Based on the Guidelines on Identification of Risky Areas IRA Opinion and IRA Table are prepared to figure out the risk profiles of banks. IRA Opinions as well as other risk assessment reports and audit products of the previous periods are sent to related departments in order to set the audit plan.</p>

	<p><u>Specific reports (SR):</u> Following the IRA process, a Specific Report is prepared for each activity area included in the audit plan within the time schedule prepared by the audit team.</p> <p><u>Rating Process:</u> Following the completion of all SR reports, a final Bank Rating Report is prepared and signed by all Audit Group members in charge of related bank, based on the Rating Guidelines. CAMELS Rating System is used for the evaluation of banks' financial structure performance, management and organization. CAMELS consists of six main evaluation criteria (1-Organization and Management, 2-Capital Adequacy, 3-Resource Structure and Liquidity, 4-Asset Quality, 5-Revenue Expenditure Balance and Profitability, 6-Sensitivity to Market Risk). In line with FSAP recommendations grading scale has been updated and a 10 level grading scale is introduced.</p> <p><u>SREP:</u> Banks prepare ICAAP reports on a solo and consolidated basis as of every year end and submit these reports to the Agency at the end of March. In the SREP process, the ICAAP reports prepared by banks and the economic capital adequacy ratios they calculate are verified by the BRSA's audit staff.</p> <p><u>Conclusion Meetings:</u> The audit products prepared as a result of audits performed since the IRA process are shared with the institutions and audit team makes conclusion meetings with the management of the institutions and opinions of the audited institutions are received by an official letter.</p> <p><u>Panel Process:</u> ICAAP reports prepared by banks, SREP and Bank Rating reports prepared by audit staff as well as other audit products are evaluated collectively by the BRSA's decision making organs and CAR ratios and other related issues are determined for each individual bank during this process.</p>
<p>Implement consolidated banking supervision and enhance the coverage of risks emanating from non-banking entities in the group.</p>	<p>BRSA has put into effect a new directive on monitoring intra-group transactions which is effective since 2014. With this directive, banks will report detailed information about their parent companies and the financial and nonfinancial companies that are owned by their parents. BRSA is able to evaluate whether banks' affiliates and parents/sister companies especially nonfinancial ones would impose any risks on banks' health.</p> <p>Legislation on the Internal Systems of Banks has changed in July 2014. Banks are obliged to prepare consolidated ICAAP reports, which take into account all financial and non-financial companies within the banking group.</p> <p>Additionally, BRSA finalized consolidated supervision of biggest banks which constitutes approximately 80% of the Turkish banking system assets, in cooperation with Capital Markets Boards of Turkey and the Treasury.</p>
<p>Revise the Banking Law to enhance the operational and organizational autonomy of the BRSA for banking supervision.</p>	
Micro-prudential regulation and supervision-Insurance	
<p>Reform the current insurance regulation and supervision processes by making them more</p>	<p>In order to achieve a more transparent, consultative and accountable regulatory and supervisory process, following steps have been taken by the Treasury:</p> <p>1-Regulation on the Principles and Procedures of Monitoring and</p>

<p>transparent, consultative, and accountable to the industry.</p>	<p>Supervision of Insurance and Private Pension Sector (dated September 14, 2011) has been enacted.</p> <p>2- Circular on the Preparation and Sharing of Views on Insurance and Private Pension Legislation (No.2011/9, dated May 30, 2011) has been published. This Circular provides a general transparent framework for consultations with stakeholders on draft regulations.</p> <p>3- In terms of reducing the regulatory burden on the insurance sector, current IT infrastructure and data reporting processes has been revised.</p> <p>4- In terms of group-wide supervision, definition of insurance groups has been revised and a supervisory forum which aims information sharing and efficient coordination among supervisory authorities of financial conglomerates has been defined with an amendment to the Regulation on the Principles and Procedures of Monitoring and Supervision of Insurance and Private Pension Sectors as of July 27, 2013.</p> <p>5- The protocol signed between the Treasury and the BRSA as of 2010 serves to ensure annual coordination on the consolidated supervision plan for insurance and banking sectors.</p> <p>6- Article 32 of the Regulation on the Principles and Procedures of Monitoring and Supervision of Insurance and Private Pension Sectors has been modified on 27 July 2013 in line with the IAIS ICP 3 in order to establish a framework for the coordination and information sharing with other countries' authorities.</p> <p>7- Draft regulations are submitted to stakeholders' opinion through "Insurance e-notification and e- legislation System". Also, enforced regulations are notified to stakeholders through "Insurance e-notification and e- legislation System".</p> <p>8- Supervision manuals have been publicly disclosed on the official web-site of the Treasury.</p>
<p>Improve the "early warning" system for the required solvency margin.</p>	<p>With the purpose of better achieving its mission as a supervisory authority of insurance sector, the Treasury has been revising its current Early Warning System since 2012. By taking 2011 FSAP recommendations into consideration, the Treasury has improved the existing Risk Based Capital (RBC) with a view of ensuring realistic assessment of risk capital requirements for companies of different size and risk profile and redesigned current Early Warning System (EWS) and established a stress-testing mechanism for Turkish Insurance Sector, as well as developing supervisory framework and international supervisory cooperation, all of which is expected to assist the Treasury to prepare moving towards Solvency II, with the project on the "Strengthening Solvency Supervision in the Turkish Insurance Sector" (World Bank and FIRST Initiative, from May 2012 - May 2014). This project is expected to serve the Treasury to resume action at each stage of the early warning system and hence provide an opportunity for identification of six categories of risks in advance and ensure timely intervention.</p> <p>In addition this system based on the financial soundness indicators of the sector, the Treasury has aimed to monitor resilience of insurance sector, by designing an insurance sector specific stress testing mechanism in order to estimate potential insurance sector losses (PMLs) for a 1-in-250 year return period earthquake event under the three different earthquake scenarios in Turkey and assesses the capital adequacy of insurers.</p>
<p>Transfer the responsibilities</p>	

