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"How to gain competitive advantage in Banking Sector & Analyses of EU and Turkish Banking Sector"

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- To my parents and

nephews Zeynep Selin and Gamze-

three of life's treasures....

Ugur H. Can

I declare that this project is my own original work and that no part of it has been submitted to any other institute of learning in support of an application for another degree. The opinions expressed in the work and put forward in a personal capacity and do not purport to represent those of the Near East University nor any other organization.

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Preface

The purpose of this paper is to provide information about banking sectors of Turkey, European Union, Northern and southern Cyprus.

In chapter 1, you will find the information about the Competitive Advantage of Nations. By using this approach, it will be made an analyze for Turkey and EU banking system in next chapters.

In chapter 2, all the information about Turkish banking system can be found. Historical developments, main features of Turkish banking system such as information can be available from chapter 2.

In chapter 3, the Central Bank of Republic of Turkey will be explained as detailed.

In chapter 4, the European Union Banking system will be presented. Each member countries' banking system will be explained as detailed.

In chapter 5, the banking system in the Republic of Northern Cyprus will be explained briefly.

In chapter 6, Southern Cyprus banking system will be presented. But, due to lack of information, this chapter will be presented briefly as well.

In chapter 7, the structure and duties of European systems of Central Banks will be explained as detailed.

In chapter 8, the condition of Turkish Banking system will be analyzed.
In this part, you will find information about the problems of Turkish Banking System and the place of Turkish Banking Systems in Economics.

In Chapter 9, The summary of the European Union's banking directives and new banking law will be compared briefly.

In Chapter 10, Global strategies and Recommendations related with Turkish Banking sector will be presented.

Lastly, a summary or conclusion of this study will be presented.

Executive Summary:

The Banking system in Turkey has a huge change. It has affected from all developments in economy and continues to be affected.

As from 1980's, Turkish banking system has striven to solve the routine problems, which are occurring in own system. While it was solving these problems, in the other hand it tries to determine the strategies in order to cover the services, which are expected by people in the best conditions.

In this paper it can be found that detailed information about banking sector which is exist on Turkey and EU member countries.

Generally, the sources, which are used while preparing this study, obtained from secondary data.

This study has prepared by examining various reports, textbooks, and working papers, which were used by Turkish Banks Association. In addition to this, web sites that are related with topics, has been used.

List of Tables:

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List of Acronyms:

ABBL: Association des Banques et Banquires, Luxembourgeois
ABN: Algemene Bank Nederland
AMRO: Amsterdam-Rotterdam Bank
ATMs: Automatic Transaction Machines
BCEE: Banque et Caisse d'Epergne l'Etat
BFN: Banco de Fomento Nacional
CGD: Caixa Geral de Depósits
EU: European Union
ECB: European Central Bank
ECU: European Currency Unit
EFT: Electronic Fund Transfer
EMI: European Monetary Institution
EMU: European Monetary Union
EMS: European Monetary System
ERM: Exchange Rate Mechanism
ESCB: European System of Central Banks
GNP: Gross National Product
MIS: Management Information System
NCBs: National Central Banks
SNCI: Société Nationale de Crédit et d'Investissement
UK: United Kingdom

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This project is my first serious and comprehensive study. Because of this reason, it was significant for me.

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chapter

1

Competitive Advantage of Nations

1. Competitive Advantage of Nations:

Introduction

Today, because of the globalization, the term "competition" has started to gain importance; so we should understand and analyze this term both inside and outside of country. By the effect of globalization, one more concept, which is called as "national competitive advantage", has entered into our life. In this chapter we'll analyze the national competitive advantage by considering the banking system.

1.1 Determinants of National Competitive Advantage and what should be criteria to gain the Competitive Advantage?

While determining the national competitive advantage basically 4 determinants help us: [1]

I- Factor condition:

The nation's position in factors of production such as skilled labor or infrastructure. We'll analyze the factor condition by regarding banking system. *(For more information see page 3)*

II- Demand condition:

The nature of home demand for the industry's product or service. Here, the analysis of services, which are given in banking sector, will be made.

III- Related Sectors:

The presence or absence in the nation of related sectors those are internationally competitive. Under this heading we'll analyze the industries, which become related in banks, affect of its to the national competitive advantage.

IV- Firm strategy, structure and rivalry:

The conditions in the nation governing how companies are created, organized and managed and also the nature of domestic rivalry.

Finally, we'll analyze the strategies of banks, which compared by European Union banking system and also will be presented the recommendations to them in order to gain competitive advantage. ***(For more detail see chapter 10)***

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(1) Michael E. Porter, The Competitive Advantage of Nations, Free Press, p 71

The determinants, individually and as a system, create the context in which a nation's firms are born and compete. The availability of resources and skills necessary for competitive advantage in an sector; the information that shapes what opportunities are perceived and the directions in which resources and skills are deployed; the goals of the owners, managers and employees that are involved in or carry out competition; and most importantly the pressure on firms to invest and innovate. (2)

Actually, it is not true to say that in a country all firms will achieve the competitive advantage in a sector. Because all firms in a sector have different sources or skills.

Due to their skills and sources are not equal, some firms have failed in sector or have been exploited by other firms.

By considering the banking system, following explanation can be made:

"The banks which are have powerful sources and capital will attain the competitive advantage. Also, skilled personnel or goals of personnel will play important role in competitive advantage"

In addition to these, there are two more concepts, which will affect the competitive advantage of nations. These concepts are chance and government. The opinion, which will support us, has expressed by Michael E. Porter:

"Two additional variables can influence the national system in important ways and are necessary to compete the theory. These are chance and government.

Chance events are developments outside the control of firms (and usually the nation's government) such as pure inventions, breakthroughs in basic technologies, wars, external political developments, and major shifts in foreign market demand.

Government, at all levels can improve or detract from the national advantage. This role is seen most clearly by examining how policies influence each of the determinations. Antitrust policy affects domestic rivalry. Regulations can alter home demand conditions. (3)

As we have seen, through Michael E. Porter's expression chance and government also play important role in competitive advantage. To be effected through technology positively, not to be effected through wars and external and political fluctuations are significant factors in competition advantage.

Now, let's discuss the four determinants of national competitive advantage as detailed which were expressed before briefly.

(2) Michael E. Porter, The Competitive Advantage of Nations, Free Press p 71
(3) Michael E. Porter, The Competitive Advantage of Nations, Free Press p 73

FACTOR CONDITIONS:

In fact under this heading it can be examined the term "factors of production".

Factors of production contain that land, labor, capital, natural resources, and infrastructure. Theoretically, factors of productions are shaped through harmony of mentioned above factors.

In practice, we should adjust these concepts in the most efficient way. For example, any country might have powerful capital but in return for this if there is no appropriate labor force for using this capital it's not possible to provide the competitive advantage. In addition to these factors of production can be explained in very broad terms.

Factors can be grouped into a number of broad categories[4]

Human Resources:

The quantity, skills, cost of personnel, (including management) taking into account, standard working hours and work ethic. Human resources can be divided into myriad of categories.

Physical resources:

The abundance quality, accessibility, and cost of nation's, land, mineral or hydroelectric power sources and other physical traits. Climatic conditions can be viewed as a part of a nation's physical resources as can a nation's location and geographic size.

Knowledge resources:

The nation's stock of scientific technical and market knowledge bearing goods and services. Knowledge resources reside in universities, government research institutions, and private research facilities, government statistical agencies, agencies, business and scientific literature market research reports, trade associations and other resources.

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(4) Michael E. Porter, The Competitive Advantage of Nations, p: 74

Capital resources:

The amount of cost of capital available to finance sector. Capital is not homogeneous but comes in various forms – such as unsecured debts, secured debt, junk bonds (high risk- high yield), and equity venture capital. The total stock of capital resources in a country is affected by national rate of saving.

Infrastructure:

The type quality, user cost infrastructure available that affects competition, including transportation system, the communication system mail and parcel delivery payment, fund transfer, health care and so on.

The mix of factors worked (known as factor proportions) differs widely among industries. A firm gains competitive advantage in they process' low cost or uniquely high quality factors of particular types that are significant to competition in a particular industry.

As we know, Germany is heart of automobile industry. Due to one of the factors of production that is labor force cheaper than other countries in east block countries, most of the plants have been moved to these types of countries such as Poland, Czechoslovakia.

2- DEMAND CONDITION:

The second broad determination of national competitive advantage in a sector is home demand conditions for the sector's product or service.

The most significant influence of home demand on competitive advantage is through the mix of character of homebuyer needs. The composition of home demand shapes how firm perceive, interpret and respond to buyer needs. Briefly, it can be said that by understanding the homebuyer needs, firms are better able to perceive and understand the buyer needs, which are occurring in outside country.

There are three characteristics of the compositions of home demand particularly significant to achieving national competitive advantage. (5)

Segment Structure of Demand:

The first characteristic of home demand is segment structure of demand. In most sector demand is segmented. A nation' firms are likely to gain competitive advantage in global segment that represent a large or highly visible share of home demand but account for a less significant share in other nations.

The more important role of segment structure at home, shaping the attention and priorities of a nation's firms. (6)

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(5) Michael E. Porter, The Competitive Advantage of Nations, p: 87
(6) Michael E. Porter, The Competitive Advantage of Nations, p: 87

Sophisticated and demanding buyers:

Sophisticated and demanding buyers pressure local firms to meet high standards in terms of quality, features and service. (7)

The customers of any product have knowledge about product means that you have to produce more quality product. So, firms can obtain the high standards in their products and services.

Anticipatory consumer needs:

The firms of a nation gains advantage if the needs of home consumer anticipate those of other nations. This means that home demand provides an early warning indicator of customer needs. To predict the needs of customer it always provides advantage to firm. In fact, this is a way to gaining experience. Because if you can predict the needs and requirement of your customer in inside means that you will be successful in outside of country. By considering the banking sector to predict the services, which will be given to customers, and to determine and reply the requirements of them inside naturally it will be affect in competition.

3- RELATED SECTORS:

The third broad determinant of national advantage in a sector is the presence in the nation related sector that internationally competitive.

The presence in a nation of competitive sectors that are related often leads to new competitive sectors. Related sectors are those in which firms can coordinate or share activities in the value chain when computing. Sharing of activities can occur in technology development, manufacturing distribution, marketing or service. (8)

By considering banking sector, it plays an important role its relations with other sectors. For example, in evaluating of any project in inside and / or external market etc.

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(7) Michael E. Porter, The Competitive Advantage of Nations, p: 89
(8) Michael E. Porter, The Competitive Advantage of Nations, p: 106

4-FIRM STRATEGY, STRUCTRY AND RIVALRY:

The fourth broad determinant of national competitive advantage in a sector is the context in which firms are created, organized and managed as well as the nature of domestic rivalry. The goals, strategies and ways of organizing firms in sector vary widely among nations. National advantage results from a good match between these choices and sources of competitive advantage in a particular sector.

In banking sector developed countries have determined their strategies according to customers. This means that it's set up the appropriate strategies for customers. So it can be said that in developed countries have gained positive value in competitive advantage. But in Turkey the situation is more different. Banks, which are operating in Turkey, they cannot determine strategies for foreign companies. So, companies generally prefer that to make transaction with foreign banks, which exist on Turkey. However, in spite of everything in last especially private owned banks by developing, they try to give service with appropriate strategies.

Chapter

2 The Banking Sector in Turkey

2. The Banking Sector In Turkey:

Introduction:

In this chapter, the Banking system in Turkey will be explained as detailed. Beside of this, you will find the information about the historical development and main features of Turkish Banking system, the impacts of global changes to the system, Individual and Institutional Banking Services and also supervision of Banks.

2.1. Historical Development of Banking Sector:

From the last years of the Ottoman Empire till now, Turks deal with banking for decades. After establishing Republic of Turkey, several Turkish banks were established to maintain banking needs of the young Republic of Turkey. Especially in recent years, Turkish Banking sector have made many remarkable achievements, several Turkish banks take their positions at top ranks of bank ranking lists. Of course this achievement reflects a positive effect on Turkish Economy [9]

The banking sector constitutes the greater part of the Turkish financial system. Banks carry out a great portion of the activities taking place in both money and capital markets. The share of the banking sector in the financial system as of the end of March 1997 was 71 % [10]. Turkey's financial system and its banking sector are virtually synonymous as a consequence of the country's economic and historical development. There are a number of factors that give banking its prominent role in Turkish economy. These are:

- the economic structure peculiar to Turkey
- the choice to turn resources into long-term investments through banks for the aims targeted in the development plans and programs, and the establishment of banks by the state to finance certain sectors
- the extensive application of continental European banking practices as a model in the legal structure of the banking system, and an emerging capital market that can compete with the banking sector in the forthcoming years

(9) Turkish Banks Association (in Turkish Türkiye Bankalar Birligi, "Bankalarımız 1998")

(10) Turkish Banks Association web site

The development of the Turkish banking sector may be divided into six periods:[11]

2.1.1 The Period of the Moneychangers and the Galata Bankers (pre1847):

During this period, all quasi-banking activities were carried out by moneychangers. The Galata bankers consisted mostly of the ethnic-minorities in Istanbul.

2.1.2 The Period of Foreign Banks (1847-1908):

Since the financial situation of the Ottoman Empire deteriorated after the Crimean War, the Empire faced the need for external -financial support. Representatives of several foreign banks arrived with the aim of extending credits to the empire at high interest rates. The *Ottoman Bank* (in Turkish Osmanlı Bankasi) was established in 1856. Its head office was in London and it served as a Central Bank until the 1930s, including the Central Bank of the Turkish Republic.

2.1.3 Development of National Banking and Implementation of Etatism (1909-1944):

The years following the proclamation of the Second Constitution (1908) gave rise to the national banking movement, which was a reaction to foreign banking. Twenty-four national banks were established in Istanbul and Anatolia between the years 1908 and 1923. However, foreign banks continued to dominate banking activities due to consecutive wars (1911-1922), capitulations granted foreigners and the scarcity of national capital. In 1923, the first National Economic Congress was held in İzmir. It dealt with a large number of economic problems that the country would have to solve. The Congress took the decision that banks would be established to finance the main sectors of the economy.
"Turkiye İş Bankası" (1924), "Sanayi ve Maadin Bankasi" (1925) and "Emlak ve Eytam Bankasi" (1927) were established to provide commercial, industrial and housing credits, respectively. However, the negative effects of the Great Depression on the balance of payments and lack of domestic capital called for a government-supported economic development policy in subsequent years. As a result of this policy, six state banks were established in the 1930s, including the Central Bank of the Turkish Republic.

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(11) Turkish Banks Association web site

2.1.4 Development of Private Banks (1945-1960)

Despite the adverse effects of the Second World War, a significant growth rate and industrialization were achieved with the support of the newly established state banks. This created a tremendous increase in the capital stock of the private sector. A more liberal and private sector-oriented policy was adopted in the following years, and as a result, more than 30 private banks were established before 1960.

2.1.5 Planned Development Period (1961-1979);

A new "planned development" policy was adopted in the beginning of the 1960s. According to this system, the state would administer the economy and issue recommendations to the private sector through five-year plans prepared by the government to cover all sectors. As recommended in the plans, several development and investment banks were established to finance various sectors in the 1960s and i970s: For example "Tourism Bank" in 1960, "State Investment Bank" (in Turkish "Devlet Yatırım Bankası" (Eximbank) in 1964, "Turkey Development Bank" (in Turkish Türkiye Kalkınma Bankası) in 1975.

2.1.6 Liberalization and Internationalization in Banking (post-1980):

The new liberal economic policy implemented in January 1980 aimed at integration with world economy by establishing a free market economy. As a reflection of this policy, the l980s witnessed continuous legal, structural and institutional changes and developments in the Turkish banking sector. During these years, a series of reforms were undertaken to promote financial market development. The main aim of these reforms was to increase the efficiency of the financial system by fostering competition among banks. In this context interest and foreign exchange rates were liberalized, new entrants to the banking system were permitted and foreign banks were encouraged to operate in Turkey. Turkish banks intensified their business relations abroad either by purchasing banks in foreign countries or by opening branches and representative offices. The liberalization of foreign exchange regulations increased foreign exchange transactions of the banks. Beginning in 1984 special finance houses, transacting business according to Islamic banking principles also became part of the financial system. The Inter bank Money Market, which is administered by the Central Bank, was established in 1986 with the aim of regulating liquidity in the banking system. A unified accounting plan and accounting principles as well as a standard reporting system were adopted for banks in the same year.

External auditing of the banks in accordance with internationally accepted accounting principles was implemented in 1987. In addition, legal and institutional arrangements were introduced to foster the development of the capital market. As a result, banks began to provide additional services such as negotiating security issues and trading in securities, underwriting fund management, establishing mutual funds and financial consultation.

As for developments in the banking industry, in the 1980's there was diversification in the services offered by banks, the technological infrastructure of the banks was improved by extensive use of computer systems, hi-tech payment systems and the sector began employing more qualified human resources, and at the same time there was more emphasis placed on training programs.

The Turkish financial system is basically a universal banking system, which enables commercial banks to operate in all financial markets. However, recently, -a new regulation regarding capital markets has banned banks from acting as intermediary institutions in The Istanbul Stock Exchange and from acting as dealers in share trading. Commercial banks are neither allowed to trade in goods or real estate nor engage in financial leasing activities. On the other hand, investment and development banks are not allowed legally to collect deposits but may engage in financial leasing services. Nearly half of the assets of The Turkish banking system are controlled by state-owned banks. Even though the number of state banks was only 8, their share in the total assets of the system as of September 30, 1997 was 41.8%. Very-recently, as of March 1998, "Etibank", a former state-deposit bank was privatized which further reduced the number of state-owned banks in the system to 7 as well as their share in the total aggregates. A further decrease in the share of state banks is expected for privatization procedures -are being carried out. There is no local bank and all banks are multi-branched. Most commercial banks have ownership links with non-financial corporations.

Holding companies or large conglomerates control the ownership and management of some banks -and also of industrial corporations. There are also financial conglomerates where the banks act as parent companies.

Banks do not face stiff competition from other financial institutions. Most of the insurance and leasing-companies are affiliated to banks. The other main characteristic of the banking sector is the high degree of concentration. The total-assets of the five largest banks amount to 47.1% of the total assets of the banking system.

According to data of December 1999, there are eighty-one banks operating in Turkey, apart from the Central Bank. (12) **(see table 1)** Total numbers of Commercial Banks are sixty-two, and the remainder; Development and Investment Banks are nineteen; four of the Commercial Banks are State-owned; thirty-eight of the Commercial Banks are Privately owned banks. The total number of foreign banks operating in Turkey is twenty-one. Nineteen of this number is Commercial Bank and the remainder is Development and Investment Bank. Eleven of total foreign banks were founded in Turkey as joint stock companies with foreign -capital, while the remaining are simply branches of foreign banks founded abroad. Despite their small -market share, foreign banks have-an important place in the Turkish banking system because of the new -concepts and practices they have introduced. Turkish banks have been developing strategies to abandon unprofitable services and activities adopt new products and increase their profitability and competitive strength through better control of operating costs.

As of December 30, 1999 banks in Turkey had-a total of **7,691** branches **7,660** of total branches are Commercial; thirty-one of which are Development and Investment Bank; **2,865** of total commercial banks and twelve of the total Development and Investment banks are state owned; **4,674** of total Commercial Banks and sixteen of the Development and Investment Banks are Privately owned banks. The total branch number of Foreign Banks is one hundred twenty-four; one hundred twenty-one of this number is Commercial and three of which are Development and Investment Banks. **(see table 2)**

(12) Turkish Banks Association web site

	1970	1980	1990	Dec 1999
Commercial Banks	44	40	46	62
State owned banks	12	12	8	4
Privately owned banks	27	24	25	38
Foreign banks	5	4	23	19
Development & Investment Banks	2	3	10	19
Total	**46**	**43**	**66**	**81**

Sources : The Banks Association Of Turkey-1999

2.1.6 Table-1: Number of Banks operating in Turkey

	1995	1996	1997	1998	1999
Commercial Banks	6.219	6.419	6.795	7.339	7.660
State owned banks	2.875	2.886	2.915	2.832	2.865
Privately owned banks	3.240	3.429	3.764	4.393	4.674
Foreign banks	104	104	116	115	121
Development&Investment Banks	25	23	24	30	31
State owned banks	9	9	10	12	12
Privately owned banks	12	10	10	14	16
Foreign banks	4	4	4	4	3
Total	**6.244**	**6.442**	**6.819**	**7.370**	**7.691**

Sources : The Banks Association Of Turkey-1999

2.1.6 Table- 2: Number of Branch Offices

As of the end of December 1999, there were 19 branches, 62 representative offices of Turkish banks abroad and the number is continuously increasing. In addition, as of the end of 1996, Turkish banks had participated in 48 financial institutions (mostly banks) abroad. State banks collect 39.7% of total deposits while private banks collect 60.3%.
The establishment of a tank depends on the authorization of the Council of Ministers. For a new bank to be established, it must be joint-stock company and have a minimum of a total TL 6 trillion of paid-up capital. Privately owned banks may open up to 10 new branches a year provided that financial standing is satisfactory. Opening up more than 10 branches, is subject to the approval of the under secretariat of the Treasury. On the other hand, state-owned banks should obtain approval from the under secretariat of the Treasury to open branches.
The legal framework concerning the functioning of foreign banks in Turkey is the same regulation, which applies to domestic banks. Foreign banks can operate in Turkey, either by establishing a branch or subsidiary or entering a joint venture with a bank established in Turkey. They may as also acquire the shares of an already established bank. The first branch of foreign banks may be opened with permission granted by the Council of Ministers.
Foreign banks must bring their capital allocated to Turkey in foreign exchange. The minimum capital requirement is the same as that for establishing a bank in Turkey. A reciprocity provision is also in force with respect to the operations of foreign banks. This provision allows the Council of Ministers to take counter measures if the conditions in any of the countries in which Turkish banks operate are changed unfavorably. All banks in Turkey are subject to the 1985 Banking Law No: 3182 and to the provisions of other laws pertaining to banks. Banks are institutions in which funds accumulating in the economy are collected mostly as deposits and channeled to investors. This makes public supervision of banks necessary. Banks in Turkey that have the status of joint-stock companies are subject to the general scope of controls under the provisions of the Turkish Commercial Code and of various tax laws. State banks are also subject to audits by the Supreme Audit Board. Besides, banks are subject to special supervision by the under secretariat of the Treasury and the Central Bank of the Republic of Turkey. As the representative body of the banking sector, the Banks Association of Turkey aims at protecting and promoting the professional interests of its members.

The Under secretariat of the Treasury supervises the banking sector within the framework of the provisions of its own governing statute as well as of the Banking Law. The Under secretariat of the Treasury exercises its supervisory authority in a direct and ongoing basis through the Board of Certified Bank Auditors. In other words, 'these auditors are responsible for on-the-site examination of banks in terms of legal considerations and financial soundness. The Central Bank is responsible for monitoring and supervising the banking sector within the framework of authority that is granted by its own Act. The Central Bank's supervision of the banks' financial structure is an off-the-site monitoring process, which depends on financial tables and documents. Additionally, independent auditing firms in accordance with the principles of accounting, which have been nationally and internationally accepted, audit the banks' financial statements. Their own auditors appointed by the general assembly, who are required to submit quarterly reports to the Under secretariat of the Treasury, also examine banks. In -recent years, the supervisory system has been further strengthened by a number of measures taken in accordance with the standards of the prudential regulation exercised by the international banking community. Tin this context, Principles for Capital Adequacy described in Communiqué No.6 went into effect in October, 1989, to reduce 'the risk arising from inadequacy of capital in banks. Some articles of this communiqué were amended in April 1993. With sufficient equity resources, banks would be able to cover their risks in conformity with international standards. Communiqué No.6 was amended by Communiqué No.12 issued in February *1995.* Under this regulation, capital adequacy principles comply with international standards. On March 1, 1995 a new communiqué went into effect to regulate the foreign exchange exposure risks of banks. According to the regulation, banks are not allowed to keep foreign exchange positions exceeding (+, -) 50% of their capital base.

Another brand new Communiqué regarding the principles of consolidation of financial statements of banks issued in May 1997 requires that the banks which are 'the parent company in a group of financial institutions' that hold the controlling power over the financial companies in the group or hold significant influence over These companies should prepare consolidated financial statements merging all on and off balance sheet accounts as well as the profit and loss statements of these companies, under those of the parent bank.

Decree on Provisioning of credits issued in January 1998 required sufficient reserves for bank loans in default, and provided more control over non-performing loans by classifying them according to the collateral provided against these loans by requiring a higher level of provisioning for loans with lower quality of collateral. The Decree amended the former one which was enacted in 1988, the new decree incurring more clearly defined principles regarding the classification of overdue loans and provisioning.

The banking sector is currently undergoing radical changes throughout the whole world. Consequently, it is not possible for the Turkish banking sector not to be affected by the changes that this global sector is going through. The expectations of the sector are harmonious with results of past similar research conducted in Europe as well as globally.

(Please see chapter 2.3 and 2.4 for more information as related with Global Changes in Banking and Finance sector)

High inflation and political instability, which are the two principal problems of Turkey, pose to be the two most influential outside factors that the banking sector faces. Lowering inflation and ensuring political stability will enable Turkish banks to operate in a more stable environment and formulate longer-term strategies.

Finalizing uncertainties, following consistent economic policies, putting into effect necessary legislative amendments, liberalizing institutions that regulate and monitor the sector will allow the banks to operate in a stronger and healthier structure.

The sector has positive expectations about lowering inflation but at the same time, this is perceived as very much dependent on political stability, for which the sector has non-uniform expectations. While lowering inflation is very much dependent on political stability, it is unclear how consistent low-inflationary policies can be utilized without first ensuring political stability and enabling the necessary infrastructure developments.

The sector expects the government to increase its regulatory role, with future regulatory amendments mainly aiming at the protection of investors and depositors and ensuring standardization and transparency.

Market expectations of the sector are that the trend towards individual (retail) banking will continue in the 2000's and the mass individual market will have a greater share in total banking portfolio. The banks, which expect the most increase in the mass individual banking market, are medium-to-small scale commercial banks. In line with these developments, it is expected that the demand for products such as cash management, consumer loans and credit cards will also increase.

The quality of service and confidentiality seem to be two most important criteria that will influence bank choices of individual customers. ***(The Individual-Banking concept will be discussed as detailed later on this project in chapter 2.6)***

For the institutional (corporate) banking market, it is expected, according to survey results that the demand for commercial loans will slow in the 2000's. This expectation is due to the fact that the possibility of raising funds from capital -markets is expected to increase, especially for big institutional customers and banks will be more hesitant to grant loans to medium-to-small scale institutional customers due to higher risk. The quality of services and the amount of fees and commissions charged seem to be the two most important criteria that the majority of institutional customers consider in their bank choices. ***(The Institutional-banking concept will be discussed in chapter 2.7)*** In line with these expectations, service quality is viewed by most banks to be the most important criterion that will enable them to gain considerable competitive advantage in the 2000's. ***(In chapter 1 theoretically competitive advantage of nations has been discussed; but by considering the whole project it can be seen that how to gain competitive advantage in banking sector)*** In case of all depository institutions implementing strategies that will increase the quality of services, This criterion will no -longer -be a determinant factor that will citable competitive advantage, instead, quality of services will be a prerequisite of operating in the -market in the 2000's. In such *conditions, the competition will* revolve around pricing, and only the banks that implement effective cost management ***(please see more information for cost management chapter 2.10)*** and hence that are able to offer the same totality of services to The customer -at the lowest cost will gain competitive advantage.

