



**NEAR EAST UNIVERSITY**

**FACULTY OF ECONOMICS AND ADMINISTRATIVE SCIENCES DEPARTMENT  
OF BANKING AND FINANCE**

**BANK 410 PROJECT**

**A COMPARISON OF TRNC AND SOUTH CYPRUS WITHIN BANKING SECTOR**

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## **ABSTRACT :**

The aim of this study is to compare banking sector of Northern Cyprus and South Cyprus. The basic findings of the study be summarised as follows. Banking sector consists of 24 banks at TRNC and 14 banks at South Cyprus. The contribution of banking sector to GDP is 4.20% at TRNC as end of 2003. South Cyprus banking sector contribution to GDP was 6.4% as end of 2002. The population per bank have been 8991 at TRNC and 51286 at South Cyprus. Total assets of banking sector amounted to the equivalent 2077.2 million US dollars or about 162 % of GDP at TRNC and 32184.2 million US dollars or about 253 % of GDP at South Cyprus as end of 2003. Total assets of the TRNC banking sector account for less than 7 % according to the size of the total assets of South Cyprus banking sector.

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## 1.INTRODUCTION

The aim of this study is to compare banking sector of Northern Cyprus and South Cyprus. A common method used to indicate financial statements in terms of currency, time. The main contents of this study can be summarized as; structural changes of TRNC banking sector during the TRNC banking crises, structural changes during the accession's of South Cyprus to the EU. In this respect both markets have been explained in their status, functionality and balance sheet structure. Furthermore both markets have been compared with each other in balance sheet items. Finally bank efficiency assessed in both banking sector markets.

## **2.THE STRUCTURE OF THE TRNC BANKING SECTOR**

After 1980's, TRNC banking sector have been succumbed structural changes due to interest rate and foreign exchange regime liberalization. TRNC banking sector have faced with crises in years 1994,2000,2001, although positive effects of changes in employment, service variety, technologic infrastructure.

### **2.1.THE DEFICIENCIES THAT MADE SECTOR VULNERABLE AGAINSTS CRISES**

- Problems based on macroeconomic policies
- Problems based on regulation and supervision and legal framework
- Problems based on commercial banks balance sheet structure
- Problems based on central bank balance sheet structure

## **A. PROBLEMS BASED ON MACROECONOMIC POLICIES**

- Deficiencies in economy which led banks to grant loans on behalf of real sector
- Budget deficit
- Foreign exchange liberalization
- High legal provisions to finance public fraction
- High interest rates and inflation
- Issuing bonds to create fund for development bank
- Inefficiency in reestablishment of conditions to safeguard stability despite of expansion in number of banks
- High cost and low profitability effects of functioning on small scaled and unrecognized country

## **B.PROBLEMS BASED ON REGULATION AND SUPERVISION INSTITUTIONS AND LEGAL FRAMEWORK**

- Inefficient regulation and supervision by the government which has the authority to rehabilitate the system.
- Before the 2001 Law, lack of single system accounting plan did not enable to monitor the system effectively
- Lack of mechanism that provides of removal monitoring and early warning to spot probable risk in the future.
- Low capital requirements to establish bank made the banking sector highly competitive which has caused bank inflation
- Weak legal framework led declines in loan repayment.

## **C.PROBLEMS BASED ON COMMERCIAL BANKS BALANCE SHEET STRUCTURE**

- Insufficient equity was among the main problems of the sector
- Shareholders of bank had been existed from same family members. In this sense capital cannot be scattered base.
- High competition forced banks to take deposits with higher interest rates on shorter terms, which has led currency mismatches among the loans and deposits
- Low GDP growth rate have been deteriorated loan repayment. Loan follow up reached maximum level 20.1% at 2001.
- Connected lending has been concentrated which associated with insufficient risk assessment.
- Banks has been taken risk higher than their capital can carry

## **D.PROBLEMS BASED ON TRNC CENTRAL BANK BALANCE SHEET STRUCTURE**

-Low loan repayment of public to the centralbank has deteriorated TRNC central bank intervention capability.