<p>for insurance regulation and supervision to an independent integrated insurance supervisory body.</p>	
<p>Anti-money laundering (AML) / Combating the financing of terrorism (CFT) regime</p>	
<p>Adopt a new Law on Combating the Financing of Terrorism (CFT) to address the deficiencies identified by the FATEF.</p>	<p>Turkey has made significant progress in enhancing its anti-money laundering and combating the financing of terrorism (AML/CFT) framework. It has addressed the deficiencies identified in its 2007 Mutual Evaluation Report, which had prompted closer monitoring by the Financial Action Task Force (FATF), including by adequately criminalizing terrorist financing and establishing procedures to freeze terrorist assets.</p> <p>As a result of this process the FATF Plenary decided at its October 2014 Plenary meeting that Turkey has taken sufficient steps in addressing technical compliance with the Core and Key Recommendations to be removed from the follow-up process. Turkey was removed from the FATF’s list of countries with strategic AML/CFT deficiencies and FATF no longer calls on countries to consider the risk emanating from such deficiencies. Several regulations have been enacted to strengthen Turkey’s CFT system and to address the deficiencies identified by FATF as shown below.</p> <ul style="list-style-type: none"> ▪ Law No.6415 on the Prevention of the Financing of Terrorism (hereinafter the TF Law) was adopted by the Turkish Grand National Assembly on 7 February 2013 and published in the Official Gazette on 16 February 2013. ▪ The Regulation on the Procedures and Principles Regarding the Implementation of TF Law was approved by the Prime Ministry and published in the Official Gazette on 31 May 2013. ▪ The Financial Crimes Investigation Board General Communique No.12 was published in the Official Gazette on 21 June 2014. This Communique regulates the procedure of access to frozen funds for necessary expenses in line with UNSCR 1452, and the implementation of freezing decisions by financial institutions and non-financial institutions.
<p>Strengthen and integrate the institutional supervisory framework for AML/CFT to include participation of sector supervisors’ within the monitoring, selection, planning and coordination of AML/CFT activities.</p>	<p>Pursuant to the Articles 11 and 19(1) (i) of the AML Law No. 5549, MASAK (Financial Crimes Investigation Board) is the overall supervisory authority for AML/CFT matters. The supervision of AML/CFT obligations is exercised by the following sector supervisors (examiners) on behalf of MASAK: i) Tax inspectors; ii) Customs and Trade Inspectors; iii) Sworn-in Bank Auditors; iv) Treasury Comptrollers; v) Insurance Supervision Experts and Actuaries; vi) Banking Regulation and Supervision Agency; and vii) Capital Markets Board Experts.</p> <p>AML/CFT supervision is planned and coordinated by MASAK through getting relevant supervisory authority’s views on the time frame and human resources so that they allocate adequate human resources to AML/CFT supervision.</p> <p>AML/CFT supervision is conducted by the sector supervisors as mandated by MASAK and relevant supervisory authority. Planned supervision is risk based focusing on risk factors determined by MASAK and sector supervisory authorities.</p>