In order to accomplish this, banks have to undergo radical changes that will enable them to increase operational efficiency as well -as minimize cost.

2.2 Main Features of the Turkish Banking Sector:

The Turkish banking system has traditionally occupied an important position in the financial sector. Therefore reforms during the 1980's led to substantial changes in both financial sector and banking system. The Turkish banking system grew very sharply after return of the 1980's. Total assets of all banks rose USD 132.6 billion in September 1999 from USD18.6 billion in 1980. In 1970, total assets had amounted to USD 6 billion. At the same time, total assets to GNP ratio rose to 80 percent from 31 percent in 1980 and 43 percent in 1970.

Turkish banks can be classified into two major groups: commercial banks and investment and development banks. Meanwhile by owners, each group can be put into three subcategories: private-owned, state-owned and foreign banks. Commercial banks operate as universal banks providing traditional depository and lending services, financing foreign trade activities and sustaining capital market services as well as investment banking activities.

Privately owned commercial banks included large commercial banks having nation-wide branches and providing all kinds of services and small sized banks of which activities concentrated on main business cities. Recently small sized banks have tried to increase their deposit market share through expanding number of branches. These banks are usually located in major business cities. Much of the private banks are owned by wealthy families and for industrial groups.

There are four state-owned commercial banks, all are large and given a special duty by the state for subsidizing some sectors such as agriculture and construction and small-medium size enterprises. Although smaller in number, the state-owned commercial banks occupy a substantial share in the banking system with 45 percent of total assets.

The state-owned banks heavily involve in quasi-fiscal activities and are reimbursed insufficiently by governments with duty losses. However, lack of sufficient reimbursement of government resulting from duty losses, they have inadequate capital and tight in liquidity. Foreign banks operate either with a branch or founding in Turkey. They are large in number but small in size in the market with an assets share of 5 percent. They face same regulation with domestic banks. Investment and development banks can serve all kinds of banking services but not take deposits. There were 13 banks listed stock exchange.

Economic and financial reforms providing positive atmosphere for growth encouraged *many foreign banks enter to the sector with full banking activities while forced existing banks to reshape and restructure their* activities. There have also been new entries into the market as investment banks. As a result, the number of banks increased rapidly from 43 in 1980 to 66 in 1990. One of the new entries was privately owned commercial bank, 19 foreign commercial banks and 7 investment and development banks while 4 of state-owned banks were merged with other state owned commercial banks.

Number of privately owned commercial banks jumped during the 1990s reaching 36 in 1997 while numbers of foreign commercial banks and state-owned commercial banks fell by 5 and 3 respectively. In the meantime 3 new licenses were given for investment and development banking.

2.2 Global Changes in Finance and Banking Sector:

2.2.1 Changes in the World:

While entering into 21st century the finance sector has huge changes. At the beginning of this change globalization and technological developments come. The liberalization of markets has increased the globalization and the world has accepted only as a market.

Globalization has brought increasing competition and shrinking profit margin to financial institution. Because of this reason financial institutions had to review their structure.

Technologic developments significant contribute to these changes. The developments which in the area of telecommunication provided the opportunities of selling and purchasing in the important capital market with "on-line" system to the banks and institutional investors. However, as related with this transaction "back office" operations are realized in information process environment rapidly.

Also, in individual banking area, technologic developments continue with unbelievable speed. Because of this banking branch offices lose their importance of traditional distribution channels. In last ten years that we have covered, automatic money machines and credit cards have taken an important place in our life. In addition to these one of the biggest technological developments, which is Internet also, it has played important role in people life. So that realized banking operation by using their TV and computers. According to the searches between 1988 and 1995 the investments, which made into technology decreased the cost of banking in Europe by 3 % annually. It's expected that the technologic developments are going on and the costs of these banks will more decrease. At the end of the developments which mentioned above, financial institutions focused on that increased their productivity to use their capital and other resources in the best way in order to improvements risk management system and increase their profit margin. In marketing area these developments have effected the financial institutions about their marketing strategies, customer portfolio distributions and service areas and distribution channels. The strategies of financial institutions have shown differences according to conditions of market.

Most of the banks want to exist on every market and also satisfy the all wants of their customers. These banks, which have these kinds of strategies, prefer that to cover the needs of their customers through one hand and they believe that this approach would increased their productivity.

2.3.2 Changes in the Europe:

EU common market is the portion of globalization and by the monetary unit this concept has gained more importance.

Actually searches which are made in Europe shown that common monetary unit will be a supportive power for existing system. Also, it's predicted that common monetary unit will have some effect on banks. Some of these effects are to decrease the excess capacity existing on system, to shrinking the profit margin, to spread into countries, which becomes out of union, and last one is merger and purchases.

Generally in EU countries expected that the competition would be increase in important measure in their banking system but this expectation will be in different degrees on individual and institutional banking areas.

There are various economic developments on European banking system, which started in the past and continue in nowadays. The most important of them are as following:

2.3.3 Changes in the Developing Markets:

Russia and Asia crises, the fluctuations in Latin America and other developing countries... All of these concepts, which mentioned above will be hazard for the European banking system. In future, this situation will effect the profitability of European Union banks which have investment in countries where effected through international financial crises.

2.3.4 Changing in the active structure:

In spite of the decreasing public debts, the increasing private sector debts are significant developments. This situation would be a reason to have more risky active structures of credit institutions.

2.3.5 Mergers and Acquisitions:

The mergers and acquisition, which exist on EU, is the part of developments, which lived in all of the world and sector. Purchases and mergers do not become just in inside of country, at the same time it's lived in outside of country.

2.3.6 Increasing Competition and shrinking profit margin:
According to information, which based on end of the 1997 shows that the profitability has began in European Banking system as from beginning of 1994. The main reason of this is the positive economic conditions, which occurred in member countries, which becomes the union in that period. As a result of this apart from interests the incomes have increased in these countries.
Due to decrease the interest rates an increasing observed which in some operations such as-capital markets purchasing, selling and mediations etc. However, although all of these developments, the pressure of profitability will more and more increase in banking sector. The net profit margin decrease in return for this the costs are able to less decreased.

2.3.7 European Monetary Union (EMU) and Common Monetary Union:
It's expected that EMU will be reason to the important developments in banking operations.
In addition to this, also Euro will affect the expansion of liquid capital market in Europe. As a result of this, the power of banks which lending credit has decreased. At the same time Euro will be able to increased the competition that are occurred in inter banks.
Especially, common monetary unit will be effect behaviors of customers of banks. Another explanation for EMU, due to ratio of price and parity differences it will be increased the competition in all products. However, the financial institutions will adjust their positions and also setup new strategies by considering the EMU in order to being successful in the competition. Because of the competition, these institutions are not only restricted with their countries also they should be focused on Europe.
Due to decrease the revenues, which provided through speculations on foreign currencies movements, banks will choose the credit risks as profit sources in future.
As connected to this concept, the credit risks will be evaluated adequately and the important of this topic will be better understood.

2.3.8 The Other Developments:
The privatization and securitization process in Europe capital market will affect the banks and institutional investors.
The public loan markets, which exist on under domestic monopoly banks in the past will be opened towards international competition and so, profit margins will more decrease. Because of this reason the banks have to create the new shapes of income.

2.4 The Impact of Global, Political, Economical, Social and Technological Changes on Turkish Banking Sector (PEST Analyses of Turkish Banking System):

The effects of global changes will be as follow in the Turkish Banking System:

- Banking services appropriate to the profile of various customers will be produced.
- There will be improvements and developments in distribution and marketing channels.
- There will be mergers and acquisitions between banks.
- There will be fluctuations in developing foreign financial markets.
- The efficiency of financial institutions, except for banks will be increased.
- There will be developments in technology used by banks.
- Common monetary union (EURO) will be efficient in markets.

In addition to global changes its necessary to study the effects of social, economic, politic events on financial markets. Some of these effects are as following:

- Political stability
- The migrations into urban areas
- *The number of working people*
- Saving level
- Consumption
- Education level
- Privatization

2.5 The Role of State and Official Regulations:

From its establishment stage to today the State has played an efficient role in Turkish banking sector.

After 1980's instead of direct control, the State has applied regulations provide liberalization.

By the Banking Law in 1985, the central bank has increased its supervision in banking sector. However, the supervision is only a part of regulations to provide the stability in financial market.

In this framework the efficiency of supervision system can be provided by:

- Autonomy
- The strong and continuous macro economic policies
- The discipline of efficient market
- Advanced public infrastructure –such as laws, acceptable accounting policies in international area, independent supervision, barter system etc.
- The procedures to efficiently solve the problems of banks
- The mechanism, which will protect the interest of deposit owners at an adequate level.

Due to the insufficiency of the regulations provided which mentioned above and increasing risk of sector, the regulatory role of the State has increased.

The regulatory roles of the State will increase in following areas:

- For commercial banks especially in institutional credits, repo and exchange transactions.
- For investment and development banks especially in institutional credit and repo transactions.
- For private finance institutions in money market transactions.
- For intermediate institutions in bond transactions.
- For consumer finance institutions in products of consumer credit.

2.5.1 The purposes of official regulations:
The purposes of official regulations can be examined as follows:

- To protect the deposit owners and investors.
- To provide transparency and standardization in applying the accounting principles
- To fix and prevent the flow of black money
- To increase the liquidity
- To provide the integration into EU

The foreign banks, which operate in Turkey, have identified to provide the standardization and transparency in applying accounting principles as their most important aim.

2.5.2 The Restrictive Regulations on Number of Banks:
In 1980, the numbers of banks were 44 in Turkey but at the end of the 1999 this number has increased to 81. In addition to this the total number of branch offices are 7691 (according to data of December 1999.) In fact this number is not adequate for Turkey. When it's examined the European Community one-bank branch office give service to each 5000 people. But in Turkey this number is approximately 8452. (65 million / 7691)
Actually the problem should not be the number of banks. Instead of examining the number of banks we should discuss the structure of banks and capital (or capital groups) of banks. So, efficient regulations should be forced into law for new banks, which will enter into market.

2.6 Individual Banking Services:

2.6.1 The Increasing Competition in the Individual Customer Market:
According to the results of research, the individual market will increase in total customer portfolio of banks. In 21st century, when analyzed this ratio in bank groups, the big-scaled banks will not change their portfolios, but middle and small-scaled commercial banks have aimed to increase their individual customer portfolios.
In the framework of foreign banks, by increasing two times their individual customer portfolios they will try to gain competitive advantage in this market.

2.6.2 The Banking Criteria of Individual Customer in the 21st Century:

The most important criteria of Individual customers which will an play important role in choosing their banks are as following:

For potential individual market:

- Service quality
- Taken commissions by banks
- Reliability
- Expected yield
- Behaviors against customers

For high-income customers:

- Service quality
- Reliability
- Expected yield
- Product variety
- Behaviors against customers
- Importance of secrecy
- International relations
- Previous experience and relations
- Taken commissions and fees

Meanwhile the efficient usage of advanced technology will play an important role in choosing bank for high-income customer.

2.6.3 The Criteria, which provide Competitive Advantage to the Banks in today and in the 21st Century:

The Criteria which Provide the Competitive Advantage to the Banks today and in the 21st Century are as following:

- Suitable and elastic pricing policy
- Efficient marketing policy
- Image and prestige
- Reliability
- Efficient usage of technology
- Customer orientation
- The power of find out sources
- Ability to ensure the adaptation into changing market condition
- Service quality

- Ability to provide new banking services
- Product variety
- A good number of investor customers
- A good number of customers taking credit

The concept of "*customer service quality*" has been accepted as the most significant criterion providing *competitive advantage* by most banks. Another concept, which is the power of find out source, will be less important in the 21st century.

The efficient usage of technology in 21st century will be important for all banks apart from big-scaled banks. Because, these kinds of banks have already now determined their strategies in technological area. However, the efficient usage of technology should be combined by distribution and communication channels in order to gain competitive advantage. All banks around the world have accepted this opinion. In addition to these, reliability will also be one of the important factors to gain competitive advantage in the 21st century.

To be focused on customer and employing efficient marketing concepts have been accepted as important criteria in providing competitive advantage especially by commercial big-scaled banks for 21st century.

2.6.4 The Banking Services that will gain importance in the 21st century:

The banking services, which will be gaining importance in the 21st century, can be expressed as following:

Commercial banks will focus on certain service activities in 21st century - such as cash management, consumer credits, insurance transactions, and credit cards etc.

Foreign banks will focus on private banking and active management services and additionally they will be specialized on credit cards.

As we can see from **Table-3** the commercial banks will focus on credit cards, cash management, consumer credits.

	Commercial Banks (big scaled)	Commercial Banks (middle-small scaled)	Foreign Banks
Cash Management	△	△	■
Consumer Credits	△	△	■
Commercial and Saving deposit	■	■	● ■
The instruments of money market	■	△	■
Portfolio Mgmt.	△	■	■
Insurance transaction	● ■	● ■	■
Credit cards	△	△	△
Private banking Active mgmt	△	■	● △

△ : increase ■ : Less increase ● : Constant

2.6.4.Table-3 The Demand, which will be to the Individual Banking Service:

2.7 Institutional Banking Service:

2.7.1 The Expected Developments in the Institutional Banking Activities:

In Turkey, the Institutional banking services have gained importance in 1980's. But, by the 1994 crisis, this concept has began to lose its weight mainly due to increasing internal competition and narrowing possibilities of fund transfers to abroad.

With the realization of alternative ways of borrowing money by companies, the profitability that was maintained through keeping these customers has decreased. So, banks have turned to middle and small-scaled companies in order to provide credit. However, these credits which orientated into small and middle scaled companies have caused an increase of credit losses because of the economic stability is low level.

In institutional product portfolio will be as following in the 21st century:

- Commercial credit
- Institutional finance
- Financing rent transactions
- Commercial and saving deposits
- Exchange transactions

2.7.2 The Choosing Criterions of Banking for Institutional Customers:

According to "Global Treasury to Year 2000" which was realized by European Intelligence Unit, the most important three features that play a role in shaping customers' bank choices are efficiency and quality, quick respond to needs and competitor pricing.

Some of the criteria affecting the choices are as follows for institutional customers:

- Supportive activities
- Secrecy
- Expected yield
- Behaviors against customers
- Previous experience and relations
- Taken commissions
- Service quality

2.7.3 The Criteria which Providing Competitive Advantage to the Banks today and in the 21st Century:

The following criteria will provide the competitive advantage to the banks in 21st century:

- Suitable and/or elastic pricing policy
- Efficient marketing
- Secrecy
- Image and prestige
- Quick respond in banking activities
- Reliability
- The efficient usage of technology
- Being focused on customer
- The ability of find out source
- The ability to ensure the adaptation into changing market conditions
- Service quality
- The ability to submit the new banking service
- Product variety
- The number of investor customer
- The number of customer who given credit

As can be inferred from the analyses above, the potential sources of gaining competitive advantage both by the bank providing institutional and individual banking services are similar.

2.7.4 The Banking Services that will gain importance in the 21st century:

In the framework of institutional customers the following services will gain importance:

- Commercial credits
- Institutional financing credits
- Financial rents
- Commercial and saving deposits
- Foreign exchange transactions

The demand will shift to the Institutional Banking Services, which is also depicted by **Table- 4.**

	Commercial Banks (big scaled)	Commercial Banks (middle-small scaled)	Foreign Banks	Investment and Development Banks
Commercial Credits	■	■	■	■
Institutional Financing Credits	▲	■	■	▲
Financial Rent	■	▲	■	■
Commercial and Saving Deposits	■	■	■	● ■
Foreign exchange Transactions	■	●	■	■

▲ : Increase: ■: Less Increase ●: Constant

2.7.4.Table-4: The Demand, which will be to the Institutional Banking Service:

2.8 Distribution Channels Of Banking And Financial Services:

The distribution channels of banking and system of financial services have become more complex. Today the phone banking system and Automatic Transaction Machines (ATMs) have been used by most of the countries. Additionally, the usage of Internet financial services has increased rapidly.

Generally the people who use the Internet in their financial transactions are high-income people. So, the contributions to profitability are significant. At the same time Internet provides the financial information (*) and mediation possibilities to the people.

Due to decreased computer prices and advanced technology, the usage of computers will be increased. Meanwhile, there will be a couple of contributions of this advanced technology to banking sector.

The first contribution will be to the " Relationship Banking System". On the other hand, the services and products will be various and the competition will only be on prices of activities. On the customer side, they will be able to compare the prices of provided products easily. Therefore, the banks will have to evaluate their objectives and services once again and some concepts -such as quality, productivity, quick respond – will be more important.

2.9 Human Resources in Banking and Financial Services:

Although most of the banks prefer the usage of the advanced technology in their activities, any decrease in the number of human resources has not been observed. Generally, banks prefer employing skilled personnel. The banks, which expect are decrease in numbers of personnel, they have shown the increased use of information technology as their reason.

(*) Bank of America forecasted that 10 % of individual customers use the on line system in their banking transactions. In Germany 3,5 million German customer have used the on line system in some of their banking transaction. (expressed by German center for information)

2.9.1 The importance of education in increasing of productivity of personnel:
According to banks the most important way to increase the productivity of personnel is the education and training. There are some methods in order to increase the productivity of working people. These are as following:

- re-regulate the activities
- the measurement of productivity
- elimination of repeating transactions
- simplify the procedures
- standardized product and service
- new advanced system
- education

2.10 The Cost Management In Banking Sector:

There are some techniques in order to decrease the costs of banks or to increase the operational productivity. The most important of these can be summarized as:

- to use the technology efficiently
- to improve the knowledge, experience and abilities of personnel
- to reorganize the following of work to increase the productivity
- to improve cost management etc.
- to increase the motivation of personnel
- to provide educational programs
- to outsource some services

The services, which are outsourced, can be explained as follow:

- accounting service
- internal supervision
- operation services
- human resources consultation
- tax consultation
- system operation
- management consultation
- law
- education
- system development

2.11 The Information Technology in Financial Sector:

The role of information technology in financial and banking sector is following:

- to increase the ability of quick respond the needs of market
- to increase the ability of responding to the demands for special product or services of individual and institutional customer
- to provide the information which will manage the cost and risk
- to constitute environment to share the knowledge and to increase the creativity
- to increase the quality of product and services
- to increase the speed of process
- to provide the required information for financial report

2.11.1 The areas which will be effected by technology:

Some areas, which will be affected by technology, are:

- product distribution channel
- risk control
- the productivity of managers
- the quality of the service given to the customer
- the quality of information management

2.11.2 The Management Information System (MIS)

The areas which will be necessary in terms of MIS are as following:

- the portfolio pricing
- portfolio performance
- the control of productivity
- personnel management
- the product pricing
- the control of served service against customer
- the control of cost and budget
- risk management
- profitability according to product
- the quality of information management systems

2.11.3 The Investment of Information Technology:

Banks are faced with some barriers while they are investing to the information technology.

These barriers can be explained as following:

- attitudes of users
- attitude of top level management
- inadequate communication infrastructure
- lack of technique ability within the institution
- inadequacy of customers in terms of information
- lack of project management ability in institution
- inadequacy of companies which give services in domestic area
- the changes in technology

2.12 Performance Measurement In Banking Sector:

Performance measurements of banks can be evaluated under two headings:

2.12.1 The Financial Indicators:

In performance measurements of banks the following information can be obtained through financial indicator:

- yield through profit centers
- profitability of departments
- profitability of branch offices
- credit portfolio
- total assets
- the yield of assets
- profitability of product
- profitability of customer
- profit level of operation

2.2.2 The Non-financial Indicators:

While evaluating the following information, can be used non-financial indicators:

- the number of branch offices
- the number of customer per branch office
- error rate
- complaints of customers
- productivity of working people
- market share
- pressure of customer

2.3 Risk Management in Banking Sector:

In order to be able to provide an efficient risk management, the following factors are needed:

- well- trained managerial staff
- efficient internal supervision
- highly educated and skilled personnel

Technologic infrastructure, written policy and procedures should support the factors mentioned above.

Nowadays, in developed financial markets of the world, the risk management is important for regulatory institutions operating within those markets.

In 1990s due to financial crises some of the big scale financial institutions have been greatly effected. The main reasons for this were consequence inadequate supervision system, unbalances in risk concentrations, inadequate policy and procedures.

In addition to these factors others such as-inadequate managerial staff, technique infrastructure-concepts have also played important role by increasing the risk. On the other hand, technology will also be efficient in solving of risk management problems. This is a view, which is accepted by everyone.

2.2.4 Supervision of Banks:

Banks are supervised according to their development and annual plans in Turkey. These supervisions can be divided into two groups:

- Administrative Supervision
- Financial Supervision

2.2.4.1 Administrative Supervisions:

The administrative supervision of banks begins with entering into system after establishment. In Turkey, in order to operate in banking area in Turkey it's necessary to get permission from the Board of Banks.

At the same time, this is valid for foreign banks as well. There is no concession for EU member countries. Banks have to perform their activities according to the monetary and credit policy determined by the government. (i.e. maturity date of credits, maturity date of deposits, the amounts of credits etc). So, banks have to obey these rules, which are enforced by banking law.

2.2.4.2 Financial Supervisions:

The financial supervisions are performed in order to prevent the negative effects which occurring by the activities of banks. In addition to this, some ratios -such as foreign currency and liquidity ratios- are determined by the central bank according to the requirements of economy and the conditions of banks. Also, the Central Bank has set up a risk centralization institute according to the Central Bank Law 1211 article no:44. In this institute the remonstrance, which belong to unpaid promissory notes accrued in banks, are collected and announced to other banks.

2. The Central Bank of Republic of Turkey

2.1 Brief History of the Central Bank

2.1.1 The Ottoman Period

In the Ottoman Empire, the Treasury' operations, money and credit transactions and the trade in gold and foreign currencies were executed in varying degrees by the Treasury, the Mint, jewelers, money lenders, foundations and guilds. In 1847 the Ottoman Government allowed Galata Bankers to set up the "Bank of Dersaadet" as a bank winch assumed the external payments of the Ottoman Empire for the first time. In 1856 the "Ottoman Bank" was established jointly with French and English capital and in 1863 partly assumed the functions of contemporary central banking after becoming a state bank under the name of "Imperial Ottoman Bank". The Imperial Ottoman Bank enjoyed the right and monopoly of issuing banknotes. The Government relinquished the right to issue banknote within the period of privilege and to grant permission to other institutions in this regard as well. Equipped with this power, the Bank would act as the Treasurer of the State, collect the State revenues, perform the payments of the Treasury and discount Treasury bills as well. The interest and principal payments regarding domestic and foreign debts would be made by the Ottoman Bank only. The capital of the Bank consisted of 135.000 shares. The 80.000 of which were bought by English Group, and 50.000 of which by French Group, whereas 5.000 shares were allocated to Ottomans.

2.1.2 The Republican Period

Even though the Republican administration extended the period of privilege of the Ottoman Bank until 1935, the preparations had been undertaken to set up a central bank since 1926. The Law on the Central Bank of the Republic of Turkey No: 1715 was enacted on June II, 1930. The Bank was established on October 3, 1931 and opened officially on January 1,1932. The Bank had, originally, a privilege of issuing banknotes for a period of 30 years. In 1955 this privilege was extended until 1999. Finally it was prolonged indefinitely in 1994. According to the Law No: 1715, the basic aim of the Bank was to support economic development of the Country. In order to fulfill this aim, the Bank was given the following duties:

- To set rediscount ratios and to regulate money markets,
- To execute Treasury operations,
- To take, jointly with the Government, all measures to protect the value of Turkish currency.

With the introduction of economic development plans in Turkey in the Sixties, several changes were made in the Central Bank Law No: 1715. For the same purpose, the Law No: 1211, which was enacted on January 26, 1970; redefined the duties and responsibilities of the Central Bank of the Republic of Turkey so as to implement the money and credit policy within the framework of development plans. In the second half of the Eighties, the Bank inaugurated inter bank money market, foreign exchange money market and started lo make use of open market operations.

3.2 Duties of the Central Bank:

3.2.1 Fundamental Duties

Pursuant to the provisions of the Central Bank Law No: 1211, the Bank carries out money and credit policy in accordance with the needs of the economy and so as to maintain price stability. The Bank takes necessary measures to protect the domestic and international value of the national currency and regulates its volume and circulation. It also extends credits to banks and conducts open market operations in order to regulate money supply and liquidity in the economy.

Moreover, the Bank determines the terms and types of deposits, as well as their maturity dates and validity periods, and the parity of the national currency against gold and foreign currencies. It manages gold and foreign exchange reserves and trades in foreign exchange and precious metals on the stock exchange. It also administers and represents the "Savings Deposits Insurance Fund".

The Bank, in particular, carries out the duties of financial and economic advisor, fiscal agent and treasurer to the Government.

3.2.2 Fundamental Powers

The Bank has the privilege of issuing banknotes in Turkey, and the authority to take decisions on money and credit issues and to submit proposals to the Government. The Bank determines the rediscount, discount and interest rates applicable to its own transactions.

3.2.3 Advisory Duties

The Bank presents to the Government, when required, its views with regard to measures to be taken on money and credit, and submits advisory opinions on matters related to implementation of the Banking Law or on banking and credit issues in general, upon request of the Government. The Bank can also be consulted prior to any decision granting permission for the establishment of banks and other financial institutions, as well as for the liquidation of such institutions for which the power to liquidate rests with the Government.

Chapter

3 Central Bank of the Republic of Turkey

Structure Of The Bank:

The organs of the Bank are as follows:

General Assembly Of Shareholders

The General Assembly of the Bank is composed of the shareholders who are registered in the share book of the Bank. The General Assembly convenes each year on a date indicated by the Articles of Association of the Bank. Each person owning ten shares or representing this number of shares is entitled to one vote. The Governor chairs the general assembly.

The General Assembly has the following duties and powers:

- to examine the annual report submitted by the Board and the report of the Auditing committee;
- to examine and approve the balance sheet and the income statements of the Bank:
- to release the members of the Board and the Auditing Committee;
- to increase the capital;
- to amend the Articles of Association of the Bank:
- to render a decision concerning the liquidation of the Bank.

Board

The Board is composed of the Governor and six members to be elected by the General assembly. The Governor is the Chairman of the Board. The term of office of Board members is three years. One third of Board members are renewed every year. Members /ho are to leave the Board at the end of the first and second years are designated by drawing names. Members whose terms of office have terminated may be re-elected.

The duties and powers of the Board are as follows:

- to determine the conditions for replacement of banknotes in circulation by a new issue, as well as their withdrawal from circulation and destruction when necessary:
- to determine the rediscount, discount and interest rates, as well as the fees and commissions applicable to the transactions of the Bank;
- to render a decision on the proposals that the Bank shall submit to the Prime Ministry in accordance with the Article 40 of the Law on the Central Bank of the Republic of Turkey, as well as on the issues set forth by the said Law;
- to determine the terms and conditions of credits to be extended by the Bank and the limits on rediscount and advances:

- to determine the terms and types of deposits, their maturity dates and validity periods;
- to determine the parity of the national currency against gold and foreign currencies in accordance with Article 4;
- to manage the gold and foreign exchange reserves within the scope of Article 4; to determine the terms and conditions of transactions to be carried out on the stock exchange in foreign exchange and precious metals;
- to approve the annual cadres of the Bank's personnel;
- to approve the regulations drafted by the Executive Committee on the administration, organization and services of the Bank;
- to take decisions on the purchase or acquisition of real property needed by the Bank, as well as on the sale when necessary of real property owned by the Bank;
- to decide on amicable settlement, release and cancellation of the amounts and values exceeding the limits stated in regulations;
- to prepare the annual report, balance sheet, budget and the income statements of the Bank, as well as the agenda of the General Assembly;
- to appoint the Bank personnel whose appointments are entrusted to the Board by regulation, and to specify the authorized *signatories binding the Bank;*
- *to determine the quality, quantity and size of real property needed by the banks to carry out their banking activities; to grant* permission to acquire real property apart from the immovable to be allocated such as office, factory, work-shop and annexes required by the objects of business of the partnerships in which banks participate with more than 10 percent of the capital, and to such partnerships and establishments in which the majority of the capital is owned by the afore mentioned partnerships.
- to take decisions on issues subject to the approval of the Board by virtue of this Law, as well as on issues submitted by the Office of the Governor for examination and approval.