Above mentioned developments forced TRNC banks working high liquidity rates. (TRNC centralbank annual report 2002)

## **2.2FUNCTIONALITY OF THE TRNC BANKING SECTOR**

TRNC banking sector consist of 24 banks functioning with 134 branches.The contribution of banking sector to GDP is 4.20% and the annual growth rate of sector has been 4.2% as end of 2003. Employment in sector rose to 2093 persons.

The number of bank was 37 at 1999 The fall in number of banks triggered by financial crises which came into effect at the end of 1999 and driven with concentrated competition effects in the market.In the period of 1999-2003 12 banks have been placed to saving deposit insurance fund. The share of banking sector in GDP have been fallen about 6.8% at 2000, 18% at 2001 and 10.1% at 2002.

## **2.3 SUMMARY OF THE ASSETS AT TRNC BANKS**

Total assets of banking sector have been increased from 200.3 million US dollars at 1985 to 1571.6 million Us dollars at 1999. Total assets have dropped heavily to 1203.9 million US dollars as a result of economic crises at the end 2001.After 2001 it followed an upward trend and reached 2077.2 million US dollars 162%of GDP at the end of 2003.



Total assets made up by 12.77% public owned banks 27.65%. Foreign branch banks and 59.98% commercial banks.

The three largest bank accounts for 53.78% of total banking assets. The concentration ratio of the five largest bank reaches 66.7% of the total banking assets.

In 2003 TRNC banking sector have been affected positive from the recovery of the economy. Both the fall in interest rates and foreign exchange rates reflected positive effects to the TRNC banks balance sheet.

The share of liquid assets increased about 4.81% and reached 48.44% of total banking assets. The main driving force behind this developments is higher deposit increase relative to the total loans increase. This structure has an diminishing effect on the liquidity risk but also has an diminishing effect on the profitability.

The share required reserves consist of about 14.17% of the total assets despite the rate of required reserves being discounted from 14% to 12% Turkish Lira and from 15% to 13% in foreign currency.

Lending of banks amounted to the equivalent of 560.1 million US dollars or 21.91% of the total banking assets as at the end of 2003 or about 44% of GDP. In the period 1985-1999 total loans had increased from 213.9 million US dollars to 844.9 million US dollars. Beginning of the crises, banks took choice being liquid on behalf of granting loans. The loans had gone down to 365.8 million US dollars at the end of 2002.

In 2003 The bulk of credit goes to public sector. Lending to public sector includes 50.99% of total lending. Non performing loans have been 15.3% of total as end of 2003.

**Table :1 TRNC Banks Asset Structure at 2003**

Liquid assets	1066204	48.44%
Marketable Securities	186416	8.97%
Deposit Required reserves	209737	10.10%
Bills Discounted	19388	0.93%
Loans and advance	455128	21.91%
Recipients	85693	4.13%
Provisions	-39262	-1.89%
Other assets	153919	7.41%
Total assets	2077223	100%
		Thousand dollars

Source: TRNC Central Bank Annual Report 2003

**Table : 2 sectoral Distribution of Loans At 2003**

Public Institutions	285623	50.99%
Agriculture	4094	0.73%
Mining Quarrying	49	0.01%
Manufacture	4888	0.87%
Transport	1044	0.18%
Trade	75768	13.53%
Export	2965	0.53%
Tourism	5549	0.99%
Building And Construction	18167	3.24%
Retail Trade	15141	2.70%
Personal and Professional	143266	25.57%
Bills discounted	3694	0.66%
Total Loans	560210	100%
		Thousand Dollars

Source : TRNC Central Bank Annual Report 2003

## 2.4 SUMMARY OF THE LIABILITIES AT TRNC BANKS

Total deposits of banking sector have been increased from 71.3 million US dollars at 1985 to 889 million US dollars at 1999. Total deposits have dropped to 823.8 million US dollars as a result of economic crises. After 2001 it followed on upward trend and reached 1785.9 million US dollars or about 139% of GDP. Both recovery in economy and reestablishment of reliability are the factors that provided expansion in the deposits.

Customer's deposits accounts for 85.7 % of the total liabilities. The distribution of deposits have been 13 % in public owned banks 26.74 % in foreign branch banks and 60.06 % in commercial banks.