	<p>Furthermore, before starting supervision, a meeting is organized for exchange of views. After starting supervision, examiners keep in contact with MASAK and are given router information by MASAK.</p> <p>Regularly, examiners are subject training program to conduct AML/CFT supervision efficiently and increase knowledge and expertise on AML/CFT issues. Moreover, workshops are organized for exchange of views and to utilize intuitional knowledge and experience and provide feedback. These activities ensure that clear, relevant and up to date information including updates on risks and threats, relevant typologies or explanation of the regulatory requirements is available to all supervisory authorities and MASAK.</p> <p>A formal supervision manual was prepared by MASAK in 2010 called “Guidance on Supervision of Obligation”. This Guidance has been updated several times by MASAK. Last update was conducted on November 2014. This guidance includes check lists for each obliged party in order to provide examiners with formal supervisory tool.</p> <p>Also, an article was added to AML Law No. 5549 put into effect on 2 November 2011. According to this Additional Article, MASAK may perform its duty of supervision of AML/CFT obligations through examiners who are temporarily assigned to MASAK for up to three years. This period may be extended for up to another three years. In this scope 10 examiners are assigned to MASAK. They are the ones who will conduct 2015 supervision. Thanks to this article, another mechanism is put into place for sharing intuitional experience and knowledge promptly. Furthermore these examiners have direct access to relevant information.</p> <p>Moreover, sectoral works have been carried out by MASAK since 2012 in terms of the functions of the obliged parties and their situation in the scope of AML/CFT issues. These works are regularly updated according to the developments in the sector and the results of the AML/CFT supervision.</p> <p>Additionally, examiners are requested to report their opinion and suggestions about the sectors they supervise. In this scope, report prepared by examiners are evaluated by MASAK and taken into consideration while determining scope of supervision and deciding on the necessity of a change in the relevant AML/CFT regulation.</p> <p>Consequently, on-going dialogues with sector supervisory authorities are provided through variety of communication channels. These authorities are integrated into monitoring, selection, planning and coordination of AML/CFT supervision.</p>
<p>Establish a definition for Politically Exposed Persons (PEP) and requirements for reporting entities in line with the FATF standard.</p>	<p>Requirements for PEP are regulated through;</p> <ul style="list-style-type: none"> *Regulation on Measures Regarding Prevention of Laundering Proceeds of Crime and Financing of Terrorism (RoM) *Regulation on Program of Compliance With Obligations of Anti-Money Laundering and Combating the Financing of Terrorism (RoC). <p>Accordingly, obliged parties listed in the Article 4 of RoC are required to establish risk management policies for all customers, carry out risk management activities (Article 11 and 12 of the RoC), and to take enhanced measures for high-risk groups (Article 13 of the RoC).</p>

	<p>Moreover, all financial institutions are required to conduct enhanced CDD measures listed in the Article 26/A(1) of the RoM, consistent with the identified risk,</p> <ul style="list-style-type: none"> *for transactions within the scope of Articles 18, 20 and 25 of the RoM and *for high risk situations they identify in the framework of risk based approach. <p>Furthermore, obliged parties are required to pay special attention to complex and unusual large transactions and the ones which have no apparent reasonable legitimate and economic purpose (Article 18 of the RoM).</p> <p>Within these respects, when they face the customer and transaction entailing a high risk they are obliged to take enhanced measures in order to reduce the risk such as:</p> <ul style="list-style-type: none"> ▪ Obtaining additional information on the customer and updating more regularly the identification data of customer and beneficial owner, ▪ Obtaining additional information on the intended nature of the business relationship, ▪ Obtaining information, to the extent possible, on the source of the asset subject to transaction and source of funds of the customer, ▪ Obtaining information on the reasons for the transaction, ▪ Obtaining approval of senior manager to commence or continue business relationship or carry out transaction, ▪ Conducting enhanced monitoring of the business relationship by increasing the number and frequency of the controls applied and by selecting the patterns of transactions that needs further examination, ▪ Requiring that in the establishment of permanent relationship the first financial transaction is carried out through another financial institution subject to customer due diligence principles. <p>Consequently, even though PEPs are not explicitly defined under legislation, they are the customers requiring special attention and additional measures. In this framework, off-site inspections conducted by MASAK evinces that some banks regard PEPs as high risk customers in their risk management policies, that is compulsory to form according to the Articles 3(1)(d), 4, 5(1)(b), 7(1), 11, 12, 13 of the RoC. Moreover, as stated in FSAP AML/CFT Technical Note dated November 2011, “the concept of a PEP is understood and properly addressed within banks (mostly as an internal policy)”</p>
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