2.2.2 Office Of The Governor

Governor

The governor is appointed for a term of five years by a decree of the Council of Ministers. The Governor may be re-appointed at the expiration of this term. The Governor, in the capacity of the highest executive officer, administers and represents the Bank within the country and abroad.

The Governor is entrusted with the following powers:

- to ensure the enforcement of the provisions of this Law and the decisions taken by the Board.
- to take appropriate measures in order to carry out the duties with which the Bank is entrusted by this Law, and to make proposals to the Board on such measures whenever the Governor deems necessary.

In the temporary absence of the Governor, the Vice Governor designated by him/her, acts on his/her behalf during this period.

Vice Governors

Four Vice Governors are appointed to assist the Governor. Vice Governors are appointed by a joint decree for a period of three years. Vice Governors may be re-appointed at the expiration of the said term or may be replaced in the same manner prior to the termination F this term.

2.2.4 Auditing Committee

The Auditing Committee supervises all the operations and accounts of the Bank. The office of the Governor is obliged to furnish all the information and documents requested by the Auditing Committee. The Auditing Committee, having no administrative power, submits its opinions in writing to the Board and also presents a copy thereof to the Prime ministry. The Committee submits to the General Assembly a report to be drawn up on the operations and accounts of the Bank as at the end of the year.

Members of the Auditing Committee serve for a term of two years.

Members of the Auditing Committee may not share in the profits of the Bank.

2.2.5 Executive Committee

The Executive Committee is composed of the Vice Governors under the chairmanship of the Governor. In cases in which the Governor is unable to chair, the Vice Governor designated by him/her presides over the Executive Committee.

The duties of the Executive Committee are as follows:

- to prepare proposals to be submitted to the Board, by examining in advance the issues subject to Board decision, when deemed appropriate by the Governor;
- to draw up regulations on the administration, organization and services of the Bank
- to render decisions on issues made subject to the decision of the Executive Committee by regulation;
- *to ensure coordination in the operations of the Bank*:
- to perform such duties related to appointment, salary, dismissal and retirement of the personnel other than those appointed by the Board.

Decisions of the Executive Committee are taken by a majority of all the members. In the vent of a tie, the proposal supported by the Governor shall be considered adopted.

2.2.6 The Discount Committee Of The Head Office And Branches

The Discount Committee of the Head Office is composed of two members to be elected y the Board and of a related Vice Governor under the chairmanship of the Governor.

The duties of this Committee are as follows:

- To make proposals to the Board about the rediscount, discount and interest rates, which the Bank will apply in its own transactions;
- To examine and regulate the credit operations within the framework of the powers given by the Board.

The Discount Committee of the Branches is composed of the members to be designated / regulation under the chairmanship of the Director of the related branch.

[illegible] Head Office

The work of the Head Office of the Bank is done by 17 departments. These departments are consisted of 13 General Directorates, 2 Units, and 2 Secretariats. Their areas of task and responsibility are described given in below in alphabetical order.

Accounting Department:

- prepares and updates the accounting plan, the balance sheet and the statements of the Bank: draws up the Bank's annual budget and follows its implementation
- keeps the books as prescribed by law, follows the smooth functioning of the accounting system and makes the necessary arrangements thereof;
- prepares the reports of extra budgetary funds:
- operates the electronic fund transfers via EFT, SWIFT, SAOS, EMKT systems, keeps their accounting records;
- is responsible for the fulfillment of the financial obligations of the Bank:
- keeps, follows and controls the accounting records of foreign exchange transactions of the Head Office;
- gives instructions to the branch offices and to the banks on the related matters.

Accounting Department executes its functions in five divisions:

- Turkish Lira Accounting Division
- Foreign Exchange Accounting Division
- Balance Sheet and Accounts Monitoring Division
- Budget Division
- Electronic Payments Division

Banking Department:

- notifies the Bank's opinion about the matters related with setting up a new bank, the abolishment of permission for banking and deposit taking activities of a bank;
- sets the principles and conditions for the legal requirements; determines the ratios which the banks are obliged to observe and the maximum interest rates applicable to their banking transactions along with the terms and types of deposits;
- gathers information on dishonored checks and informs the banks in this regard; executes the services of inter bank clearing houses:

- conducts supervision and auditing of banks and special finance institutions through on-site and off-site examinations of their operations;
- submits opinions on all kinds of legal arrangements for the banking sector;
- collects and processes the data relating to financial statements of banks based on the uniform chart of accounts within the context of "early warning system"; prepares warning and performance reports;
- executes operations relating to foreign exchange positions of the banks, special finance institutions and authorized institutions;
- collects and evaluates information on the risks and protested bills of customers of the banks through risk centralization.

The Banking Department executes its functions in four divisions:
- Banks Supervision Division
- Banking Transactions Division
- Financial Institutions Division
- Risk and Clearing Operations Division

Construction And Procurement Department:
- conducts transactions related to purchasing, selling and leasing of real estate of the Bank; executes construction, renovation and installation works of the Bank's premises;
- provides services for setting up, operating and maintaining the technical equipment of the Bank;
- procures the fixtures and equipment and writing materials for the use of the Bank;
- conducts the operations of the "Head Office Purchasing, Selling and Tender Commission"
- carries out transportation and housekeeping services for the Bank.

Construction and Procurement Department executes its functions in four divisions:
- Construction and Real Properties Division
- Maintenance Division
- Materials Division
- Housekeeping Services Division

Control Unit:

- follows and controls the transactions of the branch offices to ensure that they are executed in accordance with the regulations
- follows and audits the existence and movements of the cash and in kind values in order to verify whether they correspond to the records;
- notifies the illegal activities and important troubles concerning the security and works of the Bank.

The Control Unit is composed of the Head Office Control Unit, the Examination and Evaluation Committee, the Control Group and the Branches Control Group

Data Processing Department:

- is responsible for selecting the hardware and software suitable for the Bank; carries out bank wide installation of automation equipment;
- makes contribution to the strategies related to data processing and automation, and develops and follows the planning:
- follows the developments in the computer technology and adapts them to the Bank's structure;
- operates the EFT (Electronic Fund Transfer) System through which inter bank Turkish Lira fund transfers, clearings and reconciliation are executed; operates the Electronic Data Distribution System and develops the Bank's Web Site:

Data Processing and Statistics Department executes its functions in five divisions:

- Payment Systems Division
- Systems Technical Support Division
- Systems Operation Division
- Application Development Division
- System Research and Planning Division

Foreign Relations Department:

- establishes institutional relations of the Bank with the international organizations; follows and reports the relations with the Customs Union and the European Union:
- executes the operations of the Bank's medium and long term external credit agreements;
- monitors, on behalf of the Treasury, the foreign debts of the government and conducts their repayments; manages the disbursement of foreign credits granted to the government: acts as the advisor for the Treasury on its relations with domestic and international finance circles;
- follows the developments in the world economy and international markets; prepares short and long term reports thereon;
- implements the provisions of the regulation on the Protection of the Value of the Turkish Currency regarding the collection of exports proceeds and payment of imports, invisible transactions, capital movements:
- implements the provisions of the regulation on exports incentives.

Foreign Relations Department executes its functions in five divisions:

- European Union Relations Division
- International Organizations Division
- Foreign Economies Monitoring Division
- Foreign Exchange Regulations Divisions
- Foreign Trade Division

Human Resources Department:

- provides proposals to the top management for setting the Bank's personnel policy and for its effective application:
- recruits the personnel suitable to the Bank's needs, determines their employment conditions and employs them in the organization according to their qualifications;
- conducts and follows the matters of all kinds pertaining to personnel:
- executes the preparatory works for determination and development of the remuneration policy:
- informs the employees of the regulation pertaining to personnel, personal rights, and social security:
- makes arrangements in the organization of the Bank in order to increase the productivity of operations, to cut the costs, to enhance the service quality and develops the appropriate methods to this end.

- conducts job analysis, job and task descriptions and their standardization works; develops and implements the ways that set the productivity standards of the employees;
- conducts analysis on the training needs of the personnel;
- develops an effective training system in accordance with the Bank's general objective and policy as well as technological, economic and social developments, conducts research in this area, prepares, implements and evaluates the training plans and programs.

Human Resources Department executes its functions in five divisions:

- Personnel Management Division
- Personnel Planning and Organization Division
- Register and Social Security Division
- Training Division
- Training Planning Division

Inspection Unit:

- inspects all operations of the Head Office, branches and representative offices abroad to ensure that they are executed in compliance with the regulations; conducts examinations and inquiries within the limits of the powers and duties granted by the Banks Act and other related laws;
- conducts supervision at the banks, special finance institutions, authorized institutions and other establishments in the fields in which the duty and power of inspection are given to the Central Bank by the Banks Act and other regulations.

Issue Department:

- arranges the printing and circulation of the national currency;
- puts the banknotes into circulation, replaces them with new issues when necessary, regulates the printing programs of banknotes and coordinates with the Banknote Printing Plant in order to produce banknotes in an uninterrupted and productive way;
- determines the principles pertaining to custody, transportation, cancellation and destruction of the valuables;
- determines the working conditions of the banknote processing systems;
- gives notifications to the branches, the banks and the related institutions about the new foreign exchange banknotes which are put into circulation and those which are withdrawn from circulation:
- conducts the custodian and transportation operations of banknotes, coins, gold coins and gold bultions:

- conducts the operations concerning the banknotes withdrawn from circulation, as well as the counting, sorting, cancellation and destruction of old and worn out banknotes;
- carries out the operations concerning the exhibition of securities such as banknotes, coins, gold, government papers, stocks, bonds and historical documents and properties;
- issues warning to the banking system, financial system and branches about false Turkish lira and foreign exchange banknotes, conducts the examinations when requested by judiciary and administrative offices;
- handles all fiscal service transactions ranging from printing and destruction of the government papers, and maintains their portfolio and provision accounts, acts as the Treasurer;
- conducts the operations pertaining to the Bank's stocks;
- makes the amendments in the Terms and Conditions of the Bank in coordination with the related departments; determines the principles and conditions of the payments to be made from Turkish lira deposit accounts maintained in the Bank, as well as the remittances and collection of the bills; establishes the principles governing the interest rates, commissions and fees applicable to all kinds of banking transactions of the Bank.
- follows the operations pertaining to the Treasury Account System, tax Collection and the commissions and fees to be paid by the Bank; concludes the domestic correspondent banking agreements.

Issue Department executes its functions in three divisions:
- Issue Division
- Banknote Movements Division
- Treasury and Fiscal Services Division

Legal Department:
- submits its legal views on the duties of the Bank to the related departments;
- handles all the legal work of the Bank, including the Bank's involvement in commercial, administrative and civil litigation, and represents the Bank in actions before judges;
- participates in the preparatory works of the regulation and legal documents pertaining to the Bank, and presents its views thereupon.

The Legal Department functions as a counseling and support unit.

Markets Department:

- conducts operations in domestic and international foreign exchange, money, securities and in their derivative markets in order to manage foreign exchange and gold reserves of the Country in a productive manner;
- conducts open market operations in order to regulate money supply and liquidity in the economy;
- acts as intermediary in the inter bank money market ensuring a more rational utilization of the funds, and operates, when necessary, in the name and on behalf of the Bank;
- carries out the government domestic borrowing as the fiscal agent of the Treasury;
- acts as intermediary in the foreign exchange and banknotes markets in order to obtain a more efficient utilization of the funds in the banking system, and operates, when necessary, in the name and on behalf of the Bank, ensuring smooth functioning of the markets;
- makes arrangements in the foreign correspondent banking relationship;
- the sale of government papers by "auction" and "outright sale to public" methods;
- executes the implementation of the rediscount policy within the framework of development plans, annual programs and monetary policy; conducts the transactions of rediscount, discount, advance against bills, bonds and gold; determines the rediscount, discount and interest rates applicable to its own transactions;
- executes the credit transactions of the Bank with the Treasury, public institutions and the banking system;
- acts as the reporter of the Discount Committee of the Head Office;
- determines the sources of exchange rate, interest rate, credit, liquidity and operation risks, measures these risks, sets the acceptable risk limits.

Markets Department executes its functions in seven divisions:

- Money Markets Division
- Credits Division
- Open Market Operations Division
- Treasury Operations Division
- Foreign Exchange and Banknotes Division
- Foreign Exchange Transactions Division
- Foreign Exchange Risk Management Division

Office Of The Secretary General:

- maintains coordination among departments of the Bank, executes the duties given directly by the Governor and the Executive Committee; provides service and support to the Governor and the Vice Governors;
- *conducts secretarial work for the meetings of the Board, the Head* Office Discount Committee and the Executive Committee:
- provides service relating to public relations and protocol for the Bank; distributes information about the Bank, the monetary policy and the economy to individuals and groups within and outside the Bank by means of press releases, weekly press bulletin and other publications:
- carries out all internal and external correspondence, provides records retention and archival services of the Bank:
- provides library, documentation and translation services;
- executes the execution works of the Bank's Shareholders General Assembly.

The Office of the Secretary General executes its functions in one secretariat and four divisions:

- Secretariat of Governor's Office
- Secretariat of the Board and the Auditing Committee Division
- Correspondence Division
- Library and Documentation Division
- Private Offices Division

Office Of The Secretary For Security And Defense:

- conducts and plans, in coordination with the governmental, military and other administrations, the civil defense services during peace, mobilization and wartime, and the services of the special security unit in the Head Office and branches;
- prepares the regulations concerning protection and security services in the Bank.

The Office of the Secretary for Security and Defense executes its functions in one division:

- Security Division

Research Department:

- conducts research and analysis on economic and financial matters
- studies and evaluates the dynamics of economic developments within the framework of econometric models to make forecasts.
- coordinates the studies on the matters and measures stated in development plans and annual programs and related with the Bank;
- draws up the draft of the Bank's Annual Report.

The Research Department executes its functions in two divisions:

- Economic Research Division
- Financial Research Division

Social Affairs Department:

- provides services related to social and medical assistance to the Bank's personnel and their family members:
- administers the training, seminar and recreational centers, and the social clubs and the guesthouse,
- organizes cultural and artistic activities, encourages Bank's personnel to take part in artistic, cultural and social activities: conducts organizations regarding business ravels of the personnel.

Social Affairs Department executes its functions in five divisions:

- Catering Division
- Social Clubs, Training and Recreational Centers Division
- Medical Assistance Division
- Culture, Arts and Environment Division
- Social Assistance Division

Statistics Department:

- collects, processes *the economic and financial data: prepares* financial statistical tables;
- sets up data bank in coordination with the other departments of the Bank; develops data base applications
- prepares the table for balance of payments and that of foreign exchange assets and liabilities;
- conducts analysis based on the balance sheets and income statements of private sector companies in order to establish sectoral profile.

Statistics Department executes its functions in five divisions:

- Economic Statistics Division
- Financial Statistics Division
- Banking Data Division
- Balance of Payments Division
- Sectoral Evaluation Division

Workers' Remittances Department:

- opens the foreign exchange deposit accounts of the Turkish workers abroad and conducts transactions related thereto;
- compiles statistical information on the foreign exchange deposit accounts, prepares evaluation reports thereof.

Workers' Remittances Department executes its functions in four divisions:

- Workers' Remittances Division (Germany)
- Workers' Remittances Division (Other Countries)
- Workers' Problems and Evaluation Division
- Control and Correspondence Division

Banknote Printing Plant Department

- prints Turkish lira and foreign exchange banknotes, government papers, stocks, bonds, stamps, national lottery tickets etc.
- conducts printing services of the Bank, performs maintenance operations of the equipment,
- keeps the accounts and records of the Plant, draws up the budget and the balance sheet of the department;
- takes the necessary measures to meet the production requirements in time.

Started to print banknotes in 1957, the Banknote Printing Plant Department performs its duties according to the principles of profitability and productivity. The Banknote Printing it has a separate accounting plan and it is consolidated with the Bank's accounts at end of accounting period.

Banknote Printing Plant Department executes its functions in four divisions:

- Production Division
- Production Control Division
- Maintenance, Repairs and Plant Division
- Administrative and Financial Affairs Division

Savings Deposits Insurance Fund Department:

Savings Deposits Insurance Fund has been founded as a legal entity in order to serve confidence and stability in the banking sector, to strengthen and if necessary structure the financial structures of banks and to insure the savings deposits in banks.

Savings Deposits insurance Fund Department,

- executes the payments, in line with the insurance system, to depositors of those banks whose permissions to carry out banking operations and to collect deposits are withdrawn:
- examines the financial standings of the banks whose managements are transferred to the Fund, prepares proposals for their re-organizations;
- takes measures to strengthen the liquidity position of the banks whose managements are transferred to the Fund;
- is responsible for the management, functioning, auditing of the "Savings Deposit Insurance Fund" and for establishing the principles of savings deposits insurance;
- provides all kinds of financial and technical assistance to the banks during the period of execution and conclusion of the transfer or merger:

Saving Deposits Insurance Fund Department executes its functions in three divisions:

- Banks Liquidation Division
- Fund Accounting Division
- Fund Legal Division

FOREIGN EXCHANGE OPERATIONS

- <u>Foreign Exchange-Banknotes Operations</u>
  They consist of purchase and selling all kinds of foreign exchange and banknotes pursuant to the Law on the Protection of the Value of the Turkish Currency: transaction related to buying and selling in the foreign exchange and banknotes markets within the Money Markets and Treasury Department, and the transactions related to foreign change remittances for public sector and invisible transactions.
- <u>Imports Transactions</u>
- They include the transactions related to imports made by general and annexed budget public institutions depending on their request, and the controls of import licenses related to imports transactions realized by banks. The control in question involves in admonishing of the banks in case the licenses are delivered against the regulations.

- Exports Transactions
  They involve in the payment and collection of exports proceeds and premiums.
- The Transactions related to Promotion of Exports and Investments
- The Transactions of Workers' Remittances

They involve in maintaining the foreign exchange deposit accounts of the Turkish workers abroad and conducting transactions related thereto.

TURKISH LIRA OPERATIONS:

- Current Accounts and Remittances:
  They consist of transactions related to accounts belonging to government institutions, banks, finance institutions and funds, and to blocked accounts deposited in the Central Bank.
- Securities Operations:
  They involve in buying and selling government papers, and transactions of the dividend payments related to the Bank's shares.
- Rediscount Operations:
  They consist of the transactions related to acceptance of bills and documents held in banks' portfolio for rediscount in accordance with the Central Bank Law.

CASHIER'S OFFICE TRANSACTIONS:

They consist of all kinds of collection, payment and conversion in terms of Turkish Lira id foreign currency and realization domestic and international money transfers, as well the custody of all kinds of Turkish currency, foreign currency and other valuables.
The Central Bank of the Republic of Turkey has 21 branches in Turkey. They are in the following cities:
ADANA-ANKARA-ANTALYA-BURSA-DENiZLİ-DiYARBAKIR-EDiRNE-ERZURUM-ESKiŞEHiR-GAZiANTEP-ISKENDERUN-ISTANBUL-IZMiR-IZMIT-KAYSERi-KONYA-MALATYA-MERSiN-SAMSUN-TRABZON-VAN

The Bank may open representative and liaison offices abroad. The representative office follows and reports the economic developments, particularly the monetary, financial and inking activities of the countries in their areas. They represent the Bank abroad.

The representative and liaison offices of the Bank are as follows:
Frankfurt Representative Office - Berlin Liaison Office
London Representative Office
New York Representative Office
Tokyo Representative Office

Chapter

4 The Banking sector in European Union

The Banking Sector in European Union (EU):
Brief knowledge about European Union:

The Member States:

The European union (EU) is the result of a process of cooperation and integration, which began in 1951 between six countries (Belgium, Germany, France, Italy, Luxembourg, and the Netherlands). After nearly fifty years, with four waves of accessions (1973: Denmark, Ireland, and the United Kingdom; 1981: Greece; 1986: Spain and Portugal; 1995: Austria, Finland and Sweden), the EU today has fifteen member states and is preparing for its fifth enlargement, this time towards Eastern and Southern Europe.

Objectives:

The European Union's mission is to organize relations between the member states and between their peoples in a coherent manner and on the basis of solidarity.

The main objectives are:

- to promote economic and social progress (the single market was established in 1993; the single currency was launched in 1999);
- to assert the identity of the European Union on the international scene (through European humanitarian aid to non-EU countries, common foreign and security policy, action in international crises; common positions within international organizations);
- to introduce European citizenship (which does not replace national citizenship but complements it confers a number of civil and political rights on European citizens);
- to develop an area of freedom, security and justice(linked to the operation of the internal market and more particularly the freedom of movement of persons);
- to maintain and build on established EU law (all the legislation adopted by the European institutions, together with the founding treaties).

4.1.2 General structure of European Union Banking Sector:

Due to exist on various banks in European Union member countries, instead of bank, it's used the term of "credit institution". According to this; "credit institutions" can be defined as "institutions, which are to collect savings and other funds and to give credits to self account"

In Europe, traditionally banking is being carried out as based on two models: first one of these is Continent Europe Banking and other one is Anglo-Saxon banking.

The main features of Continent Europe Banking are:

- in addition to credit operations, they can give service in capital market transactions. Generally they give service to internal market and established by public banks; so the public banks have share in sector.

The main features of Anglo-Saxon banking activities are:

- completely are open to competition and made by private sector. Capital market transactions and partnership to industry are made by investment banks, which are, belong to this kind of banks.

From Rome agreement up to now, significant regulations have been realized to provide an economic integration among member countries. European banking system generally focused on some national regulations.(13) These regulations are as follow:

- **Single Banking License:**

Any credit institution, if it has permission to making banking transaction, it can give banking service in other European Member countries without getting permission.

- **Mutual recognition of national supervisory authorities:**

Any financial service, which is produced according to member countries' laws, can be supplied without living obligation in other countries and operations which are carried out by credit institutions can be supervised by that country's supervision authority.

- **Establishing Law:**

To be established and for operations, the minimum amount of capital should not be less than 5 million ECU.

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(13) The Inspection Committee of The Central Bank of Republic of Turkey, Seminar Works of Inspector, 1999, p: 238, 239

- **Mutual information announcement:**

If there is any increase in capitals of partners; it is given information to member countries about partnership.

- **Accounting and Supervisory System:**

Among members it will realize a regular accounting and supervisory system.

- **Standard Ratio:**

Between risky actives and equity capital, banks have to obligate to standard ratio.

Banks can be grouped into five headings: [14]

- **Universal Banks:**

They give banking service both own countries and in other countries; their numbers are very limited. Another particular properties of these kinds of banks, they get share from banking market which are occurring in own countries and also they are accepted themselves to other countries.

- **Partially Universal Banks:**

These banks give all kinds of banking services in own countries but they focused on only one or two products and / or services. Their numbers are quietly too many like *domestic banks*.

- **Specialized Banks:**

Both in its own countries and in abroad they focused on a couple of banking services such as - mortgage banks, immoveable credit institutions, residence credit institutions - etc.

- **Country Banks:**

They are banks that operate only their own countries; however in other member countries they operate in some profitability works for short term.

- **Domestic banks:**

They give banking service in an only certain region of a country by one or two branch office.

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(14) **The Inspection Committee of The Central Bank of Republic of Turkey, Seminar Works of Inspector, 1999, p: 240, 241**

When analyzed the all European Banking sector it will be seen that private sector has gained importance. However, public banks are still importance in some countries such as France, Spain, Portugal, Italy, and Greece. The reasons of this, plenty of specialized banks have been established by public.

Due to increasing competition most of the banks have chosen the concepts of merger and acquisition to cover their financial positions.
The following concepts have affected decisions of banks in mergers and acquisition:

- strong financial structure
- potential banking areas in other countries
- impacts of globalization
- increasing competition etc.

However, some banks collaborate in each other in a certain areas:

- changing of information
- entrance into market
- changing of product or service
- mutual usage of branch offices etc.

4.2 Analyses of Banking Sector of European Union Countries:

4.2.1 THE BANKING SECTOR IN ITALY

The Italian banking system consists of the Central Bank, Public Banks, National Interest Banks, Cooperative Banks, Saving Banks and Foreign Banks.

4.2.1.1 Central Bank *(Banca D'Italia)* :

It was established as a joint-stock company following the merge of three banknote export banks in 1983, and it obtained the right of being the sole issuer of the banknotes in 1926. With the banking law enforced in 1936 the Banca *D'Italia* was converted into public law institution. According to the public law even the central bank was established, it is not a centralized institution. The shares of the Central Bank do not belong to the State. The Credit Institutions, which are established according to public law, National banks, Social Security and Insurance Institution, are owner of these shares. (15)

However, the Central Bank is not totally independent from State as well. It has to obey the rules and directives of credit and saving comities. These directives are constituted according to advices of the Central Bank. The basic function of any Central Bank is to control the invested money to protect the balance of internal and external economy.

It realizes this function with some relations such as administrative credit system, treasury and foreign sector. Therefore, the Central Bank affects the demand which of the goods and services are produced in inside and outside and also the movement of foreign capital.

In modern societies, in parallel to new values the monetary policy also has developed. In spite of everything, the protection of the stability of money has been maintained by the Central Bank. In most countries including the Italy Central Banks are responsible for the control of credit system and structural intervention.(16)

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(15) Carlo A. Ciampi, "The Functions of the Central Bank in Today's Economy", Money and the Economy: Central Bankers' Views, Edited by Pierlugi Cioocca, Macmillan Press, London, 1989, p:82;

(16) Wietze Eizenga, "The Banca d'Italia and Monetary Policy", Monetary Policy and Financial Systems, SUERF Papers, No.15, Tilburg, 1993, p:9

The monetary policy in Italy aims to affect the conditions of market by short-term debt instruments of banks. The instruments that have been accepted by market - cash advance, open market transaction etc - are being used to accompany to the monetary policy.

The first duty of bank is to protect the value of Liret in external and internal markets. Also, to export the banknote, to organize the money and credit circulation, to supervise the financial and intermediaries and financial credits are the duties of Central Bank. The last purpose of Central Bank is provide the stability of money and economy.(17)

However, the Central Bank follows two ways in order to cover the needs of refinancing of banks.

The first way is constant forward advances. According to this application, which was started in 1967, given to the banks advances. The purpose is to cover the needs of short-term liquidity advances are given to the banks.

The second way is to provide the advances as rediscounts and bonds. This can be considered as an ordinary advance.

There are three features of refinancing applications in Italy. First of all, this kind of an application is not automatic. The Central Bank makes decisions by examining special conditions of banking markets. However, it has the right to reject or accept the applications, which are made, by the banks.

Second one is punished refinancing application. The purpose of this application, which started in 1969, is to curb requests of speculative refinancing. Actually, this system means that to punish the larger banks - punishments are applied by increasing the cost of refinancing - and the rates applied can be changed in time.

The third feature of refinancing applications is application of larger banks to the Central Bank.