As at December 2003 foreign currency deposits amounted to the equivalent 964.1 million US dollars representing 53.9% of total deposits. The maturity of deposits concentrated on shortterm. The percentages are amounted 58.78 % up to one month 6.11% up to three months 2.76 % up to 6 months 17.27% up to a year and also 15.08% demand deposits.

Until 2000 total equity amount had followed an upward trend reached 77.8 million US dollars. Due to 2001 equity amount decreased to 59.2 million US dollars. After this date equity amount have been an upward trend and reached 105.9 million US dollars or about 5.11 % of total liabilities at the end of 2003.

**Table : 3 TRNC Banks Liability Structure at 2003.**

Deposits	1785886	85,97%
Borrowed Funds	66289	3,19%
Other	119105	5,73%
Eguity	105943	5,11%
Total	2077223	100%
		Thousand Dollars

Source : TRNC Central Bank Annual Report 2003

### **3.THE STRUCTURE OF THE SOUTH CYPRUS BANKING SECTOR**

South Cyprus banking sector has not experienced any banking crises or payments system disruptions and bank restructuring has not been associated with bank failures.

(Cyprus Economy 2002)

The financial sector exhibited rapid growth in recent years in terms of financial intermediation. This is related to the high performance of the economy and stable macroeconomic conditions.

(Christian Thiman 2002 p:51)

Up to the end of 2000, interest rates in South Cyprus were governed by interest law 1977, which prescribed legal ceiling of 9% per annum on interest rates. Within this ceiling, the upper limits of bank deposit and lending interest rates were determined, from time to time, by the central bank of South Cyprus. The interest rate liberalization law came into force on january 2001 to provide for abolition of interest rate ceiling.

(Money.Banking and Financial Market Statistics in the Accession Countries Methodological manual volume 2 2003 p:68 )

At the same time South Cyprus Central bank abolished all restrictions on medium and long term.

borrowing with maturities over two year by residents. One practical implication of this change both banks and individuals are allowed to borrow in foreign currency ( Cyprus Economy 2002 p:24 )

The banking Law of 1977 to 2000 Law 66 (I) 1997 as amended has been subjected to a comprehensive review with the aim of introducing certain amendments that will bring the legal Framework in full conformity with EU acquis on credit institutions. The relevant amending bill was approved on 10/7/2003. Included in the amending law is provision, which abolishes, upon Cyprus accession to the EU the economic criterion that the Central Bank of South Cyprus takes into accounts when considering applications for a banking licence. Under a separate provision, also included in the amending law, following Cyprus's accession to the EU, it will become possible for credit institutions from EU member states to establish a branch or provide services in the South Cyprus without having to obtain licence from the Central Bank of South Cyprus. Moreover the above law includes an explicit provision for enhanced co-operation between Central Bank of South Cyprus, as competent supervisory and Development Authority (DSSDA) as the competent supervisory authority co-operative and credit and savings societies, enabling the central bank to exercise, in co-operation with DSSDA consolidated supervision the affiliated to the co-operative Central Bank institutions.

(Annual Report on structural Reforms in Cyprus 2003 p:49)

The following developments are noteworthy with respect the financial services action plan :

The preparatory work is underway for the transposition and implementation of directive 2002/87/EC on Financial conglomerates. In this respect, banks have submitted to the central Bank of South Cyprus information regarding their group structure, holding company, subsidiary companies including participating interest, legal structure as well as

competent supervisory authority for each company within their group. This information is at present; assessed by the central bank of South Cyprus with a view to determining the coordinator in co-operation with Securities and Exchange Commission and Superintendent of Insurance as well as competent authorities of other EU countries.