Traditionally, the Italian Banks do not apply to the Central Bank for credit. Because of this reason, the punished refinancing of Central Bank is valid for a couple of banks. This is a restrictive condition that contributes to the rediscount policy.

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(17) Eizenga, 1993, p: 14; Banca d'Italia, The Bank of Italy Portrait of an Institution, Rome, 1991, p: 18

4.2.1.2 Public Banks:

The first capitals of public banks provided by private people, state or other concessions of public institutions.

To submit the public service is one of the duties of Central Bank. Generally, public banks have the same duties with private banks. Some of the duties of public banks are as follows:

- to purchasing and selling the governments bonds (or might be guaranteed by government)
- to giving loan
- to discounting the national and international credit instruments, the treasury bonds and transaction bonds
- to open saving and deposit account on liret or foreign currency
- to giving short or long term credit to the agriculture and industry

In this group there are six banks which become their capital belong to state directly or indirectly. Approximately, public banks hold %20 of deposit in their hands in Italy.

4.2.1.3 National Banks:

Public banks were established with approval of president and the working regulations have been approved by treasury office.

Public banks do most of the transactions as well. But, generally they do not give credit to the industry and also limited strive with agricultural credit. National banks have to organize at least in 30 cities. This future is a distinctive point through other banks.

The large portion of capital shares of the banks [18] which take place in this group belong to IRI which becomes a state holding.[19]

There are 9 banks, which constitute the public and national banks. These 9 banks are the biggest banks of Italy.

The other commercial banks apart from these 9 big banks are mostly belong to private and they operate as domestic banks. Some of these banks are *Banca Nazionalle del l'Agricolture, Banca Toscana, Credito Romagnolo, Banco Larino and Credito Commerciale.*

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(18) Banco di Roma, Banca Commerciale Italiana and Credito Italiano
(19) The Italian Banking System p: 47-53; Akgüç, 1982 p: 83

4.2.1.4 Cooperative Banks:

There are approximately 160 cooperative banks in Italy. These are generally located domestically but some of them operate in other regions. Cooperative banks belong to small business and farmers. The deposits, which are provided by their members and the sources, which are provided by nonmembers, are most of time allocated to the members again as middle and long-term credit. [20]

4.2.1.5 Saving Banks:

Saving banks (*Casse di Risparmio*) in Italy are privileged banks. The purposes of saving banks are to improve the saving formations and to find out the appropriate usage areas for savings. Saving banks are established by either a person or a group of companies and managed with the banking laws.

The saving banks, which are established for social purposes provide the portion of their deposits through farmers. These sources invested to projects and given back to the farmers as loan or it's used for public services. The difference of this type of banks from other banks is all banking activities are able to made in these banks.

4.2.1.6 Specialized Banks:

Specialized Banks contain the financial institutions, which are authorized to give middle and long-term credit, and also they are organized from autonomous department of public banks. The sources of specialized banks are capital stock, specialized founds which are provided government and especially bounds which are issued by banks. [21]

The credits, which are given by specialized banks, are divided into two groups. First one is special credit and second one is subsidized credit. Special credits are used for definite economic sectors. The interest rates of these kinds of credits are lower than other one. Specialized credits are given to certain firms, which have the need of sources.

4.2.1.7 Foreign Banks:

Foreign banks in Italy, generally they provide financial resources to big industrial institutions and subsidiaries of foreign firms, which are, operate in Italy. [22]

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(20) Tuncay Artun, Banking and Monetary Problems in EEC, Finance Ministry Press, Ankara 1981 p:72

(21) Akgüç, 1982 p: 85

(22) Akgüç, 1982 p: 85

4.2.1.8 Monetary and Credit Policy:

Central Bank has two instruments to regulate the monetary and credit market. The first one is to refinancing and the second one is to investing the assets of bank to the public promissory notes, which are in determined rates by the central bank. Refinancing transactions are set as an autonomy that's ordinary intervention instruments of central bank. The other one contains authority principle and enforced by supervisory decisions and also arranged for public necessaries. In 1980's some agreements have been organized which become related with back purchasing of public bonds. By these agreements it's provided that the intervention to the bond markets in order to arrange the liquidity of economics of Central Bank. Due to the flexible periods and yield, these agreements have brought big facilities in supervising of short-term liquidity also in providing and drawing of liquidity.

In this way instead of banks the central banks have tended to the bound market.

This application, as it used cautionary purposed also it can be used for monetary and credit purposes.

According to application, which becomes up to now the Central Bank has financed the publics in three ways:

Between 1975-1981 the Central Bank had to purchase the unsold promissory notes in markets. In 1981 this obligation had been cancelled. However, the Central Bank has purchased the public promissory notes voluntarily.

The second way of financed the public of the Central Bank is current account credit facility. The upper limit of this; is %14 of total public expenditures. When exceeded this limit either should be reduced the allowed limit or be applied extraordinary advance way that, it's the third way. The extraordinary advances are applications, which are needed official a separate agreement. The time and the quantity of intervention to the foreign currency market are determined by the Central Bank. This means that; the Central Bank is main body, which is intervening the exchange rates determined by government.

There is another institution beside of the Central Bank in applications of monetary and credit transactions: The Italian Foreign Exchange Institution (*Ufficio Italiano dei Cambi*). This institution was established in 1947 and it's different as status through the Central Bank in making decision and application of these decisions. And also it's interested in regulation of banking system and manages the foreign currency resources of country the power and authority for intervention to the banking sector is belong to Monetary and Credit Committee.

This committee is organized by Saving and Credit Committees, Treasury Minister and the Central Bank. The duties of this committee are to provide the credit organization and determine the supervisory conditions. The Central Bank helps to the committee in regulations of banks. (23)

4.2.2 THE BANKING SECTOR IN FRANCE:

The Banking system in France contains various and plenty of finance institutions. The banking systems in France can be grouped as following:

4.2.2.1 Central Bank (Banque de France):

Central Bank of France was established and nationalized in 1945. The Central Bank has authorized to coin money like other classical Central Banks and some of the responsibilities of its can be expressed as following:

- to contribute the monetary policies which determined by government in order to improved and carried out.
- to make arrangements in order to control the liquidity conditions of banks
- to provide the principles and policies which related with the usage of funds which collected in banking system
- to determine obligated ratios and the rates of rediscount limits

It's necessary not to accept the authorities, which are mentioned above exactly. Because the body of current law did not give the right to making decision power and dependency to the Central Bank in France.

The Central Bank operates according to general economic policy, which is determined by government and also it contributes in preparing of policies and applications.

There is no specific determined duties of the Central Bank however the duties of its generally, is to protect the monetary and credit system. (24)

The Central Bank is the bank of government. They put limits to prevent the exceed debts of public. These limits are put at the end of consensus of the president of the Central Bank and Finance Minister but in order to be put into effect it's necessary to get approve of parliament.

(23) The Italian Banking System, p: 13-14

(24) Wietze Eizenga, "The Banque de France and Monetary Policy". Monetary Policy and Financial Systems, SUERF Papers, no.8, Tilburg, 1990 p: 2-5

4.2.2.2 Commercial Banks:

These banks are also called, as "Recorded Banks" and the numbers of commercial banks are over 400. These banks are divided into 3 groups:

4.2.2.2.1 Banks of deposit:

The banks, which are enter into this group as follow:

- the big banks which have plenty of branch offices
- the bank which administrative center located in Paris
- domestic and regional banks
- foreign banks

The banks, which become the 3 biggest banks -Credit Lyonnais, Banque National De Paris and Societe Generale-of France - take place in this group.

When the domestic banks were examined, there will be seen that both their importance and numbers decrease.

The small domestic banks either they are winding up or joining into larger bank. As for foreign banks although their development are rapidly the importance in credit market are less.

4.2.2.2.2 Business Banks *(Banques d'affaire):*

Business Banks are banks, which have relations with industry and provide advisory service to the established or being established enterprises. Until 1966 they were collecting longer term than 2 years deposit. But after 1966 by made regulations they have started to collect the shorter-term deposits. Business bank resemble to banks of deposit. While the participation of deposit banks were hold up in narrow framework the broad possibilities have been enabled to the business bank about participation.

4.2.2.2.3 Short and Long Term Credit Banks:

Short and long term Credit Banks are banks which have no special status and generally they give middle term credits (at least 2 years). They cannot accept deposits less than 2 years without getting permission through banking regulation commission.

The significant portions of their resources are provided through depended banks. About participation concept the limit that has to obey the banks of deposits are valid for these kinds of banks. The given loans are limited with their capitals. (25)

(25) Akgüç. 1982 p: 44-45; Artun. 1981, p: 36-37

4.2.2.3 Specialized Banks:
Specialized banks are official credit institutions, which are operated under state control, and they have special status. The purposes of these banks are to providing the middle and long-term credit to the private and public sector.
Some of these banks generally they give credit to the industry and the rests provide sources to the residence and ship industry. In beside of the specialized bank, which is provide credits for the institutions of public industry, there exist on some specialized banks, which are operated in financing of import and export. The sources of specialized banks are as follows:

- Bonds
- Official Deposits
- Collected Deposits
- Various founds which provided by government and
- Insurance Credits [26]

4.2.2.4 Cooperative Banks :
The banks, which are take place in this group, have cooperative characteristic and regulated by state but they are out of banking law concept. In addition to these, cooperative banks are credit institutions, which have special status, as it was happen in specialized banks. *(etablissements de credit 'a status legal special)*
These cooperatives give banking service either by using commercial banks, which connected into their own groups or directly. The members of cooperative banks are companies, which strive with agricultural activity and located in rural society. They provide that:

- operating credits for short term
- equipment credits for middle term

At the same time in order to be financed the fixed establishment in long term they also provide credit. Some of the cooperative banks also provide production and consumption credit for other sectors. However some credit for residence cooperatives are provided by these kinds of banks in middle and long term periods.
The sources of cooperative banks are provided through opened advances, the export of bonds and saving bonds, capital stock (or equity of company). In addition to banking establishment in France, there are some financial institutions *(e'tablissement finaciers)*, which are make leasing and factoring transactions. All of the institutions have realized their activities under banking laws.

(26) Artun, 1981, p: 41

…5 Monetary and Credit Policy:

The monetary policy in France not only aimed to control the money stock in economy at the same time it controls that how to allocate the sources in sector. The monetary and credit policy, which is put into force in France has interventionist feature. This feature reverberates to the usage of monetary policy instruments. The legal equivalencies rather applied strikingly. Although taken all provisions, if monetary inventory and/or bank credits exceed the aims banks are liable in constituting the legal equivalence. The indirect limitations on bank credit, which is determine the rate of credit increase for each bank, were abolished at the end of the 1986. Keeping the certain ratio of short-term obligation of banks provides *the efficiency of intervention of central bank to the* monetary market. This means that banks held up certain proportion of their money as Frank. This money can be accepted as reserve for the Central Bank.

The interventionist side of monetary and credit policy reverberates to the rediscount policy as well.

Since 1974, instead of providing finance with rediscount credits the central bank prefer to direct interventions in order to provide source to the banking system. When the place of interest rates examined in monetary policy following information can be given:

The applications of arrangements of interest rates with administrative decision were abolished in 1966. However, the efficiency of public is still important on interest rates. The applications of arrangement of interest rates, the interest rates that applied by central banks both affect their cost of finance and also inter banks interest rates.

The policies results', which are applied in the banking system in French and the institutions, which are supervise the banks in the system, are as below:

- The council of National Credit (*Conceil National de Cre'dit*) was established in 1945. The commission joins into agreed upon monetary policy and as an information office (or advisor) of government and also central bank.
- The commission of banking follows the harmonies to the regulations of credit institutions. And the committee of banking has some authorities, which are about administrative measure.
- The authorities of the committee of banking (*Comite' de la R'eglementation Bancaire)* contain to entitle the banks for banking transactions, to provide minimal financial solvency and to determine ratios of liquidity etc.

The president of the committee is the minister of finance: The president of the Central Bank takes place in committee as a vice president.
Committee determines the purposes and rules of credit policy. The central bank and committee of banking are most significant monetary institution of France.

4.2.2 THE BANKING SYSTEM IN GERMANY:

In German banking system, approximately operate over 4800 banks. These banks take place in 2 groups. In each group public and private sector banks operate together.

4.2.2.1 Central Bank:

After Second World War it was established with 2-tier system, which has federative structure in Germany. First one is state Central Banks *(Land Central Bank)*. Second one is German state bank *(Deutsche Bundesbank)*. These 2 banks have been protected until 1957. In this date the banks, which are mentioned above have joined and took its place in nowadays.

According to regulations of central bank, the purposes of bank are to protect the national money and to arrange the amount of money in order to pay the external and internal dept. To protect the stability in country is main purpose of bank, at the same time to monitor the stability of external value of money is the second purpose of bank. (27)

Generally the activities of the Central Bank are as follow:

- to regulate the money stock
- to provide the credit to economy etc.

As related with this subject, the instruments and policies, which are applied by Central Bank:

- Rediscount policies
- Advance policies (Lombard Policy)
- Open market transaction
- Minimum reserve policy
- Foreign exchange policy

4.2.2.2 Universal Banks:

The first group of German banking system is universal banks. Typical feature of German banking system is dominant role of universal banks. In principle, these kinds of banks give full range of banking services. Universal banks divided into 3 sub groups:

(27) Deutsche Bundesbank, the Monetary Policy of the Bundesbank, March 1994, p: 12

4.2.1.2.1 Private Commercial Banks

Approximately the number of private commercial banks is 330. Generally, they provide short-term credits. However, middle and long-term credits can be provided by private commercial banks.

Private commercial banks contain big branch banks, domestic and regional other commercial banks, private bankers and foreign bank branch offices. In total banking area, 18% of total assets belong to *Deutsche Bank, Dresdner Bank and Commerzbank* which known as 3 big and also 60% of external trade payments managed by these the 3 biggest banks. (28)

4.2.1.2.2 Public Banks:

They are also named " the banks which are established by banking law". At first, the deposits (or) savings, which are collected from public, were given as credit. But later all kind of banking transactions are started to made by Public Banks.

Public banks have established a clearing system with their center institution for cash less payment. The center institutions of public banks operate as municipality bank or federal state banker and their guarantors are domestic management. Their shares in banking activities are 21%. In financing of big projects, they can compete with commercial banks.

4.2.1.2.3 Cooperative Banks:

Among the universal banks the third sub group is cooperative banks. They contain agricultural commercial credit cooperatives and cooperative center institutions. Some of the cooperative banks are small as much as not enter into statistics of central bank. Cooperative banks are formed with the "help through self help" principle. The collected deposits are allocated to their member as short and middle term credit.

However, today every kinds of banking transactions are being presented by cooperative banks. (29)

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(28) The Banking system in Germany p: 4-17
(29) The Banking system in Germany p: 31

4.2.3.3 Specialized Banks:

German banking system is a universal system. Although this, specialized banks take important place in this system. Specialized bank groups formed through private and public banks. Main specialized banks are as follow:

- **Private Mortgage Banks:** They provide credits for agricultural and industrial projects. These kinds of credits for long term. However, they also provide credit to government, state and municipalities.
- **Public Mortgage Banks:** They provide real estate loan and also provide credit for public authorities.
- **The banks which financed the installment sales:** They are private banks. They specialized in financing on middle term capital investments and indirect consumption credits.
- **Residence Credit Communities:** They provide credit in order to acquire residence in constant interest rate according to the collective deposit principle. In order to be utilized through this kind of credit, firstly explicit amount of saving should be invested to the bank. Credit is given later.
- **Bail Banks:** In small or middle level business, which are operate in trade and industry when they are faced with financial problems, they can withdraw credit easily by getting help through bail banks.
- **Post Endorsement and Saving Offices:** These institutions held up check currencies of their customers for payments and they operate in transfers of saving deposits.
- **Banks with special function:** In this group, both there are public and private banks. Generally they specialized on external trade, small business, and residence construction.

4.2.3.4 Monetary and Credit Policy:

The institution, which is related with monetary and credit policy is Federal Central Bank. The possibilities, which exist on the central bank, has already mentioned above. The central bank by using these possibilities, it plays efficient role where in determining the liquidity level of banking system.

Especially, due to developed economic structure and banking system, the determination of bank credits and also allocation of these credits are being made easily.

In bewaring of foreign exchange and national monetary value, central bank plays significant role and aimed that to maintain its role in the economic stability framework.

In 1967, by discharging of interest rates the importance of monetary policy instruments of the central bank has more increase. The discharged interest rates caused that the increasing of inter bank

competition and expansion of presented service where is saving and investment areas.
There are some conditions, which are affect, the German monetary and credit policy. These can be expressed as follows;

- There is no deficit on external payment balance
- The less level of the necessities of internal public debt
- Organized finance centers (*Frankfurt, Stuttgart, Munich, Berlin, Hamburg, Hannover)*

The couple of conditions, which were mentioned above decreased the pressure of monetary and credit policy. In this situation the monetary and credit policy instruments are able to use more efficiently.

4.2.4 THE BANKING SYSTEM IN HOLLAND:

The banking system in Holland contain that the Central Bank, commercial banks, agricultural and credit banks, saving banks and specialized banks.

4.2.4.1 Central Bank (De Nederlandsche Bank)

The main monetary authority institution in Holland is the Central Bank. It was established in 1814. It was converted into a public limited company in 1863 by a prepared law.
By the Central Bank law in 1948 and also regulation that made later, beside of management of florin in Holland, the management of foreign exchange and gold have been given to the Central Bank. The capital of Central Bank belongs to public. (30)
Some of the authorities of Central Bank:

- to allow the merger among banks
- to determining the liquidity and financial solidity
- to determine the credit limitations
- to maintain the financial structure
- by maintaining the competition power, to allow the capital contribution of banks…etc.

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(30) De Nederlandsche Bank NV, Guardian of the Currency -The Nederlandsche Bank's Duties and Operations 1991, p: 5-8

4.2.4.2 Commercial Banks:

They are responsible for leasing and factoring transaction, short and middle term credit. And also they provide credit with lower interest rate to the small business by guaranty of government.

Some of the sources of banks are current account and time deposit balances. Banks develop and various deposit plans in order to withdrawn of their savings. The numbers of commercial banks are approximately 170. And the share of Holland Commercial bank is 9% in European union commercial banks.

Among commercial banks two big banks that are - *Algemene Bank Nederland (ABN) and Amsterdam-Rotterdam Bank (AMRO)* – play important role in credit market. These two banks take place in the biggest banks in the world group. The basic difference between these two banks in geographical distribution. AMRO generally focused on financial markets of Holland and it has overseas activity with foreign banks. However, on the other hand ABN in besides of activities in Holland, they have branch offices in other countries.

4.2.4.3 Agriculture Credit Banks:

Agriculture credit banks were established as cooperatives. And they have centered in two separate grouped: [*Eindhoven and Utrecht*]. In 1972 they have joint, so it was called as *Rabobank Nederland. (also known as "Cooperative Centrale Raiffeissen-Boeranbank")*

The members of agriculture credit banks are farmers and craftsmen and these members have run these banks. The sources are provided through their members and allocated back as credit again. With this its feature can be separated from commercial banks.

4.2.4.4 Saving Banks:

It was established in order to run the small deposits, and they are banks, which have social characters. Their duties are to provide the mutual helping system among small deposit (or saving) owners, and also to protect these small deposit owners against the risk, which is might be in banking system, so security is on first plan for saving banks.

4.2.4.5 Specialized Banks:

Specialized banks are credit institutions, which become specialist in certain areas. Some of these institutions, they give credits to small scaled municipalities by collecting funds through some capital market. In addition to these, they also provide middle and long-term credit to firms those have financial problems.

Other specialist banking activities are:

- to financing the installment selling
- to provide residence credits
- to make insurance the trade and politic risks
- to make leasing transactions

4.2.4.5. Monetary and Credit Policy:

The monetary and credit policy, which is followed in Holland, has been set up on an open to out world economic structure.

The Central Bank of Holland carries out this policy and its purpose due to the excess liquidity is to prevent the economic stagnation. In regarding this aim, the detailed liquidity and financial solidity rates have been determined for banks. In addition to these, for deposit accounts that is kept on abroad of banks when its necessary special rates have been applied. And also, the control of foreign exchange is significant for the central bank. The policies of monetary and foreign exchange are carried out by the Central bank. Central banking law determined the principles of monetary policy in 1948.

According to this, the regulation of money's value and protection the stability of economy has been given to central bank as duty. However, in order to protect the external value of national money (especially against Deutsche mark) the interest rates are kept in same ratio by Germany.

Because of this reason, the interest rates in Holland are affected through the interest rate in Germany directly. (31) Official interest rates are base of monetary policy money market. Official interest rates are used to determine the policies, which will be followed, and to adjust the internal-external economic changes. So, it contains a psychological mean. Official interest rates are basic indicator for financial investors, who are wishing to adjust their position according to changes in future. (32)

The credits, which will be given by banks, have been restricted by the certain multiple of their capital stock. In broad meaning the Central Bank gives importance to monetary stock and the determination of aims, which become related with liquidity and national income.

The interest rates are generally determined according to market's conditions. However, the interest rates, which will be applied to some accounts, depend upon the agreement, which is made between banks.

The applied interest rates by the Central Bank to credits which given to banks also effect the market interest rates. Deposit or saving interests are determined by the competition which occur in inter banks.

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(31) Emile den Dunnen and Sierd de Wilde, Instruments of Money and Foreign Exchange Market Policy in the Netherlands, Nederlands Instituut voor het Bank- en Effectenbedrijf, Third, Revised Edition, Amsterdam, 1992 p: 11-13

(32) Dunnen and Wilde, p.33-34

4.2.5 THE BANKING SYSTEM IN BELGIUM

The banking system in Belgium can be examined under three sub headings. First group is monetary and financial authorities. Second group is coordination and guaranty institutions and lastly comes up the public and private sector banks.

4.2.5.1 Monetary and Financial Authorities:

The institutions that follow the banking system in Belgium take place in this group. These institutions have some authorities related with the banking sector.

4.2.5.1.1 The Central Bank:

Belgium Central Bank (*Banque Nationale de Belgiue*) was established in 1850. The half of capital of central Bank had been purchased by state in 1948. The Central Bank strives the control of the banking system in macroeconomic and conjectural framework.

The main duties and activities of bank can be expressed as follow:

- to determine the obligations of banks
- to determine the ratios of money equivalent for credits
- to put limitations for rediscount and current account advances
- to determine the ceilings of credits
- to orientating the interest rates

4.2.5.1.2 The Institution of Foreign Exchange of Belgium-Luxembourg:

Due to economic union between Luxembourg and Belgium (1922), the institution of foreign exchange of Belgium-Luxembourg (Institute *Belgo-Luxembourgois du Change*) was established in 1944. The duties of this institution are:

- to control of foreign exchange
- to apply the obligations related with regulations
- to regulate the national capital movements
- to regulate the national capital movements

These duties are valid for both two countries.

4.2.5.1.3 Annuities Found:

The third institution, which is taking place in monetary and financial authorities, is Annuities Found (*Fond des Rantes*). It's an autonomous institution and was established in 1945.

It provides source by borrowing from the Central Bank and also money market. Then these sources are invested into treasury bills and state bills and they make open market transactions.

4.2.5.1.4 Banking Commission:

The third institution, which is taking place among monetary and financial authorities, is banking commission (*Commision Bancaire*). It was established in 1935. The duties of Banking Commission are as following:

- to give the certificate of incorporation
- to determine the certain ratios between capital stock and obligations in order to be hold the power of paying debt in high level.

4.2.5.2 The Institution of Coordination and Guaranty:

It takes place in between the Central Bank and banks. These institutions and their activities are as following:

4.2.5.2.1 The Institution of Rediscount and Guaranty:

The Institution of Rediscount and Guaranty *(Institute de Reeskompte et de Garantie)* provides the private credit to the enterprises which in the area of industry and agriculture and trade and also provides the possibility in order to converted the receivables into cash. For this reason, which is mentioned above it was established in 1935 and operate for public utility.

4.2.5.2.2 The Association of Export Coordination:

The Association of Export Coordination (Credit Export) contains the Central Bank, Guaranty Institution, various credit institutions and private sector banks. It coordinates the middle and long-term finance of export. Discount limits and quotas provide the sources of association of export coordination.

4.2.5.2.3 The National Credit Board:

The National Credit Board was established as an insurance organization in order to cover the commercial and politics risks in 1939.
Especially, it plays a vital role on credit insurance related to the export capital goods. In addition to commercial and politics risks; it under takes the foreign exchange risks and the capital investment risks which are made into abroad.

4.2.5.3 Public Banks and Private Banks:

These banks can be examined under two groups. These groups are as follows:

4.2.5.3.1 Public Banks:

Also they can be named as public credit institutions as well. The most important of them are:

- National Deposit Banks:(*Caisse Generale d'Epargne et de Retraite)*. They provide source to industry and residence purchasing transactions. The institution takes place among the biggest deposit banks of the world. The aim of this institution is to collect the deposits of small saving owner.

- National Industrial Credit Institution:*(Societe Nationale de Credit a l'Industrie)*. The half of its capital belongs to state and it takes place in the 5 biggest bank of Belgium. After First World War, in order to be help to economic development program, it was established in 1919. It provides commercial and agricultural credit.

- Belgium Domestic Managements Institution: *(Credit Communal de Belgique*) It was established in order to provide the long-term credit to domestic managements in 1960. The sources are provided through deposits of domestic managements. These sources are used by bank in order to cover the various needs of domestic management.

4.2.5.3.2 Private Banks:

Before 1930, Commercial Banks had provided the sources to this kind of institutions in middle and long-term credit. And they were represented in board of directors of partnerships.
Societe Generale de Banque, Banque de Bruxelles Kredit Bank is some of these banks.
Generally they interested in mortgaged credit and government bonds.

4.2.5.4 Monetary and Credit Policy:

In carried out the monetary and credit policy, the main responsible institution is the Central Bank in Belgium. It determines the money equivalent in order to regulate the liquidity situation of banking system. Banks are able to get short-term advances by showing government bonds and treasury bills, which are, exist on their portfolios. However, the main way of providing sources of banks from the Central Bank is rediscount applicants.

Because of this reason the rediscount application of the Central Bank increased the importance of instruments, which are kept in their hands. The Central Bank might bring the limitations the credits, which are opened by banks in order to prevent the expansion of liquidity rapidly. The Central bank has the right to affect the interest rates and the cost of credit directly or indirectly. The interest rates, which are occurred in money market, have been affected from the rate of rediscount policy of Central Bank.

4.2.6 THE BANKING SYSTEM IN LUXEMBOURG:

When it examined the Luxembourg through financial framework, it can be said, "Luxembourg is a different country among the members of EU."
In formal meaning there is no Central Bank in Luxembourg. As we mentioned in previous section, between Belgium and Luxembourg it was created an economic union in 1922.
According to this union;

- Belgium frank is valid money in Luxembourg but it cannot be used as reserve.
- The export amount of Luxembourg frank has connected into the Belgium monetary stock
- Belgium Central Bank provides liquidity utility to the banks which become in Luxembourg
- Belgium Central Bank has the right to interference the foreign exchange market
- The institution of foreign exchange of Belgium-Luxembourg, if it is necessary it is responsible for management of foreign exchange.

4.2.6.1 Luxembourg Monetary Institution:

Luxembourg Monetary Institution (*Institut Mone'taire Luxembourgeois – IML*) was established in order to hold the official reserves and to export the banknote in 1983. According to establishing law IML has four basic goals:

- to coin the Luxembourg frank
- to develop the monetary stability
- to implement the obligations which originated international agreements in manage financial market and also to use the rights which are occurred at the end of these agreements
- to realize the regulation of financial sector

All banks and other institutions, which are operated in financial sector, have been supervised by IML in Luxembourg.

4.2.6.2 Public Banks:

There are two significant institutions in Luxembourg finance market. One of them is State Deposit Bank (*Banque et Caisse d'Epergne l'Etat – BCCE)* was established in 1856. It is not only a deposit bank; at the same time it contains all banking transactions.

Second one is National Credit and Investment Partnership (*Société Nationale de Crédit et d'Investissement- SNCI)* and it was established in 1977. It provides middle and long-term credit and helps to economic development of Luxembourg.

4.2.6.3 Commercial Banks:

In Luxembourg, banks play an important role in financial system.

In 1856 first two banks were established in Luxembourg. After this, Belgium and France banks have followed these two banks. Due to Luxembourg located in finance center, it was created appropriate conditions to the Euro market. At the end of these opportunities some of these banks enter into Luxembourg market. In 1970's, most of the German, American, Switzerland, Italian and Scandinavia banks are the banks, which evaluated these opportunities.

However, there is no restriction on foreign exchange transactions. So, all banking activities presented by commercial banks.

4.2.6.4 Clearing House:

Clearing House is a group, which established by international banks. International bond, securities, stock shares are managed by this institution. It was established on Luxembourg and it operates in around the world independently.

The collected bonds and moneys are stored in top rated correspondent banks. In clearinghouse an effective communication system has been established.

4.2.6.5 Monetary and Credit Policy:

In addition to Ministry of Finance, Luxembourg Monetary Institution plays effective role in managing of monetary and credit policy.

To improve the monetary stability and to regulate the other financial institution are some of the duties of this institution.

As we mentioned before, Belgium and Luxembourg frank have been used in Luxembourg. In order to be regulated of Belgium frank, the branch office of Belgium Central Bank operate in Luxembourg and all banks are member of Banks Association. (*Association des Banques et Banquires, Luxembourgeois - ABBL)*

4.2.7 THE BANKING SECTOR IN DENMARK:

The banking system in Denmark are divided into 3 groups:

- The Central Bank
- Commercial and Saving Banks
- Foreign Banks

4.2.7.1 Central Bank: (*Denmark National Bank*)

The central Bank of Denmark was established in 1936. General responsibilities of the Central Bank in Denmark are to controlling the monetary system and to regulate the lending activities. (33)

The Central Bank uses the classical monetary policy instruments in carry out these duties. It can be said that the Central Bank has same authority with other Western Europe Central Banks. But there are some differentiations in applications. Denmark Central Bank does not accept the commercial promissory notes into rediscount. Most of the banks in Denmark give open credit. Because of this reason the number of rediscount application is little. Instead of rediscount credits direct credit are given to banks by Central Bank.

4.2.7.2 Commercial and Deposit Banks:

By Commercial and Deposit Banks regulations, which became valid in 1974, Commercial and Deposit banks started to make transaction in some areas. Approximately 110 banks take place in this group. The share of total asset in EU commercial banks is 2 %. The banks, which take place in this group, are able to present various kind of banking services. Some of these:

- to open deposit and credit account
- to make foreign exchange transaction
- to make bond transaction
- to make financial advisor etc.

After regulation in 1978 it was allowed to open branch office in abroad. The banks in Denmark provide credit to commercial and industry sector. However, banks provide some credits for consumers.

4.2.7.3 Foreign Banks:

Since 1975, foreign banks have opened their branch offices in Denmark. If any country is not member of EU and would like to open a branch office in Denmark, this country should get permission through industry and commercial ministry.

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(33) Danish Banking System, Danish Bankers Association, Copenhagen, 1987-88, p: 16

Foreign banks and Domestic Bank operate in same conditions; Commercial Ministry determines the working conditions of foreign banks. As it was mentioned before, banking system divided into 3 groups in Denmark. At the same time in addition to this kind of banks there are mortgage institutions. These are financial institutions and they provide credit to residence commercial and industry sector.

4.2.7.4 Monetary and Credit Policy:
Monetary and Credit policy is determined and applied according to liquidity position of banks and economics. Some of the policies, which are applied in Denmark, as follow:

- to determine the legal rediscount ratio which effect the interest rate. The banks in Denmark, both their credit and deposit interests determine according to the Central Bank.
- to determine the credit ceilings for commercial and deposit banks: Credit limits are determined separately and as global for commercial and deposit banks
- to determine the rules of regulations in order to be get loan from the Central Bank. By regarding the liquidity conditions of the Central Bank provides credit to the Banks
- to sell of state bills and open market transactions

The mentioned policies have been applied according to economic conjuncture. The effects of monetary and credit policies on banking system are monitored by the Central Bank.

4.2.8 THE BANKING SECTOR IN ENGLAND:
The Banking sector in England can be analyzed as follow:

4.2.8.1 The Central Bank *(The Bank of England)*:
Banking systems in all countries of the world have a central bank, which plays a part in controlling the other banks. In the United Kingdom this Central Bank is the Bank of England.
The basic functions of the Central Bank are:

- to act as a bank for other banks and financial institutions, providing deposit and loan facilities. (Because the central bank lends, directly or indirectly, to other banks when they are short of money it is commonly referred to as the lender of last resort')
- to act as a bank for the government providing deposit and loan facilities and often offering advice on government financing and economic affairs;
- to help to implement government monetary policy, in particular by influencing interest rates

- to represent the country in international meetings of central banks to discuss such areas as banking supervision.

These functions would normally be carried out to some extent by all central banks. In addition the Bank of England, in common with many other central banks has responsibility for:

- issuing notes and coins (although some Scottish banks also issue their own notes)
- operating the Exchange Equalization Account, looking after the country's reserves of gold and foreign currency to help to make sure that the value of the pound remains fairly stable in relation to the currencies of other countries
- advising the government about raising money through issues of government stock or the sale of nationalized industries (though other banks in the private sector have also been involved in the programme of denationalization)
- operating a deposit protection scheme (the scheme set up under the 1979 Banking Act and amended by the 1987 Act);
- supervising the whole banking system by deciding which institutions can be banks, and by collecting statistical information from them at regular intervals in order to anticipate any likely problems.

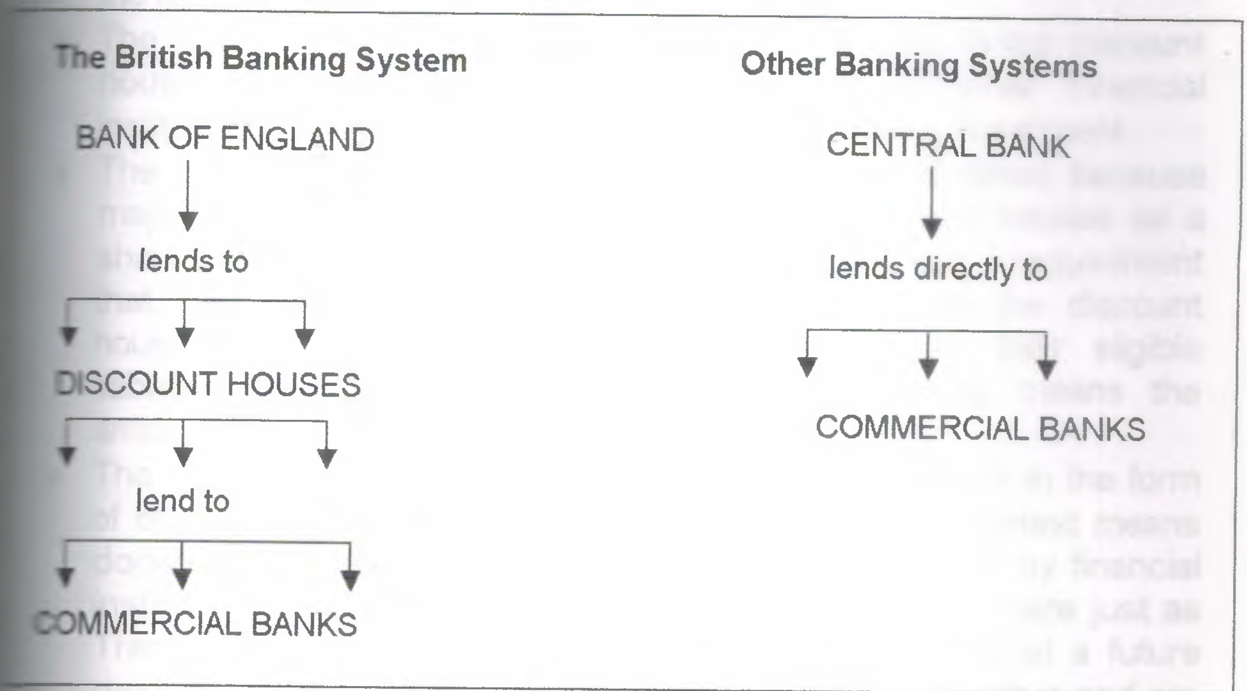
The Bank of England, although owned by the government, does operate on a commercial basis. In 1985 it made a profit of £106 million, but since it does not have private shareholders any dividend paid out goes to the government. For 1985 this amounted to almost £ 40 million, a record level. Although the Bank of England does have some private customers these are few in number and the Bank does not compete for deposits with the other banks, or try to gain new customers, and its profits therefore arise largely from its dealings with other financial institutions.

4.2.8.2 Discount Houses:

The discount houses are a unique feature of the British banking system. For many years their e has been as a kind of buffer between the Bank England and the commercial banks. Other banking items do not have a separate tier of institutions between the central bank and commercial banks, which want to borrow from it.

When the banking system becomes short of money, for example because the government sells shares in a nationalized company and the money from buyers' bank accounts goes to the government, the banks not approach the Bank of England directly to obtain loans.

In many countries central banks do lend directly to other banks (as illustrated in the diagram below), usually requiring fairly formal and well-documented loan applications. In the United Kingdom the Bank of England has been willing to lend lo the discount houses with very little formality. As there have been only about a dozen discount houses the people involved have had close personal contact with the Bank of England officials, so formal procedures have not been as important as they would be for a system permitting any of the hundreds of commercial banks lo borrow. The discount houses in return for the privilege of being allowed direct access to the Bank of England have undertaken to provide short-term Finance to the government when required.
The difference between bank of England and other central banks can be seen in **table-5.**
The special status of the discount houses means that although they are recognized as banks they do not need to use the name bank. Traditionally they were independent companies, and the Bank of England seemed opposed to the idea of any of them being taken over but the number of discount houses had declined as a result of a series of mergers to 13 in 1980 and the number has continued to fall. Outside takeovers seemed an acceptable way of preventing too much control ending up in too few hands. Agreements were therefore reached to enable larger organizations to own discount houses and by 1985 3 out of only 9 left were in the hands of larger financial institutions.



4.2.8.2 Table-5: Difference between the British and other Banking System

How The Discount Houses Provide Funds To The Government?

The government's main sources of income are taxation and borrowing. Most government borrowing is in the form of issues of government stocks, which are in effect loans over a number of years. It is also important for the government to have access to shorter-term borrowing to enable normal expenditure to be maintained while waiting for major loans or tax payments to be received.

It is in providing this shorter term Finance that the discount houses have a role to play.

The following summary outlines the key points to note about the procedure by which the discount houses provide funds for the government.

- The Bank of England offers for sale Treasury Bills - these are documents which the government promises to pay, usually in 91 days (basically 3 months) - and the money from selling the Bills goes to the government to meet its short term Financial needs, rather like an overdraft taken by a personal customer of a bank.
- The discount houses put in a bid for the Treasury Bills - this is an offer to buy at below face value (or at a 'discount') and the discount or difference between the face value and the bid is the equivalent of three months interest on the amount involved. Because the discount houses undertake to bid for any Treasury Bills that are offered for sale the Bank of England is certain of being able to raise the money it needs.
- The Bank of England sells some or all of the Bills to the discount houses, which then re-sell some to banks or other Financial institutions, which want to hold them as a short-term investment.
- The discount houses have money available at all times because major banks normally keep money with the discount houses as a short-term, highly liquid investment. Until 1986 it was a requirement that 'eligible' banks kept some of their funds with the discount houses, an amount based on a percentage of their eligible liabilities, a technical term which roughly speaking means the amount of money deposited by customers.
- The discount houses also have liquid funds of their own in the form of other 'paper', which they can sell. 'Paper' in this context means documents issued by companies, by local authorities or by financial institutions which promise to pay the bearer at a future date just as Treasury Bills are promises by the government to pay at a future date. All of these items pay interest in one form or another and are readily saleable because institutions with spare cash would rather earn some interest than none.

- The sale of Treasury Bills takes place each week and some of the money raised is used, in effect, to pay back the holders of the Bills issued 91 days earlier. If the government needs extra money a larger value of Bills will be sold but if the government has enough other money available then a smaller issue of Bills will be sold than *at the corresponding 'auction' 91 days earlier.* (34)

The special status of the discount houses has been threatened to some extent by the changes in the Stock Market following the de-regulation in October 1986 (the so-called 'Big Bang') because the government's methods of raising money have been affected. The procedure is intended to bring in more competition than before and although the Stock Market does not deal in such short-term government borrowing as the 91 day Treasury Bills short-term government stock, known also as short-dated gilts (similar in effect to Treasury Bills but dated at anything from one to Five years) may be an alternative source of funds.

4.2.3.3 Commercial Banks:

The UK is unique, in the sense that commercial banks are classified. They are classified as, "Retail Banks, British merchant banks, discount houses, other British banks and overseas banks. Hall explains their functions as follows, "the retail banks group comprises those intermediaries which have extensive branch networks in the UK and participate in a UK clearing system. Formally the group comprises; the London and Scottish clearing banks; the Northern Ireland Banks; the National Girobank; the co-operative bank; the Yorkshire bank; and the banking department of the Bank of England.

British merchant banks broadly comprise banks whose majority ownership is British and whose main business is primarily concerned with corporate finance and mergers. Discount houses comprise those institutions authorized under the Banking Act 1987 which have a money-market dealing relationship with the Bank of England.

(34) **Banking Operations, Michael Anderson, 1996, p: 12**

4.2.3.4 Accepting Houses:

They are banks, which 'accept' or put their names to bills of exchange as a special way of providing finance to companies, particularly those involved in foreign trade where bills of exchange are still widely used.

At the end of 1985 the members of the Accepting Houses Committee were:

Baring Brothers & Co Ltd;
Brown Shipley & Co Ltd;
Charter Japhet plc;
Robert Fleming & Co Ltd,
Guinness Mahon & Co Lid;
Hambros Bank Ltd;
Hill Samuel & Co Ltd:
Kleinwort Benson Ltd:
Lazard Brothers & Co Ltd;
Samuel Montagu & Co Ltd;
Morgan Grenfell & Co Ltd; ;
Rea Brothers plc;
N M Rothschild & Sons Ltd;
J Henry Schroder Wagg & Co Ltd;
Singer & Friedlander Ltd;
S G Warburg & Co Ltd.

4.2.3.5 Foreign Banks

Generally the term foreign bank refers to banks which operate in the United Kingdom but which are controlled from a head office in a foreign country.

This is certainly the case, for example, with Citibank, part of the Citicorp group based in the United States, even though, as we have seen, this does not exclude Citibank from being in one sense a United Kingdom clearer.

Within the broad category of foreign banks it is possible lo distinguish between different forms of representation.

- Some foreign banks have branch networks in the United Kingdom to meet the needs of local communities here. These include the two Irish banks already identified as Northern Ireland clearers. In addition there are branch networks of some of the banks from India and Pakistan. Example: Bank of Baroda.
- More commonly representation of a foreign bank is in the form of a single branch or office intended to provide a service for business customers coming to the United Kingdom. Very often such offices do not provide a full range of banking services. Example: Bulgarian Foreign Trade Bank.

- Other foreign banks come to London for reasons specifically associated with London's role as an international banking center, the major market outside the United Slates for borrowing and lending dollars and the major market in the world for buying and selling foreign currency. Example: Security Pacific National Bank (which has had a branch in London since 1969 but now has a range of financial interests in London including securities dealing and factoring).
- Where a foreign bank does not have the resources to allocate to setting up a full branch or office it may be possible to join with other banks in a consortium. Example: Credito Romagnolo (as a member of the ItaB Group).

Foreign banks have become of enormous importance in the British banking system because of their presence here in such large numbers, more than in any other international banking center, and because of their involvement on a large scale in international lending carried out through London. They have also gained a strong position as dealers in the financial markets in London; for example over half the primary dealers in the important market for UK government stocks are foreign owned.

4.2.8.6 Traditional English Clearing Banks:

The term clearing bank (often abbreviated to "clearer") refers to any bank, which is directly involved in a system for exchanging payments, a clearing system. Payments made between non-clearing banks or other financial institutions need to pass through a clearing bank, and this special influence within the banking system adds to the high status of the clearers.

The traditional clearing banks include the most well known names in United Kingdom Banking. In 1983 the National Consumer Council in its report tanking Services and the Consumer' described as traditional London clearing banks:

Barclays Bank plc;
Lloyds Bank plc;
Midland Bank plc;
National Westminster Bank plc.
Coutts and Co;
Williams and Glyns Bank plc.

The first four of these, the 'big four', have been the most widely represented banks in the high streets 'this country since small local banks joined together bigger and bigger groups, the last main changes taking place by the beginning of the 1970s. The "big four" are the largest United Kingdom banks in terms of capital and total asset. Of the other two listed Coutts &Co is a wholly owned subsidiary of National Westminster Bank, but has its own direct representation in the clearing house in London, and Williams and Glyns has merged with the Royal Bank of Scotland to form one bank operating throughout Great Britain. The domination of high street banking by the 'big four' arose because the mergers by which they were formed. The reorganization of National Westminster Bank provides an example of how the changes took place. In the other major banks similar developments occurred but National Westminster Bank probably ended up with the greatest duplication of branches because both National Provincial Bank and Westminster Bank had very extensive branch networks at the time of the merger in 1970.

4.2.8.6 Monetary and Credit Policy:

In England, Monetary and Credit policy are determined by the Central Bank and Treasury office. As a difference from other EU member countries, the Bank of England is not independent from government. The banking system is supervised by the Bank of England under the powers given to it through the Banking Acts of 1979 and 1987. Ultimate control of the system therefore items from the government. Government policies "determine how the banking system is to operate, and the government has used a wide range of methods to influence the behavior of banks.

The main methods of control to be considered are:

- cash ratios
- special deposits
- directives
- control over interest rates

The methods are commonly described as the tools of monetary policy, policy designed to control the amount of money in the country.

The Aims Of Government:

The government attempts to control the banking system for a variety of reasons. The relative importance of these reasons depends on the particular views and beliefs of the government in office, but rowing aims would be seen as significant by governments of most political persuasions.

- **to encourage economic growth and higher employment**

Banks, by their lending to growing businesses, play a major part in promoting growth, which, in turn, is expected to create restricted, for example because of high interest rates, or might be in the wrong sectors of the economy from the government's point of view.

- **to reduce inflation**

Banks create money by their lending and if this process is not limited, either by government or by the banks themselves, the total amount of money rises faster than the volume of goods and services produced. Prices then rise. Although governments have great difficulty in measuring the amount of money in the economy (the money supply) it is generally accepted that ending inflation depends on preventing the money supply from rising faster than the output of goods and services.

- **to maintain confidence in banks**

If depositors do not believe that the banks are able to meet requests for repayment they may try to withdraw their money, as happened in the 1973-74 fringe-banking crisis. It is important to appreciate that since the total amount of cash in the country is far less than the deposits of the major banks the system depends entirely on confidence.

These broad aims are met by a range of government policies some of which have little direct impact on banks or the banking system. Government policy on taxation (fiscal policy) or on specific schemes for helping particular industries or businesses in special areas may have some effect on banks and the lending they are able to do, but the main way in which banks are affected by government is through monetary policy, based on measuring and controlling the money supply.

The main difference between the measures of the money supply is that they include different financial assets, so the overall total of one aggregate may rise faster than the total for another. (The definitions given are an indication of the assets included under different headings during 1987 but are not the full technical definitions). Governments have used different aggregates as targets at different times, often choosing those which seemed easiest to control, and have also altered the definitions of aggregates from time to time.

Banking Regulation and Supervision in the United Kingdom:

All through the years, banks have traditionally attracted significant public regulation, mainly because of important role they have to play in society. Moreover, the survival of financial institutions, particularly of banks, is influenced greatly by the confidence of the public in the soundness of their operations.

Thus, the social consequences of large and wide-spread banking failures are generally viewed sufficient justification for some form of supervision, or prudential regulation, of banking activities"(35)

In order to maintain confidence within the system, banks must ensure that they are always able to legitimate demands for funds by depositors and borrowers, and this obligation requires the banks adherence to appropriate standards of liquidity and capital adequacy.

Effective supervision should attempt to maintain these standards both formally and informally in order to enhance and preserve confidence within the banking system. This is particularly important in a system; that of the United Kingdom, which has strong international links. One of the primary objectives of an active system of supervision should be to minimize the social cost of intermediation consistent wit Meeting depositors. The supervisory system should also help to ensure that banks do not follow prudent policies to the extent that their operational stability, or solvency, is threatened. Excessive risk taking by banks and undue risk aversion should both be discouraged.

The most important aim of the supervisory authorities, therefore, is to help ensure confidence (thereby protecting depositors) within the banking system. Even though the responsibility for the supervision of banks and other financial institutions passed to the Financial Services Authority (FSA) in 1998, the system is still the same and will be discussed below accordingly.

Tools of Supervision:

Supervisors in many countries around the world have been concerned with the measurement of one several or all of the following:

- **Capital Adequacy:**

This gives an evaluation of the capital cushion, or net worth, related to a bank's risk exposure. In general, capital adequacy appraisal may be taken to be synonymous with bank solvency assessment. A bank's capital cushion is generally regarded as a protective internal fund against unforeseen and unexpected financial pressures of significant magnitude.

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(35) Molyneux, Philip; "Banking"; an Introductory Text; Hong Kong; chapter 8 p: 102 Macmillan Education Ltd. 1991

- **Asset Quality:**

Loans constitute the major component in assessing asset quality. This is because loans are invariable ink's main earning asset.

- **Management and Earnings:**

Earnings and management/administration assessments are judged in relation to other facets of the business.

- **Liquidity:**

Liquidity is a key factor because a bank must be able to meet both normal and abnormal shortfalls in anticipated cash flows. Although the central bank support function may come into play in banking liquidity analysis, supervisory schemes have still attempted to gauge and test a bank's prudential liquidity positions. It is not a central bank function to bail out illiquid and imprudent banks.

4.2.9. THE BANKING SYSTEM IN IRELAND:

Banking system in Ireland contains that the Central Bank, Clearing Banks, Non-associated Banks and Foreign Banks.

4.2.9.1 The Central Bank (Banc Ceannais na hÉireann):

As it was happen in other countries, the Central Bank takes place in the beginning of system. Ireland Central Bank was established in1942 and the main responsibility of the Central Bank is to protect the internal and external value of Ireland pound and to control the credits movements. The Central Banks, which becomes the monetary authority of country, is also responsible for determining the monetary policy. At the same time, bank represents and advisor of government. Finance Minister appoints the board of director and in addition to this, it's an independent institution. [36]

As legal, the duty of the Central Bank is to protect integrity of the currency with ant inflationist policy.

The functions of the Central Bank in Ireland are as following:

- to be banker of banks and also government
- to coin money
- to apply the monetary policy
- to monitor the banking system
- to manage the official reserves and the policy of currency
- to give advises the government about financial subjects

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(36) Des Peelo, "The Role of Central bank", Business and Finance, 15 October 1981, p: 33

4.2.9.2 Clearing Banks:

Clearing Banks or Associated Banks are formed through the four biggest banks - *Allied Irish Banks, the governor and company of the Bank of Ireland, National Irish Bank, Ulster Bank Limited* –

The banks, which mentioned above were established in 1965. According to the Central Bank's data, the shares of banks are 55% in the sources at the end of 1995. The main activities of Clearing Banks are as follow:

- to open current account in order to cover the seasonal loan
- to support and financing the purchasing of residence and agricultural product
- to provide the credits with installments
- to mediate the investments of securities
- to realize the monetary transfer

4.2.9.3 Non Partner Banks:

Non-partner Banks are formed through three sub groups:

- Commercial Banks
- Foreign Banks
- Industrial Banks

4.2.9.3.1 Commercial banks:

The numbers of Commercial Banks are approximately over 40. The total asset of Commercial Bank in EU Commercial Banks is 1%.

Some of the duties of Commercial Banks are:

- to provide foreign exchange services
- to provide deposit and credit utilities
- to provide the financial resources to the business etc.

In Ireland, Commercial Banks are not competitor of Clearing Banks; it can be said that Commercial Banks are complementary of Clearing Banks.

4.2.9.3.2 Foreign Banks:

Most of Foreign Banks operate as wholesaler banking. They provide finance source in large scale and strive with external trade operations. Some of these kinds of banks give retail-banking service. Some of them are efficient in foreign exchange and material market as well.

4.2.9.3.3 Industrial Banks:

They specialized in providing credits the people whose existing on production process. Industrial banks purchase the assets, which demanded by their customers and rent these assets; in that way they provide leasing possibilities. At the same time, they are significant deposit taker institutions.(37)

Small Industrial Banks provide credits for consumption goods. The rests are which become larger; they provide finance for import and /or export.

In addition to mentioned banks above, there are some institutions, which strive with routine banking activities. (i.e. to provide credit, to accept the deposits etc). These institutions can be summarized as the building societies and the institution of finance public sector. Building societies provide finance sources to the residence sector by collecting small amount of deposits in return for mortgage.

These are independent finance institutions, which work in custody of public authorities. The interest rate which given by these institutions to the small amounts of deposits is higher than other banks. Because of this reason these are a good alternative for small amounts of deposits. The institutions of finance public sector are as following:

- Post Management Deposit Banks: They provide utilities in investing the deposit
- Saving Banks: They give service to deposit owners and play important role in collecting of funds; these founds are used by Treasury Office.
- Agricultural Credit Company: It provides middle and long term credits for agricultural industry and also provides leasing possibilities.

4.2.9.4 Monetary and Credit Policy:

The main institution, which related with monetary and credit policy is the Central Bank in Ireland. The Central Bank is responsible for regulating the liquidity level of banking system determining of interest rate and also it aims that the protection of monetary and foreign exchange policies. Monetary policy has been formulated by taking into consideration the economic growth and inflation.

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(37) Irish banks' Information Service, Banks and Banking in Ireland, Dublin 1985, p: 18-19

According to needs the credit of banks are restricted by the Central Bank.
In Italy, four main instruments are being used in monetary and credit policy framework by the Central Bank:

- Rediscount Policy: The rediscount ratio which determined by the Central bank effect the all interest which occurring in economy
- Open Market Transaction: They contain that purchasing and selling the promissory notes and bonds
- Special Deposit: Is a special deposit account which kept in Central Bank
- Moral Suasion: Are advices and orders which given by Central Bank related with the borrowing policy of banks.

The Central Bank has used two liquidity ratios in order to control the amount of credits. First one is primary liquidity ratio and second one is secondary liquidity ratio. These ratios can be calculated as follows;

$$\text{Primary Liquidity Ratio} = \frac{\text{Cash of Banks + The Balances of Accounts in Central Banks}}{\text{Related Sources}}$$

$$\text{Secondary Liquidity Ratio} = \frac{\text{Treasury Bills of Banks}}{\text{Related Sources}}$$

$$\text{Related Sources} = \text{Deposits} + \text{Current Account} + \text{Net External Obligations} - \text{The Balance of Account in Other Banks} - \text{The Exemptions of Central Bank}$$

Primary Liquidity Ratio can be interpreted as the intervention of Central Bank to the banking system and is regulation in order to be able to live in confidence of sector.
Secondary liquidity ratio is application which in order to provide the participation to the financing of public.
In Ireland banks, have to keep the funds as much as certain ratio of their gross assets. At the same way, Clearing Banks have to keep the fund as much as certain ratio of their risky assets as well.