The preparatory work is also underway with respect to the revision of the existing framework for capital requirements , in order to conformity with the rules set by the new Basel Capital Accord, which envisaged to become effective at the end of 2006 ( Annual Report on Structural Reform in Cyprus 2003 P:21)

With regard to the requirement to achieve compliance with the acquis on electronic money institutions , the Central Bank of South Cyprus has completed the drafting of a new bill incorporating all provisions of the EU directive 2000/46/EC ( Annual Report on Structural Reforms in Cyprus 2003 P:49)

The Central bank of South Cyprus of South Cyprus, the Securities and Exchange Commission and the Insurance companies control service have signed a memorandum of Understanding " MoU " which came into effect 1 January 2003 . The signing of MoU has paved the way for ongoing cooperation and effective coordination among the monitoring of the financial sector more efficient

A Deposit Protection Scheme for the commercial banks incorporating all the provisions of the EU directive 94/19/EC is in operation as from 1 September 2000. Amending the regulations were approved by the House of Representatives on 10/7/2003 for extending coverage to deposits in EU currencies since accession.



The Central Bank of South Cyprus issued a directive to all banks which is in full conformity with the requirements of the EU directive 97/5/EC on cross border credit transfer between South Cyprus and the member states of the European Union for amount not exceeding € 50 000 or its equivalent in Cyprus Pounds or in currency of any of the EU member states .

The Consumer Credit Law ( Law 39 ( 1 ) 2001 ) was enacted to transpose EU directive 87 /102 / EEC, as amended, and entered into force on 1 June 2002. Furthermore, the Law contains specific provisions for the liabilities of credit card holders vis-a-vis issuers , in line with recommendation 87/489/ EC concerning transactions by electronic payment instruments . ( Annual Report on Structural Reform in Cyprus 2003 P:26-27)

### **3.1 FUNCTIONALY OF THE SOUTH CYPRUS BANKING SECTOR**

-South Cyprus consist of 14 domestic banks operating in Cyprus 11 commercial bank and 3 specialized financial institutions. Institutions offer their services through a network of 532 branches, which corresponds around 1333 inhabitants per branch as end of 2002. Employment in the sector rose to about 16500 persons (Bluebook 2004 payment and securities settlement systems in the accession countries P:46) Also Three of the of domestic banks have operations abroad either through a branch network or subsidiaries (Thiman.C2Q02 P:53)

There has been rapid growth in the financial sector, over 1997-2002 five year period, despite the problems experienced through the prolonged fall in the market value of shares in the Cyprus stock Exchange (CSE) during the years 2000-2002. This was reflected in an above average rate of annual growth rate of the sector, amounting to around 6.50% in real terms,



compared with an annual growth rate of GDP of 4.2%, thus increasing the share of the financial sector to GDP from 5.7% in 1997 to 6.4% in the year 2002. (Annual Report on Structural Reforms in Cyprus 2003 P:19)

### **3.2 SUMMARY OF THE ASSETS AT SOUTH CYPRUS BANKS**

Total assets of domestic banks have expanded at an annual growth rate of 20.5% in the period 2001, 2003 and amounted to the equivalent of 32184.2 million US dollars or about 253% of GDP at the end of 2003.

State owned banks accounts less than 5% of the total banking assets as end of 2003.

Despite the fact that in terms of the number of institutions the number of foreign controlled banks is high, they account less than 20% of the total banking assets as end of 2003.

The three largest banks accounts for 75% of the total banking assets. The concentration of the five largest bank reaches 89% of the total banking assets (Report on EU banking structure).

The shares of reserves at south Cyprus Central bank have been 6.43% to total assets of banking sector. The investment portfolio comprises 12.34% of total banking assets. Also the shares of other assets have been 6.13% of total banking assets.

Lending the major assets of banks amounted to equivalent of 16831.8 million US dollars or 52.29% of total banking assets or about 123% of the GDP. The bulk of credit goes to private sector. Lending to public sector includes 96.92% of total lending. Non performing loans at the end of 2003 amounted to 9% of total lending.