In addition to these, the credits and participations of banks have been subjected to certain limitations. The indirect interventions of the Central Bank shows it self about interests to the banking system. The short-term credits, which are provided by the Central Bank to banks and purchased promissory notes and applied interest rates have effected to interest, which are occurred in between banks. These are kind of reference interest. In other words the second factor that affects the interest, which are applied by banks, is Clearing Banks. This power originated through the efficient position in the system.
There is also one more factor, which affects the interests. This is the third factor and that is international markets. Due to Ireland has external economic relations; the international capital movements have established a connection between internal and external market interest rates. The interests of internal market should not be less than the interest, which are occurred in international market.

4.2.10 THE BANKING SYSTEM IN GREECE:

Greece Banking system contains the Central Bank, Commercial Banks and Specialized Banks.

4.2.10.1 The Central Bank:

Bank of Greece is, since its foundation in 1828, the central bank of the country, rusted with the functions normally associated with the role of central banks (issue of currency, supervision of the banking system, monetary and credit policy, managing foreign exchange and gold reserves, acting as a banker to the Government). It is a limited liability public company, (S.A.), with the majority of its shares held by private individuals and entities and traded in the Athens Stock Exchange.

- It is managed by a Governor and two deputy Governors appointed by the Government for a six year term on the Bank's General Council, completely independent in the exercise of their duties, accountable to Parliament as far as the conduct of monetary and credit policy is concerned. Monetary and credit policy be formulated by a Monetary Policy Council composed of the Governor, the two deputy Governors and three members appointed by the Government, following opinion expressed by the Governor. The Bank of Greece becomes part of the European System of Central Banks and, when Greece becomes a full member of the European Monetary Union, its Governor will participate as an independent personality in the Governing Council of the European Central Bank.

- The Bank of Greece is also responsible for the foreign exchange parity of the drachma, within the framework of the foreign exchange policy pursued by the Government in consultation with the Bank of Greece.
- Naturally, in all spheres of its new role, the Bank of Greece will consult with the Government to ensure fruitful cooperation for the success of overall economic policies.
- In the last few years, the Bank of Greece has systematically developed bilateral and multilateral relations with central banks in the Balkans, Eastern Europe and the Black Sea. Equally, it has endeavored to develop relations in the Mediterranean region. In a broad sense, the Bank of Greece actively supports the policies of the Greek Government concerning the development of bilateral and multilateral relations in our region. And, certainly it intends to continue and intensify its efforts in this field by responding positively to relevant initiatives or developing initiatives of its own.

4.2.10.2 Commercial Banks:

The most important group is Commercial Banks in Greece Banking system. Commercial Banks are divided into 2-sub group:

- Greece Commercial Banks
- Foreign Banks

4.2.10.2.1 Greece Commercial Banks:

Greece Commercial Banks are state controlled banks. In these state controlled banks two banks that National Banks of Greece SA and Commercial Bank of Greece SA take important place in system. The share of these two banks in total asset of commercial banks is over 70%. There are so many company groups, which operate for these two banks in area of insurance, banking, hotel management, mining etc.
So the policies, which will be followed by these two banks, are significant for both banking system and economy. In Greece state has important effect on banking system. Commercial Banks have set up their credit policies according to general credit regulations. However, generally big portion of credits are provided for production industry and small business. Generally these credits are provided as Drahmi. But, for important investment programs, some credits are provided as foreign currency unit as well.

4.2.10.2.2 Foreign Banks:
Liberalization of economy, the formation of maritime trade, increasing in numbers of foreign investors... At the result of mentioned factors above, foreign banks have been started to establish in the beginning of 1960's.
Both domestic and foreign; all banks in Greece serve universal banking service. (38)
In other words all kinds of banking activities are presented to the private and public sector by banks.

4.2.10.3 Specialized Banks:
Specialized Banks can be divided into 5 groups:

4.2.10.3.1 Development Banks:
They provide finance resources to production, tourism, and mining industries in order to development of country.

4.2.10.3.2 Mortgage Banks:
They provide finance resources to individual, public enterprises, charity organizations, and public service companies in middle and long term.

4.2.10.3.3 Agricultural Banks:
Agricultural bank of Greece is responsible for agricultural policy. It is under control of agricultural ministry and provides all kinds of credits to the agricultural sector and also supports the agricultural cooperatives.

4.2.10.3.4 Deposit and Loan Fund:
It keeps in its hand the all kind of consignment of government and inspects the various deposits of public artificial person and controlled by finance ministry. In addition to this it provides the residence credit, for officers and retirements.

4.2.10.3.5 Post Deposit Banks:
It operates with a branch office net which contain the all post offices in country. It gives public service and inspected by ministry of communication.

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(38) **The Greek Banking system Today, Hellenic Banks' Association, Athens, 1987, p: 15-23**

4.2.10.4 Monetary and credit policy:

In passing to monetary union, the reliability and impact of monetary policy will provide with the institutional autonomous of international Central Bank.

As connected to this *it's necessary to make important changes in its status. In new regulation, which will be submitted to the parliament, it will* be provided independency to Central Bank in the meaning of determination and carried out the Monetary Policy.

The primary aim to protect the price stability has been determined by laws. The Central Bank will continue to support the economic policy of government in this framework.

During the second stage of economic and monetary union (EMU), the Central bank will increase its efficiency in open market transaction, spot and forward *transaction and inter bank money market.*

In addition to these the liquidity levels will be controlled by Central Bank.

In 1994, EU Monetary Committee and Ministers of Finance Committee has worked on a convergence program related with Greece economy in order to attain the standards of EU. This convergence program, which aimed to join into EMU in 1999, contains two sub periods:

In first sub period (between 1994-96), it's aimed that to decrease the inflation rate; at the result of this, nominal interest rate will decrease. However, monetary and foreign exchange policies will be anti-inflationist and Greece drahmi will join into ERM in 1996.

In second sub period contains the years of 1996-99. In this period, it's expected that to increase the growth rate and also to decrease the inflation rate as well.

4.2.11 THE BANKING SYSTEM IN PORTUGAL:

The Banking System in Portugal can be divided into 3 main groups:

- Central Bank
- Commercial Bank
- Specialized Bank

4.2.11.1 Central Bank: (Banco de Portugal)

In additional to government, the monetary authorities of country are local administration of *Azor* and *Maderia Islands* and the Central Bank.

The Central Bank is responsible for applying and controlling the monetary and finance policies according to economic policy, which determined by government.

Until 1974, there were three emission banks that were *Banco de Portugal, Banco de Angola, Nacional Ultramarino.* These banks were expropriated in 1974.

basic functions of the Central Bank are as follows:

- to provide the coordination with government on monetary and foreign exchange policy
- to manage the foreign assets of country
- to be representative of state in finance relations
- to provide the stability of financial system

11.2 Commercial Banks:

st of the financial institutions were effected from expropriation of vities, which were started in 1974. Deposit (or) saving banks, cultural credit cooperatives, credit institutions and insurance mpanies are some of these institutions. After this application its served that any decreasing in number of Commercial Banks. 1977, private and public sector had separated from each other. After s date it's prevented that entrance of private enterprises into banking d insurance activities. However, these limitations have cancelled in 984.

me of the activities of Commercial Banks are as follow:

- to strive with short term credit activities
- to provide export and investment credits in middle and long term etc.

ain sources of Commercial Banks are provided by current account, eposits at notice and time deposits of individual and firms.

2.11.3 Specialized Banks:

ecialized Banks are divided into 3 sub groups:

2.11.3.1 Deposit Banks (or) Saving Banks:

eposit Banks have specialized on collecting of deposits. They are able provide mortgage credits and also various special credits. Deposit anks accept the promissory notes. Main Deposit Banks are as llowing:

2.11.3.1.1 National Deposit Bank:

s a State bank and has a broad agent net. National deposit bank *Caixa Geral de Depósits, Crédito e Previdància)* is the biggest credit stitution of Portugal. In Portugal, CGD is main institution that provides nancial source to private and public sector investments, which have pecial importance. CGD had undertaken various duties in solving nancial problems and also the needs of source in the past.

4.2.11.3.1.2 Post Deposit Bank:
Post Deposit Bank inspects the deposit accounts generally, and also it's responsible for small depositors' accounts. They were almost established in everywhere of country.

4.2.11.3.1.3 Domestic Regions Deposit Banks:
They provide residence credit and also discount the Commercial promissory notes.

4.2.11.3.2 Investment Bank:
Investment Bank (*Banco de Fomento Nacional-BFN)* is a specialized institution in providing the middle and long-term credit to agricultural industry and service sectors.

Some of its duties are as follows:
- to give assurance for credit
- to accept deposits
- to export the bond to external and internal market in middle and long term
- to strive with export credits
- to strive with international loan management

The big portion of its sources provided by external credit transactions and the Central Bank transaction.

4.2.11.3.3 Agricultural Credit Cooperatives:
Agricultural Credit Cooperatives strive with credit transactions for own union in domestic level. The sources of credits are provided from collected deposits and IFADAP.
Agricultural Credit Cooperatives have been integrated into system, which manages the credit institution.
In addition to these, one more institution *(Caixa Central de Crédito Agricola)* has been formed to manage the liquidity excess and to coordinate these excess.

4.2.11.4 Monetary and Credit Policy:
Following its nationalization in September 1974, the functions and statutes of the Banco de Portugal were redefined by means of the Organic Law published on November 15th, 1975. In addition to its role as central bank, the Banco de Portugal was, for the first time, charged with the supervision of the banking system.
Responding to social changes, monetary policy became more active and the Banco de Portugal took on important responsibilities in the area of monetary and credit control, and, *mainly after joining the European*

Community in 1986, in the organization and regulation of the money market.

With greater control of the budgetary policy and growing integration in the European markets, the functions of the Banco de Portugal grew more like those performed by other European central banks.

In October 1990, a new Organic Law was published, the main innovations of which concerned the constraints imposed on the financing of public deficits, and other provisions ensuring greater independence for the Banco de Portugal's board of directors.

In the meantime, the economic policy framework underwent profound changes throughout 1992, reflecting the option of the authorities for policies seeking nominal stability, and in April the Escudo joined the Exchange Rate Mechanism (ERM) of the European Monetary System (EMS).

In December, complete freedom of capital movements was decided upon, making the Escudo fully convertible.

Within the scope of the adjustments resulting from preparation for the Economic and Monetary Union (EMU), the Organic Law of the Banco de Portugal underwent further major changes in 1995.

Price stability emerged as the main mission assigned to the Bank. Its autonomy in the management of monetary policy was enhanced, and it was entrusted with new responsibilities in the realm of payment systems.

In January 1998, the Organic Law of the Banco de Portugal underwent again further major changes, which envisaged the reinforcement of its autonomy, in accordance with the requirements relating to the participation of Portugal in Stage Three of EMU, and the preparation of its integration in the European System of Central Banks (ESCB) from the January 1 1999 onwards.

In March 1998, the European Commission proposed the inclusion in the euro area, from January 1 1999 onwards, of eleven Member States, Portugal included. That same month, the Banco de Portugal, requested by the Government, gave the opinion that the recommendation handed down by the European Commission abides by the spirit and the letter of the European Union (EU) Treaty.

On May 2 1998, Heads of State and Government of the EU decided that EMU would start on January 1 1999 with eleven Member states, Portugal included.

At that same date, the ministers of the Member States adopting the euro as their single currency, the governors of the central banks of these Member States, the European Commission and the European Monetary Institute (EMI) have agreed on the method for determining the irrevocable conversion rates for the euro at the starting date of Stage Three and decided that the ERM bilateral central rates of the currencies of the Member States at that time would be used in determining the irrevocable conversion rates for the euro.

On June 11998, the Banco de Portugal became part of the ESCB.

On January 1 1999, following the adoption the day before by the EU Council of the irrevocable conversion rates between the euro and the currencies of the eleven participating Member States, Stage Three of EMU started, marked by a single monetary policy and a single currency - the euro. The currencies of the eleven participating Member States, the escudo included, became national denominations of the euro.

On that date a new version of the Organic Law of the Banco de Portugal entered in force, including modifications required from its integration in the ESCB, which only needed to become effective as of the start of Stage Three of EMU.[39]

4.2.12 THE BANKING SYSTEM IN SPAIN:

In Spain banking system can be divided into 4 groups and can be summarized as follows:

4.2.12.1 The Central Bank:

The history of the ***Banco de España*** goes back more than two centuries. A Royal Warrant of King Carlos III founded the Banco Nacional de San Carlos, the first modern Spanish bank and direct forerunner of the current Banco de España, on June 2nd 1782. Its capital was private, but it was established under Royal patronage, which accounts for its name.

Its foundation was closely linked to growth in the public debt, a link which survived throughout its long life and through successive changes. The first director and inspiring force was Francisco Cabarrús, a French banker established in Madrid. Two years earlier, in 1780, Cabarrús had negotiated with the Treasury the issuance and placement of a new form of special government debt, called vales males. These vales reales yielded interest of 4 per cent and had the properties of paper money in wholesale transactions and in the payment of taxes.

One of the main objectives assigned to the new bank was to counter the depreciation of the vales males, and it was thus authorized to purchase them for cash when they were presented for payment.

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(39) Banco de Portugal web site

Although the Banco de San Carlos was authorized to issue bearer banknotes, it did not use this power except during short periods. At first the Bank's operations fared well, but later the involvement of the Spanish crown in a continuous series of wars between 1793 and 1814 led the Bank into serious difficulties.

By 1814, the State owed the Bank more than 300 million reales (equivalent to 75 million pesetas). However, the Bank continued to operate, with its business reduced to the new activity of discounting in Madrid and the negotiation of bills in other centers. The shareholders of the *Banco Nacional de San Carlos* expected Treasury to repay at least part of its debt to the Bank, and so it did, in 1829. The then Treasury minister, Luis Lopez Ballesteros, had in practice definitively instituted the system of annual budgets for public expenditure and revenue.

Accordingly, it was necessary for a financial institution to advance short-term funds to the Government, to bridge gaps in the Treasury's cash flow. For this purpose, he conceived the idea of giving the Banco de San Carlos a fund of 40 million males, whereupon its shareholders founded a new bank of issue named the *Banco Espanol de San Fernando*. This Bank did use, albeit with extreme prudence, the power to issue notes. Until 1844 it was the only bank of issue in Spain. That year another two banks were created with the power to print and issue paper money. These were the *Banco de isabel II* (based, like the *Banco de San Fernando, in Madrid)* and the *Banco de Barcelona*. In 1846 the Banco de Cádiz was created to distribute the banknotes of the *Banco de Isabel II* in that city.

The Banco de Isabel II emerged as a competitor to the *Banco Español de San Fernando* in the circulation of paper money in Madrid, an area in which this new institution displayed considerable initiative and innovation. As regards lending, the two banks followed different guidelines: the *Banco de San Fernando* maintained its traditional ties with the State, while the Banco de Isabel II gave priority to meeting the demand for credit from the private sector, amid a boom in investment and output. The mistake of concentrating its exposure on a few particular debtors led the Bank -at a time of financial crisis, in 1847- into a situation where there was a risk of suspension of payments. The danger was averted by a merger between the *Banco de San Fernando* and the Banco de Isabel II, with the new bank retaining the name *Banco Español de San Fernando.*

In 1849, Ramón Santillán, an expert in public finance and former Treasury minister, was appointed director (with the title of governor from 1851). Santillán successfully performed the difficult task of turning the Bank around after the difficulties caused by the merger with the *Banco* of *Isabel II.* In the early I 850s the question was raised of extending banking activity and the issuance of banknotes to the whole nation, and not just Madrid. Santillán proposed that the Banco de San Fernando -under the name *Banco de España*- should open branches in all the major cities, excluding Barcelona and Cádiz which had their own banks of issue.

However, after the liberal revolution of 1854 the policy that prevailed was to authorize the creation of banks of issue in the provinces, independent of the Banco de España (which finally adopted this name in 1856). Despite the new and ambitious title, its sphere of action was confined to Madrid and the cities of Alicante and Valencia, in which it opened its first branches. Nevertheless, there were banks distributing its banknotes in [illegible] cities (including Barcelona, Bilbao, Santander, Sevilla and Malaga).

In 1874, as a result of the financial requirements of the Government, which was engaged at the same time in both a civil and a colonial war, the *Banco de España*, in exchange for a significant loan, was granted a monopoly over the issuance of banknotes. The provincial banks had to choose between remaining commercial banks, without the power to print banknotes, or joining the *Banco de España* with the status of branches. This was the origin of the branch network, which the *Banco de España* eventually had throughout Spain. In 1887 it had 55 branches, a number which would later rise to 70. The 1921 Ley de Ordenación Bancaria (Bank Ordinance Law) regulated for the first time the relationship between the Banco de España and the private banks, with the aim of converting the bank of issue into a genuine central bank.

Its capital was increased, it was assigned the task of inspecting private banks, and a preferential rate of interest was established for discount operations with the other banks and the exchange rate policy began to be regulated through the *Banco de España*.

It was precisely in the defense of the peseta exchange rate that growing opposition between the Government and the *Banco de Espafla* became apparent in the 1920$ and in the 1930s (under the Second Republic) up until 1936. The main disagreement between the Government and the bank of issue was over the power to dispose of the considerable gold reserves built up by the Bank since the beginning of the century.

After the 1936-1939 civil war -in, which the above-mentioned reserves were used to purchase arms-, the financial policy of general Franco's Government reflected the authoritarian ideology of his regime. The 1946 Ley de Ordenación Banceria (Bank Ordinance Law) assigned most of the powers over monetary policy to the Government, making the Bank a mere appendage of the Ministry of Finance. However, after the Stabilisation Plan of 1959, the economic policy of the Franco regime became less interventionist; more heed was taken of market criteria and the economy was opened up somewhat. A product of this change of direction in the financial sector was the Ley de Bases de Ordenación de Crédito y la Banca (Law to Regulate Credit and Banks) of 1962, together with other supplementary provisions, including notably the *Decreto-Ley de Nacionalización y Reorganización de Banco de España* (Legislative Decree for the *Nationalisation and Reorganisation of the Banco de España*) of June 7th 1962, pursuant to which the bank of issue ceased to be a private company. The Ley de Bases continued to vest responsibility for monetary policy in the Ministry of Finance, but the Bank's authority, and powers, to implement and develop the relevant measures in the technical area were recognized. With the restoration of democracy in the second half of the 1970s, the *Banco de España* completed, in successive phases, its transformation into a central bank with full responsibility for the regulation and supervision of the financial system. The Ley de Organos Rectores del Banco de España (Law on the Governing Bodies of the *Banco de España*) of June 1980 and, more recently, the Ley de Autonomia (Law of Autonomy) of June 1994 have guaranteed the Bank great freedom and flexibility in the performance of its functions, especially with respect to monetary policy. Finally, and in accordance with the terms established by the European Union (of which Spain *has been a member since 1986), Spain has gained access to* EMU, having complied with the convergence criteria laid down in 1994. As a result, the *Banco de España* has joined the European System of Central Banks along with the Central Banks of the other nations participating in European Monetary Union, and the European Central Bank.

The basic functions of the Central Bank *(Banco de España)* in Spain are as follow:

- Defining and implementing the Community's monetary policy with the principal aim of maintaining price stability across the euro area, comprising the eleven countries that launched Stage Three of EMU on January 1st, *1999*
- Implementing exchange rate policy and conducting currency exchange operations consistent with the provisions of Article 109 of the Treaty on European Union, and holding and managing the Member States' official currency reserves
- Promoting the sound working of payment systems in the euro area.

Issuing legal tender banknotes:

In addition to carrying out the foregoing functions as a fully-fledged member of the Euro system, the Law of Autonomy stipulates the performance of the following additional functions by the *Banco de España:*

- The holding and management of currency and precious metal reserves not transferred to the European Central Bank
- The supervision in accordance with the provisions in force, of the solvency and behavior of credit institutions
- The promotion of the sound working and stability of the financial system and, without prejudice to the functions of the ECB, of national payment systems
- The placement in circulation of coins and the performance, on behalf of the State, of all such other functions entrusted to it in this connection
- Provision of treasury services and financial agent for government debt
- Adviser to the government, preparing the appropriate reports and studies
- Preparation and publication of statistics relating to Its functions, and assisting the ECB in the compilation of the necessary statistical information
- Exercise of all other powers attributed to It by legislation.

For the performance of all these functions, and as stipulated in the Law of Autonomy, the governing bodies of the *Banco de España* have a four tier structure.: the Governor, The Deputy Governor, The Governing Council and The Executive Commission.

4.2.12.2 Commercial Banks and Industrial Banks:

Commercial Banks and Industrial Banks carry out the 60-70% of total banking activities and their numbers are over 150.

Commercial Bank are generally interested in retail banking activities. They have plenty of numbers branch and representative offices in abroad and participate to export financing activities. Commercial banks also operate in Euro currency market as well. Industrial Banks generally provide credit in middle term.

4.2.12.3 Saving Banks and Specialized credit Institutes:
Saving Banks are credit institutions, which are not to aim the profit. Generally, they provide the social aims and small individual enterprises.
Specialized Credit Institutions are official institutions, which are operating in special areas such as – industry, residence financing, agriculture, farming etc.
They were recognized to fill the blanks of middle and long-term finance in 1972.

4.2.12.4 Foreign Banks:
There are over 20 foreign banks, which operate in Spain. They focused on wholesaler banking activities.

4.2.12.5 The Monetary and Credit Policy:
According to E.U agreement, the main principle of monetary policy is to provide the stability of prices and the Central Bank is responsible for supporting the economic policy of government.
The Central Bank is defined as monetary authority institution in the country. In finance market spot and forward transactions, repo transactions, purchasing and selling of bound in return for national and also other currency are done by the Central bank.
The primary aims of the Central Bank are to stabilize money market interest rates and to create or enlarge a structural liquidity shortage. The reserve ratio is set at 2% of an eligible liabilities base drawing on end-month balances, which includes deposits up to two years and debt securities, other than shares and other equities, with an agreed maturity of up to two years, with the exception of inter bank liabilities and liabilities vis-à-vis the Euro system.

4.2.13 NEW MEMBERS OF EUROPEN UNION:
By joining of three new countries, the number of European Union members has increased from 12 to 15. These new countries are Australia, Sweden, and Finland.

4.2.13.1 Austria:
According to world bank data [40] the population 8,072,182 and the per capital income is $ 22380. The main purpose of the Central Bank (*Oesterreichische National Bank*) is to protect the internal and external value of national currency.

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(40) **Österreichischen Statistischen Zentralamt (in English Austria Statistic Center**
http://www.stats.demon.nl/europe/austria.htm

its an official authority in determining monetary growth, inflation targets and key interest rates.
The duties and responsibilities of the Central Bank in Austria:

- to implement of monetary and foreign exchange policy
- to be bank of banks and government
- to manage of official reserves
- to protect the financial stability
- to present payment system services
- to issue banknote

4.2.13.2 Sweden:
According to World Bank data (41) the population in Sweden is 8.7 million and the per capital income is $27010 / year. The Central Bank of Sweden (*Sveriges Riksbank*) was established in 1668 by named as Staders Bank.
It's the oldest Central Bank of the world. In 1867; it was renamed and the authority of banknote issue was given in 1897.
According to establishing law the Central Bank is responsible for foreign exchange and credit policy. The Sweden Central Bank is independent in its operations from government.

The main duties and responsibilities are as follows:

- to issue banknote
- to carry out foreign exchange and credit policy
- to improve an efficient payment system

The last purpose of monetary policy is to provide the stability of prices of monetary policy like in other countries.

4.2.13.3 Finland:
According to world bank data (42) the population in Finland is 5,158,372 (July 1999 est.) and the per capital income is $19,000 / year.
The primary aims of the Central Bank in Finland (*Suomen Pankki*) are;

- to protect the monetary system and stability
- to give suggestions the government related with foreign exchange policy
- to determine the inflation rate and monetary growth
- to issue banknote
- to manage the official reserves
- *to present the payment system*

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(41) World Bank, World Bank fact book, 1995
(42) World Bank, World Bank fact book, 1995

4.2.14 THE EVALUATION OF EUROPEAN UNION MEMBER COUNTRIES' BANKING SECTOR:

The Banking system of EU member countries can be evaluated under two headings:

4.2.14.1 Similarities:

When the all EU countries evaluated, it will be seen that they have same duties and regulations in their banking system.

4.2.14.1.1 The Entrance (Or Introduction) of Banking Sector:

Banks, which are constitute the banking system, have to operate *according to predetermined regulations by authorities. It's necessary to a* mechanism and this mechanism has connected the entrance *into banking system to the permission.*

Banks who is whish to operate in a EU member country; if it is a member of EU the permission is given to this country. But, if it's not; the procedure will be more different.

Briefly, it can be said that all economic and monetary policies, which are applied by banks, are inspected and observed by Central Banks and related institutions.

4.2.14.1.2 Large Banks:

Almost in each EU country there are large banks, which have importance in economy. These banks affect the economy by their monetary and finance policies.

4.2.14.1.3 The Control of Monetary Expansion:

There are some purposes in monetary policies, which are applied by Central Banks and / or authorized institutions according to determined internal and external economic conditions. These economic conditions change from country to country. But, there is something that does not change: the control of monetary of monetary expansion.

As related whit this concept, the liquidity of banking system is always hold in under control; and it's adjusted according to economic condition of country.

Generally, the interest rates constitute according to market conditions or at least elastic interest policies are valid in EU member countries.

In addition to these, the rediscount policies of Central Banks affect interest rates.

4.2.14.1.4 Special Credit Institutions:

There are credit institutions, which are specialized in financing of certain areas in EU. Agriculture, shipping, residence, small business etc. for these works, some institutions or cooperatives have been established to provide cheaper credit by people who work in this areas. These institutions and cooperatives are supported by Central Banks.

4.2.14.1.5 The Exhilaration in Capital Movements:

The European Union members have intensive economic and commercial relations with OECD members. Due to these relations it has recorded an increase in capital movements.

In EU, England, Germany, Luxemburg, France such as countries is significant finance centers; because of these reason the international capital movements are intensive in these areas. International capital movements affect the liquidity of economy and banking system with balance of payments together. To controlling the affects of capital movements, various direct and /or indirect preventions have been taken by authorities within EU members.

4.2.14.1.6 Post Saving Banks:

There is post saving banks almost in each EU countries in accept to small deposits. These institutions play important role on bounds, which are occurred in rural region.

4.2.14.1.7 The Restrictions Related with Participations:

In some EU countries, the participations of bank are more efficiently inspected and controlled in order not to be "Holding" of banks-as it was happened in Germany, France, Holland- but also it has been applied more elastic policies as well-such as England.

The restrictions related with participations are depending upon the structure of economy of country.

4.2.14.1.8 Common Regulations:

The second banking directive of European Community (December 15 1989) has brought the license of single community banking (EU). Banks have to obey some regulations while they are giving service. Before giving the banking authority, the beginning capital of application owner, the position of managers and partners, operation plan, the risk management system and its control concept should be seen and confirmed by related institutions. After giving authority banks are inspected continuously.

Any bank, which becomes in EU country, (European Authorized institution) does not get permission to operate in other EU country. Also the branch offices of bank can be opened in other EU countries. The inspections of these branch offices are done by the Central Bank of that country.

4.2.14.2 DIFFERENCES:

4.2.14.2.1 The Portion of Public Banks:

In the banking system of EU members, in some countries, private sector's portion is more than public sector's –such as Holland, Belgium, Germany, England- or vice versa –such as Italy, Greece, Portugal, France.

4.2.14.2.2 The Pressure of Public Financial Needs:

In some EU members, it's attained to the balance of public; means that the expenditures of public are equal the sources to cover these expenditures. Germany and Luxemburg can be given as example.

In some of the countries although public need to financial resources to prevent to this pressure on banks, some implementations and regulations have been applied -such as England, Belgium, and Greece.

4.2.14.2.3 External Balance:

Generally, most of the EU members have external deficit in their balance of payments. Due to the external balance of countries shaped differently, banking sectors face with problem in liquidity and also foreign exchange control.

Some countries have problem in their balance of payment. Denmark, Ireland, Greece can be given as example. In other words, oppositely; some countries have no problem in their balance of payments. So, there is no necessary the hard control system.

4.2.14.2.4 The Efficiency In Market Economies:

Luxembourg, Germany, England are accepted as countries which are follow the best appropriate monetary and credit policy according to the requirements of market Economy.

EU has no homogeneous structure. Although members have similarities, there are some differences can be said. But, member countries regulate and adjust their economic structure and banking system in framework the aims of union.

Chapter

5 The Banking sector in the Republic of Nothern Cyprus

5. The Banking Sector in The Turkish Republic of Northern Cyprus

5.1 The Central Bank of Northern Cyprus

The Central Bank of Northern Cyprus emulates the functions of a Central Bank, but the scope of its activities is limited. Established in 1984, the main aim of the Bank was to exercise control of the monetary system on behalf of and under the control of the government. Because the Northern Cyprus does not have its own currency and Turkish Lira is used as the medium of exchange, it is not possible to determine the amount of money that is circulating in the country.

Neither can the Central Bank set monetary policy. It receives daily exchange rates from the Central Bank Turkey and passes these into the commercial banks, but has no means of influencing the rates, as the banks are free to set these up at the given interest rate ceiling. The Central Bank of Northern Cyprus is the banker of the government. It holds aid money provided by Turkey and earns profit on this money by placing it on deposit either in Turkey or elsewhere.

Through the "Interest Differential Fund", which is established within the Central Bank, those sectors earmarked for encouragement by the state, are able to get loans at a lower interest rate.

5.2 Commercial Banking:

The most important of the financial institutions are the retail or commercial banks established for the purpose of accepting deposits, giving loans and other banking services to the people of Northern Cyprus. Commercial banks are facing a fierce competition among themselves, because even though the population Northern Cyprus is only 200.000, in 1999 the numbers of commercial banks commencing banking service the country were more than 35.

One of the reasons for having so many banks in Northern Cyprus is the fact that capital requirement is still extremely low and most of the businessmen, especially in recent years, prefer to establish their own banks in order not to pay commissions to other banks while carrying on their business. Another reason is a lot of banks from Turkey are securing permits from Northern Cyprus authorities and opening branch the country. On one side, low capital requirement encourages them to establish branches but a more sensible reason, which is on the agenda among the business people of Cyprus in recent months, is the fact, if a lasting solution is found to the Cyprus problem, the island might be able to enter the EU earlier than Turkey and these banks want to have a presence in Cyprus before this happens.

5.3 Bank Regulations and Supervision in the Turkish Republic of Northern Cyprus

The Banking Supervision Division of the Central Bank of Northern Cyprus was established in 1990. The department consists of a Governor, two senior supervisors, five supervisors and three-grade examiner. The aim of the department is to co-ordinate the functioning of the country's banking and financial sector directing and supervising them to carry out their banking and financial business activities according to the rules and regulations of the country and in a prudent manner. In order to achieve this, Northern Cyprus also adapted a system similar to the ones used by many other countries around the world.

- **Authorization Procedures:**

Unlike the systems in the United Kingdom and the United States and many other countries around the world, it is the Council of Ministers and not the Central Bank in Northern Cyprus, which authorizes banks for the purpose *of carrying on banking business. In order to establish a bank or open a branch, applications are made to the Ministry responsible for* financial matters (Ministry of Finance), and the views of the Ministry of Commerce and Industry and the Central Bank are sought.

The procedure is as follows:

- Information and nature of documents required from the applicant, the minimum number of founders their qualifications, are regulated by notification of the Ministry responsible for financial matters.
- Banks are obliged to obtain authorization from the Ministry responsible for financial matters or every branch they plan to open and they must notification the Ministry of these branches within fifteen days of the date of opening.
- Foreign banks, which have one or more branches operating in Northern Cyprus, are obliged to authorize one of these branches to represent the head office.
- No institution, which does not have a valid authorization from the Council of Ministers, may carry on banking business or use the word 'bank' in its announcements or advertisements.

1-Capital Adequacy Assessment and the Equity (earnings) Concept:
The Northern Cyprus' Banking Law came into force in 1976 and there were later amendments to it in 1983, 1987 and 1989 respectively. In September 1999 a new and updated Banking Law draft was published in the official Gazette of Northern Cyprus but it is not yet in force. In 1976, the paid up capital of banks established in Northern Cyprus had to be TL5 billion. But after 1.1.1992, the Council of Ministers on 29.7.1994 (see **appendix 1),** actual paid up capital of banks was creased to TL 50 billion and all commercial banks operating in Northern Cyprus had to bring their paid-up capital to TL 50 billion by the 31 May 1995 at the latest.
Often seen as being of particular importance, is the ratio of total capital (capital and reserves) to the total of other liabilities. This ratio is important because the higher the level of other liabilities, the greater the risk that they will not be met if the bank does badly. In other words, a low ratio of capital to liabilities indicates less stability for the bank.

For capital measurement purposes, it has been also used the "capital base standard ratio", which is being used throughout the world and it has to be minimum of 8%. This means that the institution has a proper capital base and through it a strong financial position. Calculation of the "capital base ratio " can be seen in **(appendix 2).**

2-Asset Evaluation
Under this section, the asset side of the balance sheets of the commercial banks is controlled to make sure t all the requirements stated by the Banking Law, The Central Bank Law, and the amendments, regulations and decisions under these laws are fulfilled.

- **Additional Reserves:**

Additional reserves are an asset item on the balance sheet. From a decision that was taken by the Boar Directors of the Central Bank on 22.05.1991, all commercial banks operating in Northern Cyprus have establish additional reserves within the Central Bank at the rate of 15% for all Turkish Lira deposit mounts maintained by them, excluding inter-bank deposits **(see appendix 3).**
For foreign currency deposits, following a new decision by the Central Bank's Board of directors on 4 June 1996, all onshore commercial banks in Northern Cyprus had to maintain 16% additional reserves on the 30th June 1996, 17% on the 31" July 1996, 18% on the 31st August 1996 and from this date onwards 18%. This is still the prevailing rate. Again, there is no obligation to maintain additional reserves for inter-bank foreign currency deposit accounts **(see appendix 3a).**

Additional reserves in respect of foreign currency deposits in Pounds Sterling, U.S. dollars, DM and Cyprus Pounds have to be maintained in foreign currency of the same type. Additional reserves for other foreign currency deposit accounts have to be maintained in U.S dollars calculated at the prevailing rate of change between such currencies and the U.S. dollars. With the Offshore Banking Services Law No. 48/1990, Northern Cyprus has had offshore banks operating on the island since 1990. These offshore banks were allowed to have deposit accounts within the onshore commercial banks to cover their basic expenses, and sometimes the money they kept reached very high amounts. Up until 1995, they were treated as inter-bank deposits, but 30.11.1995, with a decision of the Central Bank's Board of Director those on-shore or commercial banks maintaining deposits by offshore banks and also by the foreign banks, were required to establish additional reserves with the Central Bank at the rate of 2% **(see appendix 4).**

- **Interest Differential Fund**

Under the Central Bank Law, the Bank's Board of Directors enacted the following regulations, under powers granted to the board by articles 23 and 53 of the Central Bank Law, which have been approved by the Council of Ministers. These regulations are named as "The Central Bank Regulations for the establishment of Interest Differential Fund".

- **Deposit Protection Scheme Savings Deposit Insurance Fund Law:**

This Law, in order to insure savings deposits lodged in banks by real persons, was first enacted on the 02.07.1991. Later it was amended on 14.11.1997. Under this Law, a fund named Savings Deposit Insurance Fund is established within the Central Bank. Under the provisions of this law, banks establish the purpose of carrying on banking operations within the boundaries of Northern Cyprus and branch 'foreign banks operating in the country are obliged to have their savings deposits insured.

Also co-operative credit societies, which are of limited liability under section 4 of the Co-operative societies Law, may have their saving deposits insured subject to a decision of the Board of Directors and approval of the Registrar of the Co-operative Societies.

- **Bank on the Ownership of Immovable Property and Movable Goods:**

Banks may not own movable goods or immovable property except as necessitated by their banking operations. Article 11(1) of the Banking Law of Northern Cyprus makes this point very clear for banks operating in the country.

However, part (3) of the same article says that " banks which are compelled to obtain movable goods with a view to liquidating debts due to them are obliged to dispose of them with e year, and immovable property obtained in the same circumstances within three years" **(appendix 5).** It is the responsibility of the members of the Banking Supervision Division to report any findings on the subject to the head of the department.

- **Loans and Investors:**

Article 10(1) of the Banking Law of Northern Cyprus is very important in the sense that it organizes the amount of loans that can be given, by any bank, to a real person and a corporate body at any time. As the paragraph says, "the total of all kinds of credit that may be given by banks to a real person and corporate body shall not exceed 20% of Capital and Reserves of the bank or 5% of its deposits (whichever greater). But loans given to Northern Cyprus government or to corporate bodies guaranteed by it are not subject to this restriction" (Central Bank of the TRNC, Bulletin, no.26 1998). Again, this article important because if any bank concentrates most of its loans on one person or one company and then it faces problems in recovering those loans, financial standing of the bank can deteriorate so fast that it can even lead to bankruptcy in certain situations. **(appendix 6).**

- **Total Amount of Saving Deposits that may be accepted by a Bank:**

The total amount of saving deposits that can be accepted by any bank is also regulated by the section 6(6) the Banking Law. This regulation came into effect on the *29.07.1994. In 1999 almost all banks in northern* Cyprus had more than TL50 billion as capital and reserves. So it is obvious that banks can accept either 18, or most of them 20 times more deposits than their capital and reserves. If any bank accepts deposits in excess of the rates specified above, the same regulation continues to say that, " they have to lodge 50% of the exceeded amount within the Central Bank" **(appendix 7).**

It may sound unusual, telling any bank that they cannot accept deposits after a certain limit, but the real aim is to get them to increase their capital and reserve standing in order to improve their financial positions, since the capital requirement by the Banking Law is still rather low. In September 1999, the new and updated Banking Law has gone into force, it requires the commercial bank; operating in the country to raise their minimum paid-up capital to $2 million, or its equivalent in Turkish lira. It is expected that some of the smaller banks will have to move into mergers either among themselves or with some of the stronger commercial banks in order to be able to cope with the new requirements.

chapter

6 The Banking sector in Southern Cyprus

The Banking Sector In South Cyprus (Known as Republic of Cyprus Internationally)

The standard of banking services in Southern Cyprus compares well with European countries and the United States. Bank financial statements are in compliance with international standards and audited by internationally-recognized auditors. Currently, loans to the government and semi government sector make up 54 percent of the banking system's total assets. The new banking Law 1997 provided for a properly funded deposit insurance scheme.

Currently, there are six active domestic banks in South Cyprus offering all types of services, including deposit accounts, lending advances, leasing, credit card facilities, automated teller machines, etc.

Central Bank:

Central Bank of South Cyprus was established in 1963 shortly after Cyprus gained its independence, as an autonomous institution governed by its own law. According to the Central Bank of Cyprus Law, " the main purpose of the Bank to foster monetary stability and such credit and balance of payments conditions are conducive to the orderly development of the economy of South Cyprus.

During the early years of its operation, the Central Bank undertook fully the functions of banker to the government and the administration of international reserves and exchange controls. In parallel, the Bank strengthened its internal structure and prepared the regulatory framework for banking supervision; setting also up the operational framework for the implementation of monetary and credit policy.

Following the separation of the island as Northern and Southern Cyprus after 1974, the Central Bank of South Cyprus was actively involved in the reactivation of the economy. The role of the Central Bank was instrumental in the achievement of a rapid improvement in economic conditions that took place subsequently. In recent years, the Central Bank of South Cyprus is intensifying its efforts towards deregulation and liberalization of the financial sector, which is necessitated both by economic considerations, as well as by the need to harmonize its economic structure and policies with those of the European Union.

5.2 Bank Regulation and Supervision in Southern Cyprus:

One of the primary objectives of the Central Bank of Southern Cyprus (known as the Republic of Cyprus ' the international community) is to ensure a safe and stable financial system that would preserve public confidence and foster economic stability and growth. This objective is satisfied by maintaining an effective system of bank regulation and supervision. To this effect the Central Bank of South Cyprus senses deposit-taking institutions and subsequently carries out effective off-site monitoring as well in-site inspections. Such banking licenses are issued by the Central Bank following detailed vetting applications which, inter alia, involves consideration of the applicant's reputation, the available capital sources, the directors' and managers' fitness and properness as well as the viability of the propose undertaking. If the applicant is a non-resident then the home country's supervisory authority's consent is also required.

A regular follow up of a bank's operations with a view to identifying warning signals and also ensuring compliance with regulations and guidelines is exercised through the submission of periodic returns to the Central Bank's off-site monitoring unit.

An on-site inspection aims at assessing the present condition of a bank and evaluates its future prospects his respect, the operations of a locally incorporated bank are examined on a consolidated basis. The primary areas of assessment during an on-site inspection are credit operations, treasury operations, performance, management, adherence to regulations and directions and money laundering. Both off-site monitoring and on-site inspection aim at assessing the degree of risks that a financial institution is facing as indicated by the application of various statistical measures, such as capita adequacy, large exposures, prudential liquidity ratios, foreign currency exposures and minimum reserve requirements.

Chapter

7 The European System of Central Banks

7. The European System of Central Banks (ESCB)

7.1 ORGANIZATION OF THE EUROPEAN SYSTEM OF CENTRAL BANKS (ESCB)

The European System of Central Banks (ESCB) is composed of the European Central Bank (ECB) and the national central banks (NCBs) of all 15 EU Member States. The "Euro system" is the term used to refer to the ECB and the 11 NCBs of the Member States, which have adopted the euro. The NCBs of the Member States which do not participate in the euro area, however, are members of the ESCB with a special status – while they are allowed to conduct their respective national monetary policies, they do not take part in the decision-making with regard to the single monetary policy for the euro area and the implementation of such decisions.

In accordance with the Treaty establishing the European Community (the "Treaty") and the Statute of the European System of Central Banks and of the European Central Bank (the "Statute"), the primary objective of the Euro system is to maintain price stability. Without prejudice to this objective, it shall support the general economic policies in the Community and act in accordance with the principles of an open market economy.

The basic tasks to be carried out by the Euro system are:

- to define and implement the monetary policy of the euro area;
- to conduct foreign exchange operations;
- to hold and manage the official foreign reserves of the Member States; and
- to promote the smooth operation of payment systems.

In addition, the Euro system contributes to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system. The ECB has an advisory role vis-à-vis the Community and national authorities on matters, which fall within its field of competence, particularly where Community or national legislation is concerned. Finally, in order to undertake the tasks of the ESCB, the ECB, assisted by the NCBs, shall collect the necessary statistical information either from the competent national authorities or directly from economic agents.

The process of decision-making in the Euro system is centralized through the decision-making bodies of the ECB, namely the Governing Council and the Executive Board. As long as there are Member States, which have not, yet adopted the euro, a third decision-making body, the General Council, shall also exist. [Current members of the decision-making bodies of the ECB]

The Governing Council comprises all the members of the Executive Board and the governors of the 11 NCBs of the Member States without derogation, i.e. those NCBs that have adopted the euro. The main responsibilities of the Governing Council are:

- to adopt the guidelines and make the decisions necessary to ensure the performance of the tasks entrusted to the Eurosystem;
- to formulate the monetary policy of the Community, including, as appropriate, decisions relating to intermediate monetary objectives, key interest rates and the supply of reserves in the Eurosystem, and
- to establish the necessary guidelines for their implementation.

The Executive Board comprises the President, the Vice-President and four other members, all chosen from among persons of recognized standing and professional experience in monetary or banking matters. They are appointed by common accord of the governments of the Member States at the level of the Heads of State or Government, on a recommendation from the European Council after it has consulted the European Parliament and the Governing Council of the ECB (i.e. the Council of the European Monetary Institute (EMI) for the first appointments). The main responsibilities of the Executive Board are:

- to implement monetary policy in accordance with the guidelines and decisions laid down by the Governing Council of the ECB and, in doing so, to give the necessary instructions to the NCBs; and
- to execute those powers which have been delegated to it by the Governing Council of the ECB.

The all 15 Member States. The General Council performs the tasks which the ECB took over from General Council comprises the President and the Vice-President and the governors of the NCBs of the EMI and which, owing to the derogation of one or more Member States, still have to be performed in Stage Three of Economic and Monetary Union (EMU).

The General Council also contributes to:

- the ECB's advisory functions;
- the collection of statistical information;
- the preparation of the ECB's quarterly and annual reports and weekly consolidated financial statements;
- the establishment of the necessary rules for standardizing the accounting and reporting of operations undertaken by the NCBs;
- the taking of measures relating to the establishment of the key for the ECB's capital subscription other than those already laid down in the Treaty;
- the laying-down of the conditions of employment of the members of staff of the ECB; and
- the necessary preparations for irrevocably fixing the exchange rates of the currencies of the Member States with a derogation against the euro.

The Euro system is independent. When performing Euro system-related tasks, neither the ECB, nor an NCB, nor any member of their decision-making bodies may seek or take instructions from any external body. The Community institutions and bodies and the governments of the Member States may not seek to influence the members of the decision-making bodies of the ECB or of the NCBs in the performance of their tasks.

The Statute makes provision for the following measures to ensure security of tenure for NCB governors and members of the Executive Board:

- a minimum renewable term of office for governors of five years;
- a minimum non-renewable term of office for members of the Executive Board of eight years (it should be noted that a system of staggered appointments was used for the first Executive Board for members other than the President in order to ensure continuity); and
- removal from office is only possible in the event of incapacity or serious misconduct; in this respect the Court of Justice of the European Communities is competent to settle any disputes.

The ECB's capital amounts to EUR 5 billion. The NCBs are the sole subscribers to and holders of the capital of the ECB. The subscription of capital is based on a key established on the basis of the EU Member States' respective shares in the GDP and population of the Community. It has, thus far, been paid up to an amount just under EUR 4 billion. The 11-euro area NCBs have paid up their respective subscriptions to the ECB's capital in full.

The NCBs of the four non-participating countries have paid up 5% of their respective subscriptions to the ECB's capital as a contribution to the operational costs of the ECB. As a result, the ECB has been endowed with an initial capital of just under EUR 4 billion.

In addition, the NCBs of the 11 Member States participating in the euro area have provided the ECB with foreign reserve assets of up to an amount equivalent to around EUR 40 billion. The contributions of each NCB were fixed in proportion to its share in the ECB's subscribed capital, while in return each NCB was credited by the ECB with a claim in euro equivalent to its contribution. 15% of the contributions were made in gold, and the remaining 85% in US dollars and Japanese yen.

7.2 Constitution of the ESCB History – three stages towards EMU:

In June 1988 the European Council confirmed the objective of the progressive realization of economic union and mandated a Committee chaired by Jacques Delors, the then President of the European Commission, to study and propose concrete stages leading to this union. The Committee was composed of the governors of the EC national central banks; Alexandre Lamfalussy, the then General Manager of the Bank for International Settlements; Niels Thygesen, Professor of Economics, Copenhagen; and Miguel Boyer, the then President of the Banco Exterior de España. The resulting "Delors Report" proposed that economic and monetary union should be achieved in three discrete but evolutionary steps.

- **<u>Stage one of EMU:</u>**

On the basis of the Delors Report, the European Council decided in June 1989 that the first stage of the realisation of economic and monetary union should begin on 1 July 1990 - the date on which, in principle, all restrictions on the movement of capital between Member States were abolished. At this time, the Committee of Governors of the Central Banks of the Member States of the European Economic Community, which had played an increasingly important role in monetary co-operation since its creation in May 1964, was given additional responsibilities.

These were laid down in a Council Decision dated 12 March 1990 and included holding consultations on, and promoting the co-ordination of, the monetary policies of the Member States, with the aim of achieving price stability. In view of the relatively short time available and the complexity of the tasks involved, the preparatory work for Stage Three of Economic and Monetary Union (EMU) was also initiated by the Committee of Governors.

The first step was to identify all the issues, which should be examined at an early stage, to establish a work programmed by the end of 1993 and to define accordingly the mandates of the existing sub-committees and working groups established for that purpose.

For the realization of Stages Two and Three, it was necessary to revise the Treaty establishing the European Economic Community (the "Treaty of Rome") in order to establish the required institutional structure. To this end, an Intergovernmental Conference on EMU was convened, which was held in 1991 in parallel with the Intergovernmental Conference on political union. The negotiations resulted in the Treaty on European Union, which was agreed in December 1991 and signed in Maastricht on 7 February 1992. However, owing to delays in the ratification process, the Treaty (which amended the Treaty establishing the European Economic Community - changing its name to the Treaty establishing the European Community - and introduced, inter alia, the Protocols on the Statute of the European System of Central Banks and of the European Central Bank and the Protocol on the Statute of the European Monetary Institute) did not come into force until 1 November 1993.

- <u>**Stage two of EMU, establishment of the EMI and the ECB:**</u>

The establishment of the European Monetary Institute (EMI) on 1 January 1994 marked the start of the second stage of EMU and with this the Committee of Governors ceased to exist. The EMI's transitory existence also mirrored the state of monetary integration within the Community. The EMI had no responsibility for the conduct of monetary policy in the European Union - this remained the preserve of the national authorities - nor had it any competence for carrying out foreign exchange intervention.

The two main tasks of the EMI were:

- to strengthen central bank co-operation and monetary policy co-ordination; and
- to make the preparations required for the establishment of the European System of Central Banks (ESCB), for the conduct of the single monetary policy and for the creation of a single currency in the third stage.

To this end, the EMI provided a forum for consultation and for the exchange of views and information on policy issues and it specified the regulatory, organizational and logistical framework necessary for the ESCB to perform its tasks in Stage Three.

In December 1995 the European Council agreed to name the European currency unit to be introduced at the start of Stage Three, the "euro", and confirmed that Stage Three of EMU would start on 1 January 1999. A chronological sequence of events was pre-announced for the changeover to the euro. This scenario was mainly based on detailed proposals elaborated by the EMI. At the same time, the EMI was given the task of carrying out preparatory work on the future monetary and exchange rate relationships between the euro area and other EU countries. In December 1996 the EMI presented its report to the European Council, which formed the basis of a Resolution of the European Council on the principles and fundamental elements of the new exchange rate mechanism (ERM II), which was adopted in June 1997.

In December 1996 the EMI also presented to the European Council, and subsequently to the public, the selected design series for the euro banknotes to be issued on 1 January 2002.

In order to complement and to specify the Treaty provisions on EMU, the European Council adopted the Stability and Growth Pact in June 1997 - two Regulations form part of the Stability and Growth Pact, which aims to ensure budgetary discipline in respect of EMU. The Pact was supplemented and the respective commitments enhanced by a Declaration of the Council in May 1998.

On 2 May 1998 the Council of the European Union - in the composition of Heads of State or Government - unanimously decided that 11 Member States (*Belgium, Germany, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Austria, Portugal* and *Finland*) had fulfilled the necessary conditions for the adoption of the single currency on 1 January 1999. These countries were therefore to participate in the third stage of EMU. The Heads of State or Government also reached a political understanding on the persons to be recommended for appointment as members of the Executive Board of the European Central Bank (ECB). At the same time, the Ministers of Finance of the Member States adopting the single currency agreed together with the governors of the national central banks of these Member States, the European Commission and the EMI that the current ERM bilateral central rates of the currencies of the participating Member States would be used in determining the irrevocable conversion rates for the euro.

On 25 May 1998 the governments of the 11 participating Member States appointed the President, the Vice-President and the four other members of the Executive Board of the ECB. Their appointment took effect from 1 June 1998 and marked the establishment of the ECB. The ECB and the 11 national central banks of the participating Member States constitute the Euro system, which formulates and defines the single monetary policy in Stage Three of EMU.

With the establishment of the ECB on 1 June 1998, the EMI had completed its tasks. In accordance with Article 123 (ex Article 109l) of the Treaty establishing the European Community, the EMI went into liquidation on the establishment of the ECB. All the preparatory work entrusted to the EMI was concluded in good time and the rest of 1998 was devoted by the ECB to the final testing of systems and procedures.

- **Stage three of EMU, irrevocable fixing of exchange rates:**

On 1 January 1999 the third and final stage of EMU commenced with the irrevocable fixing of the exchange rates of the currencies of the 11 Member States participating in Monetary Union and with the conduct of a single monetary policy under the responsibility of the ECB.

7.3 Capital subscription to the European Central Bank:

NCB	Capital key %	Euro
Nationale Bank van België/ Banque Nationale de Belgique	2.8658	143,290,000
Deutsche Bundesbank	24.4935	1,224,675,000
Banco de España	8.8935	444,675,000
Banque de France	16.8337	841,685,000
Central Bank of Ireland	0.8496	42,480,000
Banca d'Italia	14.8950	744,750,000
Banque centrale du Luxembourg	0.1492	7,460,000
De Nederlandsche Bank	4.2780	213,900,000
Oesterreichische Nationalbank	2.3594	117,970,000
Banco de Portugal	1.9232	96,160,000
Suomen Pankki	1.3970	69,850,000

Sources: European system of Central Bank web site

7.3 Table-6: Capital subscription of Euro area National Central Banks (NCB)

NCB	Capital key %	Euro
Danmarks Nationalbank	1.6709	4,177,250
Bank of Greece	2.0564	5,141,000
Sveriges Riksbank	2.6537	6,634,250
Bank of England	14.6811	36,702,750

Sources: European system of Central Bank web site

7.3 Table 7: Non-euro area national central banks (NCB)

The non-euro area NCBs' contributions, which are equal to 5% of their subscribed capital, amount to a total of EUR 52,655,250, as above **table 7**. The non-euro area NCBs are not required to pay up any capital subscriptions beyond the amounts already decided until such time as they join the Euro system. In the meantime these NCBs are not entitled to receive any share of the distributable profits of the ECB, nor are they liable to fund any losses of the ECB.

7.4 Objectives And Tasks Of The ESCB

The primary objective of the European System of Central Banks (ESCB), as defined in Article 2 of the Statute of the European System of Central Banks and of the European Central Bank (ESCB Statute), is to maintain price stability. Without prejudice to the primary objective of price stability, the ESCB shall support the general economic policies in the Community with a view to contributing to the achievement of the objectives of the Community. In pursuing its objectives, the ESCB shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources.

The basic tasks to be carried out by the ESCB are defined in Article 3 of the ESCB Statute. These tasks include:

- to define and implement the monetary policy of the Community;
- to conduct foreign exchange operations;
- to hold and manage the official foreign reserves of the participating Member States;
- to promote the smooth operation of payment systems; and
- to contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system.