**Table:4 South Cyprus Banks Assets structure at 2003**

Local Cash	116348	0,36%
Balance with central Bank	2070885	6,43%
Foreign Assets	7225722	22,45%
Local Investments	3972803	12,34%
Advances and Loans	16863657	52,29%
Other Assets	1934773	6,13%
Total Assets	32184188	100%

Source [www.centralbank/cy/media/xls/STRPE-MONETARYSURVEYJANO4.XLS](http://www.centralbank/cy/media/xls/STRPE-MONETARYSURVEYJANO4.XLS), 02,10,2004

[www.centralbank/cy/media/STTBE-ANNUALECONOMICINDICATOR-03.pdf](http://www.centralbank/cy/media/STTBE-ANNUALECONOMICINDICATOR-03.pdf), 26,12,2004

**Table:5 Sectoral Distribution of Loans at 2003**

Public Insitutions	519187	3,08%
Agriculture	217736	1,29%
Mining	57234	0,03%
Manufacture	1048566	6,23%
Transport and Communication	259258	1,54%
Foreign and Domestic Trade	3178478	18,98%
Building and Constructions	2667145	16,00%
Tourism	1621407	9,75%
Personal and Professional Loans	7248732	43,10%
Total Loans	16817733	100%

Source: [www.centralbank/cy/media/xls/STRPE-MONETARYSURVEYJAN04.xls](http://www.centralbank/cy/media/xls/STRPE-MONETARYSURVEYJAN04.xls), 02,10,2004

[www.centralbank/cy/media/STTBE-ANNULAECONOMICINDICATOR-03.pdf](http://www.centralbank/cy/media/STTBE-ANNULAECONOMICINDICATOR-03.pdf), 26,12,2004

### 3.3 SUMMARY OF THE LIABILITIES AT SOUTH CYPRUS BANKS

Total deposits of domestic banks have expanded at an annual growth rate of 16% in the period 2001-2003 and amounted to equivalent of 23630.6 million US dollars or about 186% of GDP at the end of 2003.

Customer's deposits accounts for 73,4% of the liabilities as at December 2003 foreign currency deposits amounted to the equivalent 7609,6 million US dollars representing 32,2% of total deposits.

Total equities of domestic banks have expanded at an annual growth rate of 47.4% in the period 2001-2003 amounted to the equivalent 4007,3 US dollars as end of 2003. The share of equities comprise 12,45% of total liabilities.

**Table:6 South Cyprus Banks Liability structure at 2003**

Deposits	23630588	73,4%
Demand	2783492	8,64%
Savings	667953	2,00%
Time	20179143	62,76%
Foreign Liabilities	1303295	4,00%
Capital and Reserves	4007826	12,48%
Other Liabilities	3242479	10,15%
Total Liabilities	32184188	100%

Source : [www.centralbank/cy/media/xls/STRPE - MONETARYSURVEYJAN04.xls](http://www.centralbank/cy/media/xls/STRPE - MONETARYSURVEYJAN04.xls) , 02,10,2004

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02,10,2004

#### 4 COMPARISON OF EFFICIENCY OF THE TWO MARKETS

Banking sector consist of 24 banks at TRNC and 14 banks at south Cyprus

**Table: 7 Distribution of Banks at 2003**

	TRNC	South Cyprus
Commercial Banks	14	9
Foreign Banks	6	2
State Banks	2	2
Co-operative Banks	2	1
Total	24	14

Source : TRNC Central Bank Annual Report 2003

[www.cyprus.gov.cy/cyphone/GovHome.nsf/0/DB677CDBA/782C89C2256B6B0022](http://www.cyprus.gov.cy/cyphone/GovHome.nsf/0/DB677CDBA/782C89C2256B6B0022)

FFID2? OpenDocument&languageNo=1,08.11.2004

In this respect population per bank have been 8991 at TRNC and 51286 at south Cyprus.

The contribution of banking sector to GDP 4,20% at TRNC as end of 2003 south Cyprus banking sector contribution to GDP was 6,4% as end of 2002 TRNC banking institutions offer their services through a network of 134 branches which corresponds to around 1610 inhabitants per branch as end of 2003. South Cyprus banking instituons offer their services through a network of 532 branches which corresponds 133 inhabitants per branch as end of 2002.

**Table:8 Competition on the Basis of Population**

	TRNC	South Cyprus
Number of banks	24	14
Number of branch	134	532
Number per bank	8991	51286
Inhabitants per branch	1610	1333

Source: TRNC central bank annual report 2003

[www.devplan.org/tur\\_ind.html](http://www.devplan.org/tur_ind.html), 02,01,2005-02-25

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Despite of high number of bank in TRNC total assets of TRNC banking sector account less than 7% relative to the scale of the assets of south Cyprus banking sector. Total deposits of TRNC banking sector account less than 8% relative to the scale of the total deposits of South Cyprus banking sector. Total equities of TRNC banking sector account less than 3% relative to the scale of the total equities of Cyprus banking sector.