7.4.1 Monetary functions and operations of the ESCB:

The ESCB Statute (Articles 17 to 24) specifies the monetary functions and operations of the ESCB. On the basis of these provisions, the European Monetary Institute (EMI) prepared an operational framework for the ESCB's monetary policy. The final decision on the operational framework will be taken by the Governing Council of the European Central Bank (ECB). The Governing Council of the ECB may decide not to use all the available options or may change certain features of the instruments and procedures presented below. Further detailed information on these issues can be found in the EMI publications entitled "The single monetary policy in Stage Three - Specification of the operational framework" (January 1997) and "The single monetary policy in Stage Three - General documentation on ESCB monetary policy instruments and procedures" (September 1997).

4.2 Monetary Policy Instruments:

The operational framework consists of a set of instruments; the ESCB will conduct open market operations, it will offer standing facilities and it may require credit institutions to hold minimum reserves on accounts with the ESCB.

- **Open market operations:**

Open market operations will play an important role in the monetary policy of the ESCB for the purpose of steering interest rates, managing the liquidity situation in the market and signalling the stance of monetary policy. Five types of instruments will be available to the ESCB for the conduct of open market operations. The most important instrument will be reverse transactions (applicable on the basis of repurchase agreements or collateralized loans). The ESCB may also use outright transactions, the issuance of debt certificates, foreign exchange swaps and the collection of fixed-term deposits. Open market operations will be initiated by the ECB, which will also decide on the instrument to be used and the terms and conditions for the execution of such operations. It will be possible to execute open market operations on the basis of standard tenders, quick tenders or bilateral procedures. With regard to their aim, regularity and procedures, the ESCB open market operations can be divided into the following four categories:

- The main refinancing operations are regular liquidity-providing reverse transactions with a weekly frequency and a maturity of two weeks. They will be executed by the national central banks on the basis of standard tenders and according to a pre-specified calendar. The main refinancing operations will play a pivotal role in pursuing the purposes of ESCB open market operations and provide the bulk of refinancing to the financial sector.
- The longer-term refinancing operations are liquidity-providing reverse transactions with a monthly frequency and a maturity of three months. They will be executed by the national central banks on the basis of standard tenders and according to a pre-specified calendar. These operations aim to provide counterparties with additional longer-term refinancing. As a rule, the ESCB will not intend to send signals to the market by means of these operations and will therefore normally act as a rate taker.

- Fine-tuning operations can be executed on an ad hoc basis with the aim both of managing the liquidity situation in the market and of steering interest rates, in particular in order to smooth the effects on interest rates caused by unexpected liquidity fluctuations. Fine-tuning operations will primarily be executed as reverse transactions, but may also take the form of outright transactions, foreign exchange swaps and the collection of fixed-term deposits. The instruments and procedures applied in the conduct of fine-tuning operations will be adapted to the types of transactions and the specific objectives pursued in performing the operations. Fine-tuning operations will normally be executed by the national central banks through quick tenders or bilateral procedures. The Governing Council of the ECB will decide whether, under exceptional circumstances, fine-tuning bilateral operations may be executed by the ECB itself.
- In addition, the ESCB may carry out structural operations through the issuance of debt certificates, reverse transactions and outright transactions. These operations will be executed whenever the ECB wishes to adjust the structural position of the ESCB vis-à-vis the financial sector (on a regular or non-regular basis). Structural operations in the form of reverse transactions and the issuance of debt instruments will be carried out by the national central banks through standard tenders. Structural operations in the form of outright transactions will be executed through bilateral procedures.

- **Standing facilities:**

Standing facilities aim to provide and absorb overnight liquidity, signal the general stance of monetary policy and bound overnight market interest rates. Two standing facilities, which will be administered in a decentralized manner by the national central banks, will be available to eligible counter parties on their own initiative:

- Counterparties will be able to use the *marginal lending facility* to obtain overnight liquidity from the national central banks against eligible assets. The interest rate on the marginal lending facility will normally provide a ceiling for the overnight market interest rate.
- Counterparties will be able to use the *deposit facility* to make overnight deposits with the national central banks. The interest rate on the deposit facility will normally provide a floor for the overnight market interest rate.

- **Minimum reserves:**

Preparatory work has been carried out with a view to enabling the ESCB to impose minimum reserves as from the start of Stage Three. It will be up to the Governing Council of the ECB to decide whether minimum reserves will actually be applied. Any minimum reserves system would be intended to pursue the aims of stabilizing money market interest rates, creating (or enlarging) a structural liquidity shortage and possibly contributing to the control of monetary expansion. The reserve requirement of each institution would be determined in relation to elements of its balance sheet. In order to pursue the aim of stabilising interest rates, the ESCB's minimum reserves system would enable institutions to make use of averaging provisions. This implies that compliance with the reserve requirement would be determined on the basis of the institutions' average daily reserve holdings over a one-month maintenance period.

- **Counterparties:**

The ESCB monetary policy framework is formulated with a view to ensuring the participation of a broad range of counterparties. If minimum reserves are applied, only institutions subject to minimum reserves may access the standing facilities and participate in open market operations based on standard tenders. If no minimum reserves are applied, the range of counterparties will broadly correspond to credit institutions in the euro area. The ESCB may select a limited number of counterparties to participate in fine-tuning operations. For outright transactions, no restrictions will be placed a priori on the range of counterparties. Active players in the foreign exchange market will be used for foreign exchange swaps conducted for monetary policy purposes.

- **Underlying assets:**

Pursuant to Article 18.1 of the ESCB Statute, all ESCB credit operations have to be based on adequate collateral. The ESCB will allow a wide range of assets to underlie its operations. A distinction is made, essentially for purposes internal to the ESCB, between two categories of eligible assets: "tier one" and "tier two" respectively. Tier one consists of marketable debt instruments, which fulfill uniform Monetary Union-wide eligibility criteria specified by the ECB. Tier two consists of additional assets, marketable and non-marketable, which are of particular importance for national financial markets and banking systems and for which eligibility criteria are established by the national central banks, subject to ECB approval. No distinction will be made between the two tiers with regard to the quality of the assets and their eligibility for the various types of ESCB monetary policy operations (except for the fact that latter two assets are normally not used in outright transactions). The eligibility criteria for underlying assets to ESCB monetary policy operations are the same as those applied by the ESCB for underlying assets to intraday credit. Furthermore, ESCB counterparties may use eligible assets on a cross-border basis, i.e. they may borrow from the central bank of the Member State in which they are established by making use of assets located in another Member State.

Chapter

8 The Condition of Turkish Banking Sector

3. The Condition of Turkish Banking System:

3.1 The problems of Turkish banking system:

Some of the problems of Turkish banking system arise from Turkish economic structure. Normally, these problems reflect to Turkish banking sector negatively.

The problems, which are affecting to Turkish banking system, can be examined as follows:

- instability of prices
- high inflation rates
- public deficits
- external deficits
- high level of cost of resources
- independence problem of the Central Bank
- transparency problems
- official and managerial differences between private and public owned banks
- inadequacy level of equity capital

Actually, the problems which are arise in Turkish banking system are result of macroeconomic problems. So, when the macroeconomic problems solved by authorities, the more affirmative developments will be recorded in economy.

3.2 The Turkish Banking Systems in Economics

3.2.1 Agriculture:

Turkey has a broad agricultural potential due to geographic condition. However, the productivity in agricultural products is 30% of EU values. To increase the productivity in agriculture products, the usage of agricultural inputs, agricultural labor force and technology factors should be increased. By supporting small and middle scaled production business it can be increased the productivity of agricultural products.

In EU, agriculture sector is important. In order to increase the income level of producers, union follow the common agricultural policies. So, for this purpose, it's being used the big portion of EU budget.

As related banking sector it should be provided credits in appropriate conditions and volumes. Because of this, the related banks such as– agriculture bank (in Turkish Ziraat bankası) should be re-regulated. Because, credits which are given to the sector they will be for long term.

Private owned banks can also provide credits for short-term agriculture activities.

8.2.2 Industry:

In EU free trade is important. In custom union framework only industrial products have free movement at the moment. By regarding this situation the competition of industrial products will be more important than other products.

Unfortunately, Turkish economy is not adequacy level to compete with EU in meaning of quality and price. So, in industrial sector, the usage of inputs and technology are important factor to achieve the EU standards. On the contrary to agriculture policy, there is no common policy in industry area. Appropriate to the rules of market economy, the decisions of investment and production belong to business.

However, some institutions such as - European social found, regional development found, European Investment bank – provide credit to industry.

Public banks, development and Investment banks are responsible for providing in long term credit with low interest rate. Other national banks and foreign banks are able to played an important role providing in credit.

8.2.3 External trade:

On of the problems of Turkish economy are external debts. Because of the external debts, export, which was made in Turkey, is important for banks.

As a result of made decisions in 1980's, today national and foreign banks play important role in increasing of external trade. But attained level in this area is not enough for Turkey. Export Insurance Company, Factoring and Forfeiting institutions have not developed in adequacy level.

In development of external trade, national and foreign banks have efficient potential. However, Turkish bans are being opened into abroad – representative and branch offices etc.

The EU banks and foreign banks can be efficient in this sector.

8.2.4 Tourism:

As happened in agriculture sector, Turkey has a significant potential in tourism. Because of this potential, the productivity of investments, which are made into tourism, will be high level. So, national and foreign banks can be efficient providing in tourism credits.

8.2.5 Residence and Infrastructure:

Due to increasing of population and immigrations to urban areas the needs of residence and infrastructure concepts has gained importance. In this framework existing banks in Turkey, provide credits to residence and infrastructure.

Chapter

9

A Comparative Summary of The New Banking Law and The European Union's Basic Banking Directives

3. A Comparative Summary of the New Banking Law and the European Union's Basic Banking Directives

The new banking law and European Union's basic banking directives can be compared as follow:

3.1 EU DIRECTIVES:

- Minimum initial capital should be *5 million Euros* and capital resources should not fall below this figure during the banks operations.

- *Larger credit amounts should be monitored more closely*, and a quorum of competent credit bodies shall be sought for utilization thereof.

- The banking law should define the term credit; credits exceeding *10%* of capital resources should be considered as large credits to be extended to one credit client or client group should not exceed *25%* of the capital resources; and the sum of all large credits should not exceed *8 folds* of the capital resources. In case a large credit is extended to a related company, the rate 20% should be applied rather than *25%.*

- Equity participations of banks in *non-financial enterprises* should not exceed 15% of their capital resources; the total equity participations should not exceed 60%.

- *Sharing of information* and security of information among supervising authorities should be ensured when authorizing establishment of bank license as well as monitoring banks. The Law should specifically list the monitoring authorities to receive information and the conditions applicable to conveying information.

- *Operating areas* of banks should be explicitly defined, and *banks* (*credit institutions*) should be defined as 'undertaking whose business is to receive deposits and other repayable funds from the public and to grant credits for its own account".

- The Law should define the conditions applicable to establishment of banks and circumstances of refusing applications for establishment.

- Approval from the supervising authority of the country where bank's head office is located should be sought while opening branches by foreign banks.

- Authorization must be sought for changes in the ownership structure of significant shareholders.

- Banks should prepare consolidated financial statements with their financial affiliates and subsidiaries, and should obey large credit related restrictions in a consolidated basis *The supervising and auditing power of the country it which the head office is located* should be recognized mutually.

9.2 NEW BANKING LAW:

- Paragraph (2)-d of article 7 sets forth a minimum initial capital amount of TL 20 trillion. Paid-up capital or capital resources must be increased up to the minimum initial capital amount n order to transfer bank shares or for opening new branches.

- Paragraph (II) of article 11 requires that banks ask for *certified account status documents and financial statements* in respect of credits exceeding a specified amount.

- Paragraphs (I) and (2) of article II. The term *large credit is defined as credits exceeding 10% of capital resources* and all large credits are restricted to *8 folds of capital resources*, credits to be extended to one client to 25%, and credits to be extended to persons with whom indirect credit relations are in question to 50% of the capital resources All credits to be extended to shareholders and Their related companies are limited to *50% of capital resources*, whereas all credits to be extended to affiliates and equity participations to *2 folds of capital resources.*

- Equity participation limits have been set in article 12 *in parallel with the EU directives.*

- Information exchange among institutions is defined in paragraph (9) of article 3, whereas *securing of information* in first sentence of paragraph (8).

- Article 2 of the Law covers a definition of "bank; however, the Law does not include definitions of banking operations and credit institutions.

- Article 7 lists the conditions applicable to establishment; and, although the Law does not specify the reasons for refusing applications for authorization, this authority may be used by inference.

- In practice, when foreign banks file an application for opening branches in Turkey, reference is made to the opinion of the supervising authorities of the country in question. Moreover, a relevant provision may be incorporated into bilateral agreements to be entered into in accordance wit paragraph (10) of article 3 of the Law.

- Share transfer rates as provided for in the 2nd Banking Directive of the European Union are subject to authorization by the Board pursuant to the provision of paragraph (2), articles.

- Paragraph (4) of article IS provides for the obligation to consolidate financial statements of banks, and requires under the latest revision of the capital adequacy and net general position ratios that such ratios should be attained in a consolidated basis (together with oversees branches). However, additional regulation is needed in this regard

Chapter

10 Global strategies and Recommendations related with Turkish Banking Sector

10. Global Strategies and Recommendations related with Turkish Banking Sector:

- Generally, small-scaled banks take place in Turkey banking sector. These banks cannot compete in both internal and external market. Due to this reason this kind of banks should merger in each other to reorganize their capital structure.

- When analyzed this strategy for banks, which are existing in Cyprus, there are approximately 37 banks and these banks are mostly small scaled. In order to prevent these crises, which are occurring in Cyprus banking sector, banks should merger in each other.

- Actually, problems, which are occurred in banking, are result of macroeconomic problems. So, macroeconomic problems should be adjusted.

- After 1980 foreign banks started to enter into Turkish banking sector. Because of the usage of west technology in Turkey banks; technology concept are shaped according to western norms. At the end of these developments existing banks in Turkey have started to use technology efficiently. However, in addition to technology, banks have developed product portfolio, quality service and management.

- In banking sector, one of the most important concepts to compete with European Union banks is equity capital and sufficiency of capital. So, these concepts should adjust according to banks position to gain competitive advantage with European Union banks. However, in order to compete with European Union, the international branch offices of banks should be expanded in Turkish banking sector.

- Turkish banking system will not face with any problem in adaptation to European Union. Because, the banks, which are, exist in system follow an open strategy to competition. The same explanation can be made for middle scaled banks. These kinds of banks play an important role in human resources.

- An increase in external trade will bring the parity risk. In order to prevent this risk, banks should focus on forward transactions.

- Public banks have 50%of banking sector. So, these banks should be privatized.

- Turkish banking sector is a small sector that as much as not to compete with European Union banks. So in internal market, banks should merger in each other.

- Although it's well known a concept, technology cannot be used in adequacy level by banks. This problem should be solved. As connected to this concept, it should be solved the human resources to use this technology.

- In addition to these, banks should prepare their strategies to be able to quick respond against changing needs of customers. Also the investment instruments should use in efficiently.

- Today the crises, which are lived in Northern Cyprus banking system, arise from regulations. Although population is only approximately 200000, according to 1999 record; the number of commercial banks is more than 35. One of the reasons for having so many banks in Northern Cyprus is the fact that capital requirement is still extremely low and most of the businessman especially in recent years, establish their own banks in order not to pay commissions to other banks while carrying business. So In order to prevent this the necessary regulations should be made by the Central Bank.

- Banks should apply the Total Quality Management (TQM) concept by giving high quality service-with low cost. Because, if all banks apply same strategy in the sector this concept will also loose its value. In this situation price of services, which are presented to customer, will gain importance.

Conclusion

Conclusion

Most of the activities taking place in both the money and capital markets are carried out by the banks. Consequently, Turkey's economic and historical development dictates that the financial system and the banking sector are virtually synonymous. Turkish finance is principally founded upon a universal banking system. Banks operate in accordance with international rules and practices and offer a wide variety of service at their numerous branches.

When analyzed the Turkish banking system by using the competitive advantage method as mentioned in chapter one, it will be seen that the basic criteria to gain competitive advantage in 2000's, is **quality service** both for individual and high income customer's market.

In addition to these **secrecy, reliability,** and **expected yields** would also play significant role in competitive advantage. In 2000's, three features, which are sought by banks in choosing bank of companies, are **efficiency, quick responds to needs**, and **prices.**

However, all institutions when applied same strategy to gain competitive advantage in a sector; the criteria, which is mentioned above will loose its importance. In this condition the banks, which are able to give service with minimum cost, they will provide competitive advantage.

Due to increasing competition, the profit margins of banks shrink. Because of this reason bank choose some methods to decrease their cost or to increase their operational productivities.

Some of the methods, which are used as follows:

- Efficiency usage of technology
- Improvement the knowledge, experiences, abilities of personnel
- Reorganizing the following of work to increase productivity etc,

In addition to these there are some expectations of banks. These expectations can be summarized as follows:

- Financial fluctuations, which are occurring in developing markets, will affect the banking sector negatively.

- Even recorded the positive fluctuations in economy, due to instability of political situation, these fluctuations reflect to the banking sector negatively.

- Official regulations will increase to protect the deposit owners and provide the transparency and also standardization.

- Its expected that, the individual banking services will focus on individual activities in 2000's – especially; cash management, consumer credits credit cards.

- Technologic infrastructure, distribution channels education level of personnel will gain importance to increase the productivity.

In the light of above information Turkish banking system can merely provide competitive advantage by mergers and / or giving with minimum cost but high quality service against European Union Banking system.

Appendix

(Appendix 1)

Decision Under Article 5(1) of The Banking Law of Northern Cyprus

11/1976
25/1983
26/1987
42/1989

The Council of Ministers decides as follows under powers granted to it by article 5(1) of the Banking Law 11/1976 as amended

Minimum capital

1- Actual paid-up capital of banks shall not be less than TL 50 billion (fifty billion Turkish Liras).

Exception in the case of banks already established which by application to the Ministry have obtained permission from the council of Ministers

2- (1) Banks established before the coming into force of this decision or those which by application to the Ministry have obtained permission from the Council of Ministers are required to increase their capital to the amount stated by the dates specified and subject to the conditions at para (2) below

(2) Banks, the paid-up capital of which is less than the minimum amount envisaged in the decision published as public instrument 52 in supplements IV of Official Gazette No=112 dated 19 November 1992 are obliged to complete their paid-up capital by cash payment to TL 25 billion(twenty five billion Turkish Liras) by 31 December 1994 and to TL 50 billion (fifty billion Turkish Liras) by 31 May 1995 at the latest.

Exception in the case of banks established by special law and Co-operative banks

3- Provisions of this decision shall not apply to banks established by special law and to co-operative banks

Coming into force

4- This decision comes into force from the date of its publication in the Official Gazette.

(Appendix 2)

Calculation of the Capital Base Ratio

A-Capital

a) Capital elements (Include)
- Paid - up Capital
- Reserves (legal and share premiums)
- Profit for the period
- Undistributed profit

b) Added Capital
- Provision against doubtful debts,
- Fixed asset revaluation fund
- Loan Capital (if any).

B- Accounts Deducted from Capital

a) Capital Investments (Banks, insurance companies, financial institutions, factoring companies, stock markets),
b) Special costs (expenses for renovating the buildings),
c) Establishment expenses
d) Pre-paid expenses
e) Capital loan given to any other bank operating in Northern Cyprus
f) Loans given to shareholders of the bank that has more than %10 share within the bank.

C- Capital Base

D- Risk weighted assets and undertakings and obligations other than loans.

A) Weight of risk %0
B) Weight of risk %20
C) Weight of risk %l 00

0 % Risk Group:

- Cash values

a) Cash
b) Foreign Currency banknotes
c) Money in transit
d) Cheques received (foreign currency cheques excluded)

- Banks

a) Central Bank of Northern Cyprus account

- Securities Portfolio

a) Treasury Bills
b) Government Bonds,
c) Shares,
d) Gold reserves,

- Additional reserves

- Loans

a) Loans against blocked cash accounts,
b) Loans against Treasury guarantee,
c) Loans against Treasury bills,

- Immovable properties that are acquired by the banks against their overdue debts by the decision of the courts.

Other Assets:

a) Pre-paid taxes,
b) Branches' current account

Undertakings and Obligations:

a) Letter of guarantees or letter of credits against cash
b) Letter of guarantees or letter of credits against treasury guarantee
c) Letter of guarantees or letter of credits against treasury bills

- Accrued interest and revenue (only the ones that go under 0% risk).

20% Risk Group:

- Cash Values:

a) Foreign currency bank-cheques that belongs to OECD countries.
b) Matured securities

- Banks:

a) Accounts within the banks established in Northern Cyprus
b) Accounts within the OECD countries that belong to the bank
c) The foreign banks established in Northern Cyprus and their accounts with their main branch or other branches in different countries.

100% Risk Group:

- Loans
- Overdue debts (administrative proceedings)
- Fixed assets (net)
- Participations (net)
- Undertakings and obligations

a) Letters of guarantee
b) Letters of credit and documentary credit

- Accrued interest and revenue (only the ones that go under 100% risk group)

$$\frac{\text{C - Capital Base}}{\text{D - Risk weighted assets and undertakings and obligations other than loans}} \times 100 = 8\%$$

(Appendix 3)

P.I 283
O.G. 23.05.1991

Resolution of the Board of Directors of Northern Cyprus

Date of Decision: 22.5.1991
Decision No: 226

The Board of Directors of the Central Bank of Northern Cyprus has in accordance with paras (2) and (3) of article 24 of the Central Bank of Northern Cyprus Law No. 35/1987, resolves as follows:

Banks shall establish additional reserve with the Central Bank of Northern Cyprus at the rate of 15 per cent in respect of all Turkish Lira deposit accounts maintained by them, excluding inter-bank deposits.

This decision comes into force from the date of its publication in the Official Gazette.

(Appendix 3a)

O.G.87
06.08.1996
P.I.523

Decision of the Board of Directors of the Central Bank of Northern Cyprus

Decision No: 388
Date of Decision: 4 June 1996

The Board of Directors of the Central Bank of Northern Cyprus in accordance with paras (2) and (3) of Article 24 of the Central Bank of Northern Cyprus Law No.35/1987 has resolved as follows:

1-Banks shall maintain foreign currency additional reserve account with the Central Bank of Northern Cyprus in respect of foreign currency external and internal deposit mounts kept with them for private persons or corporate bodies at the rate of

a) 16% on June 1996
b) 17% on 31 July 1996
c) 18% on 31 August 1996 and
d) 18% in subsequent months.

There is no obligation to maintain additional reserve in respect of inter-bank foreign currency deposit accounts.

2- Additional reserve in respect of foreign currency deposits in pounds sterling, U.S. dollars, D.M. and Cyprus pounds shall be maintained in foreign currency of the same type.
Additional reserve in respect of foreign currency deposit accounts shall be maintained in US. Dollars calculated at the prevailing rate of exchange between such currencies and the US dollar.

3- This decision comes into force from the date of its publication in the Official Gazette.

(Appendix 4)

O.G.155
18.12.1995
P.I.834

Decision of the Board of Directors of the Central Bank of Northern Cyprus

Decision No: 380
Date of Decision: 30.11.1995

The Board of Directors of the Central Bank of the Northern Cyprus has in accordance paras (2) and (3) of Article 24 of the Central Bank of Northern Cyprus Law No: 7 resolved as follows:

1-Banks shall establish additional reserve with the Central Bank of Northern Cyprus ate of 2% in respect of foreign currency deposit accounts maintained by them for foreign banks and offshore banks.

2-Additional reserve in respect of foreign currency deposits in US dollars, DM, Pound g, and Cyprus Pound shall be maintained in foreign currency of the same type.
Additional reserve in respect of other foreign currency deposit accounts shall be maintained dollars calculated at the prevailing rate of exchange between such currencies and the US dollar.

This decision comes into force as from 31 December 1995.

(Appendix 5)

O.G.29 21.04.1976
O.G.21 25.03.1983
O.G.59 01.06.1987
O.G.70 29.06.1989

Banking Law of The Turkish Republic Of Northern Cyprus

Law No. 11/1976

(As amended by Law No. 25/1983, 26/1987 and 42/1989)

1- Banks may not own movable goods or immovable property except as necessitated by their banking operations.

2- The amount and nature of movable and immovable property necessitated by banking operations are regulated by the ministry responsible for financial matters through a notification.

3- Banks, which are compelled to obtain movable goods with a view to liquidating debts due to them, are obliged to dispose of them within one year, and immovable property obtained in the same circumstances within three years.

O.G. 29 21.04.1976
O.G. 21 25.03.1983
O.G. 59 01.06.1987
O.G. 70 29.06.1989

Banking Law of The Turkish Republic of Northern Cyprus

Law No. 11/1976

(As amended by Law No. 25/1983, 26/1987 and 42/1989)

10 (1) The total of all kinds of credit that may be given by banks to a real person and corporate body shall not exceed 20% of capital and reserves of the bank or 5% of its deposits (whichever is the greater). But loans given to the Government of Northern Cyprus or to corporate bodies guaranteed by it are not subject to this restriction.

(2) a) The total of all kinds of credit that may be given to the President, members of the Board of Directors and Auditors directly or through collusive means or in anyway whatsoever can not exceed 8% of the bank's capital and reserves or 2% of its deposits (whichever is the greater);

b) The general total of all kinds of credit that may be given to the President, members of the Board of Directors, and Auditors altogether directly or through collusive means or in anyway whatsoever cannot exceed 20% of the bank's capital and reserves or 5% of its deposits (whichever is the greater).

(Appendix 7)

O.G.84
29.07.1994
P.I.179

Banking Law of the Northern Cyprus
Law No: 11/1976
(As amended by Law No:25/1983, 26/1987 and 42/1989)
Notification Under Section 6(6)

Under power granted to him by section 6(6) of the Banking Law the Minister of Economy and Finance does by this notification regulate the following matters.

Total Amount of saving deposits that

1-The total amount of saving deposits that may be accepted by a bank shall not exceed;

a) 15 times the total amount of its Capital and Reserves where the later is up to 10 billion TL.
b) 16 times the total amount of its Capital and Reserves where the later is between 10 billion and 25 billion TL.
c) 17 times the total amount of its Capital and Reserves where the later is between 25 billion and 50 billion TL.
d) 18 times the total amount of its Capital and Reserves where the later is between 50 billion and 100 billion TL.
e) 20 times the amount of its Capital and Reserves where the later exceeds 100 billion TL.
f) The Minister of Economy and Finance may in special circumstances authorize acceptance of saving deposits in excess of 20 times the total amount of Capital and Reserves. Provided that banks may accept deposits in excess of the rates specified above on condition that they lodge 50% of same as reserve with the Central Bank. No supplementary reserves will be sought in respect of deposits 50% of which has been so lodged with the Central Bank.

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2-The guarantees to be given and obligations to be undertaken by a bank cannot exceed in total five times the amount of its Capital and Reserves. The Ministry of Economy and Finance may authorize amounts in excess of these limits

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3-This notification comes into force from the date of its publication in the Official Gazette.

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b) Web sites:

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- http://www.stats.demon.nl/europe/austria.htm
- http://www.tbb.org.tr; Turkish Banks Association web site
- http://europa.net; European union web site
- http://tcmb.gov.tr; the Central Bank of Republic of Turkey web site (in Turkish Türkiye Cumhuriyeti Merkez Bankası)