**Table:9 The Sizes of the Markets at 2003**

	TRNC	South Cyprus
Total Assents	2077223	32,184,188
Total Loans	560210	16,831,821
Total Deposits	1785885	23,630,588
Total Eguities	105944	4,007,826
		Thousand dollars

**Table:10.1 Annual Growth Rates of teh Markets**

	TRNC	South Cyprus
Total Assets	*	*
2001	1204	22827
2003	2077	32184
Annual Growth Rate	36,25%	20,44%

**Table:10,2**

	TRNC	South Cyprus
Total Loans	*	*
2001	397	11918
2003	560	16832
Annual Growth Rate	20,52%	20,61%

**Table 10,3**

	TRNC	South Cyprus
Total Assets	*	*
2001	824	17875
2003	1786	23630
Annual Growth Rate	58%	16,09%

**Table 10.4**

Total Eguities	*	*
2001	59	2058
2003	106	4008
Annual Growth Rate	39,83%	47,37%
		Million dollars

**Source :** TRNC Central Bank Annual Report 2002 TRNC Central Bank Annual Report 2003

[www.ecb.int/press/pr/date/2002/html/pr020819.en.html](http://www.ecb.int/press/pr/date/2002/html/pr020819.en.html) , 08,10,2004

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Total assets amounted to the equivalent 162% of GDP at TRNC and 253% of GDP at south Cyprus.

Total loans amounted to the equivalent 44% of GDP at TRNC and 132% of GDP at South Cyprus.

Total deposits amounted to the equivalent 139% of GDP at TRNC and 186% of GDP at South Cyprus.

The concentration ratio of three largest bank assets is 54% at TRNC. This ratio is much higher at South Cyprus, which is 75%. The lack of competition between banks in South Cyprus results in a de facto cartel. But following the accession of South Cyprus's to the EU it will become possible for credit institutions from EU member states to establish a branch of provide services in the branch of provide services in the South Cyprus without having licence from the central bank of South Cyprus.

The scale of TRNC have been less than 4% at average asset per bank, 26% at average asset per branch 51 %, at average asset employer relative to the size of South Cyprus. The scale TRNC have been less than 5% at average deposit per bank. 31% at average deposit per branch, 60% at average deposit per employer relative to the size of South Cyprus.



**Table : 11 Compared Asset Scale of the Markets at 2003**

	TRNC	South Cyprus
Asset per bank	88551	2298872
Asset per branch	15502	60497
Asset per employer	992	1950
		Thousand dollars

**Table:12 Deposit Scale of the Markets at 2003**

	TRNC	South Cyprus
Deposit per bank	74412	1687899
Deposit per bank	13327	44418
Deposit per employer	854	1432

In addition to above mentioned mentioned difficulties of teh economic scale , TRNC banks is not recognized internationally. Non recognized position and small scaled economy are the factors behind the absence of electronic banking services at TRNC in order the to complete with their foreign rivals in the retial field of electronic banking, local banks offer the some services in cooperation with banks in Turkey , though less efficiently and with almost no profit But electronic banking services have not reached satisfactory level within TRNC except for some foreign branch banks

( Safaklı O. 2003 )

South Cyprus is much higher level in electronic banking services without having similar problems to the TRNC. As end of 2003 Both banking market accounts operating loss in their income statements.



## **5. CONCLUSION**

5. In conclusion, TRNC banking sector deficiencies concentrated on insufficient capital and high number of banks. The strategies would be on mergers and acquisitions to compete with strongly capitalized South Cyprus banks if there would be a comprehensive solution to the Cyprus problem- Deficiencies in TRNC banking sector have been identified by the central bank of TRNC. In this respect minimum capital requirement is risen to two million US dollars for carry out banking business with the beginning of the 2005. New directives have been circulated to induce banks mergers and acquisitions.